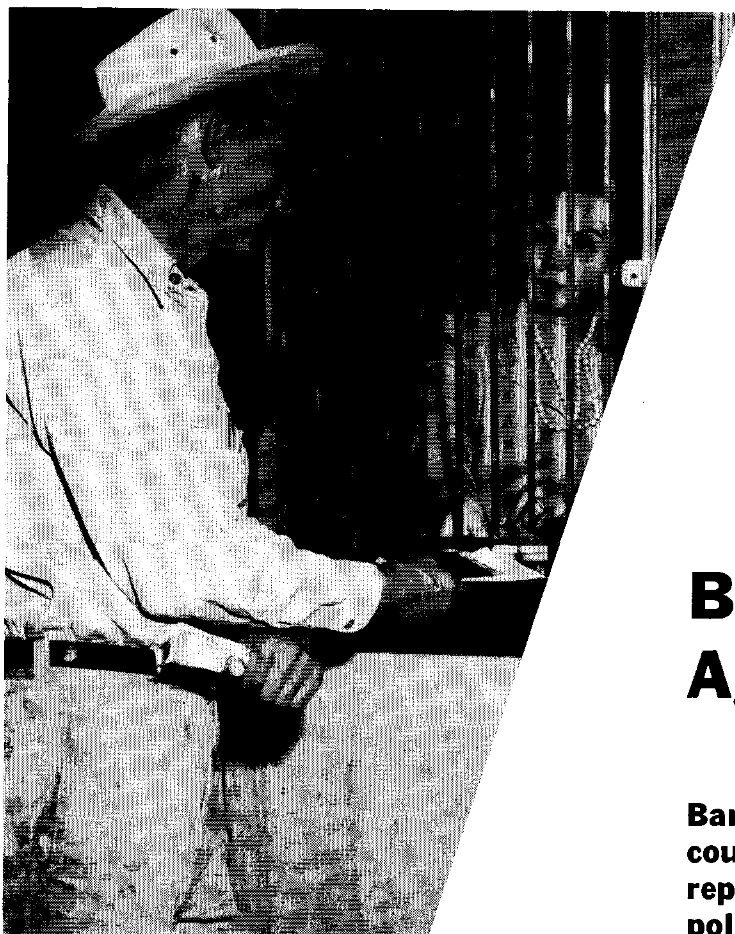


Banks in Agriculture

A Staff Survey

Bankers find it necessary to take special courses in agriculture and to hire farm representatives in order to keep farm credit policies on a sound, but progressive basis

FARMING IS A BUSINESS. And for the farmer, as for most businessmen, credit is a potent tool of the trade. Commercial banks, and several other kinds of lenders, control the total amount of credit a farmer can get—the amount of money he can invest in his business. They control to some degree, therefore, the total amount of money the farmer spends on real estate, equipment, livestock, chemicals, and the myriad other things he needs.

Just how important are commercial banks in farm credit? The Federal Reserve System's Agricultural Loan Survey showed that on June 30, 1956, insured commercial banks had about $5 billion in farm loans outstanding. This came to 27% of the total farm debt—a record $18.5 billion, not including Commodity Credit Corp. advances. Beholden for that $5 billion were 2.3 million borrowers, almost half of the operating farmers in the country.

The survey showed, too, that the size of the average bank loan had grown 60% (to $1400) since 1947, when the preceding survey was made. Number of bank loans outstanding had jumped 45% in the same time, despite a 20% drop in the number of farmers.

For a closer look, non-real-estate debt may be considered separately from the total. As of Jan. 1, 1957, it came to about $8 billion. Banks held 41% of that debt, making them the biggest single factor by far in non-real-estate debt, which includes loans for operating expenses, chemicals among them.

Banks get this non-real-estate credit into the farmer's hands in two general ways:

- They lend directly to farmers for seasonal operations and other purposes. These loans can be secured or unsecured.
- They discount paper held by farm suppliers.

Out-of-pocket costs of production account for much of the credit extended in these ways. However, annual production loans are becoming relatively less important as the volume of intermediate term credit grows. About a third of all bank credit is now on an intermediate-term (several years) repayment basis.

A bank generally requires that the farmer pay off his production loan in a year or less. The idea, here, is that money lent to support production should be repaid from the proceeds of that production. Hence the farmer should pay off his loan when he sells his crop, or whatever else he may be producing.

Bank interest rates on farm production loans vary roughly between 5% and 8% around the country; the Federal Reserve's survey put the national average at 6.2% for mid-1956. Interest rates tend to be a little higher in

the South and Southwest than in the Corn Belt and parts of the East. They depend on the size and nature of the loan, the collateral, local custom, and other factors. Of these, the size of the loan seems most important; the bigger the loan, the lower the interest rate. This reflects the lower unit cost of handling big loans, the big borrower's bargaining position, and probably the fact that a big borrower typically has a bigger, more efficient farm, and is thus a sounder risk.

Perhaps the most singular feature of farm banking is that rural banks handle most of it. Rural banks, almost by definition, do business outside the main economic stream. One short-term result of this is reflected in their interest rates which, says the Federal Reserve's survey, rose an average of only 0.4 percentage points (for all farm loans) between 1947 and 1956. (One New Mexico banker says he raised his rates 0.5 percentage points in the past year, but because of higher operating costs, not tight money.)

It is true that in the long run rural banks do compete with city banks. The relatively small rise in their interest rates may be due not only to isolation, but to the fact that rural people strongly resist higher interest rates. However, whatever the reason, it appears that rural banks do not react rapidly to shifts in the midstream money supply.

Local Resources Vital

By the same token, rural banks depend, by and large, on local resources for their deposits, the ultimate measure of their lending ability. "Local" can mean a very small area. One Illinois bank, for instance, says it does most of its business within a 12-mile radius. There are doubtless banks that, because of limited local resources, are sometimes hard pressed to meet local demand for credit, especially if many people besides farmers are competing for that credit.

There are ways out of this impasse. One is branch banking (in states where it's legal), in which the main bank can funnel its resources to parts of the state where they are needed, subject to the total lending ability of the system. A good example is the giant Bank of America with some 600 branches in California.

Another way out, when a bank cannot handle a loan, is to call in a correspondent bank. Both banks then participate in the loan. Sometimes more than two banks participate in a loan, and it is not uncommon to find large banks both originating participating loans, and participating in loans originated by others. Thus other reasons—spreading the risk, for instance—than a particular bank's inability to handle a loan may lie behind participations.

Correspondent banking is much more widespread than branch banking. However, the Federal Reserve's survey showed that in only $80 million of the total farm debt ($5 billion) held by banks in mid-1956 were two or more banks involved. Half of the shared debts were held by banks in the 10th Federal Reserve District (Kansas, Nebraska, Wyoming, Colorado, most of Oklahoma, parts of New Mexico and Missouri); 40% of them had originated in that district. That relatively few participating loans are made may be due partly to lack of need. But the American Bankers' Association does note a fair amount of feeling that more use should be made of various ways to ease the flow of capital between rural areas and big cities.

In this same vein, one pesticides man says he doesn't believe the average country bank's farm lending ability has been put to the test in the past five years. He believes that fertilizer and pesticide suppliers, by bearing so much of the credit load themselves, have masked the banks' true lending ability. The Federal Reserve's survey, incidentally, shed no light on this aspect of farm lending.

Besides that, several fertilizer and pesticide firms think that farmers in general are not using all the bank credit they could get if they wanted it. There are several reasons for this. Some farmers have no profitable use for more credit, some are averse to borrowing, some do not recognize their opportunity. And ABA says that while lending imperfections do exist, studies of impediments to farm improvement suggest that other factors cause more trouble than lack of credit.

While a bank's decision to give or refuse production credit to a farmer may depend on a number of things, they all add up to: "Is he a good risk?" If the decision depended only on the farmer's balance sheet, then the banker might not have much of a problem. Good bankers are quite aware, however, that the farmer will repay his loan out of proceeds, not out

Four branch managers of the Bank of America edge toward a herd of nervous Hereford cattle near the Davis campus of the University of California, which cooperated with the bank last year in a farm short course for the bank officers. The course, to be repeated this year, consists of two weeks of classroom work in the morning and field trips in the afternoon

of assets. They put a good deal of emphasis on how well the farmer is likely to use his loan. If he gets a high return on it, repayment is assured and the community benefits, too. And banks, typically, grow with their communities. The banker's real problem, then, is to measure the man's ability to make a profit.

Some farmers are obviously good risks; making a decision on them is not normally troublesome. Also, the average country bank has done business with many of its customers for years, knows them well, and again, should normally have little trouble deciding for or against a loan.

This leaves the perennially marginal risk and the new or untried farmer. The former is not quite the problem he used to be; he belongs to a dwindling, though still numerous, breed. Farmers who are not progressive, or who have farms that are too small to make the grade, no matter how good the farmers themselves are, are gradually moving to other jobs or getting bigger farms.

But one of the banker's biggest problems is how best to help the new, young farmer. He has two extremes of choice: to invest in an unknown quantity, or take a chance on stifling someone who might grow into an asset to the local financial community. A few banks handle this quandary by setting aside a small part of their loanable assets each year to make plainly high-risk investments in one or two promising young farmers who have little or no tangible collateral.

Farmers do get turned down by banks. A rough indication of how many lies in the percentage of total non-real-estate debt carried by the Farmers Home Administration: 5% on Jan. 1, 1957. One requirement for an FHA loan is that the borrower be unable to get the loan on reasonable terms from any other source, or that a county committee decide he probably could not get it. Thus all loans carried by FHA must have been turned down (depending on the definition of "reasonable terms"), or stood a very good chance of being turned down, by banks and other credit agencies. To these must be added those farmers who were turned down by banks but did not go to FHA.

It might be noted that FHA, too, sometimes turns down applicants, and that it sometimes does not have enough funds to take care of all those who would otherwise be acceptable.

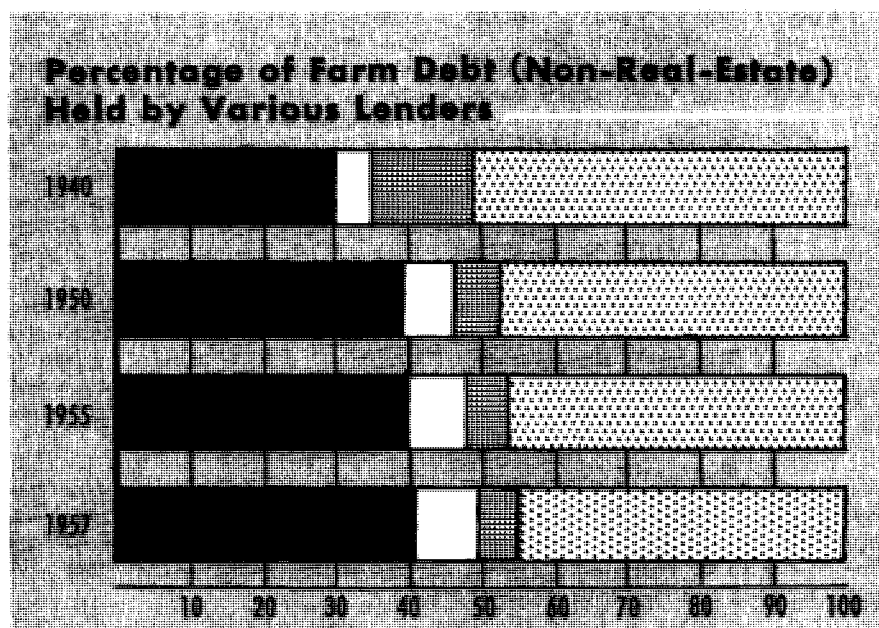
Once a bank decides to make a production loan, it prefers to handle all of the farmer's credit needs for that season. For one thing, it's nice to have the business. But the bank's main objection to split credit is that it makes it harder for the farmer to manage, and for the bank to finance, his financial program properly. This makes him a less desirable risk. As a rule, a bank will go further with a man when it holds all of his debt than when it is sharing his debt with others. However, there appears to be little or no information on how many farmers actually do place all of their credit needs with one bank.

To set up the production loan, farmer and banker normally sit down together and go over the farmer's plans for the season. They may go into great detail; they may go into very little. Says a Montana banker, "We go into no more detail than necessary to make the loan a sound one and an adequate one for the customer." In practice, that can sometimes mean setting up a very detailed budget, including even living and personal expenses.

There is no evidence to show that banks very often make truly integrated operating loans. But suppliers seem agreed that in principle this is a good idea. It recognizes farming as a complex, integrated business. Suppliers' chief complaint on this score is that too few banks maintain a close watch on the loan to see that the farmer uses it as he said he would.

An extreme example of what can happen is the farmer who first gets a production loan from his bank and

Black areas represent percentage held by banks, white areas that held by production credit associations, cross-hatched areas that held by Farmers Home Administration, and the dotted areas that held by miscellaneous sources



Places besides banks where farmers can get credit

Farmers Home Administration. Agency of USDA. Borrower must be unable to get loan, on reasonable terms, from other credit agencies. Borrower applies directly at local FHA office.

Federal Land Banks. Supervised by Farm Credit Administration. There are 12 Federal Land Banks in the U. S. They are owned by borrowers, through ownership of stock in National Farm Loan Associations. Borrower applies to the National Farm Loan Association that serves his area.

Production Credit Associations. Supervised by Farm Credit Administration. Credit cooperatives, set up by the Farm Credit Act of 1933. Qualified borrowers join local PCA's by buying capital stock. Most of the money lent by PCA's is obtained by rediscounting members' notes with Federal Intermediate Credit Banks. Specialize in short-term credit.

Miscellaneous Sources. These include merchants, dealers, individuals, finance companies, and others for whom no reports are available. Figures are estimated on basis of fragmentary data.

then takes advantage of the competition among his suppliers, buying from them, on credit, one or more items already provided for by his loan. This double financing frees some cash which he may promptly sink into a new car or some other irrelevant item.

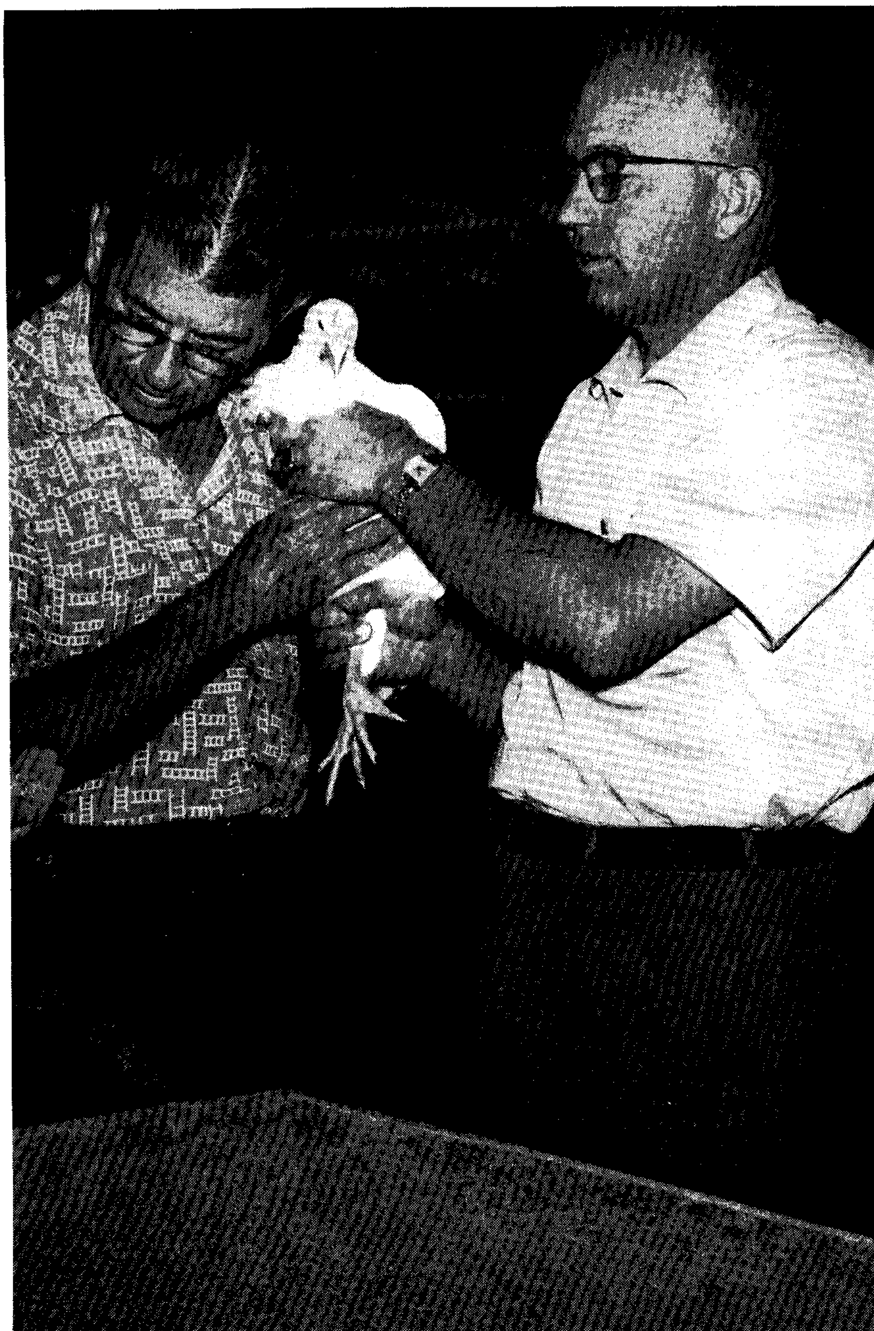
To have grounds for a close check on how the farmer is using its money, the bank must first make the loan on the basis of a fairly detailed budget. But many banks don't require much detail, especially from their well established customers. They feel it is unnecessary, and that they should not be telling the farmer how to run his business. At the other extreme, one bank tells AG AND FOOD that it would not ask for a detailed budget from its marginal borrowers because its profit margin is too slim to support a close follow-up.

Actually, relatively few banks can follow their farmer-customers' operations in detail. Those that require a budget do so to get the farmer into the bank to appraise his credit needs and repayment ability. This practice is good for the farmer, and it allows the bank to appraise his credit needs more easily and more intelligently. In this vein, a New Mexico banker remarks that budgets are being used more, and in more detail, as the economic squeeze closes in on the farmer.

Are They Too Tight?

Perhaps more serious to fertilizer and pesticide suppliers is their feeling that banks tend to be a little tight with the credit they advance for chemicals. Two years ago, a Georgia banker became interested in this feeling and decided to discuss it with a number of his confreres. He compared for them, among other things, the pounds-per-acre of nitrogen used by the average Georgia farmer in 1955 and the amounts the experiment station recommended. Most of those bankers, he says, thought the station recommendations were entirely too high for the average farmer. Many of them were concerned, however, about how wisely farmers were using their fertilizer; some thought more soil tests were in order. Others said they looked at the farmer's entire program when advancing credit for fertilizer. If they considered him sound and progressive, they were much more likely to finance heavier fertilization.

Regardless of the reason, if a bank shorts the farmer on credit for fertilizer or pesticides, one of two things can result. First, he simply uses less than he should. Or, if he knows he should use more and intends to get it, he is forced to get his credit elsewhere. Frequently he goes to his supplier, who may not like to sell on credit but may do it to get the business.



Bank of America officer and a county farm adviser visit a fryer and broiler farm in Sacramento County during the farm short course field trip

Assuming that these criticisms are valid, there is a positive countermeasure: the farm representative (FR). An FR is a banker trained in agriculture or an agriculturist trained in banking. He is a liaison man between the bank and its farmer-clients. The FR idea has come along to the point where most rural banks think it is a good one, but not yet to the point where most of them have FR's. As of mid-1956, more than 700 banks had either set up agricultural departments or added FR's to their staffs in the previous 10 years. Many other banks have lending officers trained formally or informally in agriculture, but not designated as FR's. But some 12,500 banks in the U. S. take part in farm lending. Parts of the problem are doubtless manpower (a serious problem in all phases of banking) and low profits.

Although banks' opinions differ on the FR's basic job, a primary function of most FR's is to keep a loan sound or improve its soundness by giving the farmer economic and technical advice when he asks for it. And there seems to be a good deal of feeling that the FR should be able to commit his bank to a loan on the spot.

Beyond this, the FR may help to allay bankers' traditional conserva-

tism. Or, more accurately, he can interpret correctly situations that are not so risky as they look. The University of Tennessee reports, for instance, that since the advent and growth in number of FR's in that state, bankers are lending more and more on the basis of the farmer's ability rather than on the basis of the collateral he can supply.

ABA points out that a marginal investment in fertilizer is often a good way to improve the quality of a marginal operating loan. The FR, presumably, sees the possibilities in such a situation more clearly than the deskbound man in the bank. The peach country in Georgia, to take a practical illustration, is subject to late freezes. So it is often difficult for a farmer there to get bank credit for fertilizer until the freeze danger is past and the fruit is set. If he wants to fertilize before then, he may be out of luck at his bank. Here, again, the FR should help.

Some banks train their own FR's. Last year, the Bank of America gave 30 of its branch managers two weeks of basic agriculture at the University of California; it is repeating the course this year. In a second program, the Bank of America has its lending officers work closely in the field with its trained agricultural appraisers stationed in various parts of the state.

Elsewhere in bank education, many state bankers' associations hold working conferences on agriculture. ABA sponsors an annual Agricultural Credit Conference, and also distributes a good deal of educational material on agricultural credit.

Bread on the Waters

Some rural banks, recognizing that their success depends heavily on sound local agriculture, go some distance beyond their credit function. They take part in agricultural field days, sometimes as the primary sponsor. One southern bank, reportedly, became concerned over a pesticide shortage expected at a crucial time. It laid in a supply of dust early in the year, and was then able to supply its cotton growers when others were having a hard time getting enough to fight pest outbreaks. In Missouri, the Chillicothe State Bank sparked revision of the Water Facilities Act, including Soil and Water Conservation Loans, signed by the president in 1954. (That bank, incidentally, charges 6% on production loans, but only 4% on fertilizer loans.)

Not Too Vocal

Although they have not been too vocal about it, banks could probably make out a pretty good case against chemicals suppliers for cutting into their business. Says one pesticides man: "If I were a banker, I'd be pretty darn mad about it!" Some farmers doubtless ask for credit from suppliers because the bank turned them down. But many others do it because they succumb to the suppliers' use of credit as a sales tool or because they can in some instances get it at little or no interest.

Actually, most suppliers dislike credit business. As one fertilizer man puts it, "Credit is not only the banks' job, it's their responsibility." Where competitive strife permits, most suppliers try to stay out of the credit business. They may, for instance, charge higher interest rates than local banks, thus pushing the farmer to the bank or other credit agencies. When they do this, the higher interest rate also helps to pay the extra cost of servicing the account. If they grant credit at unrealistically low interest rates, they must logically charge all customers more for their products.

Some suppliers think that banks are not so aggressive as they could be. Several years ago in the southeast, a pesticides firm worked up a plan under which the farmer would borrow from the bank and pay cash for his pesticides; if he agreed to do this, the supplier would then pay the interest on his bank loan. This scheme required bank cooperation, so the supplier took it around to the local banks. Mostly he found apathy, and the idea fell through. It is possible that the idea looked slightly nefarious to the bankers, who would thus turn it down on ethical grounds. The supplier's belief, however, is that they simply were not alert to the possibilities.

Hard to Keep Up

Farmers have had a hard time keeping up with the past decade's technical progress, and bankers, being one step removed, have probably had a harder time. This is certain to affect banks' lending policies. Chemical suppliers are trying in various ways, therefore, to get their message to the banker.

One way is through the public relations programs of their trade associations. NACA, for example, has mailed "economic benefits" issues of *NAC News* to many influential bankers. And the NPFI has for several years been conducting a broad program aimed at improving the interrelationships among farmers, bankers, and land-grant college people.

Materials developed in the NPFI program have all been worked out in cooperation with the agricultural colleges. They have generally been built around the colleges' recommendations for farmers, with particular emphasis on soil testing, and include:

- Advertising mats extolling soil testing and fertilizer use, made up in consultation with bankers' associations and supplied to the associations for use by member banks in their local advertising campaigns;
- posters for use in bank lobbies;
- soil test leaflets, distributed through the associations for use by member banks as mailing pieces or hand-outs;
- soil testing tubes, supplied to banks on request for subsequent loan to farmer-clients;
- brochures on the advantages of proper fertilizer use, sponsored jointly in each state by the bankers' association and the agricultural college.

Altogether, NPFI has now worked on these projects with bankers' groups in 25 states, many of them on a repetitive basis.

These things are happening at the company level, too. One example is Spencer Chemical which, since 1950, has been running an institutional advertising campaign in bank publications. The campaign promotes the thought that it is good business for rural banks to recommend good farming practices to their customers, the idea being to create a stronger feeling for farm credit, including fertilizer credit. In one phase of this program, Spencer got bankers in each of six states to elect a Distinguished Farm Banker from among their number. These were then featured in the advertisements and in other appropriate communications channels. Right now, Spencer is putting the emphasis on farm representatives; it has recently sponsored a seminar in which a number of FR's got together to discuss mutual problems.

A Basic Proviso

No discussion of banks' place in farm lending, or in any other kind of lending, should overlook one thing. That is that bankers feel an overriding duty toward their depositors. The safety of depositors' funds comes before anything else. Bank credit policies are rooted in this creed, which doubtless accounts for their conservative nature. One great need, says ABA, is more practical research by land grant colleges on the patterns of credit most helpful to farmers in various circumstances. Such research, it says, should be most helpful in keeping bankers' farm credit policies on a sound, progressive basis.