

# The Agricultural Credit Market

## Producer Preferences for Lender Attributes

### Summary of Survey Results

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# **THE AGRICULTURAL CREDIT MARKET: PRODUCER PREFERENCES FOR LENDER ATTRIBUTES SURVEY**

## **EXECUTIVE SUMMARY**

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- Evolutionary changes in the agricultural and financial sectors continue to impact the delivery of financial services to customers. As credit suppliers to a highly capital intensive industry, agricultural lenders must adapt to these changes and identify the opportunities that exist in this rapidly changing environment.
- The ongoing mergers and acquisitions of institutions lending to agriculture changes the competitive landscape and services to borrowers. Successful institutions may need to become more customer-driven by identifying segments and niches that result in increased customer and lender value.
- Advances in technology and the overall competitiveness in agricultural credit markets have motivated lenders to develop cost-effective strategies for delivering services to various customer segments. Some customer segments are likely to be interest rate sensitive while other segments place considerable value on lender relationships. Identifying and responding to customer expectations and offering the proper product mix are critical to success.
- The attributes farmers value in agricultural lenders are investigated in this survey. In a future report the results will be analyzed across borrower characteristics such as farm size, age, and leverage.
- The survey was mailed to 3,000 producers across Illinois, Indiana, and Iowa in August 2004. Receiving 538 usable questionnaires yields a response rate of approximately 18%.

### **Demographic and Business Information**

- A significant proportion of respondents are 46 years of age or older (78%).
- The majority of respondents intend to expand their farm operation (47%) or remain the same size (42%).
- Approximately 55% of respondents farm between 500 and 1,500 acres with 20% farming between 1,501 and 2,500 acres.
- Average total farm sales per year varies among respondents. Approximately 50% earn between \$100,000 to \$500,000 in farm sales per year.
- The largest percentage of farmers operate at a debt-to-asset ratio between .11 and .40 (42%).

## **Financing Characteristics**

- The majority of responding producers prefer to meet with their lender at the lending institution (56%). Approximately 53% of farmers desire on-farm lender visits at least once per year, while 34% report such visits are not needed.
- Over the past three years, approximately 73% of survey participants sourced operating credit from banks while 33% sought financing from Farm Credit Services.

## **Traditional vs. Nontraditional Lenders**

- Fifty-five percent of respondents source financing from nontraditional lenders.
- The strongest reasons for using nontraditional credit suppliers are interest rate and dealer financing incentives. The strongest reasons for using traditional lenders over nontraditional lenders are lender relationship and the desire to remain with the same institution for credit needs.

## **Borrower Loyalty**

- When asked to rate the importance of selected reasons for changing primary lending institutions, interest rate differences of 1%, 1.5%, and 2% represent the strongest influences to switch lenders. The lender's inability to meet borrower needs follows in importance.
- Less influential motives for seeking a different lender include the lack of on-line banking services, lender has limited office hours, and limited community involvement by the institution.

## **Importance of Selected Lender Attributes**

- Participants rated the importance of selected lender characteristics. Based on average rating, interest rate, stability of the institution, and dependable credit source rank as the three highest rated attributes.
- The least important attributes are crop insurance, Internet services, and customer appreciation events.

## Summary and Overview of Survey Questions

### Demographic and Business Information

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- The majority of respondents are 46 years of age or older (78%).

<b>Age</b>	<b>Number</b>	<b>Percentage</b>
35 and younger	19	3.5%
36 – 45	97	18.1%
46 – 55	186	34.7%
56 – 65	130	24.3%
Over 65	104	19.4%
<b>Total</b>	<b>536</b>	<b>100.0%</b>

- Education level of respondents:

<b>Education Level</b>	<b>Number</b>	<b>Percentage</b>
Less than high school	3	0.6%
High school	178	33.1%
Some college	120	22.3%
2-year degree	66	12.3%
4-year degree	142	26.4%
Graduate degree	28	5.2%
<b>Total</b>	<b>537</b>	<b>100.0%</b>

- The major enterprise for 96% of respondents is field crops. Forty-six percent of participants consider field crops their only business enterprise.

<b>Major Enterprise</b>	<b>Number</b>	<b>Percentage</b>	<b>Minor Enterprises</b>	<b>Number</b>	<b>Percentage<sup>1</sup></b>
Field crops	515	95.9%	Swine	83	16.4%
Livestock	22	4.1%	Cattle	138	27.2%
Specialty crops	0	0%	Poultry	5	1.0%
Other	0	0%	Dairy	10	2.0%
			Other	136	26.8%
			None	231	45.6%
<b>Total</b>	<b>537</b>	<b>100.0%</b>	<b>Total</b>	<b>507</b>	

<sup>1</sup>Does not equal 100.0% because respondents were asked to select all minor enterprises that apply.

- The distribution of respondents by farm business structure:

<b>Business Structure</b>	<b>Number</b>	<b>Percentage</b>
Sole Proprietor	335	62.7%
Partnership	96	18.0%
Corporation	103	19.3%
<b>Total</b>	<b>534</b>	<b>100.0%</b>

- Future business plans:

<b>Business Direction</b>	<b>Number</b>	<b>Percentage</b>
Expand	250	47.1%
Downsize	31	5.8%
Remain the same	222	41.8%
Sell out	28	5.3%
<b>Total</b>	<b>531</b>	<b>100.0%</b>

*Nearly half of responding farmers intend to expand their operation.*

- Farm size in acres for respondents:

<b>Farm size (tillable acres)</b>	<b>Number</b>	<b>Percentage</b>
Less than 500	91	17.0%
500 – 1,500	292	54.6%
1,501 – 2,500	106	19.8%
2,501 – 5,000	37	6.9%
More than 5,000	9	1.7%
<b>Total</b>	<b>535</b>	<b>100.0%</b>

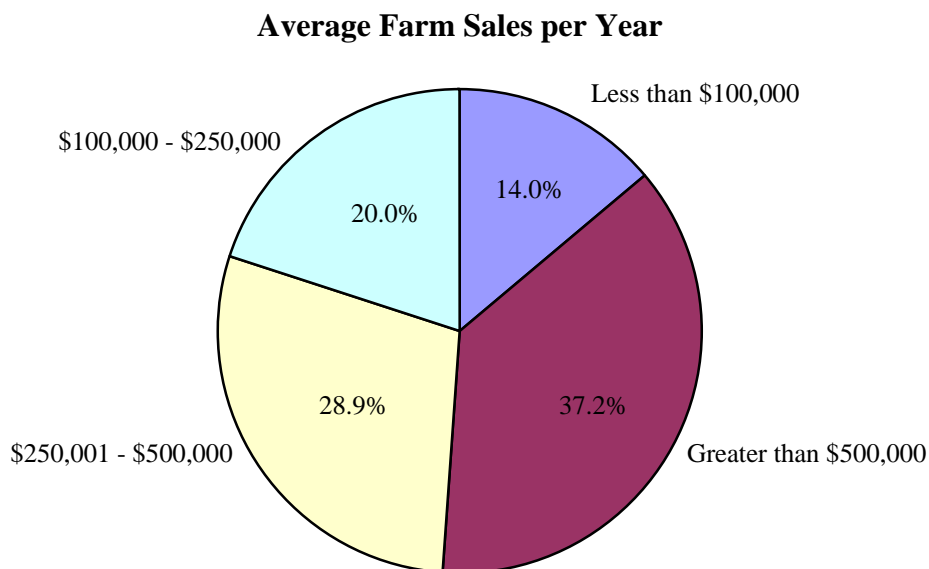
*Over half of participants farm between 500 and 1,500 acres.*

- Tenure position of responding producers:

<b>% of Farmland Leased</b>	<b>Number</b>	<b>Percentage</b>
0% - 10%	101	19.0%
11% - 20%	45	8.5%
21% - 50%	115	21.7%
51% - 75%	120	22.6%
More than 75%	150	28.2%
<b>Total</b>	<b>531</b>	<b>100.0%</b>

*Approximately 50% of respondents lease half or more of their operated acres.*

- The below graphic shows that producers vary in their reported average total farm sales per year with 516 farmers responding.



- Average off-farm income for responding farmers:

Off-Farm Income	Number	Percentage
None	114	21.9%
Less than \$25,000	193	37.1%
\$25,000 - \$50,000	123	23.7%
\$50,001 - \$75,000	55	10.6%
Greater than \$75,000	35	6.7%
<b>Total</b>	<b>520</b>	<b>100.0%</b>

*Approximately 60% of respondents earn less than \$25,000 in non-farm income.*

- Financial leverage of survey producers:

Debt-to-Asset Ratio	Number	Percentage
0	97	18.8%
.01 - .10	124	24.1%
.11 - .40	217	42.1%
.41 - .70	66	12.8%
Greater than .70	11	2.1%
<b>Total</b>	<b>515</b>	<b>100.0%</b>

## Financing Characteristics

Characteristics associated with the procurement of financing are addressed in this section of the survey. Thus, respondents who currently do not use debt financing were asked to skip this section of the questionnaire. As a result, 441 (82.0%) of the responding producers were instructed to answer this portion of the survey.

- Over half of respondents (52.2%) indicate they have been doing business with their primary lender for more than 15 years.

<b>Years with Lender</b>	<b>Number</b>	<b>Percentage</b>
Less than 1	8	1.9%
1 – 5	58	13.5%
6 – 10	79	18.4%
11 – 15	60	14.0%
More than 15	224	52.2%
<b>Total</b>	<b>429</b>	<b>100.0%</b>

- Survey respondents prefer to meet their lender at the following locations:

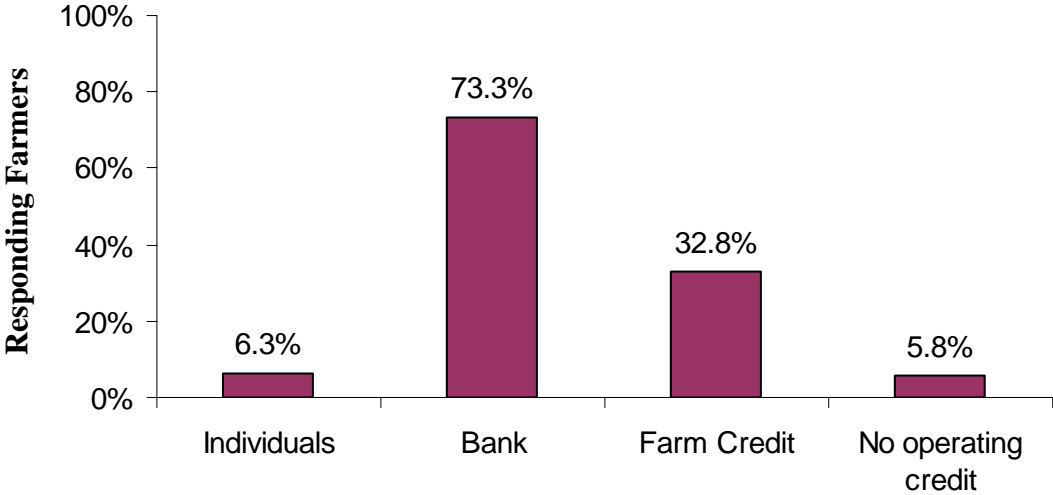
<b>Location</b>	<b>Number</b>	<b>Percentage</b>
Institution	240	55.7%
Farm	35	8.1%
Both farm and institution	156	36.2%
<b>Total</b>	<b>431</b>	<b>100.0%</b>

- Fifty-three percent of farmers want their lender to visit their farm operation at least once a year.

<b>On-Farm Visit Frequency</b>	<b>Number</b>	<b>Percentage</b>
Once per month	2	0.5%
Once every 6 months	52	12.2%
Once per year	168	39.4%
Once every 2 years	59	13.8%
On-farm visits not desired	145	34.0%
<b>Total</b>	<b>426</b>	<b>100.0%</b>

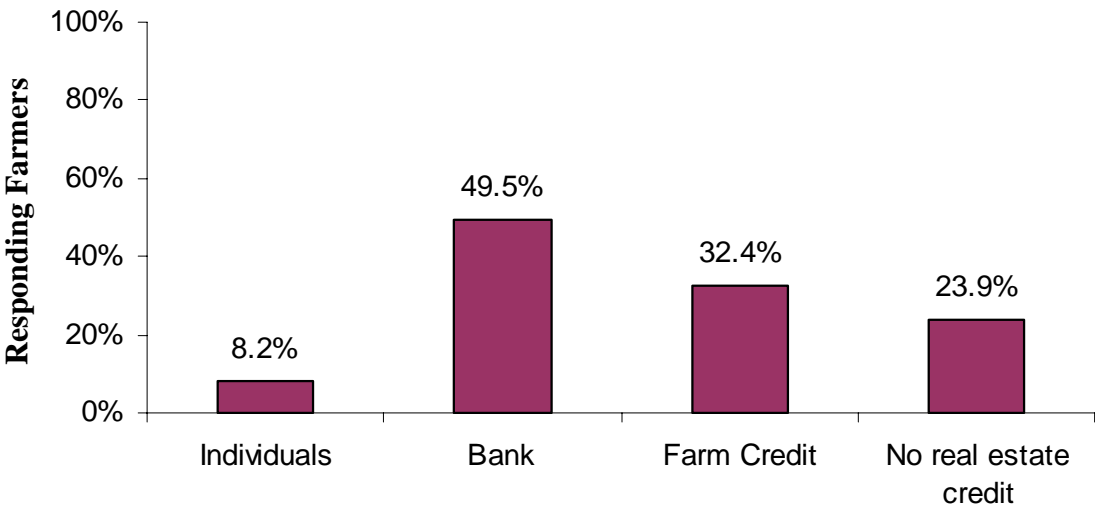
- Within the past three years, approximately 73% of 430 survey participants sourced operating credit from community/commercial banks, while 33% acquired financing from Farm Credit Services. Note that this question asks for credit providers over the past three years. Thus, respondents were allowed to select more than one provider.

**Sources of Operating Credit over Past 3 Years**



- Approximately 50% of 426 respondents utilized bank institutions to finance real estate purchases over the past five years. Farm Credit Services was used by 32% of farmers for real estate financing. Note that this question asks for credit suppliers over the past five years. Thus, respondents were allowed to select more than one provider.

**Sources of Real Estate Credit over Past 5 Years**





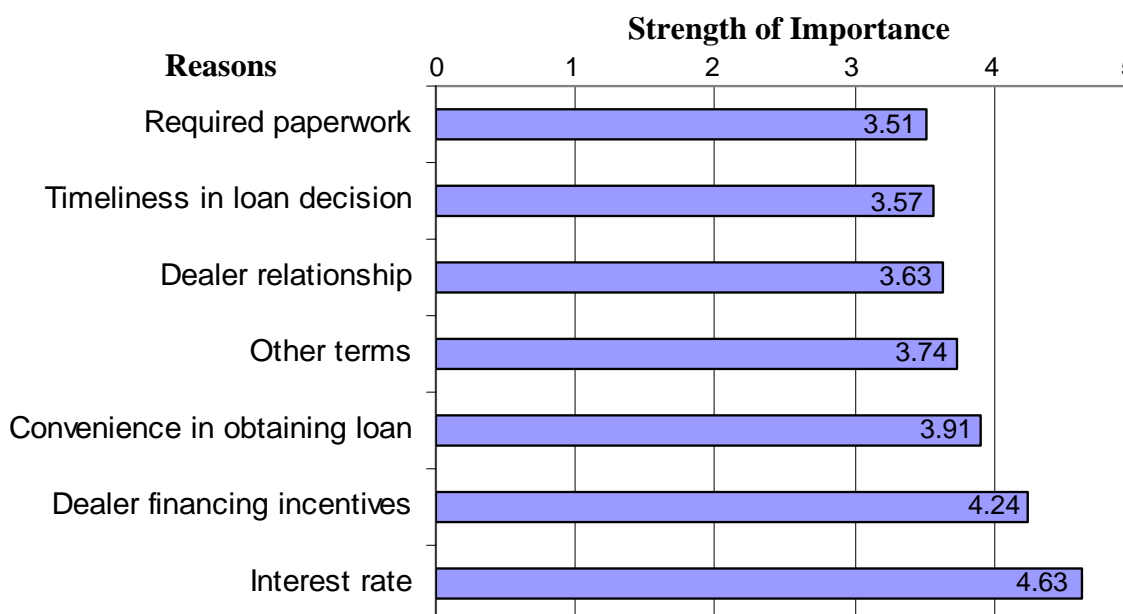
- Farmers were asked to describe the impact a bank or Farm Credit merger had on their business. This question was open to all respondents regardless of debt use.

<b>Merger Impact</b>	<b>Number</b>	<b>Percentage</b>
Positive, operation benefited from merger	44	8.7%
Negative, merger detriment to operation	79	15.7%
Merger had no impact on operation	171	34.0%
Have not experienced a merger	209	41.6%
<b>Total</b>	<b>503</b>	<b>100.0%</b>

### **Traditional vs. Nontraditional Lenders**

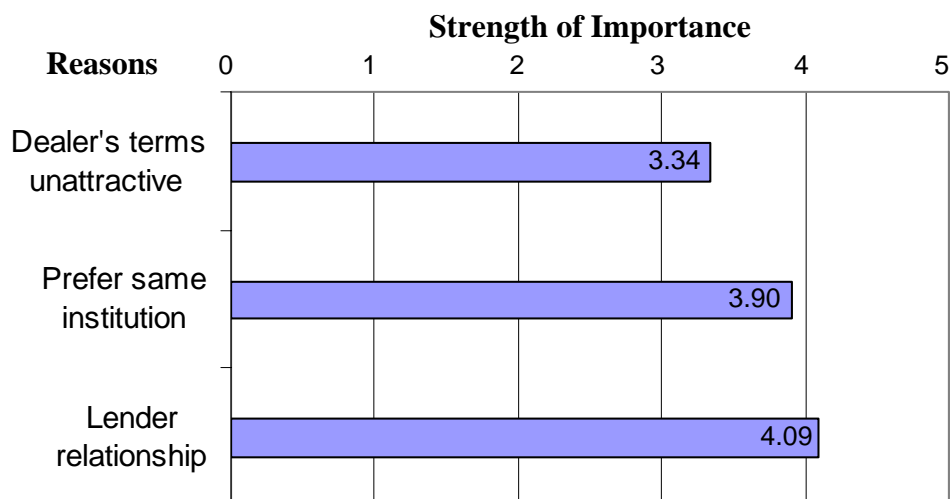
Nontraditional lenders are defined as dealers who offer financing for the purchase of a product, whereas traditional lenders are defined as lenders from a bank or Farm Credit Services.

- Farmers were asked if they have used nontraditional lenders to finance the purchase of machinery/equipment, seed, and/or chemical/fertilizer over the past three years. Fifty-five percent of 433 respondents report using nontraditional lenders and 45% indicate they used only traditional lenders to support purchases.
- Farmers who use nontraditional lenders rate the importance of the following reasons for sourcing credit from these providers on a scale of 1 (not important) to 5 (very important):



- ❖ *The strongest reason for using nontraditional lenders is interest rate followed by dealer financing incentives while the least important reason is paperwork required to obtain loan.*

- Producers who use traditional lenders rate the importance of the following reasons for using these credit providers on a scale of 1 (not important) to 5 (very important):



- ❖ *The strongest reason for using traditional lenders is lender relationship followed by the desire to remain at the same institution for all credit needs.*

## **Borrower Loyalty**

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- Respondents rated the importance of selected incentives to change primary lending institutions. Ratings are based on a five-point Lickert Scale (1 = not important; 5 = very important).

<b>Reasons to Change Lenders</b>	<b>Average Importance Rating</b>	<b>Rank</b>
2% interest rate difference	4.76	1
1.5% interest rate difference	4.55	2
1% interest rate difference	4.22	3
Current lender cannot meet needs	4.13	4
Lender's fees too high	4.13	5
Fixed interest rates not offered	4.02	6
.50% interest rate difference	3.61	7
Institution merged	3.47	8
Institution changed loan officers	3.41	9
.25% interest rate difference	3.00	10
Limited community involvement	2.88	11
Lender has limited office hours	2.68	12
No on-line banking	2.47	13

- ❖ *Respondents indicate that an interest rate difference of 1% or greater between current lender and lenders at other institutions is the strongest influence in deciding*

to switch lenders. Following in importance is a lender's inability to meet borrower needs.

- ❖ *Weaker reasons to leave current lender include no on-line banking services, lender has limited office hours, and limited community involvement by the institution.*

### **Importance of Selected Lender Attributes**

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- Producers rate the importance of selected lender characteristics using at five-point Lickert Scale (1 = not important; 5 = very important):

<b>Lender Attribute</b>	<b>Average Importance Rating</b>	<b>Rank</b>
Interest rate	4.47	1
Stability of the institution	4.43	2
Dependable credit source	4.39	3
Ability to meet needs	4.34	4
Lender's knowledge of agriculture	4.25	5
Timeliness in decisions	4.21	6
Lender relationship	4.18	7
Lender's industry experience	4.14	8
Interest in business	4.07	9
Paperwork required	3.77	10
Risk management services	3.55	11
Low staff turnover	3.41	12
Convenient location	3.31	13
Full-service lending	3.22	14
Lender's ability to advise	3.05	15
Community involvement	2.96	16
Financial analysis services	2.84	17
Offers financial counseling	2.62	18
Offers education seminars	2.46	19
On-farm lender visits	2.43	20
Extended office hours	2.37	21
Market advisory services	2.33	22
Customer appreciation events	2.14	23
Provides Internet services	2.12	24
Provides crop insurance	1.74	25

- ❖ *Based on the average rating, interest rate, stability of the institution, and dependable credit source rank the highest in importance. Crop insurance, Internet services, and customer appreciation events rank as least preferred by responding farmers.*

- Respondents ranked the three most important and the three least important lender characteristics when selecting a lender for operating needs and when choosing a lender for real estate acquisitions.

**Lender Attribute Rankings for Operating Needs**

<b>Ranking</b>	<b>Most Important Attributes</b>	<b>Least Important Attributes</b>
1 <sup>st</sup>	Interest rate	Customer appreciation events
2 <sup>nd</sup>	Lender's knowledge of agriculture	Extended office hours
3 <sup>rd</sup>	Dependable credit source	Internet services

**Lender Attribute Rankings for Real Estate Needs**

<b>Ranking</b>	<b>Most Important Attributes</b>	<b>Least Important Attributes</b>
1 <sup>st</sup>	Interest rate	Customer appreciation events
2 <sup>nd</sup>	Dependable credit source	Extended office hours
3 <sup>rd</sup>	Lender's knowledge of agriculture	Internet services