# FINANCING AND SUPPLYING INPUTS TO THE 21ST CENTURY PRODUCER

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## Preface

The U.S. agricultural industry is in the midst of major structural change — changes in product characteristics, in worldwide production and consumption, in technology, in size of operation, in geographic location. And the pace of change seems to be increasing. Production is changing from an industry dominated by family-based, small-scale, relatively independent firms to one of larger firms that are more tightly aligned across the production and distribution chain. And the input supply and product processing sectors are becoming more consolidated, more concentrated, more integrated.

Agriculture in the 21$^{st}$ century is likely to be characterized by: 1) adoption of manufacturing processes in production as well as processing, 2) a systems or food supply chain approach to production and distribution, 3) negotiated coordination replacing market coordination of the system, 4) a more important role for information, knowledge and other soft assets (in contrast to hard assets of machinery, equipment, facilities) in reducing cost and increasing responsiveness, and 5) increasing consolidation at all levels raising issues of market power and control.

These profound changes in the agricultural industry present new challenges and new opportunities that require new ideas and concepts to analyze and implement. They require new learning and thinking. Some of those new ideas and concepts are presented here, not as empirically verified truths, but as "thoughts" to stimulate different and better thinking. They have been developed based on observations, analysis and discussions with numerous managers and colleagues in agribusinesses in North America and Europe. This series focuses on Financing and Supplying Inputs to the 21$^{st}$ Century Producer; companion series are also available on Farming in the 21$^{st}$ Century (Staff Paper 99-9), and Value Chains in the Food Production and Distribution Industries (Staff Paper 99-10).

Our purpose in sharing these "thoughts" is to invite discussion, dialogue, disagreement — in general to encourage others to develop better "thoughts".

Keywords: technology platforms, agricultural finance, marketing strategy, input suppliers, grower segments, financial markets

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# The Future of Agricultural Lending

Significant changes are occurring in the agricultural sector and in the organizations and institutions that finance that sector. What does this mean to commercial banks, the Farm Credit System, insurance companies, captive finance companies, and other institutions that finance farm and agribusiness firms?

First, a basic assumption – lending is a commodity business. If all a financial institution does is provide credit to farm and agribusiness customers, it is participating in a very competitive market where a number of other suppliers can provide that product. And like all commodity markets, a lender in the commodity business must compete primarily on price.

But many financial institutions serving farm and agribusiness customers transitioned a number of years ago from being a lender to a financial service provider which, in general, provides more opportunity for differentiation. Some financial institutions provide a broad spectrum of financial services including asset and cash management services, trust services, investment banking services, deposit services, accounting and information services, etc. More recently, some institutions are providing equity financing services to farmers through venture capital companies or subsidiaries. These institutions can provide a combination of properly structured debt plus lease financing and equity capital – in essence, a total financing package or total systems solution – to their customers. Other lenders are providing financing and financial services as part of a product bundle, whether it be in form of supplier financing through captive finance companies or similar subsidiaries, or through an alliance with a conventional financial institution through a preferred supplier program that provides financing for producers who have become franchise growers or qualified suppliers in a more vertically aligned value chain.

A critical additional form of differentiation to blunt the commodity nature of the agricultural lending business has been the depth of the relationship many financial institutions have developed with their farm customers. The agricultural lender has become a trusted advisor in some cases; a financial counselor for many; a source of unbiased information about not just financing but strategic direction, marketing strategy, investment options, etc. And this relationships has had personal as well as professional dimensions that have resulted in the lender being one of the most important advisors and the farmer-lender relationship being one of the most critical to a farmer's long-run financial success. In fact, for many producers, the most critical relationships they have and the ones that are most important to maintain are the relationships with their lender and with their landlord.

For traditional farmers, the personal and professional relationships with the lender will still be important and a critical source of differentiation. But for producers who become franchise growers or qualified suppliers in a more tightly aligned value chain, the right relationships with the processor and input supplier will become increasingly important, and may be even more important than the relationship with the lender. In some cases, this qualified supplier or franchise grower relationship may even include access to financing, suggesting that the traditional lender may not be part of the package. And for those farmers who are simply looking for the lowest priced commodity type financing, the availability of Internet and other e-commerce based financing options will increase the competitive nature of the pure lending business and possibly even lower the cost of that business.

These profound changes in the agriculture of the future will dramatically change the basis for competition in the agricultural credit market as well as the types of competitors. It will change the delivery system and the products and services delivered. The future of agricultural lending with respect to customers, products, delivery/distribution and competitors might be summarized as follows:

**Customers**

1. Customers are increasingly different with different financial needs, so segmentation is essential.

2. The industrialized customer segment is growing.

3. The traditional customer segment is declining but still an important source of business today and for the near future.

4. Relationships will continue to be important, but the prime relationship a farmer has with his lender will be increasingly challenged by value-chain relationships characterized by networked qualified supplier and franchise grower structures.

**Products**

1. Risk management and financial management products and services will be increasingly integrated into a comprehensive package.

2. The financial products and services will be increasingly provided as a component of the product service bundle by value chain coordinators/suppliers.

3. Increasingly farm customers will be looking for total systems solutions that include an integrated package of information, financing and financial services, inputs and product merchandising services, and risk management services.

**Delivery/Distribution**

1. Multiple channel distribution serving different customer segments will become increasingly predominant in the agricultural industries.

2. There will be less direct retailing of agricultural financial products and services because they will be increasingly integrated with the provision of other products and services in total system solutions packages.

3. The end result of industry integration will be more point of sale (POS) delivery of credit—particularly operating credit.

4. Consortium and joint/packaged credit and financial services arrangements will become increasingly important as lenders and financial service providers combine their core competencies and emphasize their unique capacities to serve customers with a broad set of products and services.

5. There will be increased separation of the origination, servicing and funding of agricultural credits much like has occurred in the financial markets serving the housing industry.

**Competitors**

1. Non-regulated competitors will increasingly become major players in the agricultural markets including organizations such as Deere and GMAC.

2. Financing of agricultural production will increasingly become part of a product service package offered by such organizations and input suppliers such as Farmland and Pioneer.

3. Increasingly value chain integrators will provide total systems solutions including inputs, product merchandising, risk management services and financial products and services like packages currently being offered by Cargill.