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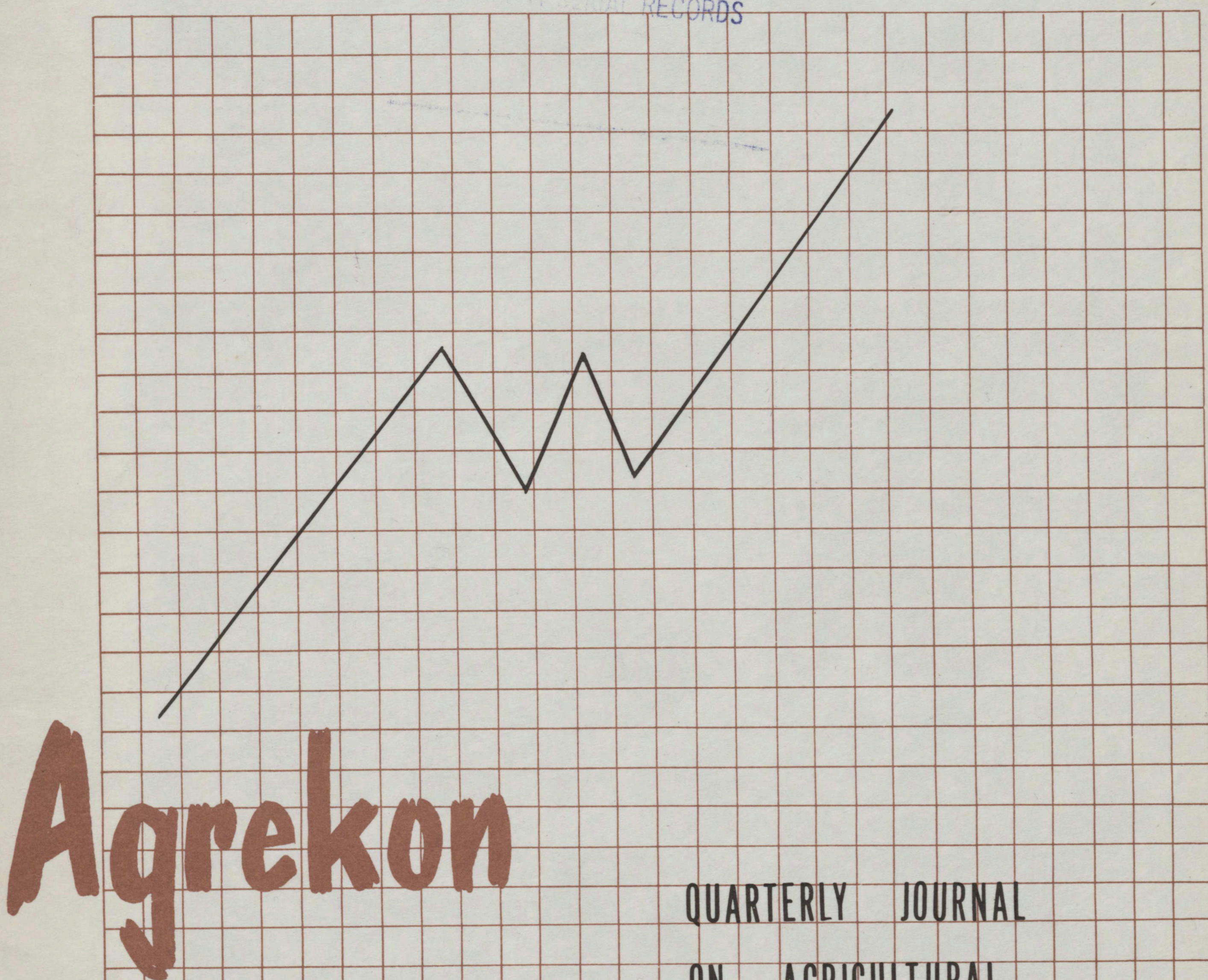

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FINANCIAL MANAGEMENT AS SEEN BY THE COMMERCIAL BANK C7

by

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INTRODUCTION

In spite of the fact that farmers have realised good crops over the last few years, it is a fact that the financial position of farmers still leaves a lot to be desired.

Commercial banks are particularly concerned about the liquidity position of their farming customers and, therefore, accurate cash management is a prime concern of these institutions. The question can, therefore, be asked whether the farmer's relatively critical cash position is due either to poor cash management on behalf of the farmer or due to incorrect financing policies of the financial institutions. In this paper the above aspects of financing will be studied.

The total capital investment in agriculture (land, livestock, fixed improvements and equipment) has increased by 173% from R6 772,0 million in 1965 to R18 517,7 million in 1976. Agriculture is thus a very capital intensive industry and as a result, sound capital management is a prerequisite for success in modern day farming.

1. What is the extent and nature of the involvement of commercial banks in providing credit and financing to agriculture in South Africa? How does the situation compare with credit and financing available from other institutions?

1.1 Policy and priorities

1.1.1 Commercial bank

A commercial bank is a business undertaking and has therefore been established to do business on a healthy and sound basis. A bank approaches any advances to be made, be it to the agricultural sector or any other sector, from the standpoint of a sound business transaction from which both the bank and the borrower should benefit, with the risk of losing money kept to a bare minimum. A commercial bank, therefore, does not advance money according to certain set priorities, but rather according to the merits of each individual case. In this respect a commercial bank also does not differentiate between farmers and other customers. Applications for loans from farmers are considered and vetted in accordance with the same formula as those received from other sectors of the economy.

The essential requirement of the bank is that its money should be safe. In this respect the whole financial position of the borrower is taken into consideration as a quarantee for the bank. The bank only registers a bond over a fixed property if the bank feels that this is necessary in a particular case. Furthermore, the bank does not restrict the farmer in respect of how the credit granted to him may be used. It also does not have a general policy in respect of what maximum amount of credit will be made available to any individual farmer. In contrast to this, most other financial institutions grant loans in accordance with certain set priorities, although the security aspect is not overlooked.

1.1.2 Government and quasi-government institutions

Government or quasi-government institutions such as the Land Bank and Department of Agricultural Credit and Land Tenure have a specified and fixed policy in respect of the class of farmer they are prepared to finance and to what extent they are prepared to finance him. They have thus specific priorities and well-defined policies when granting loans to farmers. The funds that they are prepared to place at the disposal of an applicant are further always granted for a specific purpose. A portion of their financing charges is subsidised by the State and therefore this is always a cheaper source of credit for the farmer.

1.1.3 Co-operatives

The co-operatives also have a specific policy and priorities according to which they finance farmers. These priorities can basically be specified as being production requisites and the financing only of members and those crops handled by the particular co-operative. There are also certain restrictions attached thereto, i.e. that the farmer must obtain these items through the co-operative and must also deliver the crop to them. The crop or a type of levy usually serves as security.

1.1.4 General banks and other private institutions

General banks, insurance companies, pension funds and other financial institutions in the private sector also have certain priorities in regard to the type of financing they are prepared to undertake. Most of these institutions only finance the purchasing of certain types of assets like land, cattle, machinery, etc. and the particular asset usually serves as security for the loan.

1.2 Duration of loans

1.2.1 Commercial banks

Although commercial banks assist farmers on a limited scale to obtain fixed assets such as land, they prefer not to finance such transactions. These are rather referred to either an affiliated company such as a general bank, a trust company or the Land Bank. Commercial banks see their role in financing farmers mainly as suppliers of short-term credit - usually in the form of overdraft facilities. In the Agricultural sector the purpose of these loans is to provide the daily cash requirements of the farming operation.

Despite the fact that this seldom occurs, these loans are always *immediately redeemable* and thus have no maturity date. As these are short-term loans, a commercial bank expects that repayment be made at least once a year.

1.2.2 Other institutions

Apart from specific short-term lendings like seasonal loans, which are provided by some institutions such as co-operatives or government institutions, the other financial institutions mainly provide medium or long-term loans to farmers for the acquisition of assets. These loans have a specific maturity date and are usually repayable in instalments over a period depending on the life-span of the particular asset. In contrast to commercial banks, other institutions providing short-term loans to farmers usually attach a maturity date to such loans.

1.3 Interest rate

Owing to the fact that commercial banks provide short-term finance, the finance charges appertaining to such loans are lower than those appertaining to loans from other institutions. The exception here is where a portion of these charges is subsidised by the Government where government money is advanced to farmers. Such loans, therefore, are much cheaper.

1.4 Extent of involvement

1.4.1 Direct involvement

TABLE 1 - Total indebtedness of farmers in South Africa, 1970 to 1976

Source	1970	1975	June 1976	December 1976
	R million			
Commercial banks	281,8	454,5	505,7	485,4
Land Bank	278,0	432,1	456,9	482,2
Dept. of Agricultural Credit & Land Tenure	136,2	167,0	154,4	156,7
Other financial institutions	286,9	347,5	351,6	393,2
Co-operatives	113,4	247,4	344,1	344,1
Commercial credit	45,0	72,1	77,1	77,0
Private persons	242,9	337,1	360,4	372,0
Total	**1 384,2**	**2 057,7**	**2 250,2**	**2 310,6**

Source: Department of Agricultural Economics and Marketing

In order to further illustrate the importance of the commercial banks in the financing of farmers, see Table 2.

TABLE 2 - Contribution made by commercial banks to the financing of agriculture in South Africa

	Amount provided to farmers by commercial banks	Percentage of total debt of farmers
	R million	%
1970	281,9	20,4
1971	272,4	18,6
1972	275,2	18,1
1973	373,4	21,6
1974	384,0	21,4
1975	454,5	22,1
June 1976	505,7	22,5
December 1976	485,4	21,0

Source: *op. cit.*

From the above-mentioned it is clear that the commercial banks make a very important contribution to the financing of agriculture in South Africa. As far as commercial banks are concerned, the agricultural sector is also an important field of investment. Table 3 illustrates this fact.

TABLE 3 - Analysis of advances made by commercial banks as on 31.12.76

Sector	Amount	Percentage of total
	R million	%
Agriculture, forestry, hunting and fishing	529,4	10,8
Mining and quarrying	229,5	4,7
Manufacturing	1 039,5	21,3
Building & construction	139,6	2,9
Electricity, gas and water	38,1	0,8
Transport, storage and communication	83,6	1,7
Commerce	648,1	13,2
Financial services and real estate	1 268,5	25,9
Other services	171,6	3,5
Individuals	644,7	13,2
Others	100,2	2,0
Total	**4 892,8**	**100**

Source: South African Reserve Bank

Approximately eleven per cent of the money advanced by commercial banks as on 31 December 1976 went to the agricultural sector. This is well in line with the contribution that the agricultural sector makes towards the gross domestic product of the Republic. Some banks are even more closely connected with the farming sector. The commercial bank which made the largest contribution to financing farmers lent 11,2% of its total advances to farmers and was responsible for 41,0% of all advances made by commercial banks to farmers.

1.4.2 Indirect involvement

Apart from advances made directly to farmers, certain banks also contributed indirectly by lending money to the Land Bank. These banks advanced a total R254,5 million to the Land Bank as on 30 June 1977.

2. What are the problems associated with financial farm management as seen by the commercial bank?

2.1 Definition of the problem

The major problem in respect of financial farm management as far as a commercial bank is concerned is reflected in an unsatisfactory cash flow. The most general form of credit a commercial bank makes available to farmers is a fluctuating bank overdraft. This is a short-term facility which may be called up at any time and thus does not have a specific maturity date. The least the bank expects is that the account be paid once a year. What often happens, however, is that a portion of the overdraft is not liquidated and thus this portion of the overdraft becomes a hard core medium or long-term loan. At present, where banks find it difficult to obtain long-term monies, this can result in a dangerous situation as banks have to borrow short-term funds and are in fact, making available long-term loans. This could place the bank in a dangerous position.

On the other hand, it means that banks are lending long-term loans at short-term interest rates. Naturally a long-term loan is more risky and consequently qualifies for a higher rate of interest. Banks are, therefore, suffering a loss of income. A healthy and satisfactory cash-flow is what the commercial banks regard as of paramount importance and essential to a viable undertaking. Thus if a farmer's cash-flow is unsatisfactory, the bank considers it as an indication of a lack of managerial skills on the part of the farmer and consequently views this as a high-risk investment where its money is not safe.

2.2 Underlying reasons of the problem

It is obvious that a farmer will encounter problems in respect of his cash-flow unless he correctly evaluates what effect all his managerial decisions will have on his overall cash-flow position. When the farmer neglects to do so, he may use his short-term funds for financing the acquisition of medium and long-term assets. It then often happens that the farmer finds it difficult to meet his short-term cash commitments. This is one of the major financial mistakes a farmer often commits.

Farmers are to a large extent inclined to evaluate their decisions in terms of physical standards only and where farmers have reached the stage of thinking in terms of financial results, they concentrate mainly on optimizing profits. Banks would prefer to see that the farmer also considers liquidity norms in order to assess the effect of his decisions on his overall cash-flow situation. The fact that there are not enough medium-term and long-term credit facilities available that can adequately meet the farmer's particular needs aggravates the problem. The lack of such medium-term credit facilities often forces the farmer to use his short-term facilities when financing medium and long-term assets. If this has no adverse effect on his liquidity, then a farmer can follow this financing policy. To ensure that he is not exposing himself, the farmer must, therefore, assess his decisions in terms of his overall liquidity position. This requires proper financial planning by drawing up capital and cash budgets on a monthly bais.

It cannot be over emphasised that the most effective way to overcome liquidity problems is by preventing them. The experience of commercial banks has been that farmers neglect to draw up proper financial plans to act as guidelines in the day to day operation of their farming business. Objective financial farm management is thus what commercial banks want to see. This could be compared to the alternative concept which can be defined as management by crisis. In the latter case the farmer will find himself running around putting out fires.

3. What should be done to improve financial farm management and what is the potential role of the commercial bank in this regard?

3.1 In a nutshell

As far as commercial banks are concerned, farmers should be made more strongly aware of the importance of capital and particularly cash in the modern day capital intensive farming sector.

3.2 Improvements to be made

In this regard particular attention should be given to the application of capital and especially to ensuring that the correct type of capital is used for the right purpose. A distinct difference must be made between the daily cash requirements of a farm and the purchasing of assets with a medium or long life-span. It will thus be necessary to acquaint farmers better with the finer aspects of capital management. Here we are thinking of the compilation of cash-flow projections, cash and capital budgets and how these budgets should serve as guidelines for the daily farming operation. Further, the farmer should be made aware that there are certain danger signals which he should be able to recognise when his liquidity position begins to deteriorate before it is too late. The farmer must be acquainted with these standards and should apply them regularly. The farmer should, therefore, be better equipped concerning the finer points of financial techniques.

3.3 The potential role of commercial banks in this regard

Farmers regard their bank managers as their financial advisers. A commercial bank, therefore, has a golden opportunity to instruct the farmer and must not view its role purely as a supplier of credit. The fact that commercial banks are always aware of the financial position of their customers places the banks in a strong position to serve farmers in this regard. Most companies and institutions operating in agriculture contribute largely towards guiding and assisting farmers by providing technical advice, training courses and after-sales services.

A commercial bank should also guide farmers by assisting them to employ their product, that is money, more effectively. This could be done by introducing some advisory division. This is common practice in the USA and Britain. In South Africa, unfortunately, this type of service at the moment is almost non-existent. Commercial banks can also assist the farmer by introducing suitable credit schemes to fit the farmer's needs, particularly his medium-term credit requirements. In order to be able to do so it will be necessary for commercial banks to acquaint themselves with the agricultural sector's needs and particular problems. Financing the agricultural sector should also be undertaken on a more scientific basis. Banks should realise that the safety of the monies they lend to farmers will be better secured when the production potential of the farming operations is considered hand in hand with the solvency position when vetting advances to farmers. Banks should thus also consider factors appertaining to the potential of the soils, the managerial abilities of the farmer and other technicalities. This will avoid the danger of some farmers being over-financed while others may be under-financed.

4. Conclusion and summary

Agriculture today is a capital intensive industry which more than ever relies very heavily on credit. Commercial banks have in the past - and will in the future - played an important role in financing farmers. Commercial banks in particular grant short-term credit facilities to farmers and are consequently most concerned with the liquidity position of the farming sector. From the point of view of commercial banks the greatest problem appertaining to financial farm management is the fact that the importance of sound cash management is not always recognised. Many farmers consequently suffer from severe liquidity problems. This happens particularly when farmers use the wrong kind of funds for the wrong purpose and consequently find it difficult to meet their short-term commitments and at the same time provide sufficient funds to finance their farming operations adequately. From experience commercial banks ascribe this situation to a lack of objective financial farm planning which is further aggravated by the lack of sufficient credit schemes to suit the farmer's particular medium-term credit requirements.

The lack of objective financial farm planning can be overcome by more guidance and training of farmers and banks are in a unique position to make a positive contribution. Farmers will also be safeguarded against liquidity problems if commercial banks would adopt a more scientific approach, also considering the physical production capacity of farms when vetting advances to them. This will, to a large extent, eliminate the danger of some farmers being over-financed while others are under-financed. Such a policy will benefit both the farmer and the bank as it will lead to sounder business transactions.

It must also be realised that farmers would suffer less liquidity problems if more suitable medium-term credit facilities were available. In this regard a change in the policy of the Land Bank could play a large role in alleviating the position. The greatest complaint in regard to the present policy of the Land Bank is that quite often farmers who could make more effective use of its funds, do not qualify for finance by this institution.