NEWBIE: Recommendations - Finance sector

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Problem description

Many new entrants who start an agricultural business or successors who take over their parents farm are trying to do so with new sustainable business models. They see opportunities to set up the farm in an innovative way and so respond to the wish of society and consumers to produce more sustainably. This may imply for example switching to organic farming, starting tourism activities or setting up short chains where other revenue models are possible due to the direct connection with the customer.

To do this successfully, usually substantial investments in buildings, machines, personnel, etc. are required. For these investments, most entrepreneurs depend on bank loans. However, banks hesitate to finance business plans that deviate from mainstream agriculture business models. Applications are often rejected by banks because loans are evaluated with data on prices from traditional agricultural business models which are generally much lower than prices that can be obtained in new revenue models.

For illustration, an example of an entrepreneur in the Netherlands described in the daily newspaper de Volkskrant (2-8-2021): the entrepreneur wanted to take over the farm from his uncles and in that process transform the farm into a mixed farm (arable and dairy) where all products are sold directly to the consumer through their own shop in the neighbourhood. The entire plan (including the buy-out of the uncles) required financing of 2.5 million Euros. In the business plan, a litre milk price of 1.70 Euros was calculated, which is realistic since the clientele purchases this directly and have also indicated that they want to pay this price. The bank only wanted to calculate with the normal milk price of 40 cents, the loan was rejected.

If a lot of land is owned, a bank sometimes wants to finance because of sufficient collateral. But new entrants usually do not have their own land or other guarantees. They start small because land is expensive and they develop a business model with as much added value as possible on agricultural production: processing products themselves, adding other services such as catering or a farm shop etc. If they need a loan to expand the shop for direct sale or expansion of the catering branch where its own products are sold, the bank usually indicates that it is not agricultural and they are referred to the department in the bank specialised in the catering business. They reject the loan because the entrepreneur is not a catering entrepreneur, while it is precisely the expansion with these extra branches that helps to make agriculture more sustainable. For the transition to a more sustainable agriculture, it is essential that other revenue models are introduced, otherwise the transition will not succeed. This also requires a change at the banks in how they evaluate credit applications.

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Potential solutions

Because it is difficult to obtain a bankloan on the basis of new sustainable business plans alone, more and more farmers, including new entrants, no longer opt for full financing by a bank, but partly for non-bank (alternative) financing. Simultaneously, banks also prefer to see an entrepreneur get part of the financing from somewhere else. This limits the risk for the banks because:

1. A lower amount is requested compared to the total financing
2. Non-bank financing is usually obtained in the form of a subordinated loan, which means that in the event of bankruptcy, the tax authorities and the bank have priority over the other creditors and can thus recover a larger part of their loan.
3. If others have confidence in the entrepreneur by lending money, this in turn gives the bank confidence.
4. Often non-bank financing is linked to sales models i.e. financiers are or become customers. That makes the revenue model (and thus the repayment of the loans) a lot more secure.

Opportunities that entrepreneurs have to obtain part of the loan themselves via non-bank financing are, for example (see brochure alternative forms of financing, in Dutch: https://edepot.wur.nl/511501)

1. Crowdfunding through a crowdfunding platform. You can set up a crowdfunding campaign fairly easily via a crowdfunding platform, the screening of your plans is done via the platform, the investors are anonymous and the interest rates are relatively high.
2. Crowdfunding without a crowdfunding platform. Recruiting investors and organizing the crowdfunding in-house requires a lot of effort. This form offers the possibility to directly involve investors in your company and therefore the interest rates are often somewhat lower than via a crowdfunding platform.
3. Company-specific land funds: possibility to finance land through a fund financed by citizens. Use of the land under jointly drawn up sustainability conditions. Setting up requires a lot of effort and communication skills
4. Perpetual Bonds. For farmers who want to finance land, buildings and machines with bonds. As a farmer you have to be open to others. This construction requires a lot of communication and the willingness to receive people in the yard.

Recommendations / suggestions

Banks today communicate to the outside world that it is important for agriculture to become more sustainable, sometimes even with advertising campaigns about how they see the sustainable future and how their bank supports this development. It is now important that this is used in internal policy at these banks. **This includes indicating internally the importance of these new sustainable revenue models and how they should be assessed differently.**

Banks obviously rely on the statistics from traditional agriculture that are available to evaluate business plans of new entrants. More and more data are now available about other revenue models in agriculture, but they are not yet used by bank advisers or the advisers are completely unfamiliar with these new developments. **That is why it is important that advisors within the banks that assess credits are trained in the potential of these new revenue models, which means courses on the various revenue models and more insight into the numbers behind them.**

Training of advisors certainly also applies to the combination of bank and non-bank financing. Now these are separate worlds and the entrepreneur has to figure out the non-bank financing himself. It would be a big improvement if advisors themselves could come up with an ideal mix of bank and non-bank financing. Then banks can lend more money themselves at less risk and their customers are also helped.

Banks are certainly willing to support the transition towards sustainable agriculture, but are of course also part of the current agricultural system. There are already examples at various banks that eventually (often after a long process) they do finance these new sustainable business plans. **Banks could spread these good examples within their own bank branches and in the different countries and also take note of other banks that do the same here and there. Good examples will inspire others.**

If the entire agricultural system has to make the transition to a much more sustainable agriculture, then that also means that the financiers of that agriculture go along with that transition. Ultimately, it is also in the interest of the banks that they acquire more knowledge of these types of new models and that they also finance them more easily and more often, since that is where the future lies for them too.

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New Entrant network

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