Managing Tough Times

Strategies for Dealing with Agricultural Lenders

EXPERT REVIEWED

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Many factors contribute to financial stress for small business owners, and farming is no exception. Dealing with lenders at such times can be an additional stress -- or a way of relieving it. This publication outlines 10 strategies for dealing with agricultural lenders.

Communicate

Communicate soon and often with lenders concerning any events that might have an impact on your ability to repay your debts. Often when things are not going well there is a very human tendency to avoid confronting the problem. Producers under financial stress will often immerse themselves in the day-to-day operation of their farm and ignore the long-term decisions that must be made. This can manifest itself in not telling the lender that there is a problem until it is too late. Early warning will give you and your lender the opportunity to jointly explore alternative strategies. It will also establish a better relationship as a basis for future credit requests when the situation has improved.

Share Your Plans

Share your plans to respond to financial stress, and have some evidence to support their expected success. A sound and convincing business strategy will increase your lender's willingness to extend additional operating credit, delay principal payments, or refinance existing debt.

Prepare Detailed Financial Statements

Prepare detailed financial statements, and share them with your lender. At a minimum, this should include a current Balance Sheet, recent Income Statement, projected Income Statement for the next year, and Cash Flow projections. In this situation, it is important for the lender to be fully informed. The lender has become a de facto partner in your operation. Advice that he or she might provide or changes in your loan arrangements will be conditional on your financial situation. In addition, evidence that you are hiding information will result in inflexibility of the lender and could jeopardize your relationship in the long term.

Discuss How You Will Control Risk

Discuss the ways that you will control risk. A variety of risk-reducing marketing strategies exist which use futures, options, and forward contracts. While some of these limit the upside potential of price increases, they also can secure a steadier stream of income for farmers.

Other risk strategies are contracts and joint ventures that share or transfer risk between multiple parties. It is important to note that no single party will be capable of bearing all of the risk in most cases. Thus, contracts should be written to allow re-negotiation of terms, should allow for variation in payments as market conditions fluctuate, or should share risk equitable between the participants. Involvement in a contract where you shift all of the risk to someone else usually means that you have traded exposure to short-term price volatility for longer term risk of contract termination or default when price gets extremely low.

Diversification in enterprises has also worked as a risk-reducing strategy in agricultural production, although this approach may not be as effective in every case. Diversification works when enterprises have income streams that negatively correlated.

Be Flexible, But Maintain Control

Be flexible concerning suggested changes from the lender, but try to maintain control over management. For example, it is not uncommon for lenders to suggest liquidation of capital assets such as timber, a cow herd, or real estate to reduce debt. Depending on the future earning capacity of the asset, this may or may not be a wise decision. This is where a good plan comes in handy, because it may be necessary to show the lender how and when the long-term gain of holding onto these assets occurs.

Get to Know Your Lender

Get acquainted with your lender on a personal level. It is often easier to work with people you know and trust. This true for both you and your lender.

Choose the Right Person

Choose the right person at your credit institution. If your institution has an agricultural lending expert, then this is the individual with whom you want to do business. His or her understanding of production agriculture may be essential to your success in securing credit.

Shop for Credit

Shop around for credit. Consider the institution, agent, interest rate, limits, management freedom, and useful advice before you select your lender. The advent of the Internet has greatly reduced the cost of comparing credit terms from a broad set of prospective lenders.

Ask About Credit Guarantees

Ask FSA or co-signers about credit guarantees. In some cases, sound producers will be unable to obtain credit due to lack of collateral. Credit guarantees could provide some short-term operating capital to keep the operation afloat until management changes can be instituted or markets improve. Don't wait until the last minute to line up such guarantees. If there is a chance that you will need them, then start your search for guarantees now.

Repay Promptly

Repay your credit obligations promptly. Prompt repayment of obligations, when possible, will establish a good credit record for the future.

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