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<u>Communication Blunders in Credit</u>

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In the days of the pandemic, agricultural lender communication with customers and internal team members was turned upside down. Face-to-face interaction quickly pivoted to emails, text messages, and voice or video calls with drive-up services for loan signatures and documentation. As the pandemic subsides, many lending organizations are reverting back to former patterns. However, some nuances created by the pandemic have resulted in new paradigms of doing business. With that as the context, let's dig deeper and discuss credit analysis communications including some of the blunders, as well as tools that can be used to improve interaction both internally and externally.

Understanding personality styles

One of the most powerful tools that I was exposed to decades ago is the DiSC personality profile. Of course, there are also many other popular assessments available in the marketplace. Understanding the personality styles of your coworkers and customers can be invaluable to enhance communications. For example, many credit analysts, people involved in loan documentation, and compliance professionals are high "C's" or very process and detail oriented. However, relationship officers and many of your growing customer segments are "D's" who want direct communication or "I's" who want discussion oriented toward relationship building. In the traditional producer group, the "S" or steady personality will rise to the top. While the credit person is detailed, the direct personality wants a quick summary in an elevator speech version of the credit decision and approval process. The "S" personality will be slower to make a decision and will need reinforcement. As you are preparing for loan committee, working with regulators, or speaking with customers and influencers of the customer such as spouses or advisors, aligning personality styles is critical to close communication gaps.

NexGen blunders

The next generation of agriculture producers is quickly moving into decision-making roles. A classic blunder, even with experienced lenders, is being blindsided with responsibility shifts within the business and the family. Based on my engagement with agricultural lenders, more institutions are making a concerted effort for proper alignment. Another variable being observed is that the younger generation tends to be less loyal with a focus on rates, often with nontraditional lenders. Understanding what is valuable in the eyes of the next generation must be assessed and communicated within the organization. Regardless of age or tenure, the new generation of borrowers tends to value educational events in a virtual format as opposed to the older generation who typically prefers face-to-face educational events. Generally speaking, the younger generation places a greater value on time for networking and engagement with peers and team members from the institution.

Credit denial

When I first came to Virginia Tech and started the agricultural lending school, Stan Forbes, a banker and one of the chairs of the Farm Financial Standards Task Force, taught us an important lesson. When you deny a credit, put time into providing the potential customer with plans A, B, C, and D. Another banker from the Upper Midwest recently suggested answering the following question, "What does the customer have to do to move toward acceptance?" Conditions change for farmers and ranchers with new players and the economic environment may improve. In some cases, a customer may inherit land or other assets from a relative, changing the credit assessment overnight. Both individuals recommended never to burn your bridges with a customer because you never know when you may have to travel over that bridge in the future.

Financial information interpretation

In today's world of quick credit scoring and efficiency in financial service delivery, financial benchmarking and building relationships may have been placed on the back burner. If you require financial data from the borrower, go the extra mile to provide an interpretation. Periodic benchmarking to other customers in the portfolio or in state or national farm record systems is becoming valued by borrowers that desire to improve their financial and business IQ. Through analysis, one can often identify areas of strengths and improvements through collaborative conversation. The key is not to overwhelm borrowers with ratios and numbers. It is recommended that you provide no more than one page with key performance indicators (KPI's) that can be easily tracked on an annual basis.

Cash to accrual analysis

I know lenders are probably going to roll their eyes on this one. However, even conducting a cash to accrual and earned net worth analyses using questions without the numbers can provide insight. For example, what direction did accounts payable, accounts receivable, inventories, prepaid expenses, and accrued expenses go between the balance sheet dates? Then, discussing the positive or negative reasons behind the changes can be very insightful for the customer, credit analyst, loan committee, internal review, and even regulators.

The influencers

One of the blunders being observed to a greater extent is a failure to communicate with members of advisory teams such as crop and livestock consultants, accountants, and attorneys. Whether on formal or informal teams, these individuals can be powerful influencers in decision-making. In larger operations, agricultural lenders are often part of monthly or quarterly meetings with business owners. Do not forget the importance of spouses as influencers as well!

Timeliness

Failure to communicate credit decisions to a customer on a timely basis and neglecting the touch points concerning loan progress are mistakes that are often made in a time compressed world. Improper follow-through or due diligence on credit reports, liens, or possible credit flaws that lead to rejection can be a blunder.

Once a year monitoring is not acceptable with today's consolidated larger businesses with more zeros and commas on the financial statements. With extreme volatility, the speed of change observed in financial statements can be overwhelming.

In conclusion, incorporating the next generation's decision-makers, being aware of influencers, and empowering business owners by taking the complex and making it simple can place you a step ahead of the competition. Understanding the unique personalities of those around you and compiling strong loan narratives will make the loan process much smoother. The tools discussed above are valuable to improve customer performance and are a subtle way of taking you and your institution from good to great.

Domestic Economy

The U.S. economy is cranking up in full gear as the mask mandates are lifted and vaccinations move forward. Before we examine the leading and lagging indicators, let's gain some perspectives about the economy based on surveys of the senior class enrolled in *Interpreting Economic Change* at the Graduate School of Banking at Louisiana State University. The bankers enrolled in this course were from 14 states this year. This first face-to-face class without masks and social distancing allowed surveys of their perspective on the economy.

The students surveyed responded that the biggest threat to the U.S. economy were government actions including stimulus payments, unemployment checks, and the buildup of debt leading to increased taxes. Of course, inflation was close behind as they indicated that their customer base, in many cases, were experiencing a cost and price squeeze leading to a reduction in margins. The availability of workers and increased wages was listed as a great challenge to financial institutions. Other risks included additional black swan events such as COVID-19 variants, grid and cyber-attacks, and attacks on the infrastructure. Real estate bubbles, particularly housing, and supply chain disruptions were high on their list as potential disruptors to a smooth sailing economy.

Leading and Lagging Indicators

When assessing the leading and lagging indicators, one must realize there is some noise in the numbers as a result of the Federal action due to the stimulus and pent-up demand and savings. Thus, in this article and future articles, one must examine trends in the numbers rather than a specific timeframe.

The Leading Economic Index (LEI) is a foreteller of the economy's future over the next three to six months and it is red-hot. Since January, the index has increased over four points. The LEI diffusion index, which measures whether the factors comprising the LEI are trending positive or negative, has been in the 70s, indicating 7 of the 10 factors that comprise the index are trending positively.

Oil prices are creeping toward $70 per barrel as global demand is increasing as consumers and businesspeople begin to travel more. Expect these prices to remain in the $60 to $70 per barrel range for the remainder of the year unless a disruptor occurs.

Copper prices, an indicator of world economic growth, peaked out at nearly $5 per pound, which is double from the beginning of the pandemic. These high copper prices are a result of mine shutdowns during the Great Recession ten years ago and China's demand for and stockpiling of copper being used in electric vehicles and other electrical components spurred by the green movement. However, in recent weeks these prices have declined to $4.15 per pound.

The Purchasing Manager Index (PMI), another leading indicator, has been strong in the 60 percent range as manufacturing gears up, despite shortages of components. One must watch China's manufacturing sector as the plants are curtailing production as a result of high input costs inhibiting profitability. These problems could spread to the United States.

The unemployment rate is just under six percent and just over ten percent for U-3 and U-6, respectively. The shortage of productive workers is manifesting itself in higher wages in critical areas of the economy from agriculture and manufacturing to the service-based businesses that are now opening up.

Housing starts and mortgage applications are cooling off as affordability and availability of housing is becoming a major challenge. However, housing starts are still strong at more than 1.5 million units annually. A metric to watch is lumber prices which have declined from over $1,600 per thousand board feet to about $1,000 per thousand board feet.

Factory utilization is still quite strong, despite input shortages. The onshoring of production and shortening of supply chains is a movement that is well underway globally. The movement of manufacturing to the southwestern states, from Oklahoma to Arizona, is an interesting trend as businesses seek lower cost of production areas and states with lower tax rates.

Whether it is measured by the Producer Price Index (PPI) or the Consumer Price Index (CPI), inflation is very evident. The question becomes, is it temporary or permanent? Only a trend analysis will filter this out later in the year. The current inflation rates are 5.0% and 3.8% for headline and core inflation, respectively. Again, we will have to wait and see where the inflation rate goes later this year.

The Index of Consumer Sentiment, published by the University of Michigan, could be a foreteller of permanent inflation. If this index reaches and maintains above 90 for six months later in the year, it could be a foreteller of permanent inflation. Consumer sentiment is a management variable that must be closely watched by businesses and financial institutions.

Global Economy

The U.S. is definitely in the lead concerning green shoots in the reemergence of the global economy. Generous stimulus checks, accommodative monetary policy, and pent-up demand are driving economic growth.

China, the second largest economy in the world, is pulling out all of the stops for both short and long run growth. For example, the new three-child policy allowing couples to have three children (or possibly more) seeks to alter demographics in the long run. It will be interesting to see the impacts of this policy change. Inflation is increasing the cost of inputs in the Chinese manufacturing sector, which has resulted in reduced profitability and a slowdown of output in many areas throughout China. China actually has labor shortages in critical areas, because the younger generation prefers to work in the service sector as opposed to manufacturing and construction jobs. The U.S and some European countries have recently developed the B3W Partnership which is designed in part as a counter to China's Belt and Road Initiative. It will be interesting to observe China' s counter strategy to this alliance.

Despite high rates of COVID-19 infections and over 500,000 deaths, Brazil's economy is showing some growth. Economic growth is a result of its agriculture and natural resource exports, more specifically soybeans. One can see the effects of the linkage to China and Asia through the Belt and Road Initiative in Brazil and Argentina.

The European economy has either a slow or negative growth rate in many areas. Actually, some areas of Europe are in a recession. It will be interesting to observe whether the opening of business travel and tourism will provide a boost to the positive side of the ledger in their economies later in the year.

In future articles, we will discuss digital currencies, including all the new products on the market. China is already limiting access and the Federal Reserve is pursuing the status of digital currencies. A government regulated and monitored digital currency could quickly come in our future. This will be a detriment to the value of the dollar!

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

Indicator	Current	Green	Yellow	Red
Leading Economic Index - LEI	114.5	✓		
LEI Diffusion Index	75%	✓		
Purchasing Manager Index - PMI	61.2	✓		
Housing Starts (millions)	1.572	✓		
Factory Capacity Utilization	75.2		✓	
Unemployment Rate	5.8%	✓		
Core Inflation	3.8%		✓	
Headline Inflation	5.0%		✓	
Oil Price ($/barrel)	$67.32		✓	
Yield Curve	1.57		✓	

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	<6%	6%-8%	>8%
Core Inflation	0%-2%	2%-4%	>4% or <0%
Headline Inflation[2]	0%-4%	4%-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