



## SO YOU NEED A LOAN?

I strongly suspect that there does not exist today a single agribusiness manager who, after negotiating a loan, has not had second thoughts regarding the set of terms upon which that loan was secured. Securing a loan is much like buying a new car; i.e., the borrower (purchaser) will always be plagued with the questions: "Was the loan (car purchase) really warranted and necessary?" "Might some other financial arrangement (mode of transportation) have proved equally effective?" "Will the loan (car) prove equally attractive in the long run (after long mileage)?" "Did I secure (purchase) the loan (car) under a set of terms (conditions) most favorable to my needs and requirements?" These questions, and many others, will always exist in the mind of the borrower. Appropriate answers will not always be readily available. However, the critical factor is whether or not the questions arose prior to, or only following loan negotiations. If they arise only after the loan has been secured, management will be ill prepared to respond appropriately. If, however, all these concerns are expressed and considered prior to the loan agreement, there is at least some hope that management will find accommodating answers to these important questions.

### Understand The Rules

It may sound terribly trite, but a truly "good" loan is one, which proves suitable to both the borrower and the lender. While the loan-negotiating process may be comprised of a series of opposing views, the final settlement, if it is to prove successful, must consist of a preponderance of supplementary components. The loan-

negotiating process represents a very unique "gaming" confrontation; i.e., one where distinct winners and losers are not the desired end product. Yet to play this unique game effectively, both sides must understand the rules — and abide by them. In a recent publication titled, "A Profit Improvement Program for Bank Loan Officers," Lewis E. Davids of the University of Missouri-Columbia discusses in some detail the game rules as perceived by most bank loan officers. His thoughts are not directly referenced to agribusiness financing and they are obviously slanted towards the nation's lending institutions. Hence, it occurred to me that I might consider Davids' gaming rules, rewrite them so as to be more applicable to agribusiness finance, and slant their composition towards the borrowers of this industry. At least in this environment, both parties to the gaming process will be equally aware of the rules under which the loan negotiation process will take place. Hopefully, this will result in the more rapid achievement of complementary components to the loan document and fewer uncomfortable afterthoughts once the terms have been agreed to. My proposed gaming rules are as follows:

#### **Number 1: Make no give-away offers.**

In the long-term negotiation process, borrowers should not hastily offer to give away claims on their equities. Securing the necessary collateral or endorsements is the lender's responsibility. Await their first request for collateralization and then enter into the mutual consideration of what does or does not constitute adequate security. There is no "foul play" associated with the request that some collateral or endorsements be released in the future in response to specified account conditions,

e.g., maintenance of specific financial ratios, a prescribed sequence of debt retirements, favorable equity adjustments, etc. Such requests should be submitted at the time the loan is being considered, however, and not several months or years later when they represent a true imposition on the lender.

**Number 2: Avoid Delaying Tactics.**

Neither side stands to gain much from the conscious imposition of delaying tactics. Of all the many problems, which arise in agribusiness finance, a large number are attributable to so-called "conditional commitments." Too often these agreements represent little more than the two parties' failure to reach agreement on selected, but critical items. A state of impasse exists wherein each party settles on some tentative agreements, most of which are highly conditioned. Both sides console themselves with the argument that flexibility is a desirable attribute of such conditional commitments. In truth, they too often represent a delaying tactic destined to result in confusion, misunderstanding, and an eventual violation of the game rules by both sides. For example, the borrower should never ask for, nor expect delays in rate adjustments, endorsements, or loan service activities.

**Number 3: Reference flexibility to maturation.**

Flexibility, in and of itself, is a highly desirable component of a good loan agreement. This is particularly true within the agribusiness industry where cash flow is so often linked to seasonality and commodity market cycles. Yet the borrower should recognize that flexibility is a more attainable goal under a longer-term debt. If your needs are for a seasonal operating loan, don't be too surprised if your search for flexibility in loan terms is met with substantial resistance. On the other hand, if the loan maturation period is ten or more years, the borrower should be more aggressive in his search for flexibility of loan terms.

**Number 4: Beware of an over-reliance on the future's market.**

Commodity future trading has now become a well-established activity throughout the U.S. agribusiness industry. The contribution this activity has had or, the stabilization of commodity prices has been significant, if somewhat difficult to quantify. More and more, agricultural lenders are looking at the futures market as a means for risk reduction. Keep in mind, however, that the borrower, not the lender, becomes the only active participant in the market. Risk is reduced only insofar as commodity or resource price variations are confined to a narrower range. Risk is also reduced only insofar as the borrower's market involvement does not extend into a speculative function. Regardless, the borrower must recognize that a commodity futures market entry is analogous to a "mini-max strategy;" i.e., it serves only to minimize the maximum economic adversity, which might affect the vitality of the borrower's operation. Market entry, alone, does not provide for profit stimulation. Nor does it produce an incentive for improved operational efficiencies aside from the commodity or resource price stability already noted. In brief, the borrower should not look to the future's market as a source of strong positive support in the loan negotiation process. Rather, he should point to his market involvement as visible evidence of his firm's desire to cover losses associated with excessive commodity or resource price variation. The lender, in turn, will likely be interested in your intent and ability to use the market for this specific purpose and not in the search of speculative gains.

**Number 5: Don't push personal endorsements.**

The wise borrower will not attempt to bias the loan negotiation process in his favor through the use of an impressive series of personal endorsements. Agricultural cooperatives, in particular, are sometimes tempted to provide the endorsements of their directors in an attempt to sweeten the loan agreement. Not only is this practice unwise, it is generally of little practical

value. Most experienced lenders realize that personal endorsements are of doubtful value unless those signatures are accompanied by the creditor's control, by agreement, of the disposition of each endorser's assets and the extent of his direct and contingent debts with others. Few lenders have the desire or the ability to yield this kind of control over a group of unrelated individual estates.

If, on the other hand, the lending agencies do require such personal endorsements, it is wise for the borrower to assemble financial statements on the signatures which are as complete as those provided for the borrowing organization. While this may appear burdensome, in the long run it will result in more efficient loan proceedings, fewer uncertainties, and a more favorable consideration by the lender.

**Number 6: Always concentrate on the basic repayment factors.** Many readers will recall the old story of the farmer who approached his banker for a loan and was asked to complete a loan application form. The application asked the potential borrower to describe the means by which the loan was to be repaid and provided room for the listing of three separate items. After much consternation, the farmer penned in the three blank spaces the words, "faith, hope, and charity!"

If you are in need of a loan, the means by which such a loan will later be repaid should be thoroughly considered long before you contact a lending agency. To approach a lender without this prior consideration would be like entering an athletic contest without a game plan. If, on the other hand, you approach a lender with a thorough repayment proposal, it will be much easier to reach an agreement, which is complementary to the interests of both parties.

In this regard, a borrower should remember that while faith, hope, and charity will not suffice, there are just three basic sources from which a loan to an agribusiness firm can be repaid, i.e., (1) the conversion of assets to cash, (2) earnings in the form of

savings or profits, and (3) the transfer of a debt obligation to another creditor. Of these three basic sources, the second is most desirable, the third is the most difficult to achieve (in most cases), and the first is usually the method of last recourse.

**Number 7: Make effective use of your "track record."** Your current series of balance sheets and operating statements are quite likely the most valuable prerequisites to successful loan negotiations. Be sure you use them effectively. If the documents are descriptive of your operation as a progressive, sound, and profitable one, don't be reluctant to continually press them into the lender's consideration. Nothing is quite as impressive as an outstanding (and accurate) track record.

A large volume of accounts receivable often heavily burdens agribusiness firms. Yet in comparison to other businesses' use of consumer credit, the agribusiness firm very often can demonstrate a high percentage of collectibles — particularly in the more recent three or four years. Make sure the lender is aware of this aged accounts receivable record and recognizes that such grower credit is not to be excessively discounted.

**Number 8: Don't buy a ticket to Trenton — if you're going to New York.**

This topic was recently called to my attention by the president of a large eastern bank. In discussing agribusiness finance, this bank president expressed his greatest concern to be those firm managers who approached his institution with requests for stopgap financing. In short, these agribusiness firms attempted to secure financing for an immediate or readily apparent need, while totally ignoring their less apparent, long-run requirements. Hence, if granted, the loan may plug the leak, but do little to supplement the overall strength and capacity of the water tank.

When preparing your loan request, make sure that stopgap measures are avoided and that you can illustrate to the lending

institution that short- and long-run credit requirements have been considered. Similarly, the agribusiness manager should always avoid making long-term commitments on expenditures (contracting for building construction or equipment purchases) before some form of long-term financing has been secured. Here the appropriate expression might be, "Don't agree to be in New York if you have money enough only for a ticket to Trenton."

**Number 9: Don't depend on renewals.**

To many in the financial community, the terms "repayment" or "amortization" have somehow become old-fashioned. Agribusiness firms, which regularly operate on seasonal credit too often, find that the annual payout is really not a modern operational requirement and annual renewals of that credit line is all but automatic. Any borrower (or lender) who follows this philosophy is surely destined for difficulties. Remember, renewals don't solve loan problems; they only postpone (or aggravate) them. The banker who insists, "We want to see the color of our money now and then," is not infringing on the borrower's character. Under a specific set of conditions, renewals are advantageous to both parties, but the borrower should never risk his financial future to renewals, which he assumed to be "automatic."

**Number 10: Don't play musical chairs.**

Remember the old parlor game where the objective was to be sitting down when the music stopped?" Well, a similar strategy is sometimes employed by borrowers who split their source of credit amongst several lenders. If an unexpected liquidity crunch develops overnight, the most timid of the creditors gather their commitments and bolt for the door. Those remaining hope that an unoccupied chair remains when the music stops. Inevitably, one creditor is left standing and the good name of a well-managed agribusiness firm is tarnished in the resultant settlement. Had the borrower relied on a single source of credit, the likelihood is that the lender would be less

inclined to panic in response to short-term difficulties in an otherwise sound business.

**Number 11: Is yours the deal that's "too good?"**

If your objective is to present to a lending institution a deal that is "too good" for them to pass up, then forget it. First of all, no matter what business you're in, the fail-safe loan has yet to be designed. And second, even if you were to construct such an attractive package, the average lender would be so suspicious of its contents that they would likely avoid it.

My advice to the average agribusiness borrower is to make sure you do approach the lender with a package, i.e., have some idea in advance of the loan terms, usage, repayment, etc. However, make sure the package has plain brown wrapping. Efforts to glamorize or otherwise exaggerate the true credit worthiness of your organization are always ill conceived and ill received. I have found over the years that one of the most effective ways to communicate the attributes of your business to a potential lender is to openly encourage an onsite visit by the loan officer. To some agribusiness managers this may seem to be an annoying and an unnecessary activity. I strongly disagree. If your business is to receive the loan servicing it deserves, the loan officer must be familiar with your business, its customers, and its management. An onsite visit will accomplish much in this regard and contribute to a feeling of openness so necessary for a successful loan agreement.

**Summary**

At some point in the career of every agribusiness manager, he will find it necessary to seek some form of debt capital. Once such capital is secured, it is not uncommon for the manager to develop numerous second thoughts about the contents of the loan agreement. Had such concerns been expressed prior to the time the loan was negotiated, many could have been adequately satisfied.

This paper is designed to list and describe some of the "game rules" surrounding the loan negotiation process — as presented from the borrower's point of view. Hopefully, they will assist the agribusiness manager as he attempts to deal with his pre-loan concerns. These game rules include: (1) make no unsolicited offer of collateral, (2) avoid any attempts at delay, (3) link your request for flexibility to maturation, (4) don't place overemphasis on the future's market, (5) beware of personal endorsements, (6) concentrate on basic repayment factors, (7) make effective

use of your firm's "track record," (8) always avoid stopgap financing, (9) don't depend on automatic renewals, (10) beware of the deficiencies associated with splitting your sources of credit, and (11) package your loan request with accuracy and a desire for an "open" business relationship.

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