USE OF MERCHANT AND DEALER CREDIT ON NEW YORK DAIRY FARMS

By

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USE OF MERCHANT AND DEALER CREDIT ON NEW YORK DAIRY FARMS*

1. Merchant and dealer credit is an important source of short-term credit to New York farmers.

2. Operating credit is extended to dairymen for feed, fertilizer, fuel, seed, supplies, veterinary services, artificial insemination, machinery, structures and livestock.

3. A study of farmer's and dealer's experiences of point-of-sale credit was conducted in the summer of 1977. Information was obtained from 80 New York dairy farms and 56 dealers by the personal interview method. The purpose of the study was to:

    a. To determine the amounts and characteristics of dealer credit used by New York dairy farmers.

    b. To gain a more accurate view of dealer credit so as to improve the overall credit management of farmers and dealers.

    c. To develop recommendations and guidelines to assist farmers in managing their credit more effectively.

4. Table 1 illustrates the uses made by the 80 farmers surveyed of extended open accounts. A large number of uses of dealer credit were made for feed, fertilizer, fuel, along with services for veterinary and repair work. Credit for services provided by the insemination and the purchase of dairy supplies were used infrequently by the dairymen surveyed.

5. Table 2 shows the use of short and intermediate term merchant and dealer credit by farmers for machinery, livestock, and structures.

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Table 1. EXTENDED OPEN ACCOUNTS WITH MERCHANTS AND DEALERS
80 New York State Dairy Farms, 1976

Dealer classification	No credit	Average yearly credit outstanding: Less than $500	$500 to $999	$1,000 to $2,499	$2,500 to $4,999	$5,000 to $9,999	$10,000 and over
		Percent of farms reporting					
Feed	15	13	11	21	16	8	16
Fertilizer, seed, spray, etc.	41	4	16	15	14	9	1
Machinery repair & parts	46	27	14	11	2	0	0
Fuel for farm use	55	26	13	6	0	0	0
Dairy supplies	84	16	0	0	0	0	0
Veterinary	55	34	9	2	0	0	0
Inseminator	76	24	0	0	0	0	0

* An extended open account for this study was defined as an account with the dealer for more than 30 days or after nonpayment of the account after the first billing.

Table 2. SHORT AND INTERMEDIATE TERM CREDIT WITH MERCHANTS AND DEALERS
80 New York State Dairy Farms, 1976

Dealer classification	No credit	Average yearly credit outstanding: Less than $500	$500 to $999	$1,000 to $2,499	$2,500 to $9,999	$10,000 to $19,999	$20,000 and over
		Percent of farms reporting					
Machinery	64	4	6	9	9	4	4
Livestock	83	3	3	5	6	0	0
Structures	87	0	1	3	5	0	4

6. Good financial management is an important aspect in the successful management of any farm business. An important part of this financial management is the proper use of credit extended by dealers.

7. Examples #1, #2, #3 illustrate some ways in which farmers can manage their credit more effectively.

8. Suggestions on how to more effectively manage dealer credit and dealer terms:

    a. Take advantage of discounts

    b. Use a source of financing to meet short term operating needs

    c. Consider alternative financial plans for intermediate credit needs

    d. Place more emphasis on cash flow planning

    e. Use a record keeping system

    f. Consolidate debt

Publications

A. E. Ext. 79-1 Use of Merchant and Dealer Credit on New York Dairy Farms, by David M. Kohl, George J. Conneman, and Robert S. Smith

A. E. Ext. 79-2 Merchant and Dealer Credit Policies and Practices, by David M. Kohl, George J. Conneman, and Robert S. Smith

A. E. Ext. 79-3 Guidelines for Improving the Credit of Management of Agribusiness Firms, by David M. Kohl, George J. Conneman, and Robert S. Smith

EXAMPLE #1: Savings by Taking Advantage of Discounts

A dairyman purchases $2,000 of feed per month. His opportunity cost or cost of borrowed capital is 10 percent. Dealer cash discounts are as follows:

Dealer A	2 percent 10 days, net 30 days
Dealer B	2 percent 30 days, net 60 days
Dealer C	4 percent 10 days, net 30 days

The annual rate of interest on money invested in discounts is as follows:*

Dealer A	37.2 percent per annum
Dealer B	24.8 percent per annum
Dealer C	76.0 percent per annum

Therefore a farmer should discount the invoice with Dealer A if his cost of capital is less than 37.2 percent annual. If his cost of capital is 10% (assumed in the example) his net return on money invested to take discounts would be approximately 27 percent annually.

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* $I = \frac{D}{(G-D)\ (T/365)}$ where I = annual (effective) rate of interest on capital invested

D = total amount of discount

G = gross amount of invoice

T = time difference between discount and net pay dates

EXAMPLE #2: Savings by Using Alternative Source of Financing for Short Term Operating Needs

A dairy farmer will need up to $20,000 worth of credit during the year to meet seasonal and operating needs. His three sources of operating credit are:

Dealer One	18% annual charge assessed 30 days following purchase
Dealer Two	12% annual charge assessed 30 days following purchase
Lending Institution	9% annual finance charge for operating loan

COST COMPARISONS FOR SHORT TERM OPERATING NEEDS
Merchants & Dealers vs. Institutional Source

Schedule of operating credit needs		Monthly cost of credit to the farmer considering basic assumptions		
Month	Amount	Dealer One	Dealer Two	Lending Institution
January	-	-	-	-
February	-	-	-	-
March	-	-	-	-
April	*	*	*	*
May	$ 6,000	$ 90	$ 60	$ 45
June	13,000	195	130	98
July	19,000	285	190	142
August	20,000	300	200	150
September	16,000	240	160	120
October	8,000	120	80	60
November	4,000	60	40	30
December	2,000	30	20	15
January 1	0	-	-	-
TOTAL INTEREST COST		$1,320	$880	$660

* Purchases are made at dealers but interest not charged until 30 days after purchase.

EXAMPLE #3: Savings by Using Institutional Financing Sources for Intermediate Credit Needs

After a farmer makes a down payment for a tractor, the balance of $20,000 will be financed over a five year period. The table shows the total cost of financing and the savings obtained by financing a loan through an institutional source as compared to a machinery supplier with the assumed annual interest charge.

LOAN COST COMPARISON FOR A $20,000 TRACTOR
FINANCED OVER A FIVE YEAR PERIOD
Machinery Supplier vs. Institutional Source

Method of financing	Charge for annual credit	Total loan repayment cost	Excess cost over institutional loan
Lending institution	9%	$24,910	-
Machinery supplier #1	14%	27,922	+ $3,012
Machinery supplier #2	16%	29,182	+ 4,272
Machinery supplier #3	17%	29,824	+ 4,914