



# Potential for Price Volatility FIs

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# Price volatility



- Price volatility in agriculture both **discourages farmers** from undertaking investments and lenders from providing finance on an affordable basis
- A number of financing solutions have already been developed to help mitigate its impact in the dairy sector
- These include the Milkflex fund in Ireland, plus a number of traditional banks have developed loan products with a degree of inbuilt flexibility
- **EAFRD financial instruments could offer even greater flexibilities** and play a positive role in reducing the impact of price volatility and encouraging investment



# Investigating the potential



- As part of *fi-compass* activities, DG AGRI and EIB have started a study into the feasibility of a volatility based FI
- The study is seeking to assess:
  - The market needs and gaps
  - The potential to build on/replicate an existing fund called “MilkFlex” in Ireland and other existing products
  - The key success factors and possible value added of a volatility based FI
  - Potential replicability in other agricultural sub-sectors and geographies



# Scope of the study



- An analysis of the milk market in **France, Ireland and Italy** in order to provide forecasts on the price level, volatility and future trends
- Estimate the possible demand for dairy based investment and nature of financing needs in these MS
- Assess the role of existing financing tools
- Review different data sources on milk prices and volatility so as to identify possible mechanisms
- Estimate the interest of financial intermediaries in a potential FI
- Identify the barriers to the implementation of the FI, the specific conditions and criteria for implementing the instrument in a specific market or geographical area



# Existing tools – Milkflex approach



- The fund has been structured to enable the interest rate at to be **affordable for farmers**
- The repayment schedule is linked to the **farm cashflow** and is able to respond to dairy price volatility
- The fund provides **inbuilt/upfront protection** for the dairy farmer in the event that milk prices drop below an economically sustainable price point
- The fund is **built around a large co-operative** which supports the administration process but importantly enables the fund the **first call on the milk cheque** as opposed to other forms of security



# Existing tools

## Credit Agricole approach



- **Flexilait** - prêt à piloter - was launched in 2009, in order to support the farmers. It was launched by the four Crédit Agricole agencies of Brittany
- **Prêt à piloter** is now available in all Crédit Agricole agencies
- Repayments during the first year are agreed initially and cannot be modified. Thereafter, the farmer has two options to manage its loan, with high flexibility:
  - **Rescheduling repayments.** Once a year, the firm has the possibility to increase repayments by up to 30% or to reduce them and extend the loan maturity by up to 36 months
  - **The « pause crédit ».** The firm is allowed, once a year, to suspend the repayments. In this case, two options are available: 1 - the payment is postponed and paid after the maturity date initially envisaged: the amount of the next repayments stay unchanged. Or 2 - the loan maturity remains the same and the following instalments are increased.
- To benefit from these options, the farmer must meet with Crédit Agricole who helps to identify the most suitable solution to the specific situation. **Borrowers provide a guarantee ('caution solidaire') until loan repayment is completed.**



# Initial conclusions



- Milk prices expected to remain volatile for at least the next decade
- Demand for investment – for expansion/consolidation is expected to continue
- But demand varies depending on the specific market characteristics and geography in question - financing needs are diversified
- A number of tools already exist or are being developed, these include fixed price milk schemes, income stability tools, insurance and banking products
- The study has however confirmed strong interest in additional tools such as Milkflex, to provide an additional tool to complement existing methods of intervention



# Key success factors -1



- **Level of price volatility:** differs per geographic market and product mix, low level volatility may not justify a bespoke instrument
- **Underlying investment demand:** this will vary as an outcome of the current restructuring process and would need to be tested as part of any ex-ante assessment
- **Structure of the milk value chain:** The role of an aggregation vehicle appears to be a key requirement for a bespoke instrument, such as Milkflex, for example -
  - Co-operatives provide an aggregation function and can help to enable critical mass to be achieved
  - Can support the delivery infrastructure of the FI through building awareness, loan repayment process and by providing security through milk cheque payments
  - But co-operatives only address part of the dairy sector and are not always large enough





# Key success factors - 2



- **Building on existing products**

- Examples of banks and intermediaries are already active in the sector with flexible products
- In the cases reviewed, the banks retain full discretion over flexibility triggers or requires a guarantee from the farmer
- A guarantee based FI could potentially reduce these requirements and make them more attractive for farmers. In some circumstances this may prove more efficient than the creation of bespoke new funding structures.



# Key success factors - 3



- **Structure of the instrument** - A pre-existing standardised and accepted index of milk prices, should exist. Or the creation of an appropriate index needs to be factored into the set up costs
- **Pricing** - The underlying cost to farmers accessing finance needs to be affordable and sustainable. This means that new structures need to be cost efficient and benefit from economies of scale where possible.



# Next Steps



- Review initial findings with DG AGRI and finalise Phase 1 work
- Propose a possible FI structure (s) for the dairy sector
- Commence Phase 2 –
  - Determine if an FI be designed in a similar way for any other agricultural sub-sector and geographies
  - Develop appropriate FI structures/solutions

