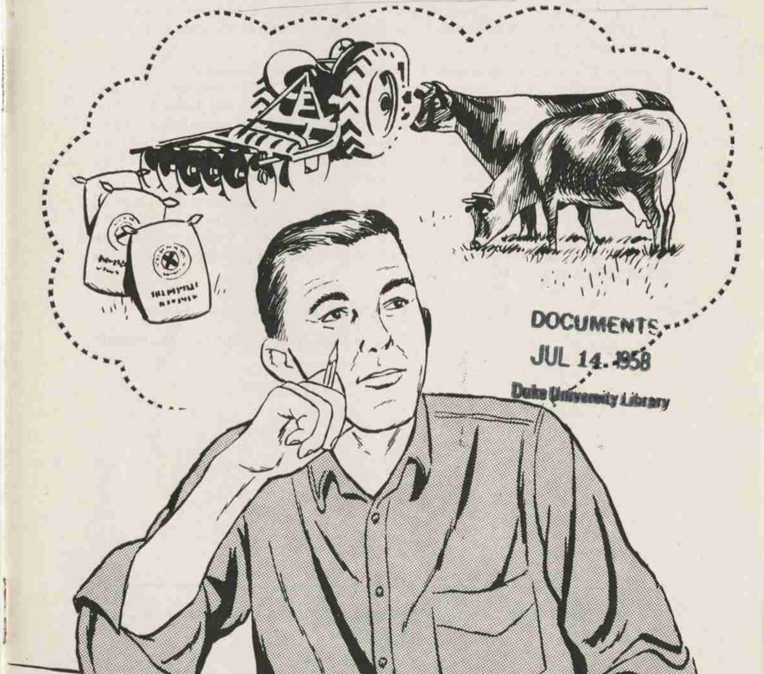
Financing a Farm Business

SOUTHERN FARM MANAGEMENT EXTENSION PUBLICATION No. 8



THE FUTURE BELONGS TO THOSE WHO PLAN FOR IT

FOREWORD

Scientific discoveries and the new technology growing out of them create a need for constant adjustments in farming. Most of these changes call for capital investments. Few farmers can save from their earnings fast enough to finance the necessary adjustments. Consequently credit is an evermore important tool in modern farming.

Credit helps those to get ahead who use it wisely. Like so many useful things, credit becomes dangerous when handled carelessly.

This publication is designed to show you some possibilities, principles, and precautions in using credit. Every situation is different, thus it becomes necessary for each farm operator to think through the credit requirements in his business and plan to use credit with great care.

The Southern Farm Management Extension Committee conceived the idea that this publication was needed. A subcommittee consisting of Messrs. Stephen J. Brannen of Georgia, Foy Helms of Alabama, Harry M. Love of Virginia, and James L. Robinson of the Federal Extension Service staff was assigned the task of outlining the proposal and getting an author. The writing was assigned to Harry M. Love. In carrying out this assignment the author had the benefit of counsel and suggestions from all the members of the Southern Farm Management Extension Committee.

The arrangement under which this publication was developed came about through the cooperation of Directors of the Extension Services of the Southern States, the Farm Foundation, and the Extension Service of the United States Department of Agriculture. The publication was approved and published jointly by the Extension Services of the 12 Southern States.

M. O. WATKINS, *Administrative Advisor*

Southern Farm Management Extension Committee

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Financing a Farm Business

Harry M. Love[1]

Credit Aids Production

Most farmers and operators of other businesses find it necessary to use credit. In this way they speed up the process by which the tools for production are put into the hands of workers. For instance, man was originally equipped to operate two faucets on a cow at one time—that is, if the cow was trustworthy and the man was reasonably skillful.

Through his creative genius man devised a machine that would produce pulsing effects similar to those in hand milking. Of course, the machine was made to handle at one time all of the faucets on a cow having standard equipment. By using capital to get a milking machine, man doubled his milking capacity. When he learned how to operate three machines at the same time, his milking capacity was increased to six times the hand operation.

The secret to this progress in milking lies in the farmer's access to credit. You see, it was practically impossible for a man to make money fast enough milking by hand to buy the machine with his savings. Therefore, he reached for a lending hand. Others who had been able to live on less than they earned had saved money and could lend. This is how credit came in to help farmers get a start with their adjustments. Those farmers who used credit to make appropriate adjustments were then able to earn money faster. They in turn could contribute to the supply of loan funds. Thus, credit has become a powerful force for production and the process tends to feed upon itself. As with any other new tool for production, a great system for selling credit has been developed.

Credit Creates Problems

True to life, there is another side to this story which shows that the successful use of credit by some creates problems for others. For instance, each addition of a milking machine has made it that much harder for the hand milker to make an equally good living. The situation is further com-

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plicated by the fact that hundreds of other devices have been created to help farmers increase their production. Each new development has been burdensome for the fellow who did not use it as well as his competitors.

Capital Needs Grow

In the process of making available more and better tools, great shifts have been made in the sources of supply. For example, horses, mules and oxen are no longer raised by farmers as their principal source of power. Instead of being cast in flesh, power units are now cast in iron and steel. Having different digestive systems, they are not capable of using farm-grown feed. This all adds up to what looks like a rather tough situation. Of course, you have the choice of building a tractor or buying it. The cost of building a modern tractor in a farm shop has been estimated at $50,000. Considering the difference between this cost and the going market price, the best idea would be to buy. Building a tractor would be worse than trying to keep up while milking by hand.

As with those tractors which factories can produce so efficiently—you had better let them do it for you rather than trying to do it yourself—there are many other things farmers must buy. Now, what does this mean for the fellow who wants to start farming or the farmer who wants to grow and stay in the game? Both must make large capital investments. The needs of each for capital have grown faster than their capacity to accumulate it. If it were not for the supply of credit and the facilities which have been developed for making it available, the situation would be difficult.

Teamwork Is Needed

Of course, the development of things you must buy and the schemes for helping you make the purchases have not always kept pace with your needs. To this extent there are real problems in financing farm business adjustments. Consequently, we have an opportunity to work out ways for making improvements. This is a joint responsibility of borrowers and lenders. It will require close teamwork. Neither can do the job alone.

Principles Point Way to Credit Use

It is the purpose of this bulletin to point out principles and procedures which borrowers and lenders have found useful in financing farm businesses. Some illustrations will be given to show you how the principles work. Beyond this point it will be your responsibility to apply the principles insofar as they may be useful in the solution of your problems either as a borrower or as a lender. Since every situation is different there are no standard procedures which may be used equally well in the solution of your individual problems.

Credit Is Two-Sided

Like most other useful devices, credit can be very destructive when handled improperly. It can operate like a two-edged sword. When handled properly it may be most useful in carving out a great productive future. If carelessly handled, it may carve you into economic shreds. Since you are never alone in the use of credit, many precautions must be observed by you as a borrower and by those having money to lend. Credit is no sure-fire remedy for all the economic ills of farmers or other business operators. Furthermore, the supply of credit is limited. This puts a price tag on credit just like that on most other commodities. Since capital is a scarce resource, those who demonstrate the ability to use it generally have first claim on it and get credit on the best terms.

There is always a clashing of interests between borrowers and lenders. The borrowers naturally want to get the loan as cheaply as possible and on liberal terms. The lender is generally under compulsion to get a price for loan funds comparable to what the money market is offering. He also has to provide for safety in keeping with his obligations to those whose funds he is lending.

Some farmers who look at the price tag and strings tied to credit say they cannot afford to use it. Others are so much impressed by the opportunities which credit may open up for them that they make great efforts to use it profitably.

Delays Are Expensive

Farm businesses are in constant need of adjustments. Some of these needs arise suddenly as the result of unforeseen developments. Other needs for adjustments are the outgrowth of conditions that come about gradually. In fact, some farm operators are slow to recognize the need for changes. Delays in doing the things that will increase the profits from your business keep you from accumulating the money that would have been available for adjustments. This means that you have depleted your financial strength and vigor while permitting the "economic disease" to spread. As a result, you may have become a high-cost producer who cannot meet the competition from those who have adjusted.

Resisting Change

Many of us are prone to resist the idea of making changes. It is just so much easier to let things go. Then, too, we are inclined to be creatures of habit. The author of the following ditty spoke for most of us when he wrote:

"I eat my peas with honey.
I've done it all my life.
It makes the peas taste funny,
But it keeps them on my knife."

How thick is the "honey" you use to keep your business going without making adjustments, or how badly do you get mired in "honey" when applying for a loan to finance an adjustment? And how often do the lenders seem to be bogged down in honey, so to speak, when they are going through the process of extending credit? This ailment is not limited to any type of business. All businessmen find it much easier to stick to the conventional ways of doing things than to change. Furthermore, once a pattern is established it tends to become the accepted procedure for all to follow. Thus, custom sets the standard and the rules of the game are drawn up around it.

Better Ways

Following conventional procedures causes many people to miss the idea that *there is always a better way*. This could happen to you. The persons who set the pace are those who have the vision to see opportunities in the *better way*, are capable of taking advantage of them, and are willing to make the mental efforts necessary to get ahead. If you do not study your business closely enough to find the places at which the most profitable adjustments may be made you will always trail in the race for profits. This "tail-man" position is a disagreeable and crowded spot. The only way to get out of it is to either adjust or adjourn. Hanging on will merely prolong the agony in ultimately being forced to adjourn. There is no use to make excuses. It takes positive action to get ahead.

A Farmer Speaks

Recently a farmer who has grown from a very modest beginning to a moderately large operator was telling about the reactions of visitors to his place. He said they would excuse themselves by saying, "You can afford to do things like they should be done. You have a lot of money and can borrow more when necessary. Being proud of your reputation makes you do things better than other people."

To these his reply has been, "How do you think we got this way? We had to do things right in order to make money. We were forced to borrow and still do." Then he observed that no one had ever given him a dollar and his wife had inherited less than fifty dollars. He said, "It has been my practice during the last forty years to always look ahead and make plans. In this way I could spot the things that promised to pay best and push them. Of course, sometimes I missed, but more often than not I got through with a profit.

"My banker soon saw how I was doing and he was ready to string along with me. He still does, but I have always shot straight with him. I figure through my plans for using borrowed money, show him where I expect to go and how I expect to get there. Whenever something happens to upset the plans, I tell him right away. This keeps him from getting uneasy about his money and he generally gives me time to work out of a tight spot." Such is the voice of successful experience. Doubtless, similar success stories may be found among your neighbors.

Progress Breeds Opportunities

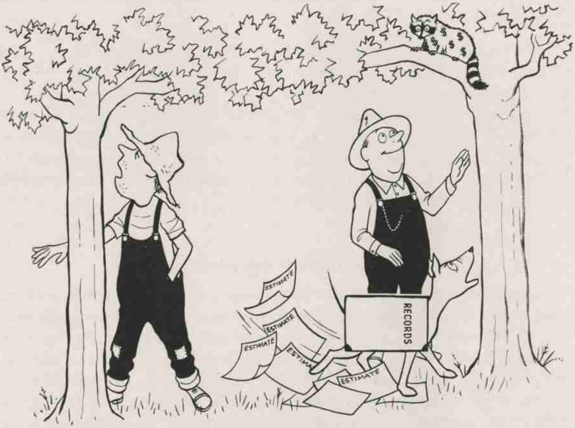
As indicated by the attitude of the farmer just quoted, there is nothing to be gained by waiting for the race to slow down. It does not work that way. The fruits of progress resulting from timely adjustments have a delightful flavor. However, the satisfactions gained in this way are not fully satisfying. They create a thirst for more. Hence, the pace of competition tends to be stepped up as each individual operator finds ways to make more progress. The process feeds upon itself. Every technological development or other adjustment which lowers production cost gives at least temporary advantage to those who are most successful in adopting it.

Adjusting for Profits

In this discussion adjustments are intended to include a wide range of conditions. They will consist of small and large transactions. The amount of increase in the total profits from your business is a more significant measure of the importance of an adjustment than the size of the capital outlay.

The successful use of capital, regardless of whether it is your money or borrowed funds, requires gumption. Gumption has been defined as "the stuff on a coon dog's nose that keeps him from barking at a tree when there is no coon up there." The first obligation of a borrower is to scent out the spots in which additional investments will produce the greatest profits. This requires real skill. Once a farmer demonstrates this kind of management ability, he is well on the road to success. Lenders, like coon hunters, find it profitable and pleasant to go along with such trustworthy borrowers.

It is frequently surprising how far a lender will go and how long he will stick to a trail which is kept warm by the assurance that the proposed adjustments will bring profits.



Where To Adjust

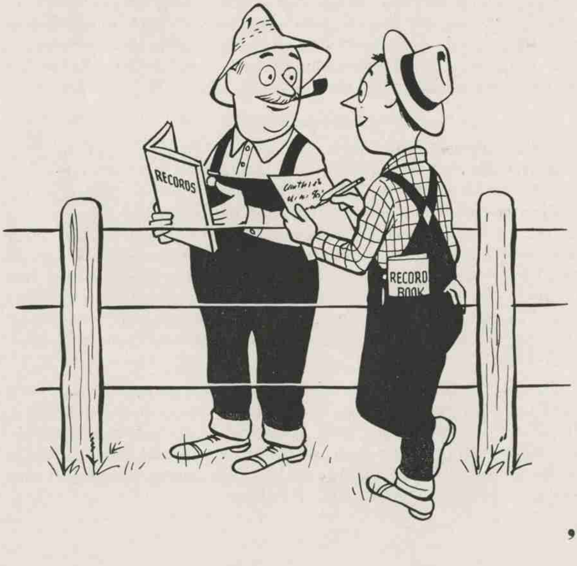
Careful choices are necessary when putting additional money in a farm business since profits will vary greatly depending upon where the money is used. For instance, the first $50 spent for fertilizer on pasture may give you additional feed worth $90. The second $50 used in the same way may produce for you feed worth $110. Offhand you might conclude that the thing to do is to keep on piling fertilizer on the pasture as long as you have money available. This is not the case. At some point, the amount of feed you get from an additional $50 investment in fertilizer for the pasture will begin to decline. For instance, it may be that the application of the third $50 unit of fertilizer will give you additional feed worth only $80. If you keep on applying fertilizer to the pasture there will come a time when the additional feed you get for $50 worth of fertilizer will be worth less than $50. It would, of course, be wasteful to go that far.

If you have plenty of money to do all the other things that you need to do in your business and you want to get the greatest amount of profits possible from that pasture, you should shoot for the point at which the value of the increased feed is equal to the cost of additional fertilizer required to get it. This would be a very exceptional situation in view of the great variety of opportunities to use money profitably in adjusting your farm business.

Generally, you will find at some point along the way up the scale of increasing fertilizer applications to the pasture that your money will pay you better in another use. You may find that some of the money required to get tip-top yields from pasture will bring more profits if used to buy better cows. Or it may be that by spending the $50 for hog feed you will get a $90 return. You see, the main purpose in studying through ways to invest money in your business is to spot the things which will bring the greatest increase in total profits. In other words, the point to which you fertilize pasture should be determined by how much more the money used this way will pay over the next best use in your business. But that point is constantly shifting around because of changing prices and other opportunities for investing the money.

How Much To Borrow

When deciding to borrow it is necessary not only to be certain that you are borrowing for the right purpose but also that you are getting the right



amount. These decisions will require you to make estimates. There is no way of figuring out the answers with absolute certainty. Three sources of information will help you to use good judgment.

The first of these is a record of what has been going on in your own business over a period of time. For instance, how much product do you get for the quantity of fertilizer, feed, man labor, and so forth you are putting into your business and what is it worth? This is the kind of information upon which you can depend when figuring on what you may be able to do and how to make your efforts count most.

The second source is information on experimental results. If your state agricultural experiment station has made tests to find out how much the crops you grow will pay for the use of different amounts of fertilizer, these results may help you in checking the accuracy of your estimates. The same would be true for different levels of feeding livestock.

The third area of information is to be found among your friends and neighbors. They are generally trying to do some of the things you would like to do. Furthermore, conditions on their farms may be fairly close to yours. By checking your experience with that of others you may avoid serious mistakes in underestimating or overestimating the possiblities. Of course, if you are just starting farming or have not kept records of your operations, it will be necessary for you to rely entirely upon estimates of what can be done. In this case your estimates should be carefully checked against other reliable experience.

A Lender's Advice

As was indicated earlier, there are many ways to improve arrangements for borrowing. One of the most important of these is to present more complete information about your business when applying for a loan and get the lender's opinion. This need is illustrated in a story told recently by a lender. He said a young farmer came to him for a loan to buy four dairy cows at $150 each. He turned the request down. The surprised young man asked what was wrong with his credit rating. After being assured that he was in good standing, the lender offered a suggestion. It was, "Tonight when you milk, make a list of your cows, look them over and put down for each the price you would be willing to pay for another one like her. Tomorrow come back."

The next day the young man was told that if he would sell the five lowest valued cows he could get a loan to buy three better than any in his herd. In the end the borrower got nearly $1,000 instead of the $600 he asked for. The lender said that after about six months his greatest trouble with the borrower was that he wanted to go too fast. The three cows were producing so well he wanted to replace all of the others.

Supporting Evidence

Many farmers are defeating their own efforts to borrow. They do it by failing to show a record of how the business has developed, what the situation is now, where it is headed and the plans for getting there. The lender has every right to know all there is to be known about your plans for using the borrowed funds. When he makes you a loan he is, for all practical purposes, in business with you until you pay the debt. How much information would you want about his business before you bought into it?

While most lenders serving farmers have on their staff men who are competent to pass judgment on the soundness of a farm loan, these fellows are frequently forced to be overly conservative because of the lack of information.

Again it might be asked, how can you make a fair presentation of the case for your business without all the facts at hand? Records made when purchases, sales and other transactions take place are more meaningful than those prepared later to support a loan application. Remember, it is your privilege to take advantage of this opportunity. If you do, it likely will improve your chances for success. The lender will have a sound basis for deciding whether he is lending you the right amount for the right purpose. To the extent that you fail to hit this target your chances for success are reduced. Poor judgment on where to use credit and how much to use is the basis for most unsound loans. The lender's judgment is often helpful to the borrower.

Reducing Risks

Thus far all the discussion has been directed toward getting additional capital by borrowing. There are other ways which should also be considered. The choice of how to get the capital can be just as important in determining the profits as deciding where to use it and how much.

Let's turn again to the idea of getting more feed from pasture. You might find somewhere along the way toward using more fertilizer that increasing the area of your pasture will pay better than trying to build its fertility higher. Now you have the choice of buying or renting more land. By renting you will be able to avoid the risk in borrowing money and attempting to buy. When renting you are simply buying the right to use the land for a specified period of time. This calls for a much smaller financial obligation on your part and carries less risk than trying to buy. Many times the risk can be further reduced by agreeing to pay with a share of the product from the rented land. Of course, there is no way to escape all risks. Hence, renting carries the risk in uncertainty of tenure and the resulting effects upon management decisions.

Renting Equipment

Some farmers also find it desirable to rent the use of equipment. Others find it profitable to sell such service through what is commonly called custom work or contract hiring arrangements. In some instances farmers are finding it profitable to rent equipment on contract leases and operate it themselves. Undoubtedly, much more needs to be learned about how to work out the details for such arrangements on terms which farmers can afford and which permit the owners of the equipment to make enough to stay in business. Quite a few experiments with such arrangements are under way. In some places the practice is pretty well established. It may be profitable for you to explore the opportunities.

Contract Farming

In some types of farming other kinds of contracting have become very important. The poultry industry has developed the greatest variety of arrangements and has them in more general use than any other group. Developments in poultry financing have moved so fast that it is hazardous to list the range of arrangements being used. However, suffice it to say that broiler financing arrangements extend from a 90%—10% sharing of the profits by the grower and the contracting agency, through various feed efficiency or incentive payments, to a flat payment of a nickel a bird for all grown out. In all such instances the contracting agency furnishes the chicks, feed, and other cash-cost items on a basis that relieves the grower of any liability in the event the returns do not cover the cash costs. In addition, the feed efficiency or incentive payment plans make it possible for the grower to be paid something even though the broilers sell for less than the dealer's cash cost of production. The flat payment per bird grown is still more definite as to the amount the grower may get. Similar schemes are being developed for financing egg production and turkey growing.

Developments along the same lines are taking place in the production of cattle, hogs, and fruits and vegetables. These developments are largely in response to the need by farmers for access to more capital on terms which enable them to get the use of it when and as needed. Contract farming also provides the opportunity to mesh the gears of production on the farm with those of processing and marketing agencies. It is reasonable to expect these and other possible benefits to bring far reaching developments.

Starting Farming

For the young man who wants to get started farming, renting offers opportunities to avoid the risk of heavier debt. Frequently young men are so anxious to become owners that they will buy a poor farm rather than rent a good one. This can be a sad mistake for the borrower and the lender. Of course, if the farms are equally good, progress may be somewhat slower when renting. However, for some the satisfactions in the feeling of security and peace of mind which comes from being free of debt compensates for slower progress. Polonius expressed this feeling in Shakespeare's Hamlet when he said:

> "Neither a borrower, nor a lender be;
> For loan oft loses both itself and friend:
> And borrowing dulls the edge of husbandry."

It would be impractical to heed this warning and try to keep pace in farming or any other modern business.

In the interest of completeness, it is suggested that other socially approved ways for getting capital are to inherit it or marry it. These involve elements of great chance. They also require phenomenal dexterity in choosing your parents and in being able to live under marital arrangements motivated by such desires.

Sources of Credit

Before deciding whether to borrow you will need to get information on the sources of credit, the conditions on which it may be gotten, what it will cost and when it must be repaid. We will discuss the credit agencies in alphabetical order lest you get the impression that one agency is being listed in preference to another.

Commercial Banks make loans to farmers for operating purposes, for short-term capital outlays up to, say, five years, and for longer term investments such as buying a farm. Your local bank is usually owned and operated by your friends and neighbors. These people generally know enough about your business to let you have money when you need it, if you will supply the information to show that it is a sound venture for both parties.

Since commercial banks must always be prepared to pay off the demands of those who have deposited money in them, they are subject to more restrictions than some other lenders. It is for this reason that commercial bank loans are most frequently made for operating purposes. In fact, banks loan more for operations than any other agency. The operating loans are usually for periods of a few months to five years.

Intermediate-term loans for purchasing equipment, remodeling buildings, putting up new buildings and other items that require two to five years for repayment are also made by commercial banks. When arranging for this type of credit, you should be alert to the fact that some banks still prefer to set these loans up on a twelve-month basis. In these cases it is usually suggested that you may get an extension of time through a renewal if you are making reasonable progress. By presenting your application with evidence to show how long it will take you to repay the loan, you stand a better chance of getting it set up for that time. Some think this to be the best procedure in that both parties know what to expect. However, others say the annual review for the extension is desirable. Both borrowers and lenders often claim they benefit.

National banks can make you a loan for 20 years if you are buying real estate and you will set it up to be repaid in regular installments during that time. The amount of this loan may not exceed $66\frac{2}{3}\%$ of the appraised value of the real estate and it must be secured by a mortgage, deed of trust, or other such instrument. Loans for shorter periods of time are available on other terms.

State banks have similar restrictions which are fixed by the laws in each state.

Sometimes banks will collect interest when the loan is made for the period it is to be outstanding. This will increase your costs above the stated rate. For instance, if you borrow one hundred dollars for a year at 6% interest and pay $6 interest when the loan is made, you are paying at the actual rate of about 6.38%.

Banks usually require security for short-term loans in the form of tangible property such as machinery and equipment, livestock or other chattels. When you offer such items as security, they must be pledged with a chattel mortgage or lien. For long-term loans you will need to pledge the land you are buying and possibly other land you own as security for the loan. This is done by giving a real estate mortgage or deed of trust. There are also other ways to give security for a loan, such as pledging the cash value of life insurance. After you have established a reputation for meeting your obligations and if you have other evidence of financial responsibility, you may be extended a loan on your personal note without other security.

Cooperative Credit Agencies operated under the supervision of the Farm Credit Administration lend to farmers. The production credit associations lend mainly for operating purposes. These loans may be set up on a one-to five-year basis. Many associations seem to prefer the year-to-year renewable loans. The production credit associations also make improvement loans. These are usually for buildings, expensive items of equipment and the like. Such loans are made for periods up to five years.

The national farm loan associations make long-term loans which may run from five to forty years. These loans are mainly to help you buy farm land. However, improvements such as new buildings may be included. Loans are also made to refinance other outstanding obligations. National farm loan associations cannot make loans for less than five years or that are not to be repaid in regular installments.

Both of these lending agencies are owned by the farmers using them. Every borrower must buy stock in the association equal to five percent of the amount of his loan. The value of the NFLA stock is applied to the last payment on your loan. You may hold the PCA stock for two years after paying your loan. When the stock is sold you no longer have a vote in the association. This keeps control in the hands of the borrowers.

All applications for loans must be approved by a loan committee before new borrowers can get any money. The loan committee consists of borrowers and the association's secretary-treasurer. These men are your friends and neighbors. This committee is under obligation to use sound judgment, for the cost of any bad loans will be charged against the value of their stock and yours.

When you borrow from the production credit associations, a chattel mortgage or lien will generally be required. When borrowing through the national farm loan associations, you will need to give a real estate mortgage or deed of trust on real property. The money loaned is obtained through the sale of bonds to the investing public. These bonds are secured by property the borrowers pledge.

Even though the contact with the people who supply the money for your loan is rather far removed from you and the officers of your local associations, it is still necessary to be certain that all loans are sound. Otherwise the supply of credit will dry up. As so frequently happens, one irresponsible borrower can damage the best interests of many innocent people.

When you have established a reputation for paying your debts and evidence of financial responsibility, you may be able to borrow on your signature to a personal note.

The interest rates in both associations vary. The associations also have differing policies regarding fees and service charges. These small charges add to the cost of credit and should be included when comparing the charges by different agencies.

The Farmers Home Administration is owned and operated by the Federal Government. It lends only to those who cannot borrow elsewhere. This agency makes loans for farm operating expenses, for the purchase of farm real estate, for farm improvements, and for emergencies. Loans may be obtained for periods up to forty years depending upon the purpose for which you are borrowing.

When you apply for one of these loans, local representatives of the F. H. A. will help you work out a plan for using the money. If you want to buy a farm, it will be necessary for you to be recommended by a local committee which has the responsibility for passing judgment upon applicants. To this extent you are again in the hands of friends and neighbors.

Since the F. H. A. lends taxpayers' money appropriated by Congress, it becomes necessary to have rather detailed regulations covering the use of the money. There is a limit on the amount you may borrow which varies by counties, townships or parishes.

When you borrow from the F. H. A., you get supervision by persons who will advise you at intervals about your farm operating procedure. These persons are also required to hold you to the terms of your plan of operations. While this assistance can be most helpful, there are conditions under which it is burdensome. For instance, a young farmer borrowed to build a broiler house. The loan specifications called for a house 200 feet long. Through good management this young man found he could put up a house 300 feet long. Yet he was not permitted to do so until weeks had been spent getting his plans changed. It seemed that his trouble came from the fact that loan standards are set for average operators. Being above average, he found it difficult to get permission to do what he was capable of doing.

Interest charges cover all costs to the borrower. The rate of interest is fixed by law and now ranges from 3 to 5% depending upon the purpose of the loan.

Loans are secured by chattel mortgages, liens, and real estate mortgages or deeds of trust given as pledges against the items financed or the proceeds from the use of credit.

Individuals are the most important source of real estate mortgage credit for farmers. They have about 40% of the farm mortgage debt. Frequently these are men who have made their money farming and would like to keep it invested in a farm. Probably the majority of such loans are made when an older farmer sells his farm to a young man. The interest charges, period of time, and other terms vary depending upon many things. If you borrow from an individual, it would be wise to set the loan up in such a way as to protect yourself against the risk of its becoming due at a most unexpected time because of his death.

Insurance Companies make real estate loans. These may be made for a variety of purposes but must be secured by a real estate mortgage or a deed of trust. Again, the terms and charges will vary depending upon many things. As a rule, there is a minimum as well as a maximum period for which these loans are made. Frequently there is also a penalty for paying the loan off ahead of schedule.

Many insurance companies have excellent farm loan departments. As a rule their terms are competitive with those of other lenders.

Merchants and Dealers are also an important source of operating credit for farmers. Generally these people are not in the business of lending except insofar as it is necessary to sell their main line of merchandise. Since merchants and dealers usually have to borrow the money to finance their credit sales and since their risks are high, it becomes necessary for them to charge more than the going rate of interest. These charges are usually included in the time price rather than being fully reflected in interest.

In addition to finding the terms and services of the lending agency satisfactory, you should have assurance that the agency has financial strength to weather a storm, is likely to stay in business and will be willing to help you work out of a rough spot if one develops.

Whether To Borrow

When deciding whether to borrow, you will need to figure out how much a loan will increase the profits in your business. In arriving at an estimate of the profits to be realized, you will need to compare the cost of the loan with the income it will produce. It is relatively easy to figure out the costs on the basis of prices prevailing at the time. However, the estimate of returns involves future production and prices to be received at some future time. While both of these are uncertain quantities, the estimate of production may be determined fairly accurately. The job of estimating future prices is the most difficult of all, even though you may have a lot of outlook information to guide you.

After recognizing all the uncertainties in estimating costs and returns, you then have the job of deciding how to invest additional money in the business and how much to put in each use. Here is where you will find use for the principles we discussed earlier. Now, as you come down to cases you will also need records of what has been taking place.

By this time you may have decided that surely there is an easier way to go about the job of deciding whether to borrow. *This is one of those situations in which the easiest way may be the most difficult in the end.* Borrowing money is serious business. Before attempting to get a loan, you are obligated to figure the proposition through carefully.

Errors in judgment or other mistakes uncovered while calculating costs and returns in the use of money are relatively easy to correct. On the other hand, when you invest the money in buildings, machinery, livestock, or other uses, it is then difficult and often expensive to correct mistakes.

It is a good precaution to test your proposal to borrow by estimating the effect it will have on the financial strength of your business. Since you are borrowing to increase the profits in your business, the loan must strengthen your financial position if it is to be sound. Otherwise you are not getting anywhere by borrowing. In fact, you may be merely delaying an "evil day" and adding to your own troubles as well as to those of your creditors.

Even though your calculations may be based upon the best information and your analysis is thorough, there are always some elements of risk that cannot be calculated. Furthermore, calculations do not come out every time as anticipated. In view of these uncertainties, each borrower needs to make a personal decision as to how much risk he is willing to take. This is something that the borrower alone can decide. You will need to be honest with yourself when appraising your willingness to sweat out tough spots as they develop. Such situations are certain to come sooner or later.

It is usually wise to be cautious. Too much debt is far more burdensome than too little and many times harder to correct.

Some farmers have said they found it easier to get a loan than to develop the maturity of judgment needed to use the money wisely. They have a point well worth remembering. There is no substitute for experience. You can hasten the process of getting it by keeping accurate records of your operations and studying them carefully. Yet it takes time to get the experience to support sound judgment.

There are so many ways to make mistakes that you can hardly expect to miss them all. Such an effort would likely confine you to an unduly conservative program. However, *if you are to stay in business and make reasonable progress, the majority of your decisions must be correct.*

Fitting Loan to Farm

Fitting a loan to your farm business calls for skillful tailoring. Not only must the garment be cut according to the cloth, but every situation is different. The most widely recommended scheme for fitting loans to operations is known as budgeting. This is simply a matter of estimating when the money will be needed and when income will be sufficient for you to make payments.

Budgeting is best adapted to the handling of loans which will be repaid during the year. The first step is to list by months the expenses you will have in operating your business during the year. The expenses for adjustments which are to be handled on an annual basis should be included. The next step is to list the source and amount of income you expect by months. Having done this, you are in a position to see when borrowed money will be needed and when you can make payments on the loan.

Now that you know how much credit will be needed, the next step is to make arrangements for borrowing a total of that amount. Permission to borrow in this way is generally described as a "line of credit." For instance, if your needs for credit during the year total, say, $4,000, then you would ask for permission to borrow up to that amount. Having made this arrangement early in the year, you can get the money later when and as needed. This plan reduces the cost, for you will be paying interest on the money for less time than if the entire amount had been borrowed at the beginning. To the extent that your income will permit you to make payments on the loan during the year, you will be able to reduce the costs still more. The loan should be set up so that you can make a payment when money is available.

When making arrangements for a line of credit to cover your needs, it is a good policy to show the lender your estimated schedule of needs and repayments. The lender is likely to favor such a schedule for it shows him what you plan to do. If you fail to keep on schedule, the lender will suspect that your plans have changed, but it is better for you to keep him fully informed of developments. A schedule will also help to push you to do more toward paying off your debt than you would without such a schedule. Budgeting is a sound procedure and a good tonic for both the borrower and the lender.

Provisions for repaying longer term loans are harder to work out because of the difficulty in estimating income over a long period. Nevertheless, the job should be done before you attempt to borrow. Estimating when income will be available and how much you can pay on the loan will help you to get a better fit.

Long-term loans set up to be repaid in installments are generally spoken of as being amortized. Two plans for amortization of loans are in general use. One calls for a fixed payment of, say, $250 at six-month intervals. In such cases the payment includes interest charges. The balance of the installment, after providing for the interest, is applied to retiring the principal amount of the debt. As the debt is paid down, interest takes less, and more is applied to payment on the principal.

The second plan of amortization calls for a flat payment of, say, $200 every six months on the principal amount of the loan. Of course, interest must also be paid on the debt outstanding in each six-month period. The total payment decreases every six months by the amount of the interest on the $200 paid on the principal.

Some people prefer the plan which calls for the same amount to be paid each time. Others who want to get money for the smallest total interest charges and are able and anxious to get out of debt faster prefer the second plan. As usual, you pay for what you get. The leisure and convenience of uniform payments cost more. The benefits such as less total cost and getting out of debt faster call for closer management and possibly more sacrifice early in the life of the loan. In choosing the plan, it would be well to remember that *there is no easy road to accumulating capital.* It only appears easy when the other fellow does it.

Summary

Credit is a great tool for production. The wise use of credit enables farmers to get ahead. Those who have been successful in using credit are among your competitors. Their success increases the need for you to make adjustments.

Delays in improving the use of credit in your business will cause you to fall farther behind in the race for profits. Remember—*there is always a* *better way.* It is your privilege to find the better way to profits in your business. Modern farming requires the wise use of credit. It will be more so in the future.

The safest road to the profitable use of credit winds through the records of what is going on now in your business and is spotlighted by new technology. Practice will improve your ability to scent the trail to opportunities to use credit wisely and profitably. This has become a hobby for many farmers. That is why they are so enthusiastic about making a success and seem to get ahead so easily.

No game of chess can equal the sport in deciding when to borrow, how much, and for what purposes. You will also find that lenders are intrigued by the game of deciding to whom a loan should be made, how much to lend, and for what purposes. You can start the game by making the first move.

There are many ways of getting adequate credit and it is available through a variety of sources. It will pay you to carefully figure out your plans for using credit and then shop around for the best source. Quality and price are just as important considerations when "buying" credit as with any other tool.

Before borrowing you should apply the acid test to the proposal by determining how much the loan may be expected to increase your profits. Getting down to specific cases in this way will require the use of complete records and sound judgment in estimating future conditions. Errors discovered through advance calculations are easy to correct and less expensive than when they show up in your operations.

Of course there are so many ways to make mistakes that you cannot miss all of them. However, *if you are to stay in business and make reasonable progress, the majority of your decisions must be correct.* When you make a mistake try to profit from the experience but do not waste time crying over spilled milk. Opportunities have a way of slipping by those who are looking backward at their mistakes.

Success in the use of credit requires that you look ahead, plan ahead, and catch opportunities as they come to you.

The Future Belongs to Those Who Plan for It.

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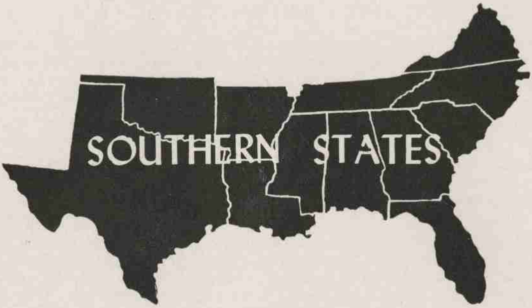

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