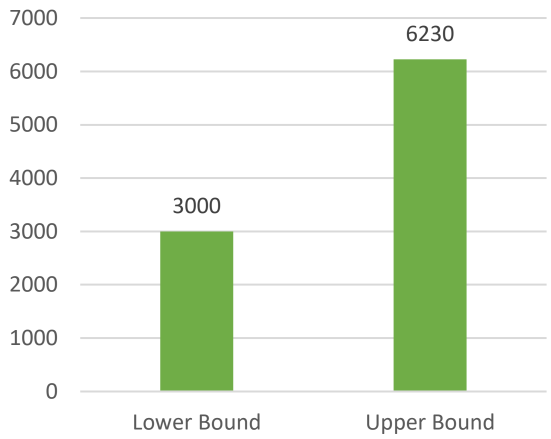
Financial needs in the agriculture and agri-food sectors in Poland

June 2020

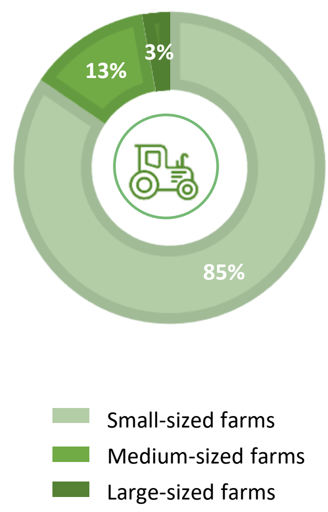
POLAND

FINANCING GAP IN THE AGRICULTURE SECTOR

FINANCING GAP IN THE AGRICULTURE SECTOR (EUR MILLION)

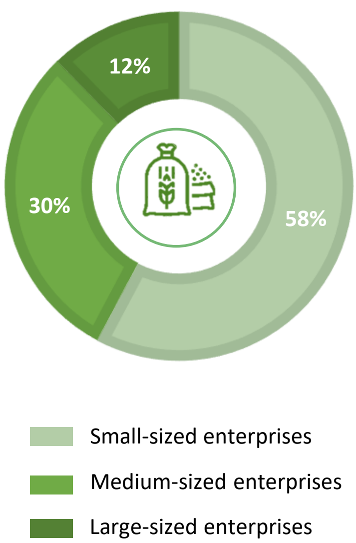


BY FARM SIZE

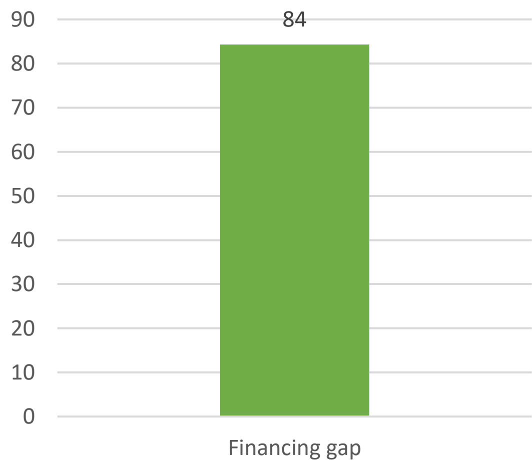


FINANCING GAP IN THE AGRI-FOOD SECTOR

BY ENTERPRISE SIZE



FINANCING GAP IN THE AGRI-FOOD SECTOR (EUR MILLION)



Source: *fi-compass* 2020

EXECUTIVE SUMMARY

This study gives an insight into agriculture and agri-food financing in Poland by providing an understanding of investment drivers, financing supply and financing difficulties as well as the existing financing gap in the country.

The analysis draws on the results from two comprehensive and representative EU-level surveys carried out in 2018 and 2019, namely the *fi-compass* survey on financial needs and access to finance of EU agricultural enterprises and a survey of the financial needs of EU agri-food processing enterprises. The report does not take into account the impact of the ongoing COVID-19 health crisis and/or the effect of any new support scheme being set-up by the Member State and/or changes in the legal basis and/or policies at the European level to mitigate the crisis since the surveys and data available covered a period prior to its outbreak. This would need to be subject to further analyses by interested stakeholders, administrations and/or researchers.

Financing gap for the agriculture sector in Poland

While the agriculture sector in Poland is undergoing an important structural change, the sector is still highly fragmented and dominated by small-sized farms, where more than half of the farms are under 5 hectares (ha) and more than 90% of the farms utilising less than 20 ha. Productivity levels remain low, despite investments in new machinery and equipment, which have been significantly supported by the Rural Development Programme (RDP). Farmers in Poland are younger than the EU 24 average and this generates a particular need for finance and technical support.

The analysis highlights the following **main drivers of investment** in the Polish agriculture sector:

(i) The **need to expand agriculture production units,** which is related to the small average size of agriculture holdings. In order to increase the production capacity, farmers need to increase the farm size and introduce more efficient production methods.

(ii) The **introduction of modern technologies**, especially in the dairy and horticulture sub-sectors.

(iii) **Improving production standards** since a large share of the agriculture production in Poland is exported. This implies adopting a stricter set of production standards in terms of the quality, size of production, food safety and packaging requirements of agriculture products. These investments generate a further demand for finance.

(iv) **Adaptation to climate change** increases the drive for investments in technologies for plant protection, such as those which protect against hail and frost, or technologies that improve farm efficiency, such as those that reduce input factors like water.

Investments in the agriculture sector are increasing but the overall level is still low. In 2018, investments in the agriculture sector amounted to EUR 1.3 billion, which was an increase of 30% compared to 2010. However, the overall level of investments compared to the GVA of the sector is low, with a share of 13% compared to the EU 28 average of about 30%. The majority of investments undertaken were related to the modernisation and update of machinery, equipment and buildings.

The CAP is an important driver of investment in the Polish agriculture sector. Poland is the fifth largest recipient of CAP payments in the EU, making this support an important contributor to the investments undertaken by the agriculture sector. The direct payments help to stabilise cash flows, and as such facilitate access to finance for farmers as it increases their creditworthiness. At the same time, improving farm viability and competitiveness has been recognised as a key priority by the Polish government with the Rural Development Programme (RDP) and 35% of the total RDP budget has been allocated to supporting physical investments in agriculture and agri-food processing. In order to benefit from the measures, farmers need to complement the grant with their own resources which, in many cases, come from bank loans. There is a particularly high demand for young farmer support and a high share of the RDP budget set-aside for this purpose has already been allocated.

While the agriculture loan portfolio of cooperative and commercial banks is increasing, these institutions are maintaining good portfolio quality. By the end of 2017, the total outstanding loan portfolio to the agriculture sector amounted to EUR 8.4 billion and, in recent years, loans to the sector have been following an increasing trend. Subsidised loans account for more than a third of the total outstanding loan portfolio to the agriculture sector.

The main providers of finance are the large number of cooperative banks and a small number of commercial banks. In 2017, more than half of the outstanding loans to farmers were provided by cooperative banks. Recently, leasing has also become a viable alternative for farmers in Poland who wish to finance fixed assets.

An EAFRD guarantee fund was launched in Poland in late 2019. The instrument aims at addressing collateral challenges on the side of borrowers. In addition, there are various preferential loans and guarantees available to the agriculture sector. However, the large majority of farmers are currently not served by these schemes because they do not comply with the requirement of being a registered enterprise.

The report shows that there is a substantial financing gap in Poland estimated to be between **EUR 3.0 billion and EUR 6.2 billion**. The gap mainly concerns small-sized farms[1] and long-term loans[2].

In particular, the finance gap consists of two separate components:

- The first component of the gap includes the estimated value of loan applications submitted in the past year by viable enterprises which were rejected by banks or those which translated into loan offers that were refused by applicants due to non-acceptable lending conditions. According to the *fi-compass* survey, 10% of loan applications from the agriculture sector are rejected and these mostly concern medium to long-term loan applications.
- The second component of the gap includes the estimated value of loan applications that were not submitted by viable enterprises due to discouragement stemming from a fear of possible rejection. In Poland, 6% of farmers did not apply for a loan due to a fear of rejection.

Access to finance is most constrained for medium and long-term loans. Loan applications are rejected due to a lack of sufficient collateral or missing information about the financial situation of the farm. Farmers are often unable to present financial data and business plans due to a lack of management knowledge and a low level of financial literacy. This negatively affects the assessment of their creditworthiness by the banks. Small-sized farms are discouraged to a greater extent than the larger farms. These farms are more frequently turned away from the banks and decide not to submit a loan application after preliminary informal meetings with banks. A significant proportion of refused loan applications due to unfavourable loan conditions were noted, which points to the fact that banks perceive the sector as risky and tend to apply a less favourable pricing policy.

The supply of finance has recently been affected by a new regulation concerning the sale of agriculture land and enforcement proceedings against farmers, which has created some incertitude for financial institutions, and might have determined stricter lending policies. In addition, there has been a diminished outreach in rural areas through the rationalisation of the branch network and the cautious overall approach of banks to farming clients.

Young farmers represent a considerable part of the gap, about 50-70%, which is twice as much as the EU 24 average. This is because, in addition to the overall challenge of providing sufficient collateral and proofing their creditworthiness, they also lack credit history leading banks to be more hesitant to provide financing**.**

1 The *fi-compass* survey, on which the estimations are based, divided farms in three size categories: small-sized (<20 hectares), medium-sized (20-100 hectares), and large-sized (>100 hectares).

2 The fi-compass survey defined short-term loans: <18 months, medium-term loans: 18 months - 5 years, long-term loans: >5 years maturity.

RECOMMENDATIONS

- It is believed that the **EAFRD guarantee fund** implemented in December 2019 will support farmers in accessing finance. However, given the dimension of the identified gap, it is unlikely that the instrument will be able to bring the market to full functionality by the end of the current programming period. For this reason, the continuity of the guarantee instrument should be ensured also in the 2021-2027 programming period, subject to an assessment to measure the effectiveness of the instrument after a few years of operation. More specifically, the assessment should in particular aim to verify:
  - the adequacy of the guarantee capital and the expected leverage, and
  - the concrete ability to address the constraints of young farmers and small-sized enterprises, which according to this analysis are the more constrained segments. The opportunities offered by the new legal framework, such as the easier combination of financial instruments and grant support or the possibility to finance the purchase of land for young farmers, might offer interesting opportunities to increase the effectiveness of the instrument towards those segments.
- Based on the analysis conducted for this study, one of the elements limiting a bank's interest in lending to small-sized enterprises is the higher transaction costs related to the assessment of loans with limited amounts, resulting in lower profit margins. This constraint might have a particularly negative impact in a market context of low interest rates. For this reason, a specific micro-credit instrument (in the form of a guarantee or a risk sharing loan fund), also involving non-banking financial institutions and small local financial players, might be considered. The possibility to combine the financial instrument with grants, including in the form of technical support, might also offer interesting opportunities.
- Technical support, in the form of training and advisory services, might be provided to farmers to help improve their relationships with banks. Training in financial management and accounting topics should be a fundamental component of this support.

Financing gap for the agri-food sector in Poland

The agri-food sector is an important part of the Polish economy. It accounts for 16% of industrial output and employs 400 000 people. The sector's share of Poland's GVA is 3.3%, compared to an average of 2.0% for the EU 28. Poland is the seventh largest producer of food products in the EU. The agri-food sector consists of many small enterprises, 95% are SMEs (below 250 employees), but the production is dominated by the large corporations.

For the agri-food sector, the study identified the following main drivers of demand for finance:

(i) **Expansion of production capacity** through automation and innovation is a driver for investments, since previous comparative advantages, such as low labour cost, energy cost and raw material cost, are being exhausted.

(ii) Like the agriculture sector, increasing **access to new markets** requires adaptation to different product requirements, packaging standards and marketing mechanisms.

(iii) **More efficient use of input factors,** like energy and water, is becoming an important criterion in investment decisions, as the prices and availability of inputs are becoming more volatile.

There has been significant investment activity in the sector in recent years, as enterprises modernise and expand their production capacity. Between 2010 and 2017, investments increased by 47% to EUR 2.3 billion, which corresponds to 17% of the sector's GVA. The main driver of this trend are the large-sized companies that invested heavily in state-of-the-art production lines and infrastructure, especially in the dairy, meat, frozen food and beverage sub-sectors.

CAP also stimulates investments in the Polish agri-food sector. Food chain organisation is one of the six priorities of the RDP in Poland. Like the agriculture sector, enterprises need to provide their own resources in order to complement the grant obtained and for this they often rely on bank loans. Until 2017, only one fifth of the RDP applications from agri-food companies for support were approved. This is a sign that a significant unmet demand for financing exists in the agri-food sector.

The overall trend of lending to enterprises is positive. While there are no figures available for the outstanding loan portfolio for the agri-food sector in particular, the sector follows the overall growing trend of the manufacturing sector. Commercial banks, cooperative banks and, increasingly, leasing companies are the main finance providers to the sector.

The guarantee scheme under the EAFRD was launched in late 2019 and aims at overcoming the collateral challenges for agri-food enterprises. As is the case for farmers, agri-food enterprises can in addition apply for general SME support under national and EU funded programmes, including COSME Loan Guarantee Facility and cohesion policy instruments like the Smart Growth Programme on a national level.

The report estimates a **financing gap for the agri-food sector in Poland of EUR 84 million.** The gap mainly concerns small enterprises (less than 50 employees). In terms of loan products, the financing gap is largest for long-term loans (maturity over 5 years), but this is less accentuated than for the agriculture sector.

The market gap is comprised of (i) the rejected loans, which made up 14% of applications for bank products and 12% for credit lines/bank overdrafts, and (ii) entrepreneurs that were discouraged from submitting a loan application. Although the survey recorded only 3% of enterprises that did not apply for a loan due to a fear of being rejected, this share is likely to be higher based on the information received in interviews.

Access to finance is constrained for enterprises due to a lack of adequate collateral, insufficient business management and planning skills, and the general risk-averse attitude among entrepreneurs towards external finance. On the supply side it was observed that loan conditions are not favourable due to the perception by banks that the sector is risky, which means that banks tend to control their exposure to the sector. In addition, banks consider loan appraisal for the agri-food sector more complex than for other enterprises.

As for the agriculture sector, the launch of the guarantee instrument under the RDP in December 2019 addresses one of the key challenges of agri-food enterprises to access finance, whereby the effects of this instrument should be evaluated before further similar interventions can be recommended for the supply side.

RECOMMENDATIONS

- As for the agriculture sector, it is recommended to ensure continuity of the EAFRD guarantee instrument also in the 2021-2027 programming period, subject to an assessment to measure the effectiveness of the instrument after a few years of operation. Also for the agri-food sector, it should be verified:
    - The adequacy of the guarantee capital and the expected leverage.
    - The concrete ability to address the constraints of small-sized enterprises.
- Combination between grants and financial instruments in a single operation could be an interesting implementation option for the new CAP Strategic Plans saving costs and resources.
- Consider the creation of a pilot risk-sharing credit fund as a solution to the risk-aversion of banks and their perception about the high risk associated with the sector, alongside the current high interest rates imposed on any agri-food company borrowing resources.
- While interviews conducted for this report showed that companies in Poland can already obtain information and advice related to access to finance, an additional effort, in terms of awareness raising and training on the financial management and investment opportunities for agri-food business, might be considered. Capacity building should therefore be an integral component of any intervention. It should cover the topics of business planning and management skills, especially with regard to accessing international markets and on technical topics such as energy and water efficiency.