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NEW SOLUTIONS IN THE CREDITING PROCESS OF AGRICULTURE

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Abstract: In the introduction of this paper are showed the principal elements for analysis taken into consideration in the crediting process of agriculture. An excessive rigour in the analysis of these elements leads to a limitation of access to banking credits for agricultural farms. The method of this research is based to quantification of flexibility degree of banks granting credits to agricultural customers and finding new solutions in the crediting process of agriculture. It results that the totality of risk factors specific to any activity, including the agricultural farm, can be quantified. Starting with the analysis of risk factors and symptoms, this paper proposes new solutions for diminishing the degree of banks risks.

Key words: credit, risk, agriculture, quantification, flexibility.

1. INTRODUCTION

For a prosperous Europe, the European Union has as priorities sustainable rural development as well as agricultural development. These priorities are motivated by the fact that over 80% of the territory of the European Union is covered by rural areas populated by approximately 1/3 of population. In order to adapt the agriculture to the requirements for the development of rural areas, new financial resources for agriculture have to be found (Rizov, 2005). Besides non-reimbursable financial sources, bank loan should have an important position in the agricultural financing process (Osborne, 2006).

In current banking theory and practice the elements for analysis taken into consideration in the crediting process of agriculture are the following (Harangus, 2008):

- financial performance of the agricultural farms;
- level, structure and quality of the guarantees presented by the agricultural customer upon soliciting credit. East European banks prefer real estate guarantees (mortgage), which is difficult for the bank to assess and less agreed by the agricultural customer;
- amount of expenses necessary for production. The level of credit granted by the bank is established according to the level of such expenses;
- analysis and credit risk assessment for each customer applying the "principle of 5 C's" used in American banking system. The 5 C's represent character, capacity, capital, conditions, and collateral;
- ensuring good conditions for preservation, storing and valuing of agricultural production credited by the bank..

An excessive rigour in the analysis of these elements and lack of adequate banking consultancy and counseling of agricultural customers leads to a limitation of access to banking credits for agricultural farms. For this reason East European banks are considered to have a rigid system of agricultural crediting, based on a static analysis of agricultural activities. A dynamic analysis of the activity of agricultural farms is necessary as well as taking crediting decision by considering a context of internal and external factors which influence agricultural activity.

In the present context of European development the main target is the increase of banking credit for supporting agriculture and sustainable rural development as well as a rapid access to banking credits for agricultural customers (Kostov & Lingard, 2004).

2. RESEARCH AND METHOD

This study is based on information regarding present circumstances of crediting system for agriculture and regarding the sum of agricultural credits in the total volume of credits granted by banks.

The need for credits in agriculture is greater than in other sectors of economy because of the following reasons:

- biological laws governing production process in agriculture generate a much slower regeneration of funds and capital, unlike other areas of production, the need for credits being thus much higher;
- immobilization of funds in agriculture is higher than in other sectors and the capital of the farmers is not sufficient;
- land is expensive but necessary and it represents the main means for production. In the Eastern Europe, buying land represents an increased necessity for farm owners as family farms are much viable and favourable for competitive agriculture;
- agriculture ensures population's alimentary security and it conditions the development of rural space;
- agriculture uses natural agricultural potential of a country.

Despite of the fact that agriculture needs a greater amount of credits than other sectors, the analysis of information regarding evolution and amount of credits for agriculture shows that the amount of credits for agriculture is very small considering the total amount of credits granted by the European banks (between 2.4% and 6.8%), according to data presented in table 1.

In these conditions we consider that the crediting decision for agriculture should be much more flexible. The increased risk factors are specific for agriculture in comparison with other sectors of economy. These risk factors are emphasized by credit risks the banks have to cope with (Loubergé & Schlesinger, 2005).

Countries	Bank credits offered to agriculture	
	€ mill.	% of total credits
France	42,100	2.4
Germany	32,500	2.6
Hungary	1,167	6.8
Romania	677	2.5

Table 1. The level of bank credits for agriculture in some European states in 2006.

Source: Data from reports of National Banks from these countries: www.banque-france.fr; www.bundesbank.de; www.mnb.hu; www.bnr.ro, Statistical Section.

Taking into consideration increased risk in crediting agriculture, the decision of a bank to grant a credit has to consider risk factors and risk symptoms manifested in the activity of the agricultural customer. Risk factors specific for any activity refer to:

- overestimating the volume of business in comparison with existing possibilities (uncontrolled expansion);
- non-corresponding capital structure, i.e. large capital of non-current assets and small capital of current assets;

- non-corresponding capitalisation (very small reinvested capital);
- investment projects in execution, too large or too many.

When carrying out a financial and economic analysis for assessing risk factors, banks take into consideration the following risk symptoms that can appear in the activity of the customer soliciting credit:

- financial signals regarding delay of payments, increase of supplies, etc.;
- “creative” accountancy (presenting synthetic data, not justified by the analytical evidence, “arranging” some indices, etc.);
- non-financial signals regarding rejection because of non-corresponding quality, non-observance of contractual deadlines, etc.;
- other signals referring to: resignation of personnel, especially management resignation; court cases;
- unfavorable rumors about the customer, customer’s involvement in various financial or corruption scandals;

Considering the above mentioned reasons, we consider that quantification of flexibility degree of banks granting credits to agricultural customers and finding new solutions in the crediting process of agriculture are very important for this research.

The totality of risk factors specific to any activity, including the agricultural farm, can be quantified as follows:

$$\sum_{i=1}^4 Ri = Rb + Rs + Rc + Rp \quad (1)$$

where Rb represents the risk of overestimating the volume of business, Rs represents non-corresponding capital structure, i.e. large capital of non-current assets and small capital of current assets, Rc is non-corresponding capitalisation (very small reinvested capital), and Rp represents investment projects in execution, too large or too many.

If we grant a score from 1 to 15 for each risk factor (Rb , Rs , Rc , or Rp), it results that:

$$\sum_{i=1}^4 Ri \leq 60 \text{ points} \quad (2)$$

It results that the totality of possible risks (T) equals to 60 points, namely:

$$T = 60 \text{ points} \quad (3)$$

In banking practice the appearance of a single risk factor (Rb , Rs , Rc , or Rp) is enough to create the danger threshold (D) for the bank. Thus, the danger threshold for the bank is:

$$D = 15 \text{ points} \quad (4)$$

The difference between the totality of possible risks and danger threshold for the bank in granting credit represents the flexibility degree of the bank for credit granting, namely:

$$F = T - D \quad (5)$$

where F represents the flexibility degree in the crediting process, T represents the totality of possible risks, and D is the danger threshold regarding risk for the bank. It results that the flexibility degree of the crediting process (F) can have the following values:

$$15 \leq F \leq 60 \quad (6)$$

Considering the small amount of credits for agriculture in all the credits granted by banks, it results that the flexibility degree in granting credits for this sector is very low (close to 15

points). Under these circumstances, the access to credits for agriculture is much lower than in other economic sectors.

3. CONCLUSION

This theoretic quantification of the flexibility degree in granting credits that I propose, allows for banks to resize and estimate the degree of exigency in the crediting process of agriculture as well as a pertinent assessment of risks the banks face. It also allows for a more efficient management of credit risks.

In banking practice, regardless of credit level granted and risk degree, the bank requires ensuring guarantees to protect from risks. Guarantees requested by the bank (collateral), usually cover the maximum level of debt to the bank, namely the credit plus the interest until the reimbursement of first installment. Under these circumstances, it becomes evident that the lack of flexibility in the crediting process of agriculture is not completely justified. It can be motivated by the attitude of the banks that consider agriculture as a non-attractive sector implying great risks.

Moreover, in the crediting process of agriculture, the banks can find solutions to retrieve granted credits by making use of surrendering compensation rights obtained by the agricultural customer from the specialized insurance companies. These compensations can be obtained from the insurance companies if the agricultural production credited by the bank has previously been insured by the agricultural customer. The banks possess many instruments to protect themselves from risks generated by the agricultural credit. The small volume of credits for agriculture from the total volume of credits granted by European banks implies a revision of the crediting process of agriculture, as well as its greater flexibility.

The research described in this paper proposes to improve the methodology for the analysis of the credit risks by banks. The research will be continued by other studies with the same theme and by a summary contained in a book.

The topics will be placed in the working plan of the Center for Research of the Faculty of Economics, “Tibiscus” University of Timisoara, from the academic year 2008-2009. The results of the research are addressed in particular to the commercial banks that grant credits for agriculture sector.

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