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

June 2020

FINANCING GAP IN THE AGRICULTURE SECTOR

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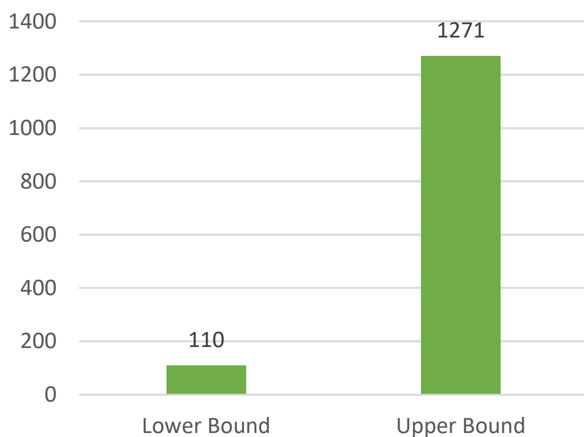
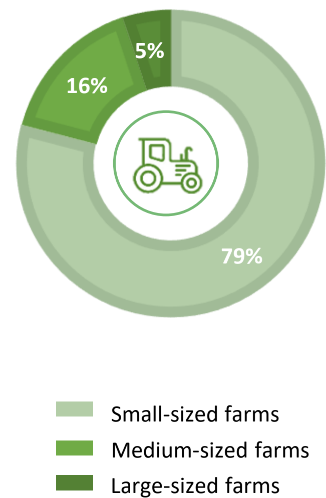
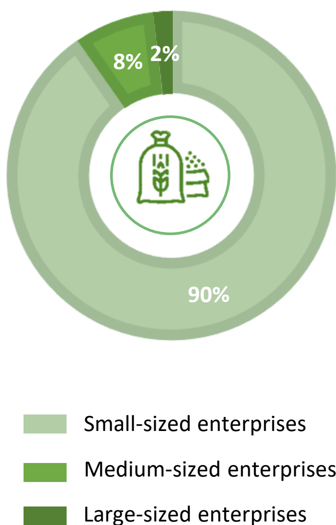


BY FARM SIZE

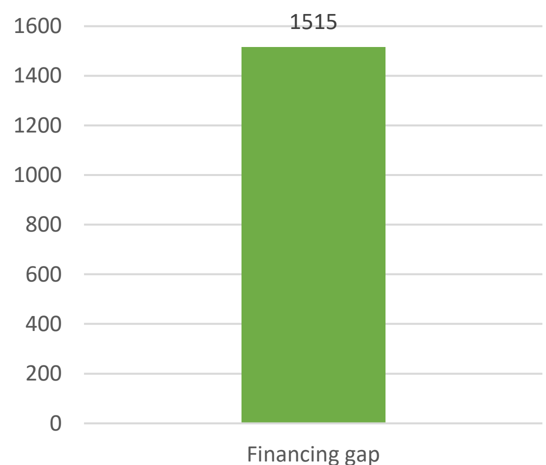


FINANCING GAP IN THE AGRI-FOOD SECTOR

BY ENTERPRISE SIZE



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



Source: *fi-compass* 2020

fi compass EAFRD

European Commission

European Investment Bank The EU bank

EXECUTIVE SUMMARY

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

The analysis draws on the results from two comprehensive and representative EU-level surveys carried out in 2018 and 2019. These were 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 legal basis and/or policies at European level to mitigate the crisis, as 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 Italy

Although Italy is one of the largest agricultural producers among the EU 24 countries, with a total agricultural production of EUR 55.8 billion in 2018, the sector is still characterised by a number of structural and long-standing weaknesses that are crucial in understanding the overall demand for finance:

- **A high number of small-sized farms** with weak integration in the value chain, meaning that farmers face difficulties related to both the input costs and selling prices of their products.
- **A substantial presence of family-run enterprises** with little or no formal accountancy, which hinders farmers' capacity to access banking credit.
- **Low generational turnover and a relatively high average age of farm holders**, which translates into a limited propensity to invest in new technologies and products to improve competitiveness and productivity.

In 2017, total investments in the agriculture sector stood at EUR 8.6 billion, placing Italy among the top three EU countries in terms of the total value of investments (15% of the total investments in the EU 28), after France and Germany. However, when it comes to investments in physical assets as a share of Gross Value Added, Italy is below the EU 24 average and shows a decreasing trend. The highest demand for finance is noticed for the poultry and milk sub-sectors.

According to the *fi-compass* survey, demand for credit from farmers is mostly driven by medium and long-term investments. Even though most, if not all, of the major banking groups in Italy offer financial products and services to farmers and agricultural enterprises, only a few banks have dedicated departments and staff with agricultural expertise who understand the inherent risks associated with such an operation. As a result, financial needs are not well matched by the existing financial offers, which are not well adapted to the sector's specificities. These include seasonal production cycles, sensitivity to climate issues and other external risks. In addition, the sector is mainly financed through short-term loans (two-thirds of total outstanding agriculture loans), which suggests an insufficient supply of longer-term financing for investments.

Direct payments from the Common Agricultural Policy (CAP) often facilitate access to credit for farmers by acting as a guarantee for the bank. Furthermore, the demand for finance in agriculture is many times ancillary to investment support from the regional Rural Development Programmes (RDPs) meaning that agricultural enterprises tend to apply for bank credit once they have been granted investment support. CAP payments, therefore, play a crucial role in influencing farmers' demand for and access to finance. However, this may in some cases lead to imprudent levels of indebtedness.

The study shows that there is a significant financing gap in the Italian agricultural sector, which is estimated to be between EUR 110 million and EUR 1.3 billion.

The financing gap consists of the unmet financing demand from economically viable enterprises operating in the sector. The unmet demand includes lending applied for but not obtained, as well as lending not applied for due to the expectation that the application will be rejected by the financial institution.[1]

75% of the gap relates to small-sized farms (below 20 ha)[2] and its relatively significant size is mostly related to unmet demand for medium and long-term loans.[3] Non-satisfied financing of young farmers and new entrants also make up an important part of the gap.

The existence of a gap is explained by a lack of collateral, financial literacy and proper accountancy systems at the farm level, and by a lack of agricultural expertise in the banking sector. In fact, the insufficient specialisation of banks in agriculture - most of which do not have specialised departments or credit scoring models for agriculture - coupled with the sector's structural weaknesses, automatically put farmers in the highest risk category when applying for finance. As a result, long-term loans are usually heavily collateralised, many times requiring mortgages on personal property of more than 150% of the loan value. This particularly penalises young farmers and new entrants, unless they are supported by their families or if they can leverage prior experience in the sector in other ways.

EAFRD-funded and other financial instruments therefore have a key role in helping to reduce the risk associated with longer-term loans and to ease collateral requirements. Apart from mutual guarantee associations, the main existing financial instruments for the agriculture sector are guarantee products provided by ISMEA (a public body funded by the Ministry of Agriculture), four regional EAFRD financial instruments (two loan funds in Friuli Venezia Giulia and Lombardy, and two guarantee funds in Umbria and Puglia), and a recently launched EAFRD guarantee instrument managed by the European Investment Fund (EIF) where eight of the Italian regions joined forces and budgets (Calabria, Campania, Emilia-Romagna, Piemonte, Puglia, Toscana, Umbria and Veneto).

RECOMMENDATIONS

In order for EAFRD financial instruments to increase their role in facilitating access to finance for agricultural enterprises, particularly for those run by young farmers, the following recommendations could be considered:

- **A larger share of RDP funds in future programming periods could be allocated to financial instruments as opposed to grant-based investment support**. Feedback collected from the interviews with representatives of banks and guarantee funds indicates that grant-based investment support, combined with a lack of financial education of the farmers, encourages them to pursue large investments in order to access the grants. Many of these investments then remain unfinished and this may lead to over-indebtedness. Allocating a larger share of RDP funds to financial instruments would promote greater accountability and responsibility among farmers, encouraging the evolution of the sector from its traditional dependency on grant funding schemes towards a culture based more on entrepreneurship and bankability.
- **More assessments of needs at regional level are needed to support a greater outreach of any new centralised financial instrument supported by the EAFRD.** More schemes are needed within such financial instrument to cover the needs of young farmers and start-ups, or to reduce the risk by sharing funds through credit schemes. These can cover working capital finance, micro-credit and/or complementarity with grants. Better leverage for guarantee funds could be targeted through improvement of the design of the financial product and the participation of external financing providers.

1 The financing gap is calculated using data from the *fi-compass* survey and additional data and statistical indicators from Eurostat.

2 The *fi-compass* survey divided farms in three size categories: small (<20 hectares), medium-sized (20-100 hectares), large (>100 hectares).

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

- **Procedures to access, manage and use financial instruments need to be streamlined and simplified**, reducing the administrative burden and allowing for faster implementation. The banks and regional managing authorities interviewed stressed how administrative and reporting requirements for existing financial instruments may discourage their use. Simplification may also reduce the existing fragmentation between the various stakeholders involved in managing financial instruments, namely between financial intermediaries, financial instrument management bodies and managing authorities.
- **Support from financial instruments could be coupled with technical support to enhance farmers' financial, managerial and technical skills, and to support generational renewal in agriculture**. Financial instruments or partnering banks could provide training or coaching services to farmers, particularly to young farmers and new entrants, to facilitate the transfer of know-how, experience and farm assets from older farmers to younger entrepreneurs. These services could focus on financial/business-related matters (e.g. enterprise financial management and accounting, education on banking products and financial instruments), as well as risk management issues (e.g. mitigation of adverse weather conditions and commodity price fluctuations). They could also provide farming traineeships and coaching on the acquisition of farm enterprises, the launching of new investments, and on promoting innovation in the sector.
- **Financial instruments could also support the offer of flexible financial products for agriculture** to allow, for example, the tailoring of repayment schedules to farmers' actual cash flows (seasonal cycles) and/or the temporary suspension of loan instalments in response to external events affecting the enterprise's ability to repay (besides the existing exemptions/moratoria already proposed by the Italian Banking Associations for unexpected events). While a few banks already offer such flexible products, they are currently insufficient.
- **Efforts could be made for exploring the possibilities for setting up specific and focused equity funds in agriculture,** based on well-founded ex-ante assessments and analyses.

Financing gap for the agri-food sector in Italy

With a total production value worth EUR 113.7 billion in 2018, the agri-food sector is the largest manufacturing sector in Italy. The sector is mainly defined by the following characteristics:

- A predominance of micro and small-sized enterprises (under 50 employees), which make up 98% of all enterprises.
- The importance of exports – EUR 34.6 billion in 2018 – as a driver for the stability and growth of the sector, especially during periods of economic recession.
- The 'Made in Italy' quality scheme as a key driver for Italian competitiveness worldwide, with a record in terms of registered products at EU level.

The Italian agri-food sector ranks third in the EU in terms of the total value of gross investments in tangible goods, after France and Germany. Even so, the sector's propensity to invest has decreased considerably in recent years, due in part to constrained access to credit. This is shown by the decreasing trend in the volume of banking credit to the agri-food sector. This decrease was especially large for Central and Southern Italy, which decreased by 18% and 9%, respectively, between 2014 and 2018.

Demand for finance in the agri-food sector is driven by the need for medium and long-term investments in the most productive and largest-exporting sub-sectors. These sectors are bakery and farinaceous products, fruits, vegetable and meat processing, dairy and wine. Investments are mostly directed towards the acquisition of machinery and equipment. As with the agriculture sector, most of the major banking groups in Italy offer financial products and services to the agri-food sector, but few banks have dedicated functions and staff with agri-food expertise.

The study shows that there is a substantial financing gap in the agri-food sector in Italy, which is estimated to be up to EUR 1.5 billion.

The financing gap calculated for the agri-food sector is independent of the financing gap calculated for the agriculture sector. Following the same methodology, the financing gap consists of the unmet financing demand from economically viable enterprises operating in the sector. The unmet demand includes lending applied for but not obtained, as well as lending not applied for due to the expectation that the application will be rejected by the financial institution.

The gap mainly concerns small-sized agri-food enterprises (90% of the total gap) and is driven by the lack of access to long-term loans for viable enterprises. The gap is mostly due to agri-food firms who do not apply for finance due to a fear of rejection. The available data suggests that the drivers of the gap mostly relate to a lack of credit history, which particularly affects start-ups and those led by young entrepreneurs, and insufficient financial education and collateral, which mainly affects firms in Central and Southern Italy. While banks do not appear to have major challenges financing the sector, their lack of dedicated staff with agri-food specific expertise may create some difficulties in their relations with agri-food enterprises. In addition, banks are more reluctant to lend to enterprises in Southern Italy, due to higher risk and a generally less favourable macroeconomic environment. Agri-food enterprises would furthermore have a higher demand for loans if interest rates would be lower, repayment schedules would be better tailored and if public guarantees were available to lower collateral requirements.

As with the agriculture sector, CAP support positively impacts the agri-food sector's demand for and access to finance, and respectively, their investments. This is particularly the case of the investment support available through the regional Rural Development Programmes.

EAFRD-funded financial instruments also play a crucial role in helping to increase access to finance for agri-food firms, especially for young entrepreneurs and start-ups in Central and Southern Italy. At the time of writing, about ten regions are activating their financial instruments for the sector. Financial instruments can also play a key role in fostering greater integration in the agri-food value chain, linking primary producers to agri-food companies.

Based on the lessons learned, recommendations on how to improve the functioning of the instruments are provided in the report.

RECOMMENDATIONS

- **Make a broader use of financial instruments to promote greater integration in the agri-food value chain, especially in regions with weaker access to credit** (Central and Southern Italy). This will allow multiple players along the value chain to reap the benefits of the instrument. These instruments should aim to provide uncollateralised loans to a greater extent, to reduce the challenges faced by firms with insufficient collateral.
- **Pursue the use of guarantee instruments, specifically for agri-food enterprises led by young entrepreneurs and for start-ups,** which lack the credit history and collateral needed to access longer-term investment loans. This is provided that procedures to access, manage and use such instruments are streamlined and simplified.
- **Explore the possibilities for setting up specific and focused equity fund(s) in agri-food, preferably at centralised level to allow economies of scale and ensure better coverage and successful implementation,** based on current experience of business angles, equity investors, backed-up by well-founded ex-ante assessments and analyses.
- **Provide technical support and capacity building on financial instruments to all stakeholders involved** (banks, agri-food firms and national managing authorities) to increase the awareness, knowledge and competencies needed to set-up and use such instruments.