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Questions and Answers about Agriculture Loan Officers and Farmers' Investments in New Generation Cooperatives

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Many new value-adding contract agricultural cooperatives (here-after, new generation cooperatives or NGCs) have been formed in North Dakota in the 1990s. Farmers often obtain money to invest in these co-ops from lending institutions. This report responds to questions agriculture loan officers and their supervisors have regarding loans to farmers wishing to invest in these new cooperatives.

The information discussed in this report comes from a U.S. Department of Agriculture-sponsored study conducted between fall 1995 through spring 1996. It involved a survey of 388 agriculture loan officers (including those from banks, Farm Credit Services, and credit unions), 215 agricultural loan supervisors, 321 farmers who had invested in one of the NGCs, and a comparison group of 191 farmers who had not invested in one of them. For more information on research methodology and detailed results, see the 1996 report by Brooks Wilson and colleagues listed in the reference section.

Before the survey process was started, agricultural loan officers in several lending institutions were visited about the concerns they had regarding farmers' investments in the NGCs. Following are some of the questions that emerged from those visits, and the answers that were found from the surveys.

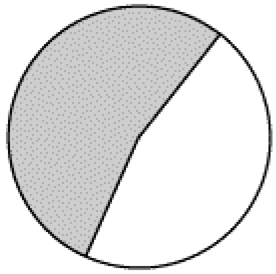
1. What types of institutions make loans to farmers investing in new generation cooperatives?

Of the 118 institutions in the study, over half (54%) made loans to farmers to invest in the NGCs. Several characteristics differentiated institutions that made such loans from those that did not. First, institutions that made these loans differed by region (Figure 1). Seventy-one percent of the institutions in North Dakota's eastern crop reporting region made these loans, compared with 44% in the state's central region and 33% in the state's western region. The regions where most of the institutions making these loans are located reflects the regions where the majority of the NGCs currently are being formed.

Figure 1. Comparison of lending institutions that made loans to farmers to invest in new generation co-ops with those that did not make them.

Made co-op loans 54.0%

Characteristics typical of institutions that made loans to farmers to invest in new generation co-ops
- Eastern region of state
- $25 million or more in assets
- Capital as 10% or less of assets
- All FCSs and half of banks and credit unions



No co-op loans 46.0%

Characteristics typical of institutions that did not make loans to farmers to invest in new generation co-ops
- Western or central region of state
- Less than $25 million in assets
- Capital as more than 10% of assets

All four of the state's Farm Credit Service (FCS) institutions made these loans, compared with 54% of the banks and 48% of the credit unions in the survey. Of these three types of institutions in North Dakota, the FCS held only 12% of total dollars of loaned assets. But, they held 26% of the agricultural loaned dollar assets and 64% of the co-op stock loaned dollar assets. On the other hand, banks held 83% of total loaned dollar assets, 70% of the agricultural loaned dollar assets, and 34% of the co-op stock loaned dollar assets.

Eighty-nine percent of the farmers who applied for a loan to invest in an NGC did so at only one type of lending institution; 11% applied at two or more types of lending institution. Sixty-one percent applied at a bank; 32% at a FCS office; 9% at the Bank of North Dakota; 7% at a credit union; and 1% from a neighbor, friend, or family member.

2. What are the financial characteristics of institutions that make loans to farmers to invest in new generation cooperatives?

More institutions with larger assets made loans to farmers to invest in NGCs than those with somewhat smaller assets. Seventy-eight percent of the institutions with assets over $100 million and 67% of the institutions with assets between $25 million and $100 million made these loans, compared with 32% of the institutions with assets less than $25 million that made them. Over one-half of the institutions in the survey were in the $25 million to $100 million asset category; thus, a substantially greater number of these institutions make this type of loan than the other two categories combined.

Seventy-one percent of the institutions with low capital-to-asset ratios (capital as less than 7% of assets) and 61% of those with medium capital-to-asset ratios (capital between 7% and 10% of assets) made loans to farmers to invest in NGCs. Only 40% of the institutions with high capital-to-asset ratios (capital as more than 10% of assets) made these loans. However, nearly 57% of all institutions in the study fell into the medium capital-to-asset ratio category. No other financial variables (agricultural loans as a percent of total loans, return-on-equity, loan-to-deposit ratio, and non-current loans to total loans ratio) showed significant differences between institutions that made loans to farmers to invest in NGCs and those that did not.

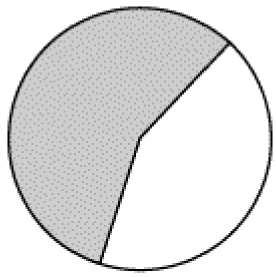
3. What are the characteristics of loan officers who make loans to farmers investing in new generation cooperatives?

Fifty-seven percent of the loan officers in the study made a loan to one or more farmers to invest in an NGC; 43% had not. Several observations were made when these two groups of loan officers were compared (Figure 2). First, we found that the loan officers who made NGC investment loans have an average of 15 years of lending experience, compared with 11 years for those who had not made these loans. Second, those who made NGC investment loans spent an average of 78% of their time making agricultural loans, whereas those who had not made NGC investment loans spent 53% of their time making agricultural loans. Third, 83% of the officers who made NGC investment loans had reviewed one of the new co-op's business plan, compared with 43% of the non-lenders. And 76% of the lenders had attended an orientation meeting of an NGC, compared with 49% of those who hadn't made these types of loans. Finally, 79% of those who made NGC investment loans had family and/or friends who had invested in these co-ops, compared with 38% who had not made NGC investment loans.

Figure 2. Comparison of loan officers who made loans to farmers to invest in new generation co-ops with those who did not.

Made co-op loans 57.0%

Characteristics typical of loan officers who made loans to farmers to invest in new generation co-ops
- 15 years of lending experience
- 78% of time spent on agricultural loans
- 83% reviewed co-op business plan
- 76% attended co-op orientation meeting
- 79% had family/friends in new generation co-ops



No co-op loans 43.0%

Characteristics typical of loan officers who did not make loans to farmers to invest in new generation co-ops
- 11 years of lending experience
- 53% of time spent on agricultural loans
- 43% reveiwed co-op business plan
- 49% attended co-op orientation meeting
- 38% had family/friends in new generation co-ops

4. What are the institutions' lending policies regarding new generation co-op loans?

A strong majority (71%) of the institutions in the study stated that their policy regarding NGC investment loans was equally restrictive as their policy for any other agricultural loan. Twenty-five percent reported that they were more restrictive, and only 4% were less restrictive. When asked about specific terms for NGC investment loans, 32% of the institutions offered reduced or deferred principal payment, 18% offered reduced levels of interest, and 18% offered longer amortization. Of the institutions that provided NGC investment loans, 48% were willing to offer favorable loan terms; only 12% of those that did not make NGC investment loans were willing to offer favorable terms.

Although 86% of the institutions use formal loan committees to approve loans, only one-third (36%) used a loan committee to develop policy regarding NGCs prior to reviewing loan applications. Of those with a predetermined policy, 89% focus on the specific characteristics of the borrower, 89% look at each new cooperative on a case-by-case basis, 86% emphasized risk reduction for themselves and their borrowers, and 81% emphasized profit maximization for themselves and their borrowers. Fifty-eight percent reported that, although they never advise their borrowers where to invest, they do advise them where not to invest, and 58% stated that they do not distinguish investment in an NGC from any other loan.

5. What's the nature of new generation cooperative investment loans?

The loan officers reported that, on average, 11 farmers talked with them about the possibility of funding all or part of their NGC investment. The loan approval rate of farmers who filed a loan application was relatively high. An average of 4.9 farmers filed a loan application with them for this investment, and an average of 4.8 applicants were granted the loan. The difference between 11 visitors and 4.8 loanees suggests that a substantial amount of screening likely occurred — self-screening on the part of the borrower, borrower-screening on the part of the lender, and lender-screening on the part of the borrower.

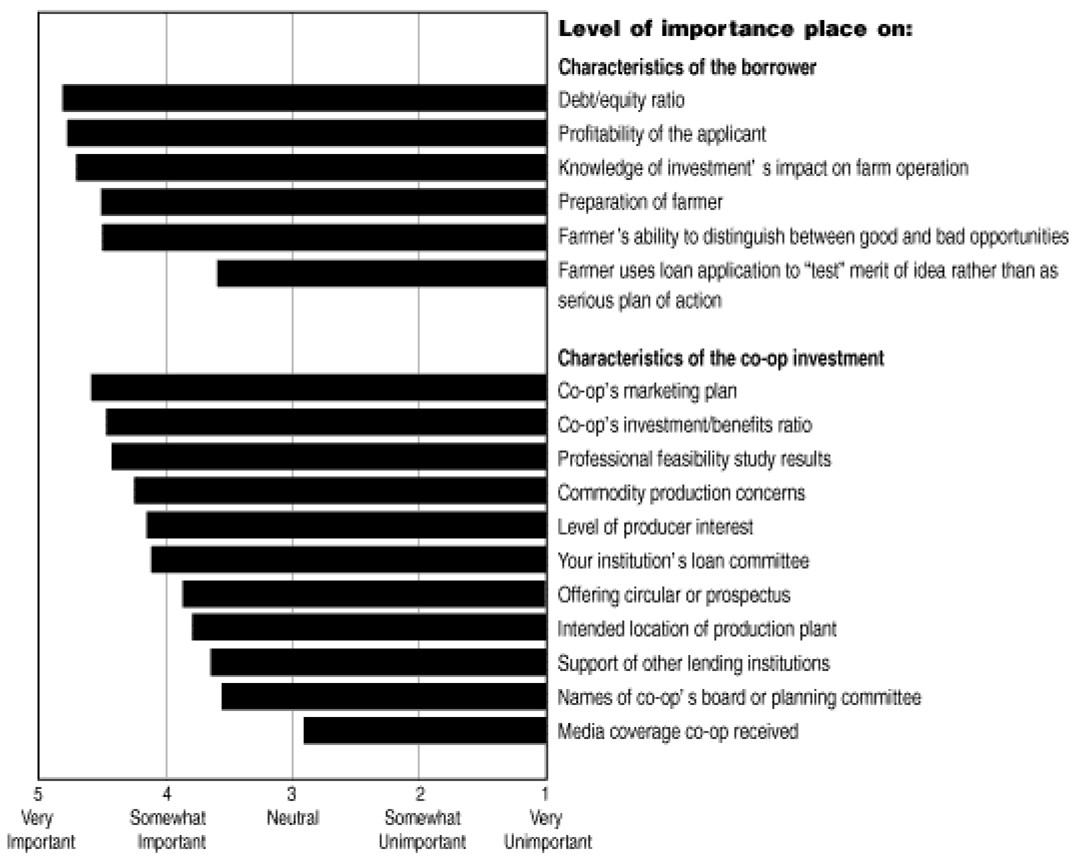
Over three-fourths (79%) of the loan officers stated that the NGC investment loans are about as time consuming to process as any other agricultural loan request of similar size. Eighteen percent stated that they were more time consuming, and only 3% said they were less time consuming. Three-fourths (74%) of them said that the NGC investment loans are about the same difficulty to process as other agricultural loan requests of the same size; 25% said they were more difficult to process; only 1% said they were less difficult.

Loan supervisors stated that the median highest amount their institutions loaned to farmers to invest in an NGC was $25,000. The median lowest amount was $5,000. The typical (median) loan size was $10,000. On average, 9% of these loans were co-mingled or included with other loans.

6. What do agricultural loan officers base their decisions on when making loans to farmers to invest in new generation cooperatives?

Loan officers were asked about the importance of several items pertaining to the borrower's and the cooperative's characteristics when they consider making a loan to a farmer to invest in an NGC. Of the top seven items, five pertained to the borrower's characteristics and two pertained to the cooperative's characteristics. The leading items the officers considered were (1) the applicant's debt and equity, (2) the applicant's profitability, and (3) the applicant's knowledge of the investment's impact on the farm operation. The next items included (4) the co-op's marketing plan, (5) the farmer's preparation, (6) cost of the cooperative investment relative to its benefits, and (7) the farmer's past ability to distinguish between good and bad business opportunities (Figure 3).

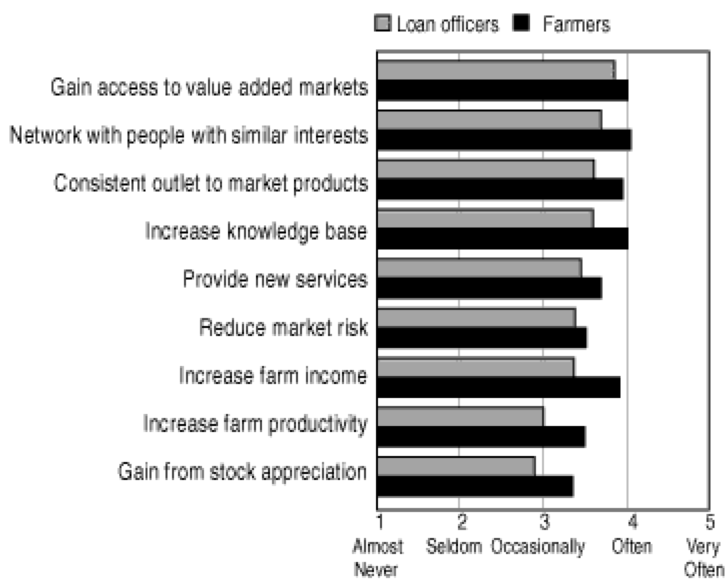
Figure 3. Loan officers' evaluation of the importance of borrower and co-op characteristics to consider when making a loan to farmers to invest in a new generation co-op.



7. How do loan officers' and farmers' beliefs compare regarding a co-op's ability to accomplish its objectives?

Both the loan officers and farmers were given a set of nine objectives and asked how often the NGC could achieve them. Both groups were very optimistic about the cooperative's ability to accomplish these objectives. The loan officers were less optimistic about cooperative share speculation. They reported that investors may "seldom" to "occasionally" be able to purchase shares at a low price now and sell them for a higher price later. Otherwise, the officers' and farmers' average scores for each of the nine objectives ranged between "occasionally" to "often" or between "often" and "very often." The four objectives that both groups were most optimistic were the NGC's ability to (1) gain access to value added markets, (2) network with people with similar interests, (3) have a consistent outlet to market products, and (4) increase knowledge and information base (Figure 4).

Figure 4. Loan officers' and farmers' beliefs in how often new generation co-ops can achieve their objectives.



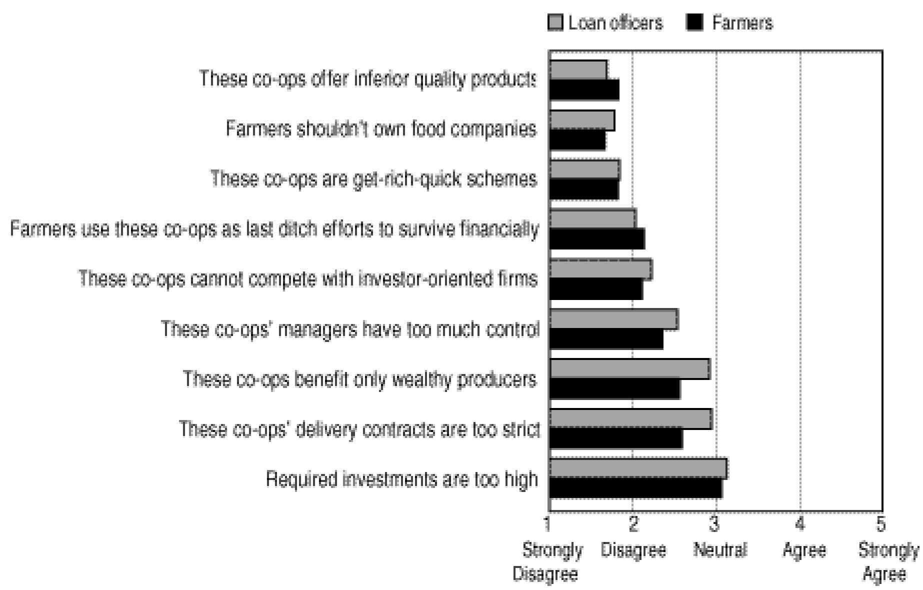
The average scores of the farmers were significantly higher than those of the loan officers on every one of the NGC objectives. When the farmers were divided into investor and non-investor groups, the investors had significantly higher scores than either the non-investor farmers or the loan officers on every objective. Even the non-investors had higher scores than the loan officers for every objective except for the NGCs' objectives of gaining access to value added markets and reducing risk associated with marketing.

The possible disparity between loan officers' and farmers' perceptions of an NGC's ability to accomplish its objectives could be a source of strain between them. It is important for the lender and borrower first to jointly assess the anticipated performance of existing NGCs and compare these results with a proposed cooperative. Second, they should jointly determine which of the NGC's objectives are key to them as they consider an investment in one of them. And third, they must both recognize the expertise and knowledge of the other. For example, the loan officers were asked to rate the level of understanding potential co-op investors had about how it would affect their farm enterprise. On average, they said that 20% of the investors had what the lenders believed to be a "very good" understanding, 28% had a "good" understanding, and 33% had an "average" understanding, but 13% had a "poor" understanding and 4% percent had a "very poor" understanding. These are measures of lenders' perceptions and not of farmers' actual knowledge; they illustrate the wide diversity of perceptions that lenders have regarding farmers' understanding of NGCs.

8. How do loan officer's and farmers' attitudes compare regarding new generation cooperatives?

Both loan officers and farmers were asked the degree to which they agreed or disagreed with nine negatively-worded attitudinal statements about NGCs. There were significant differences between the loan officers and the farmers for only three of the nine items. Although the average scores for both groups ranged between "disagree" and "neutral," farmers were more likely than loan officers to report more disagreement with the following three statements: (1) "these co-op's managers have too much control"; (2) "these co-ops benefit only the wealthy producers"; and (3) "delivery contracts are too strict" (Figure 5).

Figure 5. Loan officers' and farmers' attitudes about new generation co-ops.



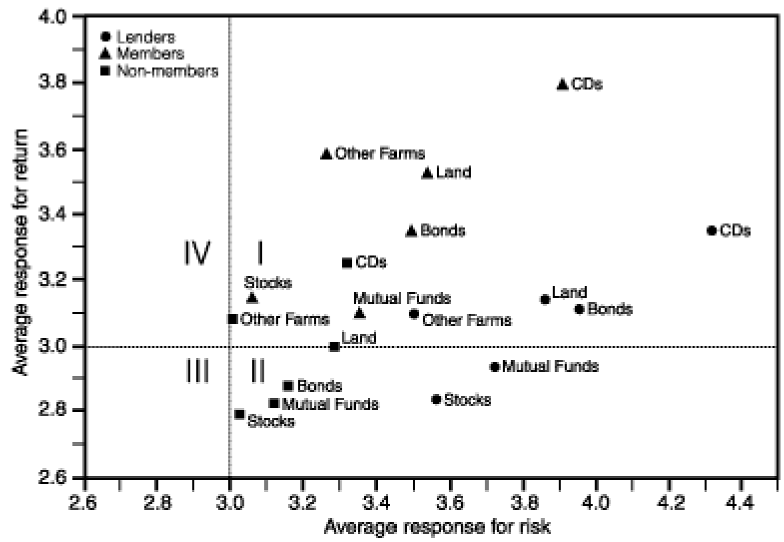
Both loan officers' and farmers' scores ranged between "disagree" and "strongly disagree" for the following items: (1) "these co-ops offer inferior quality products"; (2) "farmers should not own food companies"; and (3) "these co-ops are get-rich-quick schemes." And both loan officers' and farmers' scores ranged between "neutral" and "agree" for the item: "required investments are too high."

These data suggest that the loan officers and farmers share a somewhat similar philosophical understanding about the new co-ops. They appear to have similar attitudes about ***not*** investing, since most of the attitudinal statements were phrased in a negative way. This should be an aid to them as they mutually decide about the efficacy of an investment. Hopefully, their similarity in viewpoint will help them to avoid point-counterpoint arguments about the merits of a particular NGC investment.

9. How do new generation cooperative investments compare with other types of financial investments?

Figure 6 shows the relationship between loan officers', farmer investors', and farmer non-investors' views of long-term return on investment and long-term risk of investment in the NGCs as compared with other investment alternatives. Loan officers were risk averse compared to both NGC investors and non-investors. Loan officers viewed NGC investment as a riskier investment alternative than did the investors and non-investors. They believed that it offered a higher rate of return compared with other alternatives than did the non-investors. If loan officers rely heavily on investment criteria when evaluating an NGC investment loan, their conservative attitudes toward risk and return relative to those of their NGC investment loan applicants may limit the number of projects that they view as acceptable.

Figure 6. Average estimate of risk and return of co-op investments compared to alternative investments by agricultural loan officers, members and non-members, North Dakota, 1996.
Source: Wilson, Goreham, and Kibbe. Based on 5-pt Likert scale: 5 = Much Higher and 1 = Much Lower.



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Wilson, Brooks M., Gary A. Goreham, Theron Kibbe, and David Cobia. *Agricultural Loan Officers' Roles in Cooperative Investment in North Dakota*. Agricultural Economics Report No. 366 (November, 1996). Fargo, ND: Department of Agricultural Economics, North Dakota State University.

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