CREDIT AGRICOLE AS AN ORGANIZATIONAL MODEL FOR THE FARM CREDIT SYSTEM

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Credit Agricole as an Organizational Model for the Farm Credit System[1]

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This paper provides a description of the origins and evolution of Credit Agricole (CA) and the Farm Credit System (FCS or System) as a means for thinking about why the organizations evolved to their current situation and as a way of suggesting future directions for the development of the System. The Farm Credit System, like other financial intermediaries in the United States, is going through a period of major adjustment. The adjustment is driven both by the changing financial needs of American farmers and by changes in the nature of the technology available to lenders, changes in the types of firms providing credit and by changes in the regulatory environment under which traditional lenders operate (Duncan and Taylor) However the set of possible adjustments open to any financial intermediary is determined to a considerable degree by the prior history of the organization. Thus in the search for future directions one must consider the elements of the past which led the organization to its present situation.

In the search for new directions a useful method is to examine similar organizations as a guide to assessing the current situation. As the System attempts to define a new vision for its future it has tended to look at its competitors in developing models for how it should respond to changing conditions. For the most part the FCS has concentrated on commercial banks, since they are both the most important form of direct competition and the leading form of financial institution in the United States. Indeed, parts of the FCS seem to have adopted strategies that are very similar to those employed by specific commercial banks (Freshwater, 1997), and throughout the System there is considerable attention paid to the types of loan products and pricing polices adopted by competing banks. However while banks are the primary form of competition for the FCS and therefore must be carefully monitored, they differ radically from the System in terms of organizational structure, objectives and regulatory status. This suggests that trying to make the Farm Credit System behave like a bank holding company may not be a wise strategy.

If the System should not directly compare itself to commercial banks, what is an appropriate yardstick for measuring progress and defining opportunities? The origins of the FCS suggest suggest that one possibility might be other cooperatively organized national agricultural lenders. The cooperative agricultural credit banks of Europe - Credit Agricole in France, DG Bank in Germany and Rabobank in the Netherlands, and the Norinchukin of Japan have very similar structures to the FCS - and in the

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case of the European banks were the original models for the creation of the System (Hoag). Our contention is that of these organizations Credit Agricole is the most appropriate for study. Although other cooperative banks may be more directly engaged in competition for loans with the System in the United States, their core domestic lending structure is less similar. Although the value of agricultural production in France is considerably less than that of the United States, the diversity of agricultural production is similar to that of the United States in terms of number of products and complexity resulting in a similar lending environment with regional specialization in specific products. Since our objective is to suggest how the evolution of other organizations may be a guide for the evolution of the FCS this is an important issue.

Why Credit Agricole?

Credit Agricole was a model for the foundation of the Farm Credit System in 1916 and through the 1950s they had a similar evolutionary path. At present Credit Agricole is one of the largest financial institutions in the world and is a direct competitor with the FCS for large loans to cooperatives in the United States. More importantly, however, despite its diversification into all aspects of banking, CA has retained a dominant role in funding French agriculture and it remains a mutually owned organization with farmers as the dominant group at all levels of governance. In addition some of the other changes that CA has experienced in the last twenty to thirty years may be particularly important for the future of the FCS. These include a transition away from direct control by the French government to autonomy, diversification into the provision of a broader range of financial products, and managing to maintain a broad rural focus despite the dominance of urban activities in the credit portfolio.

The Structure of Credit Agricole

Like the Farm Credit System, Credit Agricole has a geographically defined hierarchical structure that includes local associations, regional banks and a national structure (Figures 1 and 2). The basic unit of CA is the Caisse Locale which serves the same function as an association in the FCS. Each Caisse Locale has a distinct geographic territory and has open membership. They function in a similar manner to PCAs in that they take loan applications and make lending decision, but the actual loan is originated and held at a higher level. Elections provide both a local Board that oversees day to day management and also directors for the higher levels of CA.

The next level in the CA structure is the Caisses Regionales which roughly correspond in function to district banks (Figure 3). Their original purpose was to supervise the activities of the Caisses Locales but currently their major function is as a conduit for funds that move between the national organization and the Caisses Locales. Like the district banks, Caisses Regionales are owned by the Caisses Locales within the region and their Board of Directors is selected from delegates from the Caisses Locales. As did the former Federal Intermediate Credit Banks, Caisses Regionales originate and hold short and intermediate term loans.

The highest level of Credit Agricole consists of two national organizations, the Caisse Nationale du

Credit Agricole (CNCA) and the Federation Nationale de la Caisse Nationale (FNCA). It is at this level that the structural differences between CA and the System become the most pronounced. CNCA can be thought of as combining the functions of the Funding Corporation, the Presidents Planning Committee and the Farm Credit Council as well as some of the functions of district banks. It acts to ensure that the component parts of CA behave in a coherent manner, it develops operating policy, manages affiliated agencies and subsidiaries, carries out research, issues debt on behalf of CA, and makes long term loans.

There is no counterpart to the FNCA in the Farm Credit System. The FNCA was created by the French Government at the time it gave up its direct policy control of Credit Agricole. FNCA is the main policy setting entity for CA. Its members come from the Caisses Regionales and are primarily directors of these entities, but there are some individual members of FNCA who are part of senior management of Caisses Regionales on the FNCA board. The FNCA provides the ultimate direction for CA in terms of policy and in this respect the CNCA provides the staff function, making suggestions and conducting research and analysis for various options.

Development of Credit Agricole[3]

Both the FCS and CA were formed to provide credit to farmers at a time when other intermediaries were unwilling or unable to make sufficient funds available. In both cases the government provided the initial capital and set the policy and operating procedures. There were major differences in the funding mechanisms chosen and the type of initial institution. For CA, the French government first created the Caisses Locales and gave them deposit collecting authority. Thus, from the beginning CA was structured as a locally based, self-financing organization. By contrast, the original units of the FCS were the district Land Banks which obtained funding by selling commercial paper. Later the governments added pieces to each organization to give them a parallel structure. In France the Caisses Regionales were added to provide better coordination of funds and to supervise local decisions. In the United States associations were added to create a local presence and provide peer pressure on borrowers.

Through the 1930s as the credit needs of agriculture increased, the scope of both organizations was expanded, but in both cases the national government kept control of the function and strategic decisions of the organizations. In the United States this was accomplished by Congressional oversight and the direct role of the Secretary of Agriculture. In France the Ministry of Agriculture directly supervised Credit Agricole and had the ability to direct CA into a broader set of responsibilities, including broader rural development responsibilities. Nevertheless, up to the early part of the 1950s the two organizations had an essentially parallel evolution (Auzimour pp. 12-20).

Shortly after the Second Word War the French government made a conscious decision to end its

3 Since there are numerous sources that describe the evolution and condition of the FCS no parallel discussion will be provided here. Interested readers can consult Barry Ellinger, and Baker or Lee and Irwin for a clear discussion.

direct control over Credit Agricole. In 1945 the FNCA was established as a successor organization to the Ministry of Agriculture, but the transition to autonomy was only completed in 1988 when ownership of CNCA was transferred to the Caisses Regionales from the government. Over the period the authority and independence of CA steadily increased as it was given increased lending authority and its sources of funding were made more independent of the government. By 1990 CA had become a major financial institution where agriculture comprised only a small part of its portfolio. Nevertheless it still dominates agricultural finance in France with more than 90 percent of all farm loans.

Similarities and Differences

Unlike Credit Agricole the Farm Credit System has not experienced significant functional change. Individual components of the FCS have been reorganized or combined, but the core elements and functions today remain remarkably similar to those established during the 1930s. One might think of change in the FCS as taking place at the margin while since 1950 CA has assumed a very different form and function. While it is possible that the FCS still meets the needs of those it was designed to serve, it is clear that the structure of agriculture and lending have both changed greatly over the last sixty years and as a result evolution of the FCS might be expected to be a desirable thing.

At present the important differences in the nature of the two organizations can be described by Figure 4. Although the organizational structure is still superficially similar, there are import functional differences. Because the System is a federated cooperative, the component parts of the FCS are highly decentralized and only weakly connected. By contrast CA can be thought of as an integrated cooperative where there is a coherent organizational structure having decentralized components but with central control. In the FCS the federated nature and past behavior have led to autonomous districts and associations that carefully guard their independence and resist efforts to impose direction from outside the local unit. Because CA was initially established with a clear hierarchical structure and had decades of experience with this type of structure the replacement of the Ministry of Agriculture as the policy setting entity by CNCA did not result in a demand for regional autonomy.

Research and development for the two organizations is also an areas of difference. While there is now closer coordination among the districts of the FCS, they individually remain the main point for the introduction of new products and services. Because the FCS has a restricted Congressional charter and FCA has regulatory authority that also restricts the ability to independently introduce new ideas the System has been less innovative than CA. Within CA, research and development is carried out at all levels, but there is only limited authority for regions to act autonomously. However, unlike the FCS, CA has the authority to introduce new organizational forms and new products without obtaining legislative approval.

Perhaps one of the potentially largest emerging differences between the two is internal competition. For CA internal competition is improbable because of its integrated nature. The organizational structure remains based upon unique geographic areas that ensure customers only have one service choice within the organization. By contrast the constituent parts of the FCS were allowed to over-charter in the 1987 Agricultural Credit Act, and as a a result there is direct competition between districts in certain parts of the nation.

Unlike the FCS, which experienced major financial turmoil in the 1980s that depleted much of its net worth, CA has faced no corresponding problems with agricultural loans or loans to other sectors. Because Credit Agricole is a diversified lender with farm loans only comprising 14 percent of total assets in 1996, compared to 73 percent for the System it also has an inherently smaller degree of risk from agriculture or any other sector. Because the FCS required financial assistance from the federal government in the 1980s it has been under considerable pressure to both repay this loan and rebuild its capital. This may explain a considerable difference in the levels of return on assets for the two organizations (Figure 5). While in 1996 CA had an asset base that was roughly six times the size of that of the FCS, their net income was roughly the same (after adjusting for exchange rate differences). This suggests that the System has been earning larger margins on its lending than CA.

Conclusions

Clearly much of the reason for the evolution of Credit Agricole has to do with the decision of the French Government that it would end its direct control and privatize the organization. However given that initial stimulus the path that CA chose was largely driven by strategies that were developed internally. It could have chosen to remain much more focused on agricultural lending and not diversified into other activities and urban areas. It appears that much of the initial pressure for a broader array of services came from the non-farm depositor base who were interested in obtaining loans from the bank once they had made deposits there. Butt even so agricultural producers had to be willing to respond to this request because at the time they clearly controlled the direction of the enterprise.

Although agriculture now accounts for a relatively minor share of the activity of Credit Agricole, the organization remains tightly linked to agriculture. Not only does it continue to dominate agricultural lending, but farmers still dominate policy setting at CA. Farmers are the majority of the boards at all levels in the organization including FNCA. This may explain the continued interest in agriculture. It also suggests that one of the often noted arguments against expanded authority from within the FCS may be spurious. Farmers need not lose control of the organization because it has non-farm activity. If Credit Agricole can become one of the largest banks in the world and still maintain a board that is dominated by agricultural producers it should be possible for U.S. farmers to retain control of the FCS if they choose to.

Perhaps the most important difference between the organizations is the existence of FNCA which provides a clear policy direction for the whole bank. During the 1980s the FCS experienced far more stress than it might have had there been a better internal coordination mechanism. While it is unlikely that the System will become an integrated cooperative, the adoption of a member driven policy unit that deals directly with the President's Planning Committee at the strategic level for the organization might improve the ability of the FCS to develop policies that receive broad-based support by the members.

Arguably a critical problem for the FCS has been this lack of mechanism to provide effective member control at the national level. Much of the opposition to recent mergers has revolved around the loss of control by the grass-roots owners as the institutions moved further away from local boards. While the FCS is nominally owned and directed from the association up through the banks and to the service organizations like the Funding Corporation, the reality is that there is little control exercised by owners. The senior management of the district banks is largely in charge, although the degree of management autonomy varies from district to district.. The beauty of the CA approach where the FNCA has responsibility for operations and CNCA for policy is that there is a direct path for the owners to the policy formation process and senior management does not have as clear an opportunity to dominate the deliberations.

Certainly there is little reason to believe that the FCS should try to adopt the strategy that Credit Agricole followed. To a great extent the path CA followed was dictated by the initial decision to allow it to take deposits when it was created and the particular structure of the French banking system. Current conditions in the United States are not likely to allow the FCS to become a deposit taking entity even if it now wanted to. The main lesson from the CA experience is that specialized, cooperatively-owned agricultural credit organizations can evolve successfully form their original purpose. Moreover the evolution can allow them to continue to serve their original client group -farmers, and the evolutionary process can result in them severing their dependence on national government. Both of these issues are likely to face the Farm Credit System in the near future (Freshwater, forthcoming). This suggests that for the FCS to survive it must consider how it will evolve to meet both its competition and the needs of future farmers.

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