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Behaviors and Actions of Successful Ag Lenders

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Dialogue of a very interactive webcast with agricultural lenders recently led to a thought provoking question. What behaviors and actions make a successful ag lending institution? With over 30 years of working in the agricultural lending field, speaking from the heart and gut, here is my best shot.

Well Grounded Credit Culture and Industry Knowledge

First and foremost, the ag lending institution that is successful over time has a strong, well-grounded credit culture backed by sound financial analysis packages, solid files of documentation, and due diligence. It demonstrates a consistent credit culture, not chasing hot markets, but targeting the customer base with a sustainable financial position and growth along with risk management philosophies similar to the institution.

Another element is that the lending staff and the organization in general know the industries that they deal with, along with the customer base. One lesson from the recent financial crisis was that lenders that did not know their customers had financial and portfolio exposure.

“What If” Lenders

Successful lenders are not “yes” or “no” lenders, but they are “what if” lenders. That is, while they are working with customers, they conduct sensitivity tests on cash flows, profits, liquidity, and collateral. Sensitivity testing collateral values is particularly important with inflated land values. They are “what if” lenders concerning structuring of debt. That is, they examine various rates, terms, loan structures, and alternative programs that provide the best mix for the customer in the long run.

For example, a loan officer provided a great illustration of sensitivity testing in a strategic planning seminar recently. First, he reduced revenues by 10 percent, increased input cost by 10 percent, and increased interest rates by 3 percent. He illustrated to the senior management group and the board how it impacted not only individual credits, but also the portfolio in general.

In the same seminar, he shock tested his customers’ financials with $120 per barrel oil prices, a $2.00 per bushel reduction in corn, soybean, and wheat prices, and 25 percent higher fertilizer input cost. The results illustrated the percentage of the portfolio's grain producers that were challenged under these conditions, and how these specific volatility factors influence management and growth strategies of the customers.

With land values skyrocketing, he then shocked this important component of the balance sheet with a 10 percent, 20 percent, and 30 percent decline in market value. Soon it was very clear that while all factors are important, the land value shock was the number one factor impacting many of his customers' financial health and the overall portfolio.

Marketing and Learning Culture
The institution's marketing culture is more than throwing a few advertising dollars to the marketplace. Their marketing culture exemplifies how they are a relationship lender that understands the needs, not only of the business, but the family, and personal customer needs. The successful lender knows how to "customer-ize" rather than throw out an array of generic products and services.

One culture that is emerging in recent years is an overall lifetime learning culture for employees, customers, and to some extent the public. In an economic downturn, there is a tendency to cut training budgets; however, the peak performing lenders step up the learning and realize that the employees and staff are knowledge workers who need consistent upgrading and refreshment of their skill base. More lending institutions are sponsoring schools, seminars, and webcasts for their customers. They are edu-marketing; that is, they educate while they market.

Support from Leadership
Finally, the management and board of directors of successful ag lending institutions are consistently supportive of the agricultural portfolio. As institutions grow, this sometimes becomes an issue as their leadership becomes more corporate and distant from the customer base, which is observed not only by the customers, but employees and staff as well.

A combination of cultures, strategies, behaviors, and actions is necessary for a successful ag lender that stands the test of time. While this list is not comprehensive, it is a starting point for dialogue and discussion at your next planning meeting.

The global economy has a number of issues surrounding the rebalancing of emerging nations, i.e. the BRICS (Brazil, Russia, India, China, and South Africa) and the developed nations in the world in North America, Europe, and Japan. China has challenges concerning inflation, particularly food inflation, which is currently over 14 percent on an annual basis. China and other emerging nations have sent stern warnings to the U.S concerning debt issues and budget imbalances. This bears watching since China is the U.S's largest federal debt financier.

The euro sector and banks in that region are facing concerns relating to capital and portfolio issues in the southern tier of Europe known as the PIIGS (Portugal, Ireland, Italy, Greece, and Spain). Germany's general public is becoming very impatient concerning financial assistance to these nations. Is this enough to break up the euro, which would be another round of uncertainty to a struggling global economy?

The major concern this fall will be whether the U.S. is headed for another recession. The lead economic indicators, the LEI, diffusion index, and PMI, would suggest a slowing economy. Housing starts at 604,000 annually still suggest a sector that is slightly over halfway back to normal. Large down payments and high unemployment are contributing to a very anemic housing sector, which is a large variable in the U.S. economy. Unemployment is reported at 9.1 percent, but when discouraged and displaced workers and those who have dropped out of the workforce (U-3 to U-6 workers) are included, the unemployment rate is 16.1 percent. Automation, regulation, and general uncertainty have played a critical role in high unemployment.

Factory utilization has improved to 77.5 and is just below full capacity for this component of the economy. Core inflation is just below the Federal Reserve's target of 2.0 percent; however, headline inflation, which includes food and energy, has increased from 1.6 percent to 3.6 percent in a matter of seven months, suggesting high oil and food prices are squeezing consumers.

Oil prices have bounced all over the board as global economic uncertainty and currency valuations have moved these prices by nearly $25 per barrel over a two month period. The July month-ending price was above $100 per barrel, but as of today, oil prices are considerably below $100 per barrel. Worldwide investors have driven short term Treasury rates down as a safe haven for the global economic storm. The economy should be exciting to observe this fall to say the least!

Lender and Business Dashboard Economic Indicators (for the month of July)

Indicator	Current	Green	Yellow	Red
Leading Economic Index - LEI	115.8	✓		
LEI Diffusion Index	65%	✓		
Purchasing Manager Index - PMI	50.9	✓		
Housing Starts (millions)	0.604			✓
Factory Capacity Utilization	77.5%		✓	
Unemployment Rate	9.1%			✓
Core Inflation	1.8%	✓		
Headline Inflation	3.6%		✓	
Oil Price ($/barrel)	$113.46			✓
Yield Curve	2.71		✓	

Lender and Business Dashboard Economic Indicator Benchmarks

Indicator	Green	Yellow	Red
The Conference Board Leading Economic Index® - LEI	**Increasing**	**Flat to Decline**	**Decline 0.3% for 3 consecutive months AND >1% over the period**
LEI Diffusion[1]	**>60%**	**40%-60%**	**<40%**
Purchasing Manager Index - PMI	**>50**	**41.7-50**	**<41.7**
Housing Starts (millions)	**>1.5**	**1.0-1.5**	**<1.0**
Factory Capacity Utilization	**>80%**	**70%-80%**	**<70%**
Unemployment Rate	**5%-6%**	**6%-8%**	**>8% or <5%**
Core Inflation	**0%-2%**	**3%-4%**	**>4% or <0%**
Headline Inflation[2]	**0%-3%**	**3%-5%**	**>5% or <0%**
Oil Price[3] ($/barrel)	**<$50**	**$50-$100**	**>$100**
Yield Curve[4]	**Steep**	**Flattening**	**Inverted**

[1]Ten indicators make up the LEI - measures % that are increasing; [2]Includes food & energy; [3]Consumer's perspective; [4]3-Month Treasury Bill rate to 10-Year Bond rate