fi compass EAFRD

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

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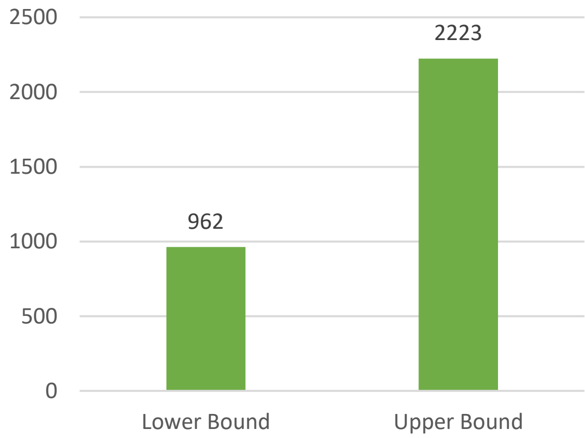
European Commission

European Investment Bank
The EU bank

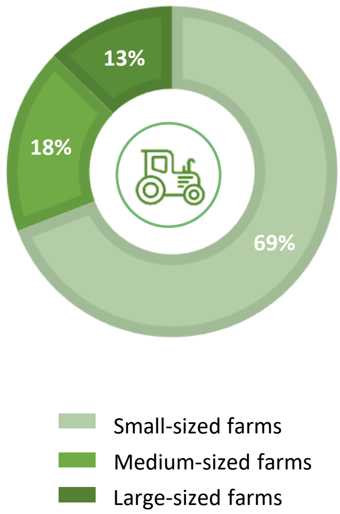
LITHUANIA

FINANCING GAP IN THE AGRICULTURE SECTOR

FINANCING GAP IN THE AGRICULTURE SECTOR (EUR MILLION)

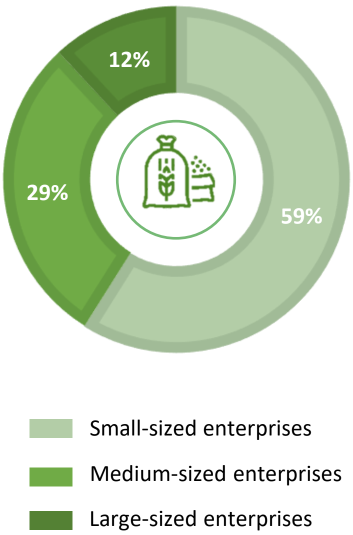


BY FARM SIZE

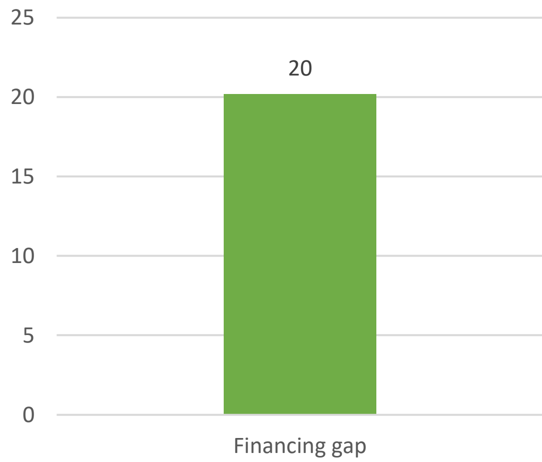


FINANCING GAP IN THE AGRI-FOOD SECTOR

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 Lithuania by providing an understanding of the investment drivers, financing supply and financing difficulties, as well as on 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 are 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 done in the context of this study work. 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 Lithuania

Between 2010 and 2018, the investment volumes undertaken by the agriculture sector almost doubled. In 2018, the Gross Fixed Capital Formation[1] (GCCF) was EUR 640 million, depicting a positive investment trend in Lithuania over the last years, although starting from low levels. The ongoing structural change in the agriculture sector, along with the growing importance of large-sized farms, are driving the investment dynamic in the country. Investments are carried out in order to expand activities through the purchase of land, as well as the adoption of modern technologies through the purchase of additional machinery and improvements to facilities. Dominated by foreign owners, the pork sub-sector represents the largest share of investments, followed by the crop sub-sector. The demand for working capital is particularly high in relation to purchases of inputs (e.g. seeds or fertilisers for crop production). Many farms in Lithuania seek finance to keep the business afloat, with limited head room for investing in long-term tangible assets. The share of farmers that seek finance is higher than on average in other EU countries. In 2017, more than 45% of Lithuanian farmers applied for finance, compared to less than 30% in the EU 24.

The Common Agricultural Policy (CAP) supports investments directly through grants, as well as indirectly via increased access to finance. Direct payments (Pillar I) and rural development grants (Pillar II) play an important role in stimulating demand for finance. Besides contributing to the beneficiaries' income, they also serve as a form of collateral when farmers apply for loans. Investment support is a priority in the 2014-2020 Lithuanian Rural Development Programme (RDP). Between 2014 and 2020, EUR 360.6 million were committed under sub-measure 4.1 'Support for Investments into Agricultural Holdings'. This is a significant contribution to investment made by the Lithuanian agriculture sector, leading farmers to undertake investments that would not otherwise have been undertaken, and also to invest greater amounts than what would have been possible without the support.

The supply of finance is concentrated to three Scandinavian owned banks, which together control approximately 84% of the overall market. These banks have specialised expertise and products targeted at large-sized farms in the Lithuanian agriculture sector. The share of non-performing loans within the agriculture sector is among the lowest in the economy, which is indicative of the banks' risk averse approach to lending to the sector. Small loans are often provided by credit unions, who mainly finance small-sized farms. In addition to traditional loans from financial intermediaries, agriculture entities often use commodity credits from input suppliers (such as suppliers of fertilisers or machinery) based on contracts for future re-payment in kind. This financing method is one of the main sources of external financing for farmers and small businesses. According

1 GFCF measures the value of acquisitions of new or existing fixed assets. GFCF/GVA is used as a measure for how much of the new value added in the economy is invested rather than consumed. Increase of the GFCF is a measure of business confidence, a belief in that investments will be profitable in the future. In times of economic uncertainty or recession, typically business investment in fixed assets will be reduced, since it ties up additional capital for a longer interval of time, with a risk that it will not pay itself off.

to interviews with banks, financial institutions consider agriculture as an increasingly attractive sector. And its volume of financing is expected to increase. However, banks' interest is foremost directed to large-sized farms.

Financial instruments for agriculture are implemented in Lithuania through the Agricultural Credit Guarantee Fund (ACGF). There are five financial instruments: (i) individual guarantees for credits, (ii) portfolio guarantees for loans for working capital and/or the acquisition of biological assets, (iii) loans for agriculture machinery and equipment, (iv) support for guarantee payment compensations and (v) support for loan interest compensation. The highest uptake of preferential loans is for short-term loans. According to the analysis in the report, stakeholders have a positive opinion concerning the usefulness of the financial instruments, but the overall amount of resources allocated to the instruments is considered too limited. Approximately 85% of the agriculture producers who were asked by banks to provide a guarantee for a loan used a public guarantee.

In 2018, the total outstanding loan volume to the agriculture, fishery and forestry sectors was approximately EUR 300 million. Despite the limited volume of the financial market for agriculture, the market has grown significantly since 2012. This growth is related to the implementation and pay-out of the 2014-2020 RDP support, and the growth of the portfolio instrument covered by the ACGF. Despite this positive trend, small-sized farms, young farmers and new entrants face difficulties in accessing finance.

The study shows that there is a potential for further financial instruments, with a financing gap for agriculture estimated between EUR 962 million and EUR 2.2 billion. A large share of the gap can be attributed to farms below 20 hectares (ha)[2]. Interviewed stakeholders from both banks and representatives of the agriculture sector, suggest that access to finance is more complicated the smaller the size of the farm. Furthermore, approximately 30% of the overall gap may be attributed to young farmers. The type of loans for which the gap is the largest are long-term investment loans.

The estimated market gap consists of two separate components. The first component the estimated aggregate volumes of loan applications submitted in the past year by viable enterprises, which were rejected by banks or which translated into loan offers refused by the applicants due to unacceptable lending conditions. The second component of the gap relates to the estimated aggregate volumes of loan applications that are not submitted by farmers considered viable, due to the farmer fearing a possible rejection, whereby he/she is discouraged from applying for a loan.

Several factors that cause viable loan applications by farmers to be rejected, refused or farmers to be discouraged from applying, have been identified. The key constraints on access to finance are farmers' lack of financial management skills and access to collateral. Also the lack of business data and business history, particularly amongst young farmers and new entrants, is an important explanation for the gap. In addition, the supply of finance is highly concentrated, with banks adopting a selective approach to clients and applying higher interest rates. Banks have also shown a reluctance to work with small-sized farms. Young farmers and new entrants face additional constraints due to their lack of assets to use as collateral, and their lack of business and credit history.

RECOMMENDATIONS

- A review of existing instruments should be undertaken to assess how they might better meet the needs of smaller farms, young farmers and new entrants. The sector consists mainly of small-sized farms (82% of farms are below 20 ha), which have a potential to invest more. Although the existing public guarantee system facilitates access to loans on preferential terms, small-sized farms, young farmers and new entrants continue to face difficulties in accessing finance due to their lack of collateral assets and business history. The opportunities offered by the new legal framework for EAFRD funded financial instruments (e.g. greater ease of combining financial instruments and grant support, or the possibility to finance the purchase of land be young farmers) might offer interesting opportunities to increase the effectiveness of the instrument towards these segments. More generally, some stakeholders indicate that the adequacy of the currently available budget of the financial instruments is also indicated as a possible issue by stakeholders.

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

- Long-term loans are rarely used. Almost half of the liabilities of the sector consists of short-term loans, often provided by credit unions. Loan application rejection rates are also the highest for long-term loans However, the ongoing structural changes in the sector require long-term financing. Thus, financial instruments (guarantees or loans), which could also be financed by the EAFRD, to address this problem, could be helpful.
- High cost of financing is also an obstacle, in particular for small-sized farms. Instruments with a higher impact on interest rates (e.g. risk sharing loan funds) might be considered for future policy actions, including in combination with grant support.
- Application and administration procedures for existing instruments administered by the ACGF could be simplified and digitalised. To save time and reduce costs for applicants and administrative staff, data requests could be linked with already functioning official registers and databases.
- Technical support to improve financial literacy of farmers, particularly those with small-sized farms, could help overcome some of the current constraints on access to finance. Such support could be delivered through a training and advisory facility under the EAFRD/RDP.

Financing gap for the agri-food sector in Lithuania

The investment dynamic in the agri-food sector in Lithuania shows a positive trend. During the period 2014-2018, investments increased by approximately 15% to reach EUR 185 million in 2018, representing almost 22% of the total investment in the Lithuanian manufacturing sector. Over this period, the number of enterprises with foreign direct investments increased by 42.5% and the average foreign direct investment per agri-food enterprise rose by 30%, with aggregated foreign direct investment in the Lithuanian agri-food sector reaching EUR 585.6 million by the end of 2018.

Lithuanian agri-food enterprises' demand for finance is mainly driven by the necessity to invest in capacity expansion to increase economies of scale, to reduce costs, and to improve productivity. In addition, the need for modernising and improving production standards in response to changing consumers' demands is an important driver of the search for finance. A root cause of this demand is the low productivity of the agri-food-sector. In the period 2014-2018, despite the increase in labour productivity, the annual productivity per employee remained below the EU 28 average. Further growth in labour productivity is needed to maintain profitability in a context of increasing input costs. Improvements in labour productivity are expected to come from investments in new technologies and advanced equipment. In addition, enterprises also need short-term financing for working capital to buy raw materials for processing, such as milk and grains. According to the study survey of the agri-food sector, more than 33% of bank loan applications were directed to inventory and working capital.

The supply of finance is provided by a group of financial intermediaries including banks and credit unions serving the agri-food sector. The market currently offers products for investment loans, leasing for machinery and equipment, and working capital financing, such as credit lines and working capital loans. The high concentration of the banking sector impacts on the supply of financial products to the agri-food sector, leading banks to be more selective with their clientele. Credit unions mostly supply short-term finance. For companies operating in the agri-food sector and not directly linked with agriculture by ownership, the state-owned financial entity, Investment and Business Guarantees (INVEGA), provides support in a similar way to the ACGF. INVEGA manages financial instruments financed by the European Structural and Investment Funds (ESIF), allowing small and medium-sized enterprises to start or expand their activities with a small loan and through access to guarantees. For the current RDP programming period, as of April 2020, the Lithuanian government had not set up a financial instrument supported by the EAFRD that targets the agri-food sector.

The overall growth of investment in food production companies is also supported through grants under the EAFRD. For the 2014-2020 programming period, an allocation of EUR 83.8 million has been made to support investment in the processing, marketing and/or development of agricultural products (sub-measure 4.2 'Support for the processing, marketing and/or development of agricultural products of the RDP'). The demand for grants is significant and the requests for financing of a high number of applications could not be satisfied due to a limitation of budgetary resources. Although demand for grants differ from the demand for bank loans, this process supports the findings of a potential high unmet demand for finance from the sector.

Although overall lending to the agri-food sector has increased over the last few years, a significant constraint of the supply of finance to small agri-food firms has been identified in the report. Rejection rates of loan applications from the agri-food sector are relatively high for small-sized enterprises. The reasons for banks to reject loan applications from the sector include: (i) the high risks associated with the sector, leading banks to request high collateral levels, whereby lack of collateral of the sector becomes an issue, (ii) the lack of credit history, providing obstacles for start-ups, and (iii) inadequate business plans.

According to the results of this study, the financing gap for the agri-food sector is estimated at EUR 20.2 million. Almost 60% of the overall gap can be attributed to small-sized firms and start-ups that appear to experience particular difficulties in accessing finance. The financing gap for small-sized firms is calculated to be EUR 12.1 million. The reasons for small-sized firms representing a large part of the gap are attributed to the high entry barriers for small-sized companies, and new entrants, in terms of lack of collateral and business history, or the lack of knowledge and understanding of the financial products.

RECOMMENDATIONS

The following recommendations to improve the current offer of financial instruments could be considered:

- The portfolios of the ACGF and INVEGA could be scaled-up to ensure support to more actors active in both the agriculture and agri-food sectors.
- To improve access to finance among small agri-food enterprises, the existing financial instruments, administered through ACGF and INVEGA could be reviewed and simplified. The application and administration procedures could be digitalised, for example. To save time and reduce costs for potential users and administrative staff, data requests could be linked with already functioning official registers and databases.
- Dissemination of information on the different preferential loan products available through INVEGA for enterprises from the agri-food could be enhanced.
- To ease access to the credit market, technical assistance to improve firms' financial literacy could be provided, with a focus on small and new enterprises. This could be achieved by enhancing the financial support provided by ACGF or INVEGA through advisory services.