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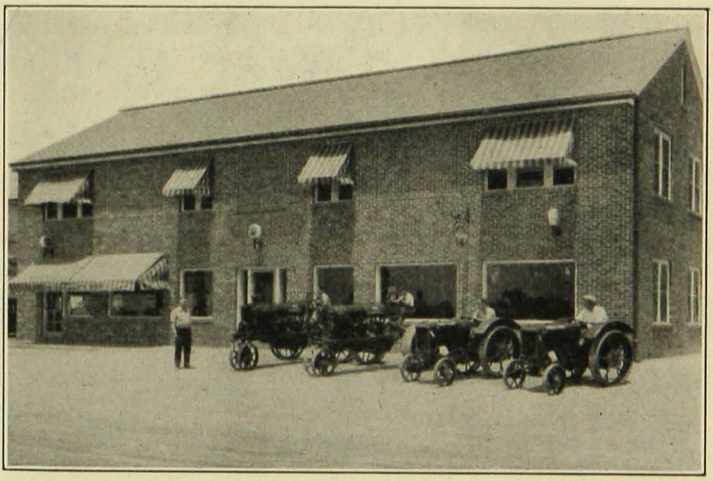

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USE OF MERCHANT CREDIT BY FARMERS

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Credit is used to a great extent in the operation of farms, and part of this credit is provided by merchants. Farmers often purchase tractors, trucks, autos, farm machinery, farm supplies, and household articles on credit extended by the merchants. In providing this credit merchants and dealers are of distinct service to farmers. However, the survey reported in this bulletin shows merchant credit usually is more expensive than credit obtained from credit institutions such as local banks and production credit associations, and farmers who can borrow from these institutions may find it advantageous to do so and pay merchants cash for goods purchased.

Credit Sales by Merchants

To obtain facts about the use of merchant credit by farmers a survey was made in August and September 1935 among merchants, farm implement dealers, farmers, and banks in southwestern Minnesota. Included in this survey were 30 general stores, 16 hardware stores, 11 lumber dealers, 9 furniture stores, and 9 cooperative elevators selling supplies to farmers. Their total sales and credit sales to farmers during eight months of 1935 are given in Table 1.

Table 1.—Total Sales and Credit Sales to Farmers during Eight Months, January through August 1935, by Merchants in Southwestern Minnesota

Type of merchant	Average sales per store to farmers		Average sales to farmers per month		Per cent credit sales to farmers
	Total sales	Credit sales	Total sales	Credit sales	
General	$38,337	$4,414	$4,792	$ 552	11.5
Hardware	21,531	8,613	2,691	1,077	40.0
Lumber	14,300	8,526	1,788	1,066	59.6
Furniture	11,344	2,364	1,418	296	20.8
Cooperative elevator	19,555	3,879	2,444	485	19.8

Practically all credit sales to farmers by general stores, lumber dealers, and cooperative elevators were on open account. General stores classified 64.4 per cent of their credit sales to farmers as open accounts payable in 30 days, and 34.3 per cent as open accounts which run for more than one month and average about four months. Hardware and furniture stores grant a smaller share of credit on open account and a larger share on the basis of secured notes. Since heavy items of hardware and furniture are durable goods, they may be used as security for credit granted the customers and many of these articles are sold on installment payment contracts. Thus 35.6 per cent of the credit extended to farmers by hardware stores and 56.6 per cent of that extended by furniture stores was based on conditional sales contracts or notes secured by chattel mortgages on the goods purchased.

Price discounts to customers for payment in cash were given by 3 of 30 general stores, 5 of the 11 hardware stores, 2 of 11 lumber dealers, 7 of 9 furniture stores, and 5 of the 9 cooperative elevators included in the survey. In view of the fact that the granting of credit usually means added costs, including additional record keeping, collection expense, interest costs, and losses on bad accounts, the merchant must ordinarily charge more for goods if he sells on credit than if he operates on a cash basis. If the merchant gives no discounts for cash, the cash customer really pays part of the cost of providing credit service for credit customers. Discounts for cash will encourage customers to pay at the time of purchase. Country merchants indicated that they preferred to sell goods for cash and thereby avoid the expense and risks incidental to credit sales.

Credit Sales by Implement Dealers

Dealers in farm implements and automobiles also sell a large amount of goods to farmers on credit. Farm implement dealers usually sell tractors along with the general farm machinery line, and many sell automobiles and trucks. In the survey in southwestern Minnesota, 57 farm implement dealers were interviewed and asked to supply figures on their sales to farmers during the period January to September 1935. Their total sales and sales on credit are summarized in Table 2.

Table 2.—Total Sales and Credit Sales to Farmers by Implement Dealers in Southwestern Minnesota for Period January to September 1935

	Average sales per dealer handling the unit	Amount of credit in dollars	Percentage of dollar sales on credit
Tractors	$15,331	$ 7,726	50.4
Autos and trucks	21,463	12,820	59.7
General farm machinery	14,821	5,242	35.4

In the sale of tractors, automobiles, and trucks on credit, some cash payment is demanded and therefore the amount of credit in dollars as a percentage of total sales is less than the percentage of tractor and auto units sold on credit. Fifty of the 57 implement dealers handled tractors and sold 911 during the period covered by the survey, and 94 per cent of these tractors were sold on credit. Automobiles and trucks were handled by 15 of the 57 implement dealers, and their sales totaled 447 units of which 73.3 per cent were sold on credit.

In selling tractors on credit dealers usually required a cash payment of not less than one-third the purchase price. The tractors were sold on a conditional sales contract, the balance to be paid usually over a period of 18 months. Generally the payments were made in three installments, and the notes were drawn accordingly. The rate of interest on notes reported by dealers varied from 6 to 7 per cent plus a finance charge of 5 per cent on all payments running longer than 12 months on 18-month contracts. If, for any reason, the contract was drawn with payments running longer than 18 months such payments were subject to a finance charge of 7 per cent. These finance charges tend to encourage the farmer to pay for the tractor as soon as possible. Dealers generally reported that they allowed a discount of 5 per cent on the selling price of the tractor if the farmer paid cash. In purchasing a tractor on credit, therefore, the farmer foregoes a discount of 5 per cent, which would mean a material saving on so high-priced an implement.

In the sale of the general line of farm machinery credit does not play as important a part as with tractors. Dealers reported that they ordinarily required a cash payment equal to at least 50 per cent of the purchase price of the general farm machinery. The machinery is sold on a conditional sales contract with a note for the balance usually drawn for six months with 7 or 8 per cent interest payable at maturity. There were no finance charges in the sale of the general line of farm implements, but it was common practice to allow a price discount of 5 per cent for cash. On repairs and supplies most sales were for cash without discounts.

Installment Credit

Much of the financing of the purchase of automobiles and trucks falls in the class of installment credit which is quite expensive. To illustrate an installment credit contract used in 1935 when this survey was made, the following is given:

Sale price of automobile	$622.00
Down payment	207.00
Balance unpaid	415.00
Carrying charge	59.84
Terms $39.57 per month for 12 months—Total	474.84

The carrying charge of $59.84 included a payment for insurance against loss from fire and theft during the period of the contract which on the basis of current rates was calculated to be $15.55. This amount deducted from $59.84 left a net carrying charge of $44.29. In reality the purchaser of the automobile under the above contract was obtaining funds on credit equal to $415.00, the unpaid balance, plus prepaid insurance of $15.55, or a total of $430.55, and paying $44.29 for this credit. However, the contract was paid in 12 monthly payments of equal amount, and therefore the average principal outstanding for 12 months was one-half of $430.55 or $215.28. In other words, the purchaser paid

$44.29 for a loan averaging $215.28 for a period of 12 months, and $44.29 ÷ $215.28 gives an annual interest rate of 20.5 per cent.

Installment credit costs may change from time to time depending on the contracts used. Since 1935 there has been a marked decline in the costs of installment credit to purchasers of automobiles. During 1936 the usual plan has been to charge 6 per cent interest in advance on the unpaid balance, and have the debt paid in equal monthly installments over a period of 12 months. However, the interest rate is actually about 12 per cent instead of 6 per cent. For example, on a note of $500 the purchaser pays interest at 6 per cent or $30 for the period, but since payments are made monthly the average amount outstanding during the period is only $250.

Furniture and other household goods are sold extensively on installment payment plans. The types of installment contracts differ, and therefore there is a wide range in the cost of such credit. Purchasers of goods on installment credit will find it advisable to figure the costs as such credit may be very expensive. The following is an illustration of a high-cost plan used by a furniture store. It is not necessarily a typical contract used by many dealers but serves as an illustration of high-cost installment credit.

Sale price of furniture	$100.00
Down payment required, 10 per cent	10.00
Balance unpaid	90.00
Finance charge, 8 per cent	7.20
Terms $8.10 per month for 12 months—Total	97.20

The furniture was sold on a conditional sales contract with a finance charge of $7.20 on credit of $90. The furniture was paid for in 12 equal monthly installments, and therefore the average amount outstanding for the 12-month period was $45. For this $45 advance the purchaser paid $7.20, making a rate of 16 per cent. In this case the dealer would have allowed a 5 per cent price discount for full payment in cash. Thus the credit purchaser had to pay $5 more for the goods plus the $7.20 interest, a total difference of $12.20, which is a rate of 27.1 per cent.

Because the costs of obtaining credit on installment contracts may be high, farmers may find it advisable either to delay purchasing until they can pay cash or to obtain credit from other sources. Many individuals are in a position to borrow from local banks or production credit associations and pay cash for goods, thereby making a saving in interest.

Survey of Farmers Using Credit

A survey was made to study the financial position of 87 farmers in southwestern Minnesota who purchased tractors in 1935. Of these farmers, 47 were tenants and 40 were owners or part owners. While most of the farmers obtained credit from dealers in purchasing their tractors, a fairly large number paid cash without borrowing or obtained credit from other sources. Of the 40 farmers who owned farms, 12 paid cash for tractors without borrowing, 5 obtained credit from other sources, and 23 borrowed from implement dealers. Similarly, 9 out of 47 tenants paid cash without borrowing, 7 borrowed from other sources, and 31 received credit from implement dealers. Most of the farmers paying cash for the tractor without borrowing were in stronger financial condition than those purchasing the tractors on credit. Thus, 7 out of 12 owners and 8 out of 9 tenants paying cash for tractors had liabilities totaling less than 26 per cent of total assets. The financial position of farmers obtaining credit from other sources was favorable on the whole but not as favorable as the group paying cash for their tractors. Among the group of farmers receiving credit from dealers we find more in a weaker financial condition as indicated by the fact that 15 of the 23 owners and 9 of the 31 tenants who received credit from implement dealers showed liabilities amounting to more than 50 per cent of the value of their assets.

Might a number of the farmers who secured credit from implement dealers have obtained credit from other sources and taken advantage of the usual five per cent discount for full payment in cash? To throw light on this question, an analysis was made of the financial position of the farmers who obtained credit from implement dealers. In this analysis major consideration was given to the ratio of liabilities to assets, net earnings of the farmer, security available for the loan, and moral risk. Only farmers with a favorable rating in all factors were classed as satisfactory risks for a local bank or production credit association. Thus it was estimated that of 31 tenants who had obtained credit from dealers for the purchase of tractors, 12, or 39 per cent, were apparently satisfactory risks for other credit agencies, and of 23 owners, 10, or 43 per cent, were satisfactory risks. In other words, among these 54 farmers, 22, or 41 per cent, were probably in a position to obtain loans from other agencies and make a material saving by taking advantage of discounts for cash in the purchase of tractors or other farm machinery.

Other Sources of Short-Term Credit

Local banks, production credit associations, and private credit corporations are important sources of short-term credit for farmers. In September 1935 a survey of 37 local banks in southwestern Minnesota was made to obtain information on loans to farmers. The loans to farmers outstanding per bank averaged $154,886 of which 64.7 per cent was secured by chattel mortgages on livestock and equipment, 19.6 per cent by personal notes only, 11.1 per cent by real estate mortgages, and 4.6 per cent by other security. Fifteen banks reported an average rate of interest of 7 per cent and 22 banks an average rate of 8 per cent on short-term agricultural loans to farmers. Production credit associations are cooperative loan associations established under provisions of the Farm Credit Act of 1933 to provide short-term credit to farmers. Their loans are limited to agricultural purposes and are usually secured by chattel mortgages on livestock, equipment or crops. The rate of interest has been 5 per cent and the borrower also has paid a fee of approximately 1 per cent to cover costs of inspection. Farmers borrowing from production credit associations must hold class B voting stock in the association in an amount equal to $5 for every $100 or fraction thereof which he borrows.

Conclusions

Local merchants are an important source of short-term credit for farmers. For many farmers a credit account with a local merchant is a great convenience, enabling them to purchase goods at the time they are needed and paying monthly or within a short period of time when income is available. While many farmers use merchant credit only as a convenient method of purchasing and paying for goods, others depend upon merchants to provide a large share of the credit needed for the purchase of supplies and equipment. Included in the latter class are some farmers who are in a comparatively weak financial position and therefore ineligible for loans from regular credit institutions. The merchant may be their only source of credit.

The cost of merchant credit to farmers is generally higher than credit from other sources. The main reason for this is that the merchants may grant credit to individuals that are poor credit risks and therefore they take losses from bad accounts. Also, merchants in granting credit assume costs of accounting and costs of collecting. The result is that merchants must ordinarily take wider margins and charge higher prices if they sell goods on credit.

The cost of merchant credit to farmers is often higher than users recognize. This is particularly true in the case of installment credit. Not only is installment credit expensive, but the opportunity to purchase goods with only a small down payment, the balance to be paid in installments, may result in unwise purchases. Generally speaking, it is wise to postpone the purchase of consumption goods until savings are available or until credit can be obtained from other sources.

Farmers using credit will find it advantageous to use the sources which provide credit at lowest cost. Implement dealers make a practice of offering discounts for cash in the sale of farm machinery including tractors. Many hardware and furniture stores also give discounts for cash. Therefore, there is an opportunity for the farmers to make a saving by paying cash for goods. Many farmers using merchant credit are in a position to borrow from local banks or production credit associations at favorable rates and will find it advantageous to do so and will benefit by cash discounts. Other farmers by thrift and careful planning of the farm business should be able to improve their financial position and become eligible for credit from the lower-cost agencies.

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