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Agri-lending Vision 2020: When Vision and Reality Meet

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Envision the future of agricultural lending as it evolves over the next 15 years. By recognizing current trends and looking toward the future, individuals can strategically position their businesses and people to proactively mitigate risk in adverse events and capitalize on opportunities. This paper will first examine the realities of the agricultural lending marketplace. Second, we will analyze the future structure of agricultural products, services, and credit risk assessments demanded, and then conclude with strategic planning implications for financial institutions serving agricultural producers.

The Landscape of Agriculture

First, examination of the landscape of agriculture will set the stage. Agriculture will continue to consolidate mainstream production in North America and throughout the globe driven by consumer wants and needs and the food retail sector. Agri-lenders will be providing financial products and services to a smaller group of producers that will generate a larger share of revenue. This segment will be faced with margin compression created by global competition. On the other hand, a large number of agriculturalists will be involved in agriculture that will stretch the paradigms of any planner to think outside the box. For example, financing hunting lodges, bed and breakfasts, or multientity businesses (such as grain farmers who own a car wash or computer consulting firm to fully employ resources) will be common.

As a large share of production consolidates to approximately one million producers worldwide and 150,000 producers in the United States, natural and man-made risk potential will increase. Although large farms tend to manage risk better, a breakout of pandemic flu or a natural disaster in an agricultural cluster area can be devastating to a large share of the portfolio. This will create an environment of extreme earnings and deficits for commercial agribusiness producers, which will test portfolios and management strategies of the smallest to the largest institutions.

Direct government support for agriculture will decline and shift toward environmental and natural resource management in many developed countries over the next 15 years. With more women and minorities operating farms, a lending institution that fails to have a female or minority strategy will be behind the curve in meeting a very important emerging agricultural market.

In a time-compressed environment, producers will differentiate themselves from competitors through information and people, rather than production and capital as was common in the past. In the workplace, lifestyle issues, like time management and balancing family and social activities, will drive the business model rather than the business model driving the lifestyle. Leaders' failure to recognize this balance imperils long-term sustainability of a customer or employee of the institution or business.

Finally, the first of many shots were fired in the summer of 2004 when Rabobank made an offer on a Farm Credit Services entity. This was a wake-up call to a complacent agri-lending environment, stagnant through government supports and high land values. Agri-lending will be required to evolve into a more fluid and competitive global industry that can quickly but objectively meet a changing environment.

Agricultural Structure

The 2004 Family Farm Report, based upon data from the annual Agricultural Resource Management Survey (ARMS), uses the ERS typology on farm size and organization to define the current state of agriculture. As agricultural industry structure progresses toward the year 2020, subsequent hypotheses suggest that it is evolving into seven unique business and lifestyle models yet to be defined in the research literature or captured in the databases.

Super Commodity/Agribusiness

Model one will be the *super commodity/agribusiness* operation. Anecdotal evidence suggests this model will generate $1.5 million of revenue on average in today's dollars, but will generate twice this amount on the East and West coasts outside the traditional government payment zones. These operations will pocket in 35 to 40 regions in the United States and Canada in prime natural resource base areas for land and water, with minimal public disruption. Control, rather than ownership, of assets will require lenders to revolutionize underwriting standards and alter marketing, operations, products, services, and delivery systems.

These entities will extend to multiple counties, states, provinces, countries, and (to a small extent) hemispheres. They will be comprised of multiple entities, some not defined as agriculture, to provide balance and diversity in their businesses. This model will operate for the most part as a multiple family unit or investor under the guise of corporations and limited liability corporations to foster business formality. This segment will stretch the parameters of government-based lending entities that are historically slow to react to change, making them an excellent target for an international lending institution.

Super commodity/agribusiness operations will be geographically and publicly challenged with site selection and location. For example, environmental, air quality, and animal welfare issues will be numerous and constant. Those that finance crop operations will find land use, resource management, and water issues a high portfolio risk factor. This customer, while dealing with large input suppliers on a regional, national, or international basis, will not always be the most profitable relationship for the institution despite large volumes.

Moving toward 2020, these entities will utilize very sophisticated information systems, such as global positioning systems and autotrack equipment, allowing them to link production to the bottom line profits. Profits on food and fiber products will ultimately be driven by the demands of the consuming public and retailers.

Needs for this model from the agri-lender include growth and strategic management, cash and working capital programs, venture capital, equity management, coaching services, execution of strategies and facilitation of acquisitions, mergers, and alliances as delivered by a lender management team that handles no more than 40–50 accounts. These specialists must be adept in the awareness of macro issues, but be able to drill down on specific issues of the entity as a solutions-based provider.

The five C's of credit will still apply from the credit side. The challenge to the credit analyst will be to develop underwriting standards on soft asset financing, such as human resources, business best management practices, execution strategies, and metrics, that can be quantified and tested in a volatile marketplace.

Traditional Family Farm

The second model is known as the *traditional family farm*, generating revenue in the $50,000–600,000 range, in today's dollars. Although this range is large, it encompasses a large number of farms. Global economics will produce dramatic change in this segment in the future. The Norman Rockwell version of the farm or ranch will evolve by those who have the passion to carry on the farm family legacy. This model will be particularly important to agri-lenders, because these operations have traditionally been the most profitable customers.

Vision 2020 finds that the number of traditional family farms will be driven by dynamics of rural communities, lifestyle issues, economies of scale, and technology. These operations, particularly crop and less intensive livestock farms, while large by today's standards, could be operated on a part-time basis, bringing a whole new mode of ownership and management to the picture.

Ten percent of current traditional family farms will grow to larger entities generating $600,000 and $1.5 million in revenue. Thirty percent will scale down, becoming lifestyle farms and ranches; another 30% will exit the industry because of development or recreational use opportunities, leaving approximately 30% remaining as traditional family farms. To any strategic planner, realizing the rapid reduction of government supports, the introduction of new technology, information base, or regulatory standards could radically adjust these numbers in a five-year period, similar to what occurred in western Canada, South Africa, Australia, and New Zealand.

The visionary lender will find new methods to make this customer segment transition profitable. The land-based operations will be purchased by extended family members or outside investors for recreational, housing, water, and natural resource development. Farm management services and reverse mortgages to pump liquidity into a cash-starved older age rural population base could be opportunities knocking on the door.

Today's credit standards will still work quite well, but marketing financial products and services will have to be adjusted using enhanced delivery systems involving alliances with realtors and accountants to be able to gain exposure to absentee property owners. Youth that leave areas to seek higher incomes and exciting lifestyles may boomerang back to these areas in later stages of life to seek balance in quality-of-life issues.

Vertically Integrated Operation

Vertically integrated agricultural models, such as hogs and poultry, which have been the bread and butter of the agricultural finance portfolio in some areas late in the last century, will not be as large of a growth segment in the portfolio of the future. Large multinational agribusiness firms will find it more economical and environmentally friendly to move a portion of this business offshore. These businesses will still be popular with the younger segment who are technology-oriented and seek a stable earning base as an entrance into agriculture; however, more will seek vertically integrated opportunities on a part-time basis.

Contract Agriculture

Contract agriculture will be a growth market with traditional commodities such as vegetables, beef, milk, and tobacco, but will also meet the needs of a more sophisticated affluent consumer. Strategic alliances with agribusinesses, medical, and technology companies will stretch the paradigms of what is considered farming and life sciences. This type of operation will have the image of a white collar or scientist's family farm. Contracts, patents, and copyrights will be the collateral and conditions that will underwrite these loans and financial services. This segment will be very attractive to large national and international financial institutions and equity capital entities. These entities will be pocketed and isolated in rural areas to protect their products and services. The contract agriculture segment will frustrate planners, regulators, and government policy makers, who will struggle to develop policies and standards that are flexible and expedient enough to meet technology and cutting-edge initiatives driven by the affluent consumer.

Lifestyle Segment

The *lifestyle segment*, which should not be referred to condescendingly as "hobby farmers" or "sundowners," is the largest segment of producers by number and will continue to represent a dynamic marketplace. Ninety percent of these businesses will locate within reasonable driving distances of rural affluent zones, which have the following characteristics: good schools, hospitals, health care systems, infrastructure, technology, natural amenities, reasonable cost of areas to live, and convenient shopping and social opportunities.

Some efficient agri-lenders already handle 600–1,000 lifestyle loans. Streamlined, simple underwriting standards will be the norm, with the deeper analysis being concentrated on the layering of risk, that being industry, community, and economy risk. Twenty-four-hour access to loan services, through kiosks, will not be an option but a requirement. Again, developing alliances, such as with realtors, and being able to target specific areas and match the products and services to the customer will be critical. With over 50% of Americans desiring to live on 20 acres in the country (according to *USA Today*), this segment will be dynamic and profitable to those who mesh credit, marketing, and operations into a streamlined mode of delivery.

Value-added Agriculture

The *value-added model* is alive and well, particularly outside the traditional government payment zones with agricultural enterprises that encourage and reward outside-the-box entrepreneurial thinking. These businesses exploit a location, production, servicing, technology, branding, or systems aspect to give them the differential advantage. Markets will be 80% domestic and 20% international, with a focus on natural and organic foods and emerging energy and natural resource products, such as ethanol, biodiesel, wind power, water, and mineral harvesting aspects.

Special units or teams will evolve to handle these entrepreneurial entities across institutions and even with competitors. This agricultural segment is in dire need of new credit underwriting standards that capture the risk and components of a successful entity. Needs of these enterprises from lenders include business planning, strategy development, growth management, coaching, working capital and cash management, and networking across markets and sectors. Profits and sustainability, along with risk, are high as this group takes on the characteristics of entrepreneurial small businesses.

Agri-entertainer

Finally, the fastest growing model will be coined as the *agri-entertainer*. Financing of lodges for hunting, pumpkin festivals, bed and breakfasts, the urban farmer's market, horse trails, or all-terrain vehicle recreational sites will become more commonplace. This model can be easily integrated into any of the previously mentioned entities as a side venture. Lifestyle, value-added, and the agri-entertainer models will attract a new set of youth and adults bringing needed energy to North American agriculture as they seek to fulfill their dreams.

The Future of Agri-lending

The new models just discussed will be better defined by their consumer-driven attributes than by demographics. This in turn will change the landscape of agri-lending institutions. Agricultural community and commercial banks that currently number approximately 2,500 will most likely decline to near 1,000 in the future. Small community or family-owned banks will continue to serve the traditional, lifestyle, and new emerging segments. Their strategic advantage will be investors and management teams that do not focus on a maximization of next quarter's results to satisfy stockholders, as the large institutions tend to do. Quick decision-making and fast, friendly, human-oriented service with baseline technology will be critical to success. Government guarantees and special program initiatives, such as government liquidity savings accounts and reverse mortgages, may provide the differential advantage. Being located near rural affluent zones may be critical for the attraction of human resources to provide quality service.

The Farm Credit System, which has nearly 100 associations and five district banks nationwide, will most likely consolidate down to 25–30 associations or alliance entities with other institutions. Government Sponsored Enterprise (GSE) status may become a concept of the past, if the agricultural environment requires the system to expand products, services, and authorities to meet a dynamic marketplace. Farm Credit will find that the "better is better" strategy rather than the "bigger is better" strategy is very applicable in a cooperative system that operates 364 days a year as a business and one day as a cooperative.

Farm Credit's strategic advantage as an efficient deliverer of credit must evolve to become a financial solutions-based provider. They must continue to brand the image of not being a fair-weather lender regardless of government entity status and having a well-trained educated staff and customer.

The Farm Service Agency and Farmer Mac will be critical in either guaranteed lending or pooling of risk, particularly as agriculture consolidates. This will be necessary as commodities such as soybeans and corn find increased competitive pressure from South America, wheat gets competition from the Baltic States, and cotton and apples move to China, shutting windows of opportunity and increasing volatility. These programs will be critical in providing stability and opportunities for young producers in the agricultural financial sector as well as assisting in farm business transition.

Insurance companies and particularly nontraditional lenders and input supply firms will continue to compete as niche and stealthy competition, exploiting the vulnerabilities of the larger institutions. They will continue to build on strategic advantages of streamlined decision-making and being a total agribusiness solutions provider to the segments that they target. Some agribusiness firms may form global alliances with international lenders. This will be more common with the larger producer and agribusiness segments that are perceived to be sustainable in the global marketplace without subsidies and supports.

Implications

The following are items that any strategic planner needs on the agenda to help envision and plan for the future. The objective is to provoke thought, which may provide the differential edge for success in the agribusiness and agri-lending industry of the future.

- Data systems must evolve to facilitate moving raw data to information, leading to knowledge that is shared throughout the organization and with customers. This will, in turn, help anticipate opportunities and provide solutions that transform vision to reality. Although leading agribusiness firms are currently doing this, the traditional lender of today has yet to see the advantages, particularly those of a portfolio made up of the seven business models outlined above.
- Leadership and boards of directors of institutions and agribusinesses must be revamped to reflect the realities of the marketplace. Having representation of women and minorities, as well as board accountability, education, and evaluation, must be a requirement. Businesses will seek higher levels of expertise in line with the portfolio concentration of segments represented by the seven business models. The practice of appointing versus electing directors, particularly in cooperatives, will be re-examined to help seek this balance.
- Education of employees and customers must be a high priority even in times of tight budgets. A concept called "edu-marketing" is an effective differentiation strategy by making your customer more knowledgeable and sustainable through educational pro-

grams, such as young, beginning, and executive producer schools sponsored by lenders. Smaller banks and cooperatives will join in alliances with agribusinesses and even competitors to provide these opportunities. Programs for both customers and employees that deal with medical, pension, retirement, and transition planning will be a high priority to maintain a sustainable customer and employee base, as Medicare and Social Security face more challenges. The concept of blended education, encompassing Internet-based training guided by mentor experience and oversight, will be critical to combine the components of high tech and high touch. Internship and cooperative education programs that are organized nationally or internationally can provide an opportunity for red-shirting of prospective employees—a popular concept in sports—which is similar to the employee and employer having an extended interview. These concepts will challenge banks and lending cooperatives of small-town America but will also be a must for both customers and employees in a global environment.

- CEOs, leaders, and management of agri-lending institutions must operate with a long-term mentality rather than a short-term maximization strategy. Agriculture, particularly in the United States, is an industry that does not adjust readily to large paradigm shifts; those that do not recognize it will be doomed to failure.
- Historically, technology has been the differentiator in the competitive marketplace in lending. In the future, as the technology curve flattens, the differential advantage will come through a humanization strategy—combining high tech with a balance of high touch. The challenge will be to train younger employees who are technology-oriented, but challenged when it comes to emotional intelligence, involving working with people and critical thinking skills, which are both very important for success. Lenders in rural areas that don't have the quality of life attributes desired will struggle to find new employees.
- Products and services must be "customerized." That is, a customer could have access to a menu of choices inside and outside the organization through strategic alliances to be customized to meet their needs. This will require the 2020 agri-lender to play the roles of a teacher, coach, and facilitator.

Agriculture in 2020 will be an industry in which one size does not fit all. Being fast, fluid, and flexible, and realizing the customer drives change and the business model, will be important. The competitive agri-lender must think globally—beyond 20 miles of their home base—but act locally. Understanding people, philosophies, and consumer dynamics, while demonstrating a passion for the agricultural industry, is the recipe for making the vision become reality.

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