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Managing Farm Finance

Introduction

Two players are at least involved in the field of farm finance: the borrower and the lender, the farmer and the bank. They play their role, however in the "environment" of the economy, more specific in the development of the agricultural sector as such.

That means that for a good understanding of farm finance it will be of importance, in my opinion, to have first of all insight in the composition, the significance, the financial position and the developments that may be expected in the agricultural world. For the farmer who needs outside capital is important to be aware of the background, policy and daily practice of his bank. In this paper these elements are taken as the core elements performing as "the banks between which the agriculture boat is floating".

In our experience cooperative credit has a crucial function in farm finance. At the same time it is a part of the cooperative world, which is governed by specific rules. These are simply formulated as "Ten Commandments" in annex I.

1. Development in Dutch Agriculture

Up to the 1950s, capital expenditure in the agricultural sector was limited, resulting in only little recourse being had to capital from outside. Such external finance as was needed was generally provided against mortgage or personal guarantee, which securities were considered to involve a low level of risk. This way of financing could be described as static.

This changed from the start of the 1960s onwards. The agricultural sector's borrowing requirements steadily increased, following the necessary increase of scale and modernization against the background of emerging social trends.

Agriculture changed from a highly labour-intensive industry to a mechanised, capital-intensive industry. As a result of the disappearance of a large number of enterprises and the increase in size of those remaining, the capital requirements per enterprise increased even more strongly. Whereas approximately 100,000 guilders¹ was required for the average enterprise in 1964, by 1991 the figure has risen to almost 1.5 million guilders.

Within the European Community, the Dutch agricultural and horticulture sector tills about 1.6% (2 million ha) of land under cultivation, while comprising 1.7% (120,000 holdings) of the total number of holdings and producing about 8% (38 billion guilders) of the overall gross production value of the Community's farming sector.

¹ 1 Hfl. (Dutch guilder) = US \$ 0.55 (May 1992)

Economically, the Dutch agricultural and horticultural sector is of particular importance to Holland's trade balance. Thus, the 1991 agricultural trade balance showed a surplus of nearly 27 billion guilders (61.6 billion guilders export and 35 billion guilders import), against only 14 billion guilders recorded for the overall trade account. Nearly one quarter of the total export of the Netherlands consists of agricultural produce.

While thus contributing substantially to the country's surplus on trade, the Dutch farming sector's share in employment and national income is more modest at slightly above 5% and 4% respectively.

Nearly 60% of the gross production value of agriculture and horticulture relates to livestock products, with close to 40% of this being accounted for by milk and about 60% by meat and eggs. The share of horticultural products amounts to about one third of the gross production value. The smallest sector as to production value is arable farming, which accounts for some 9% of agricultural's gross production value.

More than half of the total agricultural output of the Netherlands is being exported, with 80% being destined for the European Community. This made the Netherlands the largest exporter of agricultural produce after the United States of America and France.

2. Features and prospects of the Dutch agricultural sector

Strong points

- a. The family farm is the cornerstone of agricultural and horticultural production.
- b. A high degree of organization (unions and professional organizations).
- c. Efficient supply, processing and marketing systems.
- d. A stimulating and supportive role of government, through research, education and extension services as well as by improving agricultural infrastructures.
- e. A varied package of agricultural commodities of a constant and high quality.
- f. In general, a continuing sound of financial position of most farm holdings.

Weak points

- a. A number of products of Dutch agriculture, horticulture and the food industry has increasingly become of a bulk-production nature.
- b. The strong specialization and intensification of the production systems, which predominantly focussed on an increase in productivity, has had a negative effect on the environment and the wellbeing of animals. In the years to come these systems will have to be adjusted.

Environmental investments up to the year 2000 are estimated to be an average of Dfl. 700 million a year. This is well over 15% of total investments. These adjustments will have to be made in a climate in which farm production is being discouraged by means of less support and border protection due to a change of course in the Common Agricultural Policy as well as an expansion of the Common Market.

For the Dutch farmer and horticulturist these adjustments entail a further industrialization based on durable production systems and a better control of the production process. All this demands a higher level of both knowledge and entrepreneurship for the farmer and horticulturist.

Capital structure

The capital structure of agriculture is strongly determined by developments in the market for land. Despite the decline in acreage, the share of landowners' capital in the financing of agriculture increased by the end of the seventies owing to sharply rising land values. It should be noted in this context that leasehold land has been valued at the same price as has land in ownership.

In the 1980s, however, the share accounted for by landowners' capital diminished due, among other things, to a further decline in the acreage leased.

The development of shares of the three capital components (capital structure) is shown in table 1.

Table 1: The capital structure of Dutch agriculture and horticulture (in %)

As at 1 January	1964	1969	1974	1980	1985	1988	1992 ²
Landowners' capital	28	24	22	28	23	20	18
Borrowed capital	15	17	17	17	19	20	23
Own funds	57	59	61	55	58	60	59
Total capital	100	100	100	100	100	100	100
Own funds as a % of own funds + borrowed capital	79.8	77.3	78.5	76.6	74.7	74.7	72.0

This table reflects a high degree of self finance of the agricultural sector

3. The landscape of Credit Institutions

Various credit institutions are involved in the extension of credit to the domestic private sectors. They can be classified into the following categories:

- * money-creating institutions
- * commercial banks
- * cooperative banks and their central institution
- * saving banks
- * security credit institutions
- * mortgage banks
- * finance companies.

² estimate

4. Borrowed capital

The long-term borrowed capital in farming increased roughly tenfold in thirty years to 22.5 billion guilders. The shares accounted for by the different providers of capital changed greatly in that period (table 2). The share of Rabobanks in overall lending increased significantly from one quarter to three quarter of long-term borrowed capital to agriculture enterprises. The Rabobank's share in the overall financing by banks to the agricultural sector amounts to well over 90%. Loans provided by relatives roughly tripled in absolute terms, but dropped in relative terms from 45% (in 1963) to 12% (in 1991).

Table 2: Growth of long-term borrowed capital in agriculture³

Loans (in %) as at 1 May	1963	1968	1975	1980	1985	1988	1991 ⁴
Rabobanks	25	43	60	74	74	75	72
Relatives	45	41	27	16	15	12	12
Other private individuals							
Institutions and other banks	28	13	9	7	8	10	13
Government	2	3	4	3	3	3	3
Total	100	100	100	100	100	100	100
(in millions of guilders)	2,130	3,050	5,090	13,150	16,340	20,530	22,400

Table 3 demonstrates that in the past thirty years, the share of the Rabobanks in lendings in horticulture rose from 58% to 90%, which in money terms is, in 1991, roughly 10 times the figure recorded in 1963.

Table 3: Growth of long-term borrowed capital in horticulture⁵

Loans (in %) as at January	1963	1968	1974	1980	1985	1988	1992 ⁶
Rabobanks	58	62	69	82	81	85	90
Relatives	24	22	21	7	8	7	5
Others	18	16	10	11	11	8	5
Total	100	100	100	100	100	100	100
(in millions of guilders)	620	1,090	1,620	5,360	6,150	6,550	5,382

Although loans by relatives more than tripled in absolute terms, their share in the overall capital provided to horticulture dropped from 24% in 1963 to 5% in 1991.

³ All agricultural enterprises, excluding small ones (less than 20 Economic Standard Units)

⁴ estimate

⁵ All horticultural enterprises, excluding small ones (less than 16 Economic Standard Units)

⁶ estimate

In the non agricultural sectors some 40% of small and medium-sized companies bank with Rabobank. Rabobank handles some 40% of the private savings market and 25% of the residential mortgage market. This is demonstrated in table 3, which reflects also the breakdown of Rabobanks' portfolio.

Table 3: Share of the market as per 31-12-90

	Rabobank		
	Share of the market	Amounts outstanding	
		US \$(billion)	in %
Agriculture	90 %	15.5	26
SME and Industry	42 %	20.5	34
Mortgages (housing)	25 %	24.0	40
Total		60.0	100
Savings	42 %		

Almost a third of all payment transactions in the Netherlands is performed by Rabobank. Rabobank Nederland's position as a bank for large corporations and institutions is growing rapidly.

5. History and structure of the Rabobank organization

Over the years, the Rabobank organization has been closely involved in the expansion of the agricultural industry. For that reason it seems useful to start with a brief outline of the structure and development of the Rabobank organization.

Local banks

The Rabobank organization is made up of about 750 local cooperative banks affiliated to a central organization - Rabobank Nederland.

Rabobank Nederland is a secondary or joint stock cooperative society with the local banks as members whereas the local banks are primary cooperatives, having between them a total of approximately 850.000 members. The membership is open for everyone, but compulsory for borrowing businessmen. The local cooperative banks are independent of one another and independent of Rabobank Nederland, to a certain extent. They have their own field of operations, linked to the communities in the society. So they have their own balance sheet and profit and loss account. It means that the local bank is authorized to accept financings to a rather high level without interference of Rabobank Nederland.

The first cooperative banks in the Netherlands date back to the end of the last century there was an economic depression in Europe which affected the agricultural sector in the Netherlands very severely.

As a result of the shortage of liquidity in farming, many farmers had to resort to merchant credit and the exorbitant interest rates and financial dependence that went with it.

The first cooperative farmers credit bank was created in 1896 on the principle of Raiffeisen (Germany). In 1896 the established 2 Central Banks (Cooperative Centrale Raiffeisen Bank and Cooperative Centrale Boerenleenbank). They merged in 1972 to what now is Rabobank Nederland. The core objective as cooperative is to provide financial service to members on optimal conditions. That means among other things interest rates in the bottom of the market.

The local cooperative banks were set up without members subscribing any share of the bank: the members accepted an unlimited liability. This was a rather basic characteristic of Dutch cooperative banks. It is retained to the present day but its function has been minimized by the creation of high amounts of own reserves (up to 5% of the balance sheet total).

Nowadays liability at Rabobank is limited to 5.000 guilders each member.

The Rabobank organization as it exists today form a homogeneous group, in which there is good team-work between local banks and central institutions. The continuity of every individual local bank is safeguarded by a mutual cross guarantee system between the local banks and Rabobank Nederland.

Rabobank Nederland

Rabobank Nederland keeps a watchful guard over the interest of the group as a whole on behalf of the The Netherlands Bank. This implies that there is a central liquidity policy, a common profitability policy, a common market policy, financing policy, social policy, etc. Not until it is shown that a local bank would be willing to grant a loan but lacks the funds for doing so, is an appeal made to Rabobank Nederland. The funds needed by the central institutions perform a supplementary financing function, are to a large extent procured on the capital market. Experience has shown the system whereby the primary financing task is exercised by the local banks and a supplementary financing task by the central institution to function extremely well. The role of Rabobank as funder in the international market is increasing. This is one of the foreign activities of Rabobank Nederland who performs abroad:

- * to be an internationally specialized bank for members and customers;
- * to be a specialized agribusiness bank.

The number of offices abroad where these specific aims are executed has grown to 50 meanwhile. The share of the foreign activities are significantly contributing to the results of the organization.

Policy making

The Rabobank organization is divided into forty groups of banks, in which each local bank is represented. In their turn the groups send representatives to the Central Delegate Assembly. This Assembly meets at least four times per year and discusses all important matters pertaining to the common conduct of policy. The Central Delegate Assembly is essential for the formulation and implementation of an integrated policy within the Rabobank organization as a whole.

The Central Delegate Assembly has a strong advisory function towards the General Assembly, which has the highest authority within the organization. A scheme of the policymaking structure of the Rabobank organization is recapitulated in annex II.

Financing in practice

As regard to the daily financing business of the local bank, the banks are able in most cases to make a decision on their own analysis. If the plans are too complicated the bank can use the service of a credit adviser of Rabobank Nederland, for which service the bank will be charged by Rabobank Nederland. It must be emphasized, however, that the final decision is always for the responsibility of the local bank involved. In addition to reporting in case of a complicated financing, this credit advisor gives a lot of instruction and information in the shape of many lectures and courses on agricultural and horticultural schools, to farmers unions, club of young farmers, bankseminars, advisory service of the Ministry of Agriculture, etc.

Because of the high degree of penetration as mentioned before, it is imperative for the bank to make a thorough study of the problems concerned with financing. In this respect, four elements are in my opinion of crucial significance, namely:

- know-how;
- tailor-made solutions;
- funding;
- account management

Know-how

We are especially concerned with the availability of know-how relating to the relevant branch of industry to market developments. For this know-how to be acquired it is essential that there should be an extensive network of contacts between our organization, the public authorities and industry.

Tailor-made solutions

From the 1960s onwards, agriculture has been characterized by the pursuit of economies of scale and a wide variety of methods used in running farms. As a result, agricultures' financing needs are highly varied, and it is therefore the entrepreneur who, in the first place, determines the way of responding to such needs.

He is the central figure and the main point is what he is able to achieve on his farm, given his abilities and under the prevailing circumstances. This means that the bank has to provide tailor-made solutions; we call this a dynamic way of financing.

For this purpose, we have designed such a product package that the adequate financing facilities can be offered to any (agricultural) enterprise (see annex III). In order to be able to select the right financing product from the wide range on offer, the depreciation of the assets to be financed is directly related to the maturity of the loan.

Furthermore, the analysis of the loan application is related to the assessment of the business. For that reason we developed through the years analysis systems based on the ratio's produced by the enterprise in question.

Such a procedure is fully justified from a business management point of view and therefore ties in with the interests of the entrepreneur.

In general a bank can always manage to provide appropriate finance if:

- the entrepreneur's capabilities are sufficient and the bank is presented with a well thought out investment plan;
- the business offers sufficient profitability prospects;
- its capital position and liquidity position are acceptable;
- the security given by the entrepreneur is sufficient related to the financing that will be granted by the bank.

The amount of interest and annual redemption which is accompanying the financing is incorporated in the budget for the next coming years. After the close of the financial year these obligations can be compared in accordance with the credit control with the amount available for interest, redemption (and new investments).

In this context it is just as well the role of the government in the field of agricultural lending.

A public body functioning in this area is the Agricultural Loan Guarantee Fund, which grants guaranteed for such investment and financing plans for which no adequate security can be provided by the business concerned. These loans are granted by banks under the normal commercial conditions without interest subsidy.

As a result no upper limits are placed on loans in our country because the relevant business's prospects are the chief consideration.

However, in providing tailor-made finance it is also necessary to balance current and/or potential risks against each other. This requires a critical analysis, which can only be conducive to the long-term relationship entered into by the bank and the entrepreneur.

This also clearly brings out the significance of the cooperative structure: the bank can thus be regarded as an extension of its members' business. For the bank as cooperative profit and capital are not aims in themselves but are only used towards realizing the objectives of the organization. It is in accordance with this principle that profits are annually added to the banks' reserves. The member may therefore expect his bank to protect his interests and not to let him down in case of trouble. It is for this reason too that acceptable rates generally at the bottom of the market are applied.

On the other hand we may not lose sight of the fact that a cooperative bank too functions as an economic unity and that it may also be faced with the necessity of ending the relationship with a member for in bussiness reorganization processes will always occur.

Funding

In order to be able to provide appropriate finance it is essential that such finance should originate from well-structured funding sources. Here, too the organization can turn its extensive banking network to best account.

The point is that an important source of finance is made up of customers' savings funds which formed for many years the cheapest "raw material". As a consequence of severe competition the price for saving funds has sharply risen. This forces our organization to reduce the level of costs in our own bussiness strongly in the coming years.

Account management

In the past years another development has taken place, the bank has grown from a mere financing institution to an all purpose bank. Banking is more than financing; the bank should focus on the total relationship between bank and customer. This means that the bank must give constant attention to both the debit and credit side of the customer's account.

Here, too we have what may be called a dynamic development in that the bank seeks to be fully acquainted with all banking aspects relating to an agricultural enterprise.

Apart from financing this therefore also means that the bank renders services in the matter of credit balances, domestic and foreign payments, export facilities, insurances, etc.

All these services, provided by our member banks, are united into an integrated relationship management to optimally serve the (banking) interests of the members.

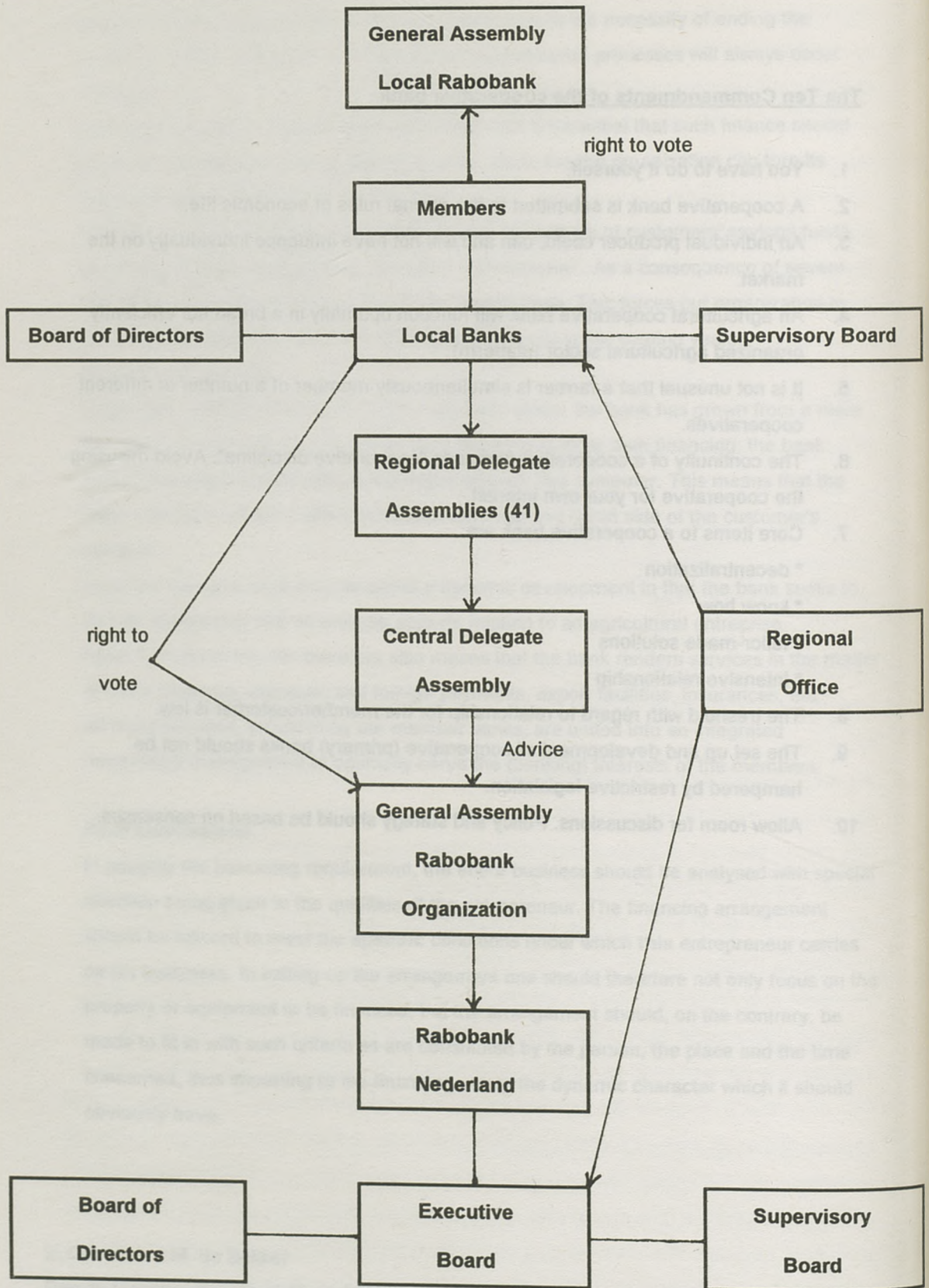
Final conclusions

In gauging the borrowing requirement, the entire business should be analysed with special attention being given to the qualities of the entrepreneur. The financing arrangement should be tailored to meet the **specific** conditions under which **this** entrepreneur carries on his bussiness. In setting up the arrangement one should therefore not only focus on the property or equipment to be financed, but the arrangement should, on the contrary, be made to fit in with such criteria as are constituted by the person, the place and the time concerned, thus imparting to the financing set up the dynamic character which it should obviously have.

Ir. Cornelius J.M. de Bekker
Deputy Manager Rabobank Nederland
Senior Expert Cooperative Banking
4 mei 1993

The Ten Commandments of the cooperative bank

1. You have to do it yourself.
2. A cooperative bank is submitted to the normal rules of economic life.
3. An individual producer could, can and will not have influence individually on the market.
4. An agricultural cooperative bank will function optimally in a broad but efficiently organized agricultural sector (platform).
5. It is not unusual that a farmer is simultaneously member of a number of different cooperatives.
6. The continuity of a cooperative demands "cooperative discipline". Avoid misusing the cooperative for your own interest.
7. Core items to a cooperative bank are:
 - * decentralization
 - * know how
 - * tailor-made solutions
 - * intensive relationship
8. The threshold with regard to relationship for the member/customer is low.
9. The set up and development of cooperative (primary) banks should not be hampered by restrictive legislation.
10. Allow room for discussions. Policy and strategy should be based on consensus.



Principal types of finance in agriculture and horticulture

	Security	Object	Level of Lending	Maximum Life
1.	mortgage	land,buildings,glass-houses	up to 70% of the valuation	agriculture:30-55 years horticulture under glass: 15-20 years
2.	mortgage	buildings,on right of building/longterm lease	up to 50-70% of the valuation	15-20 years
3.	maximum-mortgage	land,buildings,glass-houses	up to 20% of the valuation(on top of the normal mortgage)	15 years
4.	transfer of demolition right	buildings and glass-houses on leasehold land	up to 25% of the valuation	agriculture: 15 years horticulture under glass: 10 years
5.	transfer of right to compensation	buildings and glass-houses on lease	up to 50 % of the valuation	agriculture: 15 years horticulture under glass:10 years
6.	personal security	guarantor's fin. status	limited	20 years
7.	guarantee by the Agricultural Loan Guarantee Fund	viable business	not applicable	20 years
8.	hypothecation	dairy herd,tools and implements,machinery	up to 50 % of the valuation	15-20 years; agriculture: 5-8 years, horticulture under glass: 5 years
9.	transfer of ownership of harvested crops etc. and assignment of debts	arable farming crops	up to 25 % of prospective proceeds	9-12 months
10.	transfer of auction-money	auction money	up to 15 % of auction money	9 months
11.	transfer of ownership of bulbs etc. and assignment of debts	reproductive flower bulb stock	up to 40 % of the valuation of the bulbs and prospective proceeds	6 months
12.	hypothecation	accounts receivable	up to 60-70 % of the accounts receivable	to be established per year
13.	transfer of ownership-assignment of debts, if necessary, supplemented by suretyship	stock of pigs and poultry (livestock financing)	dependent upon the type of livestock; varies per arrangement	continuous