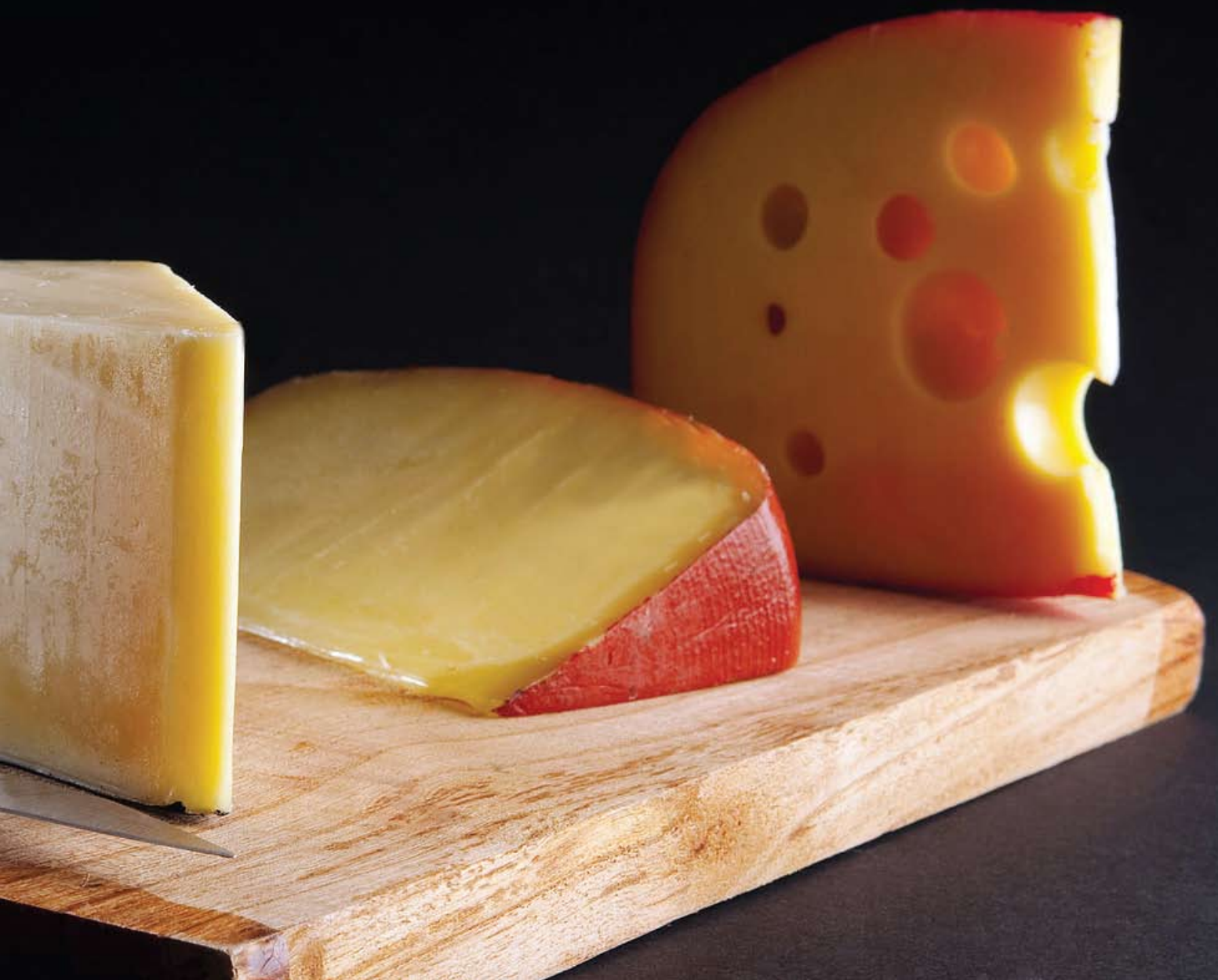


# INNOVATIVE FINANCING IN AGRICULTURE - II

LENDING AGAINST WAREHOUSE  
STORED CHEESE AS COLLATERAL

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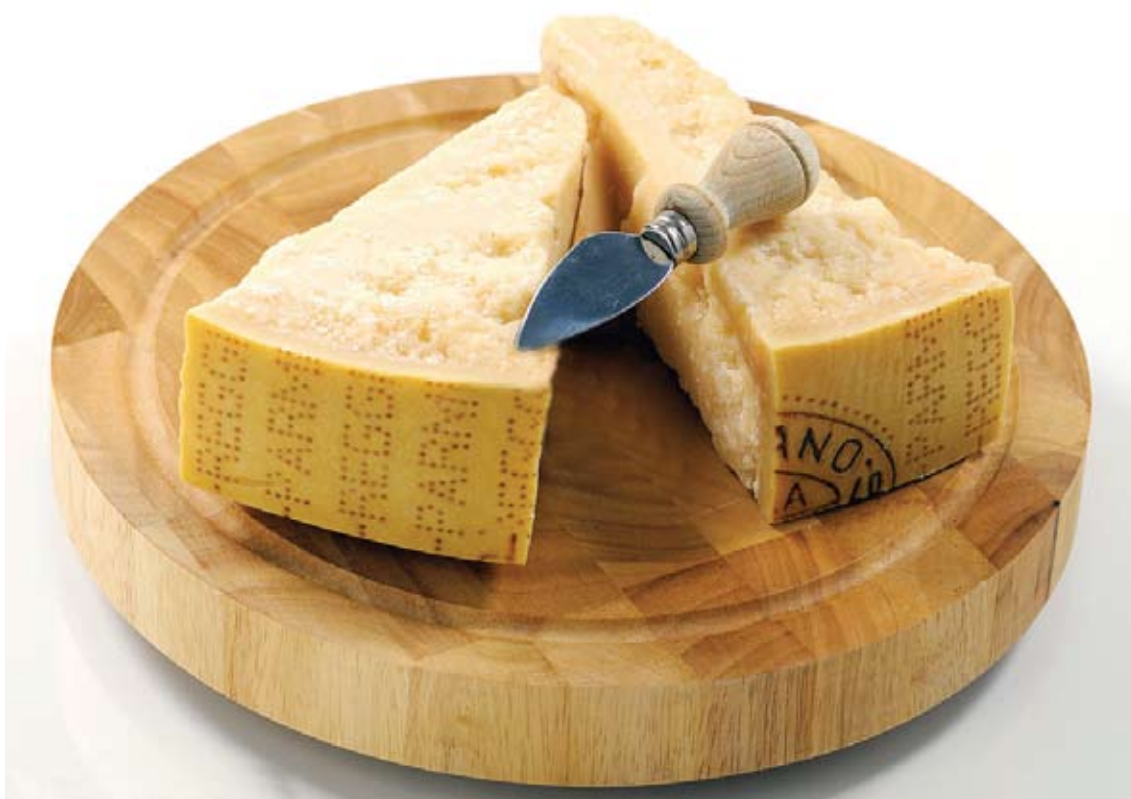
# INNOVATIVE FINANCING IN AGRICULTURE - II

## LENDING AGAINST WAREHOUSE STORED CHEESE AS COLLATERAL

There has been a spate of articles and news items in recent months about the unique and highly successful activity of financing of cheese makers in Italy. Articles have appeared in leading newspapers and magazines in Europe, USA, and other parts of the world, including India. Internet has several news items and interviews with cheese makers and bankers about financing against cheese as collateral. BBC and some other reputed television channels had special shows on rural financing that is in practice in northern and parts of central Italy for more than five decades now. In this article, an attempt is made to summarize the key steps in this innovative way of financing agriculture, which the world is taking a second look at in these times of global economic downturn.

### **The Parmesan Cheese**

Parmigiano Reggiano (the Parmesan cheese) is used in many food preparations as appetizers, as pasta fillings, and even in desserts. The love for Parmesan cheese is even growing outside Italy, especially in the US. Its growing popularity is further evidenced, interestingly so, by it being reported as the third most stolen item in Italian supermarkets.



## **Geographic Origins**

The name Parmigiano Reggiano for the hard, dry, skim milk cheese is allowed to be used legally only in the area of Emilia-Romagna in Italy. First made in the region in around 1200 AD, the sale of Parmesan in 2008 was around €1.54 billion (Rs 10,780 crore), with nearly 25% coming from exports.

## **Falling Prices**

Sale of Parmesan has suffered from the recent global economic downturn. Prices have fallen, supermarkets are offering discounts, and international competition from 'look and taste-alikes' is growing. The latter is an international problem of real concern to the Italian Parmesan industry. The cheese averaged €7.27 (Rs 509) a kg in July 2009, down from €7.49 (Rs 524) in January 2009, which had once peaked to €9.36 (Rs 655) a kg (in January 2004).

Earlier this year, the Italian government came to the rescue of cheese makers by buying 150,000 wheels of Parmesan and giving it away to charity. This has somewhat helped halt the fall in prices and stabilize the prices. The government has also asked banks to keep lending to help the industry.

## **Bank Finance against Warehouse Cheese**

Since the early 1950s, the unique system of giving loan against Parmesan is followed by four banks in the Northern Emilia-Romagna region - the key producing region. The cheese is stored in climate-controlled warehouses as collateral while giving loans. This infuses cash into the business while cheese is sitting on a shelf for the long ageing process.

The Credito Emiliano—a regional bank, mainly in Central and Northern Italy—is the main bank in offering loans, which benefitted around 430 Parmesan producers in and around Parma (the main Parmigiano producing area). The bank holds around 400,000 wheels of Parmesan (each weighing 39 kg or 85 lbs) in their temperature-controlled vault stores. The straw-colored Parmesan cheese takes as long as 24 to 30 months to mature or age.

For Credito Emiliano Bank, with 6,000 employees and 590 branches, cheese financing accounts for less than 1% of its total revenue. However, according to the Magazzini Generali delle Tagliate—the unit of Credito Emiliano that handles the Parmesan transactions—the financing of cheese is critical to its image in the region, a region where agriculture is a key economic driver. Further, it is a proof that there are more ways than one to keep doing business.

The financing of Parmesan has helped keep the cheese makers in business and bolstered the local economy. So far this year, the bank has extended loans amounting to €90 million (Rs 630 crore), against cheese storage certificates (warehouse receipts) — a 10% increase in requests for cheese-based financing.

## Storage and Ageing



During the process of ageing of Parmesan of over 24 to 30 months, the cheese maker incurs a number of costs and expenses. To meet the expenses, banks lend against cheese as collateral. The two climate-controlled warehouses of Credito Emiliano hold Parmesan worth €132 million (roughly Rs 924 crore). If the loans are not repaid the bank sells the cheese to recover its investment.



Inside the storage vaults, with heights of 10 M (or 33 ft), a temperature of 18-20 C (64-68 F) with greater than 90% humidity is maintained. Once the bank accepts the cheese as collateral it also oversees the ageing process, with its trained employees turning the wheels several times a week, cleaning using machines and checking periodically for cheeses that have gone soft. A master tester taps cheese wheels with a small metal hammer with a hollow sound indicating that the wheel is a 'dud'. This then results in its disposal —after scraping off the Parmigiano Reggiano imprint from the wheel and selling at a 15% discount as ordinary table cheese.

Each wheel is stamped with a serial number, the month and the location of production and a Parmesan imprint (after ageing for 12 months). Recently, the Italian police were able to recover 570 stolen wheels from their markings /serial numbers and return them to their owners.



### **Lending against Cheese as Collateral**

Typically, a cheese maker who deposits 25% of his production (or say 2,000 wheels out of a production of 7,000 wheels) in a bank warehouse gets a certificate against which he receives 60 to 80% of the value as loan. At €300 (Rs 21,000) for each wheel, the value of the cheese collateral could be €600,000 (Rs 4.2 crore) and then the bank could provide a loan of €420,000 (Rs 2.94 crore). Sometimes, the cheese maker may decide to sell the title to the cheese (certificate) to a distributor, while the cheese is still in ageing.

Credito Emiliano offers loan to an extent of 80% of the value, based on prevailing market prices, for as long as 24 months or the time it takes Parmesan to age. The bank loans are offered at the Euro-Interbank rate plus 0.75% to 2% points.

When the loan period is about to expire, the cheese maker either reimburses the bank or lets it sell them at market prices. After recovering its investment, it then returns any difference to the producer.

Thus, in Italy, the financing against cheese as collateral is considered a low risk activity by banks, and, over the years, there have been few defaulters.

### **Cheese Makers Benefit**

Cheese makers see finance against ageing Parmesan as collateral a great way to finance buying of milk at convenient rates. They feel that financing is necessary since it is a high value product (with 550 litres of milk going into making of each wheel followed by two years of ageing). Farmers agree that the financing against cheese is important to them and it is helping them in times of economic crisis or falling prices.

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