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The Agrilender of 2010 Part II

by:
David M. Kohl

Editor's Note: This is the second part of a series that explores economic trends that will impact the health of the U.S. agricultural and rural sector.

David Kohl is professor of Agricultural and Applied Economics at Virginia Tech, Blacksburg, Va.

A quadrant system can be used to identify rural communities, which can be useful in strategic decision making concerning marketing plans and resources allocation.

Quadrant I

This quad consists of the strong, vibrant agricultural small town or city that has very competitive agriculture for the first 10 years of the 21st century. Quad I rural communities are agricultural trade centers surrounded by an abundance of class one soils, sufficient water, and good

quality infrastructure, roads, schools and agribusinesses to service needs. Larger farm family units (Quad III and IV ag producers), or vertically integrated agriculture operations that are globally competitive, are heavily vested in this region along with consolidated agribusiness and machinery dealerships.

Quadrant II

These are the smaller towns, some distance from interstate or major road systems. Lower quality soils and limited water reduces the global competitiveness of producers. A windshield inspection of Main Street will find closed businesses, consolidated schools and few agribusiness firms. You see assisted-care facilities and a noticeable brain drain of youngsters seeking opportunity elsewhere.

The customer base is older, with either high or low equity, and erratic income streams dependent on government subsidies. The result is both financial and physiological pressures that lead to an exit strategy, because of the lack of global competitiveness.

Quadrant III

If you whiz down the interstate or travel near popular natural amenities like mountains, lakes

or rivers, you will find Quad III rural communities.

Each small city has a strong infrastructure that demands a stellar education and health care system. Farms and ranches here are a mix of competitive Quad III and IV or Quad I life-style producers. Land values are high because of demand from farmettes and some developments. Producers seek value-added opportunities for products or services. Farm/city conflicts are more prevalent concerning property rights, land use, and environmental concerns.

Quadrant IV

For lack of a better description, this is the urban connection. These are areas around the big cities in North America, or throughout the world.

These areas have either very small Quad I producers or larger III and IV businesses. Many producers are quite competitive, but they face urban pressures and concerns from the nonfarm public. Many lease, use land swap, or sell their land outright and migrate to a new location. Land use, regional planning and green space issues are hot topics. While some producers are very competitive using value-added marketing, profits can be squeezed because of the high cost of labor and living. This is usually offset by a strong balance sheet propped up by urban demand for land.

Age Wave

Research suggests that 70 percent of all farmland will change hands within the next 15 years, offering financial institutions the potential for 4 percent

to 6 percent annual loan growth if they are properly positioned as wealth management solutions providers. Much of the land transfer will occur as traditional-sized (quadrants II and III) family farms, the "tweeners" that currently account for nearly 25 percent of farm numbers, either increase in size to become larger commercial farms or decrease in scale to become part-time farms. More of the land will be leased, rented or combined through strategic alliances as the next generation operates business through the control rather than the ownership of assets.

The current agricultural recession will accelerate the structural change in the industry. Financial services staff must understand the factors that separate winning and losing opportunities in this environment.

Institutions that are competitive will develop a four-corner approach to wealth management. That is the creation, management, preservation and transfer of wealth with each cycle having opportunities and risk.

The General Economy

The general world economy will have a significant impact on the health of the agricultural and rural sector. Seventy percent of agricultural producers have a dependence on nonfarm revenue streams. Changes that happen in general business economic cycles with the leading economic players can have a dramatic impact on agricultural profits and demand for food.

Macro economic policy changes, shifts in the equity and stock mar-

kets, and consumer and federal debt levels, oil and energy consumption will be factors on every agribusiness's radar screen as they strategically position themselves in the 21st century. In some areas recreational farm ground purchased by high income households or those who have gained paper wealth in the equity markets have fueled strong land values despite an agricultural economy in recession.

Thus, any restructuring of the world economics will change trading partners and wealth centers throughout the world. This in turn will suggest a moving target in agricultural risk management, and business development.

In summary, the following major trends necessitate an enhanced examination:

- **Managers of large commercial farms are becoming increasingly sophisticated and demand more from a financial services provider.** A bimodal distribution in farm size and profitability continues to take shape, with large commercial farms accounting for an increasing proportion of total production output (6 percent produce 72 percent). Needs include financial packages that reduce risk and provide solutions to business challenges in the areas of marketing, environmental issues, financial and transition planning, and related business and financial matters. Staff must be at an equal or greater level of sophistication than their customers in order to confidently sell a premium-priced value proposition to this segment.

- **More farming operations are forming strategic alliances and sophisticated contracts with large food and agribusiness companies to market domestically and internationally.** The complex needs of these leaders and innovators in the agricultural industry will raise the bar for financial service providers. Participation in alliances and partnerships inside and outside these organizations will be necessary to meet their integrated and sophisticated needs.

- **Smaller, part-time farms will demand quick, convenient financial services that**



are compatible with the life-style of the owner/operator. While large commercial farms will dominate the new agricultural structure in terms of production output, smaller part-time, or "life-style," farms will represent nearly 70 percent of farm numbers. These farms have a major dependence on off-farm revenue and are located near urban, suburban and emerging rural areas. Profitably serving this segment will require credit processes that resemble those for consumer loans and the ability for staff to identify opportunities to cross-sell products and services.

- **Environmental regulations, food safety and farm subsidies, along with intellectual property rights, contracts and anti-trade sanctions will play a major role in agriculture and agribusiness.**

Organizations serving the agricultural market must have a sound understanding of these issues and their implications. While many areas of the world are moving away from direct farm subsidies, the United States actually has been increasing this type of support in recent years. With the United States producing 50 percent of the world's food and fiber, changes in its policy have a large ripple effect on global farm incomes.

- **Agricultural businesses will be required to invest greater amounts of capital for environmental compliance (waste disposal, water quality and supply, etc.)** Operations located near cities, towns and natural amenities such as lakes, rivers and mountains will bear the brunt of environmental compliance costs. Organizations must

understand the environmental risks facing their customers, and possible relocation to circumvent the brunt of regulation.

- **Increased coordination from production to delivery to the consumer across the agri-food chain will change the role of financial institutions in the future.**

For a certain segment of the market, financial services providers will serve as coordinators and facilitators of financial transactions and offer added value through the delivery of solutions-based knowledge and financial services.

- **Global economics will play an increasingly important role in determining the success of agricultural businesses in the future.**

Global demand for food and fiber, consumer, political and media perception of agricultural products, comparative advantages in production, government policy, shifts in equity markets, consumer and federal debt levels, and currency exchange rates will be integrated into managerial decision-making. Agricultural lenders and businesses can expect to operate in an environment with more variation in net incomes resulting in a need for attention to risk management, contracts and overall marketing arrangements.

- **Zone of tolerance.** Management and corporate staffs must develop zones of tolerance given scenarios of economic conditions and enterprise concentration. Credit quality zones must be established for favorable and weaker economic times (94 to 98 percent favorable vs.

85 to 89 percent in weaker times). Systems must be established to determine how levels of concentration and adversity can move a portfolio outside the zone. The system must explore liquidity, rainy day, or cyclical funds, similar to Australia and Canada, that can be used to inject liquidity to producers in stressful times created by a global economic event.

- **Lending to soft assets.** Credit systems will continually be challenged by the new, emerging agriculture that will see less in hard assets, i.e., land and improvements, and more financing to soft assets, i.e., leasing/renting contracts, human issues and alliances. The small business or franchising approach to the development of underwriting standards for these unique requests will be required and challenging.

- **New generation producers.** In most developed countries, it is virtually impossible for a young person to start agriculture. The new generation producer will frequently be a family member or key employee with a desire of ownership or control of assets. It could be an individual who has worked for a number of years inside and outside the industry to build equity and a desire to return to production agriculture and a rural life-style. This new generation producer will forge alliances with other producers in the purchase of inputs of sale of products to receive bulk discounts or revenue enhancements. They will produce more under revenue contracts for large food and agribusiness chains. They will be categorized as networkers, deal makers, excellent labor managers, and achieve results through people and others.

- **Large institution/coopertition.** In countries with many small banks and lending institutions, an alliance with a larger entity inside or outside the financial services industry will provide the infrastructure or array of products or services that can be utilized by a click on the computer or command of the voice. In this manner, regardless of location, producers will



be exposed to a choice of products and services and delivery systems that will come with convenience, and value added through superior expertise and solutions based problem-solving teams.

• **Benchmarking and best management practices.** Database profiles of commercial agricultural producers will be readily available by enterprise and size throughout the world. Benchmarking that incorporates best management practices will be available for risk profiles as well as customer profiling very similar to investment and stock portfolios of today. Best management practices will be a total integration of the production, financial and management systems that produce bottom-line results. Innovative lending institutions will organize key financial and investment data for customers so that very conveniently they can have a quick analysis of the business and personal financial structure, with comparisons and profiles accessed through computer technology.

• **Risk profile tentacles.** Concentration of debt becomes a bigger risk issue as agriculture continues to consolidate with tentacles through contracts and possible financial wraps with large processors, food chains, and agribusiness companies. A major challenge of existing institutional lenders may be whether the food companies finance the new era 21st century agricultural producers with new sets of underwriting standards and measures of risk. Environmental issues or public opinion may slow this process or possibly revert agricultural structure back to an historic version.

• **Lifetime customer profitability models/paradigm shifts.**

Demographic and transition issues will create the need for a lifetime customer profitability model. Customers will be more mobile – lease rather than own – and grow the business through partnering and alliances.

During this period, the 2010 agrilender will have a high probability of going through a prolonged recession in the U.S. That would impact global trading partners as well as the balance sheets and income statements of the customer base. Throw in weather and domestic disputes, or agroterrorism, or volatility of incomes, and swings in public opinion of agriculture would be more pronounced. Institutions will have to manage under paradigm shifts ranging from the perfect storm analogous to the 1930s and 1980s to an environment conducive for business development.

• **The three-dimensional lender.** The 2010 agrilender will be three-dimensional. In some cases, they will be teachers, explaining analysis, organizing information, and demonstrating how products and services meet the customers needs at point of anticipation. Other times the agrilender will play the role of coach by motivating and guiding the customer in the four cornerstones of wealth (creation, management, preservation, and transfer) with products and services provided in a timely manner.

Finally, the role of facilitator will increase. This includes successfully handing off a customer to another in