# Potential role of market responsive EAFRD financial instruments
## Feasibility study – initial findings

Price volatility in agriculture can discourage farm investments and hinder farmers' access to affordable finance. Ultimately, it can negatively impact on the achievement of rural development policy objectives. Financial instruments, supported by the European Agricultural Fund for Rural Development (EAFRD), could play a useful role in helping to mitigate the impact of such issues.

As part of *fi-compass* activities, Directorate General for Agriculture and Rural Development (DG AGRI) at the European Commission and the European Investment Bank have started a study into the feasibility of a market responsive financial instrument supported by EAFRD. The study is seeking to assess:

- The market needs and gaps for a market responsive financial instrument in the dairy sector
- The potential to build on/replicate an existing fund called "MilkFlex" in Ireland
- The key success factors and possible value added of a such an instrument
- Potential replicability in other agricultural sub-sectors

## Methodology and status

This feasibility analysis, which started in August 2016, is the first phase of a larger study and has an initial focus on France, Ireland and Italy. Its first phase aims to propose a specific financial instrument for the dairy sector, capable of being replicated in different EU Member States and/or regions. The second phase of the study will involve a wider analysis of other price-volatile, agricultural sectors. It is intended that the outputs of the two phases will include

potential models for a market responsive financial instrument(s) or investment platform that could also be financed with EAFRD resources.

Desk research, stakeholders' interviews and data analysis in relation to the first phase are currently being finalised. The second phase of the study will be launched in early 2017.

## Preliminary findings of the market analysis

The preliminary findings indicate that, given market dynamics and wider world price fluctuations, milk prices are expected to remain volatile over the next decade. Demand for expansion and efficiency investment is nevertheless expected to continue, with variations on the type and level of investment demand, depending on the specific market characteristics of the geography and sub-sector in question.

The study has highlighted the negative impact of price volatility in terms of both dissuading farmers from investing and also in making assessment of dairy investment proposals by banks more challenging. These constraints can result in less demand, a reduced supply of and/or higher cost of finance for dairy farmers.

A number of tools are already being developed to mitigate the impact of price volatility in the diary sector, including fixed-price milk schemes, income stability tools, insurance schemes, and more tailored banking products such as the Credit Agricole[1] loan scheme for farmers. However, the study confirms a strong interest in additional models such as the "MilkFlex" fund in Ireland and other potential market responsive financial instruments, potentially combined with EAFRD resources. These additional instruments could be more efficient and/or complement existing instruments that together could help meet the diversified needs of the sector.

1 In France, with a product called Prêt à piloter, Credit Agricole offers clients the possibility to modify loan conditions in response to their financial situation that might change. It is possible to adjust the amount of the recurrent payments by reducing or increasing the term of the loan and even to skip one payment per year without need to provide justification.

The MilkFlex fund - Ireland

The MilkFlex fund is a new and innovative financing vehicle, recently established to support Ireland's dairy sector. The €100m fund combines investment from the National Treasury Management Agency, Rabobank, Glanbia and Finance Ireland (the fund manager).

Agriculture plays a crucial role in the Irish economy and the dairy sector in particular has strong expansion potential, benefitting from a relatively low cost of production due its mild climate and the availability of outdoor grazing (i.e. low input costs). Irish dairy farmers are not, however, immune to milk price volatility. Since the sector in Ireland is also characterised by a number of relatively small family farms, the current market volatility presents issues, particularly for them.

The MilkFlex fund aims to provide a financing product which creates a direct link to the milk price and therefore the Glanbia Cooperative farmer's ability to pay the loan. It also seeks to be more competitively priced than traditional bank financing and easily accessible. The fund has been designed by the stakeholders so that the rate is affordable for farmers. Importantly, the repayment schedule of the farmers' loans can better respond to milk price volatility, using inbuilt volatility triggers. These triggers allow for either, a temporary reduction, suspension or acceleration of loan repayments depending on the milk price. Loans from the fund can be used to support a range of investment activity in productive agricultural assets, such as additional cows, farm infrastructure and land improvement measures.

By utilising the existing infrastructure of Glanbia, who is also investing in the fund, MilkFlex is able to take security through a first call on farmers 'milk cheques' as opposed to other forms of security. Glanbia is also supporting the marketing efforts of the fund and through the 'milk cheque' process, collecting loan repayments for the fund.

## Key success factors and challenges for the set-up and implementation of a new financial instrument so far identified

In parallel with the market analysis, initial feedback from the *fi-compass* study identifies some key success factors for a market responsive financial instrument, being:

- **Level of price volatility**: The analysis shows that the level of price volatility is different per geographic market, depending mostly on the destination of the produced milk within the value chain (high added value products like PDO cheese vs commodities like butter). A low level of market volatility may not justify the setting up of this type of instrument.

- **Envisaged level of investment**: With the elimination of the dairy quota system, a restructuring process of the milk sector in Europe will continue. This will provide opportunities to increase production and market share in the most competitive regions whilst a reduction in the less competitive areas can be expected. Robust underlying investment demand will of course be essential to underpin any proposed new financial instrument, and this should be borne out in any market specific ex-ante assessment that would anyway need to be concluded before establishing a financial instrument in a particular Member State and/or region using EAFRD.

- **Structure of the milk value chain**: The strong presence of diary cooperatives appears to be a key requirement for the instrument's success (at least in replicating the MilkFlex structure). Based on interviews undertaken to date in all the three countries analysed, these are also the organisations that appear to be more active (or at least interested) in offering this type of instrument to their associated farmers. As evidenced in the MilkFlex fund set up, the cooperatives can also perform a much needed agglomeration role in terms of generating the necessary level of critical mass needed to underpin the development of a new financial instrument. The cooperatives can also provide some of the infrastructure needed to implement the fund for example to support the loan repayment process. The presence of cooperatives or organisations that can provide similar functions is therefore considered important.

- **Structure of the instrument**: There should ideally be a pre-existing standardised and accepted index of milk prices. Alternatively, the creation of an appropriate index needs to be factored into the set up costs and the cost/benefit analysis of the proposed instrument for the region/country.

- **Where banks and intermediaries are already active in the sector**: Consideration could be given to other forms of financial instrument support, through for example the provision of guarantees. Such forms of support may also achieve the objective of improving the underlying access to finance where price volatility exists. In some circumstances, such an approach may prove more efficient than the creation of bespoke new funding structures. In all cases, the financing products provided, must however meet the financing needs of the underlying farmers.

- **Pricing**: Linked to the point above, the underlying cost to farmers accessing finance from the potential instrument should remain affordable and sustainable. Where new structures are proposed, the costs of these structures and set up processes of the structures should therefore be as efficient as possible, this should include maximizing economies of scale. This is important, in order to keep the cost of financing affordable for farmers.

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