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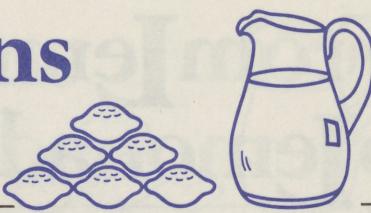
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From Lemons to Lemonade



After several years of turmoil in agriculture and ag banking things are starting to look better. This year, in spite of the drought, bankers are viewing their ag portfolios in a cautiously positive light.

The following articles, written by three mid-western bankers, are indicative of the new trend in ag lending.

A Future in Rural Community Banking

by David Gohn and Scott Corman

David Gohn has served on the Advisory Board of the ABA's Community Bank Division for three years. He is president of West Plains Bank in West Plains, Missouri, and has been in the banking profession since 1964. He is a graduate of Drury College and has attended the Graduate School of Banking in Madison, Wisconsin. As contributing author, Scott Corman is a graduate of the ABA School of Commercial Lending. He attended Southwest Missouri State University and received a B.S. in General Agriculture. Presently, he serves as an Ag Loan Officer for West Plains Bank.

We have turned the corner of the problem in agriculture" is a phrase being expressed by many community bankers. If we have truly turned the mythical corner, it is probably a result of many events, some of which are not completely associated with a rebound in agricultural prices.

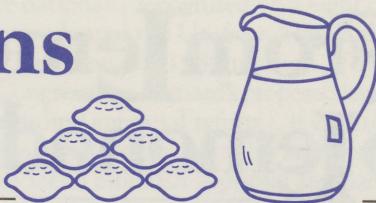
At our bank, we helped ourselves around that corner by charging off some heavy losses on ag-related loans, increasing scrutiny on marginal operations, and instituting more

stringent lending standards before considering expansion of existing ag credit or in evaluating new credit applications. We require all our ag borrowers to truly be in the business of agriculture as opposed to just working and living on the "family farm". Those borrowers who are unable to distinguish between the two are encouraged to do their borrowing elsewhere because today's volatile agriculture environment demands that farmers be committed to running quality operations. Internal changes in lending practices, like these, coupled with some increases in prices paid to farmers, have given bankers a greater level of comfort with the ag loan portfolio than two to three years ago.

Our ag loan portfolio

Our bank is in a beef, dairy, and pork producing area. Agricultural loans have averaged 21 percent of the loan portfolio over the past five years. The beef loans in

From Lemons to Lemonade



our bank have been dominated by backgrounding feeder cattle for three to six months and then sending those heavy grass feeders to western Kansas feedlots. Our borrowers have enjoyed profits since June, 1986. Certain conditions have recently emerged—mainly dry weather, that will reduce their profitability margins. But, we think efficient operators should be able to stay in the black. The higher prices received by our cattlemen over the last two years have prompted more interest in cow calf operations with more cows going back to the farm instead of to slaughter. However, changes in the tax laws affecting costs of replacement heifers and high cattle prices have discouraged some of our farmers from retaining replacements. As a result, the increasing

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national average age of the cow herd gives optimism for the long-term health of the industry.

The dairy industry in our area has returned to profitability over the last two years. Lower feed grain prices have contributed and the 1986 buy-out program reduced the number of dairy cows in our area by around 23 percent. However, some causes of concern to us have been recent increases in the dairy cow herds of existing operations and in the number of the new dairy start-ups. If this expansion exists nationwide as it does

in our area, our concern is that the 1986 buy-out program will turn out to be only a temporary fix, and further adjustments and "congressional fixing" will be necessary.

In our area, there continues to be an ever growing gap between those producers who are doing a good job of managing their business and the balance of the dairy farmers who are only cow milkers. Genetic and hormonal research suggests an ability to increase production as much as 30 percent in some dairy cows. Such technological breakthroughs, when they occur, have a traumatic effect on our dairy industry. In addition, projected higher grain prices and lower milk prices will put the squeeze on some producers in our area who are not able to adapt and grow with technology as it becomes available. As a result we have tightened our loan standards in this area and require producers with a high debt-to-asset ratios to be members of the Dairy Herd Improvement Association. This management tool, combined with other techniques, will allow those low-cost producers to be profitable into the 21st century.

The Ozarks Region was considered one of the top exporters of feeder pigs during the 1960's and 1970's. However, many of our producers who stayed in the swine industry during the 1980's have become farrow-to-finish operators. A large percentage of the remaining producers have either become larger or have found another occupation. We anticipate projected higher feed grain prices for this fall and beyond will inflict not only higher input costs, but also a lower price received for feeder pigs. We feel the future appears uncertain for pork producers in our area but there seems to be opportunities for the good managers.

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Rural development needed

Agriculture is a cyclical industry. However, we think it's a mistake to believe that all farmers experience the cycle at the same time. During the last three years, our livestock and dairy industries have been profitable due in large part to the fact that our grain producers have operated at losses. We are conscious that new set-aside policies, declining surpluses, export expansion, and dry weather seem to indicate a new cycle is beginning to form and the result will be a profitable grain farmer and a marginal livestock and dairy industry.

We believe that to remain profitable in agricultural areas we must be aware of subtle, but certain changes occurring in rural America. The move to a volatile, market

oriented agriculture is occurring at the same time our rural areas are trying hard to diversify their economics into such areas as regional trade centers, tourism, light industrial manufacturing, and the service sector. We are more concerned with the impact of these long run changes than the short run effects of a more prosperous ag sector. Ultimately, the rural community bank's survival depends on the vitality of its community. Rural areas in the past have been able to depend totally on agriculture, but no more. Rural community banks should take an active role in their communities' transition from a one dimensional economy to a diversified one. If they don't, they may find themselves looking to turn that rural bank problem corner once again.