

Ag Lender[®]

Profitable Lending to Agriculture



VOLUME 10, ISSUE 5
MAY 2006

Segmenting Today's Agricultural Borrowers: Anything but "Run of the Mill"

by Drs. Brian Briggeman and Michael Boehlje

IN THIS ISSUE

PORTFOLIO
page 4

KOHL'S CALL
page 5

**CALCULATING
RELATIONSHIP
PROFITABILITY: PART 15**
page 6

**HUNTING & RECREATION—
A VALUABLE SECOND
CROP**
page 7

**LARGEST 100 AG BANKS
RANKED BY AG LOAN**
page 8-9

LENDERS' LEGAL BRIEFS
page 11

**STRUCTURAL CHANGES IN
THE FARM SECTOR**
page 12

CREDIT PLANNER
page 14

Today's agricultural borrower is anything but *run of the mill*; farms differ in size, commodities produced, types of inputs used, etc. Often overlooked when characterizing a farm, is one important characteristic: the structure of the farm household itself. These characteristics are critical to understanding the customer base, segmenting the market, and tailoring different financial product and service offerings to different market segments. This series of articles will first identify a new typology or structure for segmenting farms. The financial characteristics of these different segments will be described, and then the discussion will turn to different financial products and services that might be targeted to the different segments. In this first article, we will focus on characterizing farm households based on household incomes and resources.

¹ *The U.S. Farm Household Typology is based on the 2003 Agricultural Resource Management Survey of U.S. farm households and was developed in Brian Briggeman's Ph.D. thesis.*

To aid in describing the diversity in a farm household's income stream, a new typology is necessary. This typology extends beyond the more commonplace segmentation of farms based on total sales; it considers the resources available to a farm household. The U.S. Farm Household Typology¹ is a classification system of today's farms that is based on a farm household's use of its capital and labor resources. This classification system consists of six groups:

- Single Income Ruralpolitan (SIR)
- Double Income Ruralpolitan (DIR)
- Active Seniors (AS)
- Farm Operator with Spouse Working Off Farm (FOSOFF)
- Traditional Farm (TRAD), and
- Commercial Farm (COM).

Figure 1 shows the average of the different income sources for each group in the U.S. Farm Household Typology. The income

(Continued on page 10) ►

PERIODICALS
POSTAGE
PAID

sources are household net farm income, off-farm wages for the operator and spouse, and other off-farm income which includes dividend earnings, interest earnings, social security, etc.

The Ruralpolitan Segments

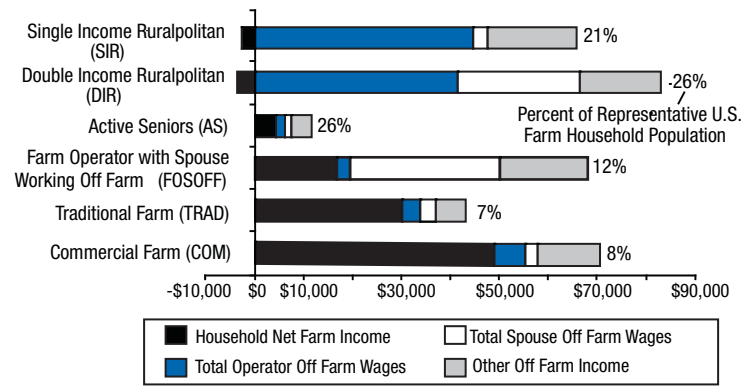
Ruralpolitans (SIR and DIR) are individuals who operate a farm but primarily work off the farm. Figure 1 shows that the average farm income for these two segments is negative, yet total household income is quite high for both segments. In the SIR segment, the operator primarily works off the farm, and the average SIR operator's off-farm wages is the highest among all segments. The DIR segment has the highest total household income among all categories, largely because the operator and spouse both work and earn wages off the farm. Since these two segments represent 47 percent of all farms, agricultural lenders cannot afford to overlook them just because they are not the "traditional" farm (i.e. operator and/or spouse primarily work on the farm).

Ruralpolitan households are a substantial and potentially profitable customer segment for lenders. For example, a ruralpolitan household may be professionals who chose a rural lifestyle. These households are of special interest to agricultural lenders for multiple reasons. One reason is the need for not just a loan, but also management assistance concerning the entire farming operation. Here, the lender's agricultural expertise may be the competitive advantage that will get the business. Loan repayment is secured by the stable income stream from off farm sources. Another opportunity with these customers is the need for credit to purchase and improve the rural homestead. Many of these customers also need smaller scale modern equipment and livestock facilities for their farming or recreational activities. With the increasing trend of families moving from the city to the countryside, the ruralpolitan segments clearly cannot be overlooked or ignored.

Mature Farmers

The AS segment constitutes 26 percent of all U.S. farm households, making it a large group of potential customers. This segment is the oldest group of the typology. Yet, nearly 50 percent of their total household income is earned on the farm.

FIGURE 1. INCOME SOURCES FOR THE U.S. FARM HOUSEHOLD TYPOLOGY.



Although most of these farm households are not actively seeking credit, they may be the "gatekeepers" to potential customers. Some of these operators have a second generation decision-maker working on the farm. Developing a relationship with the AS group might open the gate to this younger generation and a prosperous relationship for both parties. This segment also may likely need deposit and retirement and asset management financial services.

Farmer Businessmen

The last segments (FOSOFF, TRAD, COM) have a larger amount of resources allocated to the farm business, compared to the other categories. In general, these segments have a larger commitment to the farm and are trying to get the highest return out of their farm operation. This is evident from the fact that these segments have the highest household net farm income relative to all other categories.

A particularly interesting group is the FOSOFF segments which represent 12 percent of farms. The operator in this segment primarily works on the farm, but the spouse is working off the farm. This segment is similar to the ruralpolitan segments because 73 percent of total household income comes from off-farm sources. Although these customers may not need agricultural expertise, the off-farm income causes these farm households to not be as affected by fluctuations in farm income. For this reason, this segment includes a large number of profitable, low risk, and long term customers.

The TRAD segment has both the operator and spouse working on the farm. The COM segment only has the operator working on the farm. This segment has the largest value of farm assets. These two

segments have more than half of their total household income coming from farming. Also, they are the primary producers of agricultural commodities in the U.S. Farm Household Typology. The TRAD and COM segments are the typical agricultural borrowers; however they only make up 15 percent of the farms. Even though they are the smallest segment in terms of number of customers, they devote a substantial amount of resources to agriculture and have the largest amount of agricultural loan volume.

Where To From Here?

A new typology of characterizing U.S. farm household customer segments and their income characteristics has been identified. Only 27 percent of the two million farmers in the U.S. are in the farmer-businessmen segments. The ruralpolitan segments are of special interest given their desire to be involved in agriculture and their substantial and stable household income. The next article will discuss the investment decisions and additional financial characteristics of agricultural borrowers within the context of the U.S. Farm Household Typology. Subsequent articles in this series will discuss the various financial products and services that might be targeted to these different customer segments and the profit potential and risks of doing so. ♦

Brian Briggeman is an Assistant Professor in the Department of Agricultural Economics at Oklahoma State Univ. He can be reached at 405-744-6171 or brian.briggeman@okstate.edu.

Michael Boehlje is a Professor in the Department of Agricultural Economics at Purdue Univ. He can be reached at 765-494-4222 or boehljem@purdue.edu.