Perspectives for Producers and Lenders

The ABA National Agricultural Bankers Conference was recently held in Omaha, Nebraska. This four-day power-packed educational networking conference brings together agricultural bankers and industry leaders to examine the short-run challenges and opportunities and the long-term trends in agriculture. The theme of this year's conference focused on a shift in the agricultural landscape. The following are some perspectives for both lenders and producers that are designed to stimulate critical thinking about the future.

Dr. Joseph Glauber kicked off the conference with a session on U.S. agricultural trade. Agriculture trade is not conducted in a neat silo; negotiations are mixed with steel, aluminum, technology, and overall supply chain management. The policies and priorities of U.S. trading partners are inherently integrated into agricultural trade. With one out of every five dollars of net farm income being generated by agriculture exports, the consensus was that U.S. agriculture is only seeing the start of extremes in price, cost, and market volatility based upon domestic and global headlines. Close attention must be focused on emerging nations as they represent up to 60 percent of U.S. agriculture trade. The implications for producers are that disciplined cost and capital management, and the execution of marketing and financial plans will no longer be optional.

What was on the minds of bankers as I traversed through the exhibit booths and sessions? The overall mood could be characterized as “economic concern.” Many bankers stated that business IQ and financial acumen are dividing the profitable and not so profitable borrowers. As with the 1980s financial crisis, producers who are innovative, adaptable, and guided by sound business practices are operating sustainable businesses.

Speaking of financial practices, the FINPACK team from the Center for Farm Financial Management at the University of Minnesota pointed out that accrual income statement analysis is critical when lenders examine the bottom tier of agriculture producers when ranked by profitability. This segment had the biggest difference between cash and accrual net farm income. The variance between cash and accrual net income often is the result of selling inventory combined with the buildup of accounts payable and other accrued expenses. A lender’s “accrual x-ray” will be necessary to uncover some of the potential hidden issues that Schedule F analysis fails to show.

A hot button issue was the mental health of those involved in agriculture. While many will discuss phone hotlines for agriculture producers, others are stating that the mental health of our agricultural lenders needs to be closely observed as well. Sam Miller of BMO Harris Bank in Wisconsin mentioned in his session that lenders should not take their customer's problems home during difficult times. He encouraged physical exercise and mental decompression with positive people to keep your resilience and improve your mental and spiritual well-being. In his session with Keith Knudsen, a banker from Nebraska, they expressed some lessons learned over the years and the following are a few of the nuggets.

- Agricultural lending is an art, not a science. Many of the risks are nonfinancial factors of the human element and are not as simple as a financial ratio.
- Second, it is okay to say "no" to a borrower and then attempt to outline what it will take to get a "yes," whether at your institution or another.
- Next, do not let the borrower burn through all their equity. In today's agricultural cycles, the preservation of equity is often the best alternative. This requires open communication with all the partners, spouses, and stakeholders in the borrower-lender relationship.
- A key piece of advice to lenders was to build a network of agribusiness people including veterinarians, agronomists, and others. Through this network, a lender can maintain the pulse of a borrower's character, one of the most overlooked attributes in agricultural lending.

The Sunday session with FINPACK and Farmer Mac uncovered an interesting perspective from the super cycle years of 2007 to 2012. During this stellar economic period, tax minimization strategies employed by producers drove up fixed costs, which are now hindering profitability in the economic reset.

Debt service on operating funds has increased 47 percent over 2013 levels. Dr. Jason Henderson, Associate Dean and Director of Extension at Purdue University, indicated that the Federal Reserve would like for prime interest rates to return to normal levels at 6.5 percent to 7 percent.

Turning the focus to long term trends, Beth Ford, President and CEO of Land O'Lakes, and Cameron Holbrook of Amazon Web Services challenged the group's thinking. Venture capital outside of agriculture is being invested at record rates, particularly into food systems. Process modeling and blockchain technology linking the consumer back to the producer will change how and where agricultural production occurs. This will be driven by millennials, Generation Z, and Generation A as they seek specialization, personalization, and customization through bite-sized experiences, which will be the driving attribute.

Beth Ford indicated that Land O'Lakes' largest group of new hires is comprised of statisticians to analyze big data and link the consumer to the producer. By the way, this strategy has been profitable and the speaker from Amazon seconded this point.

I came away from the session with a lot of thoughts on how the 2020s will be a period of transition for both producers and agricultural lenders. In the coming years, I believe that two primary types of agriculture will emerge. The first category could be described as consolidated and commodity-based farm operations with a focus on capital and economic efficiencies, operated by multiple partners, family businesses, and complex operations. The second category of producers will be value-added with higher margins and will create a connection with the domestic and global consumer. I could go on forever, but these were just a few of the nuggets from this power-packed conference attended by over 500 bankers and 200 industry specialists.

Management Tip: Why are some borrowers more profitable than others? It is called the "little bit better" principle. Producers who are a little bit better in many different areas of their business experience cumulative, positive results. Although it may seem insignificant, nine bushels more per acre, marketing commodities at ten to twenty cents more per bushel, input cost control, fixed costs of five cents less per bushel, and just a little bit quicker capital turnover ratio all make a big difference in the long run.