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Financialization in the food system

*Special Issue: Mapping the Global Food Landscape***Finance and the global land rush: Understanding the growing role of investment funds in land deals and large-scale farming**Oane Visser¹

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In the wake of the 2007–08 food crisis, we have seen the combined development of a rapid financialization of agriculture with the expansion of large-scale corporate farming through large-scale land deals, in particular in developing countries and emerging economies. The rapidly growing appetite for agriculture among financial investors is driven by: mounting risks in “conventional” stocks following the financial crisis, the growing demand and prices for food, and the soaring subsidies for biofuel production. Whereas farming was long considered backward and financially uninteresting, with the new conjuncture in financial firms, a range of farmland settings are now seen as a new, promising frontier of finance.

Important questions arise from these developments. What is the magnitude of the involvement of the financial sector in the farmland rush? What kind of financial actors are involved and how do they operate? How does the involvement of the financial sector change agriculture? And how viable are these investments economically? Contrary to common wisdom, which conceives these farmland investment projects as highly profitable, this article provides evidence of unprofitable and failed investment endeavours. It subsequently looks into causes of such failures, focusing on the intrinsic tensions of the investor-led farming model, and discusses implications for research and policy.

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Situating finance in the global land rush: Magnitude, mechanisms and actors

Until recently, the land rush debate focused predominantly on food security, wider geopolitical motivations, and the role of states. But the role of private actors and commercial motivations in driving the land grab is much more influential. Recent research has shown that the predominant actors acquiring farmland are in fact not the usual suspects in the media, such as states like China and South Korea, but rather companies from the West and emerging financial hubs in Asia such as Singapore and Hong Kong (Cotula, 2012). An inventory of media reports found that agribusiness companies constitute the largest share of investors, with investment funds also being key players (Deininger et al., 2011), showing rapidly increasing interest in farmland (Fairbairn, 2014; Isakson, 2014). By 2010 over 190 private equity firms were investing in farmland globally, with another 63 firms raising capital for such investments, with an aggregate target of US\$13.3 billion (Prequin, 2010). More recently, insiders from the financial sector have estimated overall private institutional investment in farmland at 30 to 40 billion dollars, with the potential to rise to US\$1 trillion (Wheaton & Kiernan, 2012).

Investors looking for ways to invest in farmland can do so through a variety of vehicles, such as large investment banks, hedge funds, private equity funds, publicly listed agricultural companies, and private and publicly traded real estate investment trusts (REITs) (Daniel 2011; Merian Research & CBRM, 2011). Initially, wealthy business families or endowments were the major contributors to such investment vehicles, but increasingly large institutional investors such as pension funds and international development banks invest in these funds (ibid). From outside the financial sector, large food traders (the “ABCD” traders like Cargill) and other commodity traders increasingly invest in such vehicles and have set up their own ones (Murphy, Burch, & Clapp, 2012).

Finance and agriculture: Gaps in the current state of knowledge

In studies on the land rush and the expansion of large-scale farming, the focus is mostly on the land acquisition process itself and the effects of the large-scale land deals in terms of socio-economic effects for small-scale farmers, as well as the related issue of food security and food sovereignty or their environmental impact. The role of finance is mostly addressed as a macro-economic background or context, whereas research analyzing the connection between financial and farmland investment empirically is rare (notable exceptions are Daniel, 2012; Fairbairn, 2014).

Whereas most media, NGO, and scholarly attention has focused on land deals in Africa, the continent where the state-led land rush by China and the Gulf States is most pronounced, the financial sector has predominantly targeted farmland in emerging economies where large-scale

agriculture and rural infrastructure is more developed, in particular South America (Brazil, Argentina) and Eastern Europe (Romania, Russia, Ukraine) (Visser, 2014; Watson, 2010).

Investment funds and the rise of large-scale farming

That agriculture is ripe for investment is not immediately apparent. For farms to become assets attractive for the financial sector, there is a need to scale up their operations, in order to: (1) allow the introduction of new technologies to increase productivity, reduce production costs, and achieve economies of scale; and (2) allow sizeable amounts of money to be invested in one go (i.e., with low transaction costs).

The strategy of private equity firm EmVest operating in Africa is quite illustrative of the first point. The firm aims to increase yields “based on the introduction of modern farming techniques and technologies...while agglomerating farms to increase efficiency and generate economies of scale” (Daniel, 2012; Emergent, 2011).

Second, most financial actors have minimum investment thresholds to enter a business. Private equity funds normally enter only with investment of at least US\$1–2 million (Middler, 2008). Large institutional investors such as pension funds and international development banks such as IFC and EBRD require an even larger scale for their investments (Luyt, 2013). A Swedish agrifood company operating on 20,000 hectares of land in Ukraine, which tried to get financing from the EBRD, was told to come back when they would have a size of 100,000 hectares or higher (Kuns, Visser, & Wästfelt, 2014). In sum, farmland acquisitions by the financial sector tend to generate a drastic enlargement of farm size.

Is large-scale farmland investment actually profitable?

Investors, investment brokers, and media predominantly stress the huge profits that can be made through farmland investment. However, this article argues that there is a serious danger of taking at face value the investor discourse celebrating the juicy profits to be made from farmland investment or in reading it as reflecting the real state of affairs (Visser, 2014). The growing pressure on the supply of farmland through urbanization and climate change, and rising demand for farmland due to a growing population, change to more high-value diets, and expanded biofuel production, are among the factors mentioned by investors to suggest a growing global scarcity of land (Li, 2014; Visser 2004). Based on these global trends, it is subsequently argued that there is a strong business case for profitable large-scale farmland investment. Although undoubtedly there are regions and sub-sectors where farmland investments are profitable—and sometimes very profitable—such results are contingent on a whole range of favourable conditions being in place in a particular locality and investment project. As a result, the simple adage among

investors, “land is getting scarce, so buying farmland cannot be but a profitable investment” (Li, 2012, p. 1), is inaccurate.

It is relevant to briefly examine some examples from various continents of farmland investments that did not fulfill early expectations and/or failed. In Africa, “there is mounting evidence of failed land deals” (Cotula, 2012, p. 675). The private equity farmland fund Africa Invest, for instance, with five farms covering over 2000 hectares in Malawi, won two major business awards. Nevertheless, after disappointing harvests for all of its crops, and unable to pay back its loans, the company saw its CEO step down, and was in danger of bankruptcy without a major external capital injection (Merian Research & CRBM, 2011, p. 28–29). In Indonesia, none of the planned farmland acquisitions by companies from the Gulf States have led to functioning farms (Bakker & Nooteboom, 2014). In the U.S., despite rising crop and farmland prices in the years following the food crisis, the share price for Farmland Partners and Gladstone Land (the first land investment fund in U.S. farmland that is listed on the stock exchange) has been volatile, indicating investor uncertainty (Stevenson, 2014). Also, in Brazil, where land prices are booming, revenues have been very volatile. Adecoagro, for instance, one of the large Brazilian agro-companies (with billionaire George Soros as major shareholder), had a profit of US\$28 million in 2011, preceded by a huge loss of US\$70.6 million in 2009 (Peuple, 2011). Currently, numerous investors in Brazil’s large-scale sugar plantations are in dire straits. In Russia and Ukraine, the majority of the foreign farmland investments are loss-making to date (Kuns et al., 2014; Luyt, 2013; Visser, 2014). Also more widely in Eastern Europe, seven out of eleven large Danish agricultural investment projects were loss making (Jyllands Posten, 2010).

Land rush dynamics and the tensions of finance-led farming

Although the precise mix of causes for such failures may vary, some more general causes can be distinguished. These relate to the boom characteristics of the farmland rush as well as the intrinsic tensions of the current finance-led farming model. Digging deeper into these factors helps to provide a better understanding of such failures.

Causes related to the boom dynamics are the tendency among investors to prioritize a rapid entrance in the market (instigated by the “first mover advantage”) (Li, 2012) over a more gradual approach of testing the waters and expanding gradually. Further, there seems to be an aspect of “herd behaviour,” in which some investors with very little knowledge of agricultural markets and the countries at stake copy the strategies of early movers.

The intrinsic tensions include, for instance, the friction between the “land banking” approach (a business model focused on land appreciation or speculation) and the operational approach, aimed at gaining profits from farm operations. Those two approaches are mostly presented as nicely complementary, but in reality a strong orientation on land banking can go ahead at the cost of viable farming operations (Visser, 2014). The focus on land banking can lead to the prioritization of acquisition and registration of land over developing productive operations,

in terms of time spent by the management and finances invested (Kuns et al., 2014). Further, a strategy of land banking tends to lead to rapid expansion of landholdings when land prices are still low. This may lead to land acquisition decisions driven mainly by the price and availability of land, instead of by well-informed choices from a productive view, such as the fit of land plots in the company's overall landholdings (ibid). Another tension is caused by the huge size of agro-companies required by large institutional investors and the localized nature of farming (Kuns et al., 2014). This means that an increase in scale may not only bring economies of scale, but also increased complexity and monitoring costs and subsequent diseconomies of scale.

A major tension results from the mismatch between the investment horizon of the average investor from the financial sector and the time horizon (and cycles) of farming. The typical investment cycle of private equity and hedge fund investments (which also manage most farmland investment by public institutional investors like pension funds) is five to seven years, after which the company invested in is sold to a large investor or brought to the stock exchange. Agro-funds often promise a return on investment of 15 to 25 percent (Daniel, 2012). Such investment horizons and profit expectations often contrast with the dynamics of farming. Normally, there is just one harvest per year in crop production, in contrast to, for instance, the retail sector, which has a daily turn-around of inventory. The production-feedback-improvement cycle takes two years at minimum in agricultural production. If improvement involves some trial and error, which is often the case due to insufficient agricultural know-how among investors, it takes even longer. Due to the volatility of agriculture because of its weather dependency (reinforced by climate change), agro-investment projects also frequently face losses after the start-up phase.

Numerous investors celebrate a business model of bringing into cultivation “unused” land, in order to rapidly achieve considerable profits. This model of buying up very cheap “marginal” or “abandoned” land is based on the assumption of low start-up costs, and a sharp rise of land value after turning it into productive land. In reality, much of the marginal land is not so empty as it seems, with local dwellers using the lands and having (informal) entitlements, for instance for grazing animals or hunting and gathering (Visser, Mamonova, & Spoor, 2012; White et al., 2012). Consequently, land investors are confronted with costs to compensate or appease local communities, or lingering discontent and the potential for conflicts and litigation costs (see Li, 2015 on the social and political risks).

Another often underestimated expense of acquiring abandoned land is the cost of bringing such fields into production. With a longer duration of abandonment, this can easily be up to one or two decades in countries such as Russia and Ukraine; the expenses and time required to bring these fields into cultivation are therefore considerable (Visser, Mamonova, & Spoor, 2014). Bushes have to be cleared, the soil has to be recovered, and in the first year(s), unprofitable crops may have to be sown to recover the soil. In the above-mentioned countries, for land that was abandoned for a decade, it takes at least two to three years as a rule to get a reasonable yield, let alone perform according to ambitious global benchmarks.

Conclusion

This paper argues that the widespread notion that farmland investment is highly profitable and relatively low-risk is problematic. Investment in farming by investment funds is much more complicated than it seems at first sight, and various tensions are characteristic of the finance-led, corporate agriculture that is associated with large-scale land investments. Note that it is *not* argued here that there are no settings in which such investments are profitable and/or even meet the investor's expectations. What the limited available evidence so far suggests is that profitable farmland investment is *not* the solid, global trend that is often proclaimed.

In terms of lessons for further research and policy, this paper suggests that in addition to mapping the scale of land investments and analyzing the social and environmental impact, the economic viability of those investments also requires attention. Currently, only some media articles and investor-oriented reports pay attention to the latter, normally focused on the successful cases.

More research and reliable data would facilitate a more nuanced analysis of farmland investment, which goes beyond the celebration of successful cases (or the opposite, an *a priori* denouncement of such investments). Such an analysis, also showing the often overlooked tensions and subsequent economic risks of farmland investments, might be an effective tool in advocacy for a more prudent approach to farmland investments among both investors and policy makers.

It seems unlikely that a prudent, consistent approach could be based solely on the voluntary guidelines, principles for responsible investment, and other types of “soft law”. Whereas investors with a public reputation might be interested in applying these principles, there is a risk that short-term profit motives will override social responsibility considerations in the case of less publicly visible investors (Fuchs, Kalfagianni, Clapp, & Busch, 2011). State regulation thus also has a role to play. However, as state regulation of farmland investment becomes increasingly difficult due to the transnational nature of such investments (including, for instance, the use of offshore constructions), this would only be effective with regulation in both the host countries and the countries from which investments flows originate.

Sound regulation would also require more insight in the investment flows. More research is necessary to map such flows, and to distinguish, for instance, which types of actors are directly involved in farmland acquisitions and ownership, and which actors are secondary investors. Other important questions for further research are: In what contexts is investor-led large-scale farming economically viable, and when is it likely to lead to failure? What is the wider social and environmental impact of respectively failed and functioning farmland investment projects? In terms of the tension between the short-term investment horizon of the financial sector and the long-term dynamics of farming, an important question is: Who are the actors within the financial sector that take a more long-term perspective on farming? And what difference does that make in terms of sustainable and equitable agrarian development?

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