



**The Invincible
LAND**



Land Market Review Ukraine

**ANALYTICAL REPORT
IMPACT OF THE RELATED PARTY
RESTRICTIONS ON THE MARKET SIZE FOR
THE PARTIAL CREDIT GUARANTEE FUND**

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INTRODUCTION

The Partial Credit Guarantee Fund in agriculture (hereinafter referred to as the Fund) is a financial institution established to support small agricultural producers. A detailed overview of the Fund's activities and its legal framework is provided in Appendix 1 to this report.

The main objective of the Fund is to provide loans guarantees to small agricultural producers (with a land bank size of up to 500 hectares) in order to correct market distortions that hinder their access to bank financing. Working with small producers presents certain challenges. First and foremost, it involves high transaction costs for banks relative to the loan amount, as the scope of due diligence required for issuing a small loan to a farmer is roughly the same as for a large loan. Another limiting factor is the simplified financial reporting of small producers compared to large companies, which complicates risk assessment when issuing loans. However, it is assumed that by partially covering the risk involved in working with small producers (in the case of the Partial Credit Guarantee Fund, guarantees cover up to 50% of the total loan amount), banks will be more interested to provide financing to such farmers, which will help expand their access to bank lending.

However, the Fund currently does not have enough guaranteed loans in its portfolio to

have a significant impact on lending to small producers. This is likely due to restrictions imposed on its operations. These include the requirement that potential loan recipients must belong to the category of micro, small, or medium-sized enterprises, as well as the limitation that the producer's land bank must not exceed 500 hectares. However, there is one restriction that likely has the greatest impact on the Fund's capacity and effectiveness. This is the prohibition on issuing loan guarantees to legal entities whose shareholders or ultimate beneficiaries are also participants in other agricultural legal entities. In other words, if a small agricultural producer with up to 500 hectares of land bank operates several legal entities with agricultural CTEA (Classification of Types of Economic Activity) codes, they are excluded from eligibility for loan guarantees from the Fund.

In this analytical note, we analyze the potential maximum market size for the Fund under two scenarios: the current scenario, in which loan guarantees cannot be provided to legal entities with related parties, and an alternative scenario without this restriction. This will allow us to determine whether the restriction has a significant impact on the market size for the Fund's operations.

METHODOLOGY AND DATA PROCESSING

The target sample for determining the number of agricultural producers potentially eligible for partial loan guarantees was based on data from the State Agrarian Register (SAR). It included users who, as of October 2024, were registered in the SAR and had the status of either legal entities or individual entrepreneurs (IE), assuming that individuals are not part of the Fund's target audience.

As of October 2024, a total of 17,629 individual entrepreneurs were registered in the State Agrarian Register. Among them, 2,325 records were missing either the region of registration or the CTEA code. Of the remaining 15,304 records, 4,131 individual entrepreneurs did not have any agricultural CTEA codes, which limited the pool of potential loan guarantee recipients to 11,173. It is important to note that loan guarantees are only available to agricultural producers with land bank of up to 500 hectares. Among the 11,173 individual entrepreneurs, 469 had no land parcels, and 81 had land bank area exceeding 500 hectares, narrowing the final sample to 10,623 individual entrepreneurs.

As for legal entities, in October 2024, a total of 32,720 were registered in the State Agrarian Register. Among them, 3,017 entries were missing either the region of registration or the CTEA code. Of the remaining legal entities, 2,099 had no agricultural CTEA codes, and another 3,292 did not have any agricultural land

parcels. Another 6,039 companies had land bank exceeding the maximum size of 500 hectares. Thus, the final sample of legal entities potentially eligible for partial loan guarantees from the Fund amounted to 18,273.

Thus, out of the 50,349 companies and individual entrepreneurs registered in the State Agrarian Register as of the end of October last year, 28,896 — or 57% — could potentially qualify for guarantees from the Fund.

Based on this list of individual entrepreneurs and legal entities, a sample of 1,000 observations was formed. It was representative both at the regional level and in terms of whether the observation belonged to a subsample of individual entrepreneurs and legal entities.

Next, using the YouControl service, information was collected on the directors, shareholders, and ultimate beneficiaries of the legal entities and individual entrepreneurs from the representative sample, as well as the company status (registered or terminated) and their legal form. As shown in Table 1, the majority of observations in the sample fall under either the legal form of a Farm Enterprise (44.9%) or an Individual Entrepreneurs (36.9%). The third most common form is a Limited Liability Company (LLC), accounting for 11.2%.

Table 1. Distribution of Observations in Our Sample by Legal Form

| Legal Form | Number of Observations |
|---|-------------------------------|
| FARM ENTERPRISE | 449 |
| INDIVIDUAL ENTREPRENEUR | 369 |
| LIMITED LIABILITY COMPANY | 112 |
| PRIVATE ENTERPRISE | 38 |
| PEASANT (FARM) ENTERPRISE | 12 |
| AGRICULTURAL PRODUCTION COOPERATIVE | 7 |
| JOINT STOCK COMPANY | 3 |
| SUBSIDIARY ENTERPRISE | 2 |
| MUNICIPAL ORGANIZATION (INSTITUTION, ESTABLISHMENT) | 2 |
| AGRICULTURAL SERVICE COOPERATIVE | 2 |
| OTHER LEGAL FORMS | 1 |
| MUNICIPAL ENTERPRISE | 1 |
| COOPERATIVES | 1 |
| AGRICULTURAL COOPERATIVE | 1 |

Information on directors and ultimate beneficiaries obtained from public sources made it possible to determine whether the directors, shareholders, or beneficiaries of the companies or individual entrepreneurs in the representative sample were also involved as directors, shareholders, or beneficiaries in other companies — which could disqualify them from receiving guarantees from the Partial Credit Guarantee Fund.

RESULTS

Thus, the representative sample consisted of 1,000 observations, of which 631 were legal entities and 369 were individual entrepreneurs, 4 of whom had ceased their activities.

Among the 369 individual entrepreneurs, only 180 had no related legal entities. The remaining 189 individual entrepreneurs were collectively linked to 730 entities, of which 529 were active legal entities. However, only 140 of these had at least one agricultural CTEA code, which would

disqualify them from receiving guarantees from the Fund. These 140 legal entities were owned or managed by 104 individuals who were registered as individual entrepreneurs. **Therefore, out of the 369 individual entrepreneurs in the representative sample, 104 (or 28.2%) would be ineligible for Fund guarantees due to having related companies engaged in agricultural activities.**

Among the 631 legal entities in the representative sample, 209 had no related parties. The remaining 442 legal entities

were collectively linked to 3,783 related companies, of which 1,093 were inactive. As a result, 379 companies were identified as having 2,690 active related legal entities. Among these 2,690 companies, 1,863 had no agricultural CTEA code. **Therefore, out of the 631 legal entities in the representative sample, 242 legal entities (or 38.37%) had 827 related agricultural companies** that were not in the process of termination, bankruptcy, or liquidation at the time of the study.

CONCLUSIONS

Among the representative sample of legal entities and individual entrepreneurs, **346 entities or 35% had related entities engaged in agricultural activities**, which would disqualify them from accessing the Fund’s services.

While this restriction clearly has a significant impact on the overall market size available to the Fund, it is noteworthy that, based on an analysis of the Fund’s relatively small guarantee portfolio during the first 9 months of 2024, the share of those with related entities engaged in agricultural activities increases with the size of the farming operation. For example, if we analyze the segment of 300–500 ha, the share of farmers with related legal entities increases to 63%.

| <u>Maximum</u> | <u>Potential</u> | <u>Market</u> | <u>Size:</u> |
|--------------------|------------------|----------------|--------------|
| <u>Scenario</u> | <u>Without</u> | <u>Related</u> | <u>Party</u> |
| <u>Restriction</u> | | | |

If there were no restriction on issuing guarantees to companies and individual entrepreneurs with related parties, the total market size (assuming only companies and individual entrepreneurs registered in the SAR are eligible for Fund services) as of October 2024 would amount to 28,896 entities. Using data from a World Bank survey, we can estimate that the maximum potential market for the Partial Credit Guarantee Fund consists of small agricultural producers who answered “yes” to the question: “If you had the opportunity to obtain a loan for working capital or investment, would you use it?” This

represents 76.5% of all agricultural producers with land bank of up to 500 hectares — or approximately 22.1 thousand producers.

At the same time, 37.2% of potential loan recipients are not willing to pay even 5% interest on loans, and therefore are unlikely to become clients of the Partial Credit Guarantee Fund.

If the guarantees of the Partial Credit Guarantee Fund are combined with the “5-7-9” program, approximately 63% of small agricultural producers interested in loans would be willing to pay at least 5% interest, and 37% would be willing to pay at least 7%. Therefore, under the condition that the PCGF operates in conjunction with the “5-7-9” program, between 8.1 and 13.9 thousand agricultural producers could potentially make use of the Fund’s services. In contrast, if the PCGF does not cooperate with the “5-7-9” program, no more than 1.5 thousand agricultural producers would currently be willing to become clients of the Fund due to low demand for loans with high interest rates.

Based on the average desired loan amount of UAH 3.9 million (noting that the median is significantly lower, at UAH 1.5 million), it can be assumed that if the PCGF cooperates with the “5-7-9” program, the potential volume of loans issued under the Fund’s guarantees could reach between UAH 31.6 and 54.2 billion. In the absence of cooperation with the “5-7-9” program, the

maximum estimated potential loan volume would be approximately UAH 5.8 billion.

Maximum Potential Market Size: Scenario With Related Party Restriction

In the current scenario, where the related party restriction is in place, 35% of potential guarantee recipients are excluded from accessing this service. As a result, the total number of potential recipients drops to 18.8 thousand. Among them, only 14.3 thousand would consider attracting financing. If combined with the “5-7-9” program, the maximum number of loan (and potentially guarantee) recipients would be between 5.3 and 9.0 thousand individual entrepreneurs and legal entities. Without the “5-7-9” program, the number of potential recipients would be limited to just 1.0 thousand.

Thus, if companies or individual entrepreneurs with related entities engaged in agricultural activities are excluded from accessing the Fund’s services, the maximum potential market size decreases to UAH 20.5–35.2 billion under cooperation with the “5-7-9” program, and to UAH 3.8 billion in the event the affordable loan program for small businesses is closed.

Overview of the Operation of the Partial Credit Guarantee Fund in Agriculture

The Partial Credit Guarantee Fund in Agriculture (hereinafter referred to as the Fund) is a non-bank financial institution with special status, established to support micro, small, and medium-sized enterprises, as well as individual entrepreneurs operating in the agricultural sector. Its main function is to provide partial guarantees for the fulfillment of obligations under loan agreements by such entities.

The Fund operates on the basis of the Law of Ukraine “On the Partial Credit Guarantee Fund in Agriculture,” which establishes the legal framework for its activities, the eligibility criteria for business entities and financial institutions, as well as the procedure for providing guarantees.

FUND OBJECTIVES

1. **Ensuring access to financing** for small and medium-sized agricultural producers who often face difficulties in obtaining bank loans due to insufficient collateral.
2. **Supporting the development of agriculture**, promoting the modernization of production and enhancing the competitiveness of small and medium-sized enterprises in the sector.
3. **Reducing loan risks** for financial institutions, thereby encouraging them to provide more active lending to the agricultural sector.

FUND FUNCTIONS

1. **Providing partial guarantees** on the loan obligations of agricultural producers. The Fund covers up to 50% of the outstanding principal loan amount.
2. **Concluding cooperation agreements** with financial institutions that meet established eligibility criteria.
3. **Risk control and monitoring:** the volume of uncovered guarantees may not exceed four times the size of the Fund's regulatory capital.
4. **Developing eligibility criteria** for business entities and financial institutions.
5. **Investing temporarily available funds** in accordance with the investment policy.

FUND BENEFICIARIES

Micro, small, and medium-sized business entities that meet all of the following criteria:

- Their primary business activity is the production of agricultural products;
- They own and/or lease agricultural land in an amount not exceeding 500 hectares, including land parcels acquired with loan funds;
- They meet the requirements for micro, small, or medium-sized enterprises in accordance with the Law of Ukraine "On Accounting and Financial Reporting in Ukraine", specifically:

Microenterprises are businesses whose indicators, as of the date of preparation of

the annual financial statements for the year preceding the reporting year, meet at least two of the following criteria:

- Book value of assets – up to and including EUR 350,000;
- Net revenue from sales of products (goods, works, services) – up to and including EUR 700,000;
- Average number of employees – up to and including 10 persons.

Small enterprises are those that do not meet the criteria for microenterprises and whose indicators, as of the date of preparation of the annual financial statements for the year preceding the reporting year, meet at least two of the following criteria:

- Book value of assets – up to and including EUR 4 million;
- Net revenue from sales of products (goods, works, services) – up to and including EUR 8 million;
- Average number of employees – up to and including 50 persons.

Medium-sized enterprises are those that do not meet the criteria for small enterprises and whose indicators, as of the date of preparation of the annual financial statements for the year preceding the reporting year, meet at least two of the following criteria:

- Book value of assets – up to and including EUR 20 million;
- Net revenue from sales of products (goods, works, services) – up to and including EUR 40 million;
- Average number of employees – up to and including 250 persons

(Part 2 of Article 2 of the Law of Ukraine

“On Accounting and Financial Reporting in Ukraine”).

The above-mentioned threshold indicator is calculated cumulatively for **the entire group of counterparties related to the business entity**.

Two or more counterparties are considered a single counterparty (a group of related counterparties) and as bearing a shared economic risk if at least one of the following criteria is met:

1) **Control** relationships:

- One counterparty exercises control over another counterparty (or counterparties);
- Counterparties share a common controlling entity;

2) Economic dependence: If one counterparty experiences financial difficulties in funding or fulfilling obligations, it is highly likely that the other counterparty (or counterparties) will also face similar financial or performance difficulties (Clause 9, Section VI, Chapter 1 of NBU Resolution No. 368 dated August 28, 2001 “On Approval of the Instruction on the Procedure for Regulating the Activities of Banks in Ukraine”).

In this context, “**control**” means the ability to exercise a decisive influence over the management and/or activities of a legal entity through the direct and/or indirect ownership by one person, either independently or jointly with others, of a share in the legal entity equivalent to 50 percent or more of its charter capital and/or voting rights, or, regardless of formal ownership, the ability to exercise such influence based on an agreement or in any

other manner (Article 2 of the Law of Ukraine “On Banks and Banking Activities”).

CONDITIONS FOR PROVIDING GUARANTEES

1. Guarantees are provided exclusively for loans issued by financial institutions that have signed agreements with the Fund.
2. The guarantee term corresponds to the duration of the loan agreement but does not exceed 10 years.

NOT ELIGIBLE FOR GUARANTEES

- 1) Legal entities whose participants (shareholders, members) or ultimate beneficiaries are citizens of an aggressor or occupying state;
- 2) Individuals affiliated with or formerly affiliated with terrorist organizations;
- 3) Legal entities whose participants (shareholders, members) or ultimate beneficiaries are foreign states;
- 4) Legal entities with unidentified beneficial owners (controllers);
- 5) Legal entities whose beneficial owners (controllers) are registered in offshore jurisdictions;
- 6) Individuals and legal entities subject to special economic or other restrictive measures (sanctions);
- 7) Legal entities under the control of persons registered in FATF-listed countries;
- 8) Legal entities whose participants (shareholders, members) or ultimate beneficiaries are also participants

(shareholders, members) of other legal entities engaged in agricultural activities;

- 9) Individual entrepreneurs who are also participants (shareholders, members) of legal entities engaged in agricultural activities.

Additional creditworthiness criteria for business entities eligible to guarantee the fulfillment of obligations under loan agreements are determined by the Fund's Council.

FUNDING SOURCES OF THE FUND

- Budget funds allocated by the Law on the State Budget.
- Contributions to the Fund's authorized capital.
- Loans, grants, and international technical assistance.
- Income from financial and economic activities.
- Domestic government bonds.

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