How to make grain-markets work for producers

We were motivated to embark on this initiative in the belief that the Prairie grain-economy was in trouble and needed to reinvent itself: a reality we saw based on our previous experience in this domain and having observed it for two decades from overseas. Despite all the technological advancement, yield increases, and export growth, the grain-economy was not living up to its potential and was under threat from global competition.

We are unabashed producer-advocates and believe that they are not getting a fair shake in overseas export-trades. We had supported liberalization and privatization efforts, but in many ways, they were carried out in a rush through asset-sales with no regard for industry-structure or market-competition. This left our overseas grain-exports in a bulk-warp, in the hands of a handful of grain-companies with too much market-power, squeezing producer-margins and limiting crop-diversification.

In this article, we touch on many of the topics we discussed before but with a slightly different twist – how to make grain-markets work better in the interests of our core constituency, producers. We start with the observation that North American grain markets, where we sell about half our output, work more competitively. There are traders, consolidators, and wholesalers, but direct-sales to corporate-buyers exert enough pressure to keep markets in check for producers to get fair-margins.

In overseas export-sales, grain-traders drive their market-power from the control they have over bulk-systems, limiting not only producer-margins but also their crop-choices to trades more suitable to bulk-handling. Unless a shift is made, our bulk-trades will come under more pressure from low-cost emerging grain-regions – which many seem to be in denial of – producers will feel the margin-squeeze even more, perhaps even threatening their very viability to continue to produce the same crops.

With half our grain-output moving to overseas markets under these precarious conditions, at least from producers' perspective, we need a *paradigm shift*, nothing radical but one more in line with the healthier market conditions we observe in North America, with more market discipline exerted through corporate-buyers. This shift has three dimensions – diversification, containerization, and direct-sales. These are common themes of many of our articles, but here we come back to them again.

The shift we call for is not radical, but it will not come without a concerted effort. We may not realize it, but our global reputation is built on grain-terminals and bulk-shipping, with little mention of crop-varieties and their special-attributes that stem from the virtues of our advanced-farms and their production-capacity. We will come back to this challenge, what we call recasting our global image, together with all the end-market research requirements in our next article, but here we will focus on market-fundamentals – what will bring the *paradigm shift* we are calling for.

Competitive grain-markets in North America

We keep talking about lack of alternative channels to bulk, but always with a qualifier, in overseas markets; in our own backyard the situation is very different. What we consume domestically plus cross-border sales to the US make up about half of our grain production. As most other sectors, grain-markets across North America are highly integrated and function quite competitively though multiple-channels.

A significant share of grain output is consolidated in the hands of grain-companies or distributed through wholesale channels, depending on industry or supply-chain structures in end markets or the handling and processing requirements of the grains being sold. But direct-sales, producers to end-users, are equally significant, a critical factor that makes markets function competitively to protect producer-interests.

At the receiving end of these direct-sales across North America are mostly corporate buyers – flour-millers, food-processors, crushing-plants, feed-producers, or other end-users. The larger ones have their grain-procurement programs that reach out to multiple producers in their vicinity or even more distant grain-producing regions to buy the crops they need in quantities they require. Naturally, they have their quality or grade standards, and compete in the marketplace to procure what they need, pay pre-negotiated contract-prices or prevailing market prices, or some combination of both – a contract-base with agreed upon market-adjustments, premium or discount.

However, not all mills, processors, or other end-buyers are equipped to set up their own multi-source procurement systems. Either they are too small and do not want to rely on too few sources, or their grain-needs are too diverse to contemplate this model. For these buyers, alternative sales-channels tend to form, which can be clustered in two groups. First, wherever there are grains for sale, there are always speculative or opportunistic traders that emerge. Second, market conditions give rise to *bona fide* consolidators that cater to the needs of those buyers that are too small to source directly. Markets can function without the first but not the second.

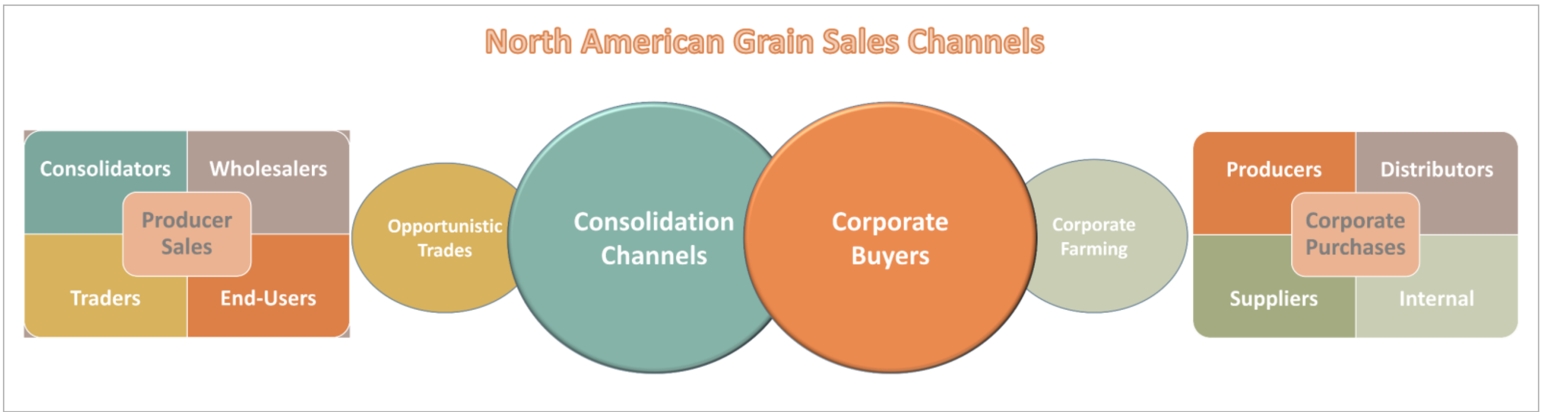
As long as there are prospects of direct-sales, we do not have to worry about producer interests being undermined by market forces. There may be much fewer buyers than sellers, but as long as there are multiple buyers to compete for the same crops, producers can be assured of their fair share of margins along grain supply-chains. If there are too few buyers of certain crops with too much market power, producers can switch to other crops, which is a blessing in our region with such a diverse crop-base. Even if there was undue concentration in any one crop segment, wise buyers would know the dangers they would be facing if they were underpaying.

In this context, we would be amiss not to mention corporate farming as an often-feared threat to producer-interests. If this trend were to take hold, essentially many of today's major grain buyers would be growing their own crops, limiting sales prospects for producers – taken to the extreme, not just limiting sales but wiping out grain markets altogether. There is more evidence of this in the US than in Canada, and we tend to believe that we could be facing the same threat if it was not for our laws or regulations standing in the way. In fact, we have little protection per se, but we can take comfort in the fact that this is not a real danger to be worried about.

Corporate farming is not a new threat; it goes back to the 19th century in the US. An often-cited case is our own Hudson's Bay Company trying its hand in Washington but eventually pulling out, a rare defeat to the brutal colonial trader. History tells us that there will always be pockets of it, and over time spurts of revival, like recently even across our Prairies, but corporate farming is not a threat to family-farming traditions. Lately we are seeing consolidation, which is in part due to scale-economies, but not a sign of inevitable corporatization. Where scale comes into play, mainly in technology applications, a bit of cooperation among neighbors can always rise to the challenge.

At times we tend to be critical of the production-base of our grain-economy, but its core-strength, drawn from family-farming traditions, is alive and well, though we may have to get used to larger farms and cooperation among smaller ones. Also, the broader primary-production sphere is as strong as we can hope for. Producers have access to world-class research-capacity in agronomy, the best farm-supply sources, latest equipment, and info-tech applications. We have a strong institutional base through grain commissions or associations to fend for producer interests; if they do not, it is up to producers to get more involved for stronger representation.

Moving from production to the trading sphere, we have competitive markets functioning to protect producer-interests, at least across North America where about half our grain-output is destined to. Producers have market access through direct-sales channels that function competitively and impose the same discipline on other channels through consolidators or other intermediaries. There is little reason to worry about producers being gauged by corporate interests in North America. But when it comes to accessing overseas export-markets, where the other half of our grain-output is destined, we cannot be as sanguine about market conditions.



Captivity of overseas exports to bulk-trades

What makes North American markets competitive is the preponderance of direct-sales between buyers and sellers. Producers make crop-choices based on best prices they can get from end-users, mainly corporate buyers. There are grain-companies playing consolidation or wholesale functions, but they must compete with prices that prevail through direct-sales channels. This competitive dynamic ensures that producers get best possible prices and make their crop-choices accordingly.

There are no barriers for trading parties to connect directly. Buyers have visibility into production sources and can reach them directly to enter purchase-contracts; if necessary, they have access to those sources to conduct further due diligence. Also, there are no cultural or language barriers to business relations between them. All grain regions have the service-capacity to clean, grade, or further process grains to buyer-specifications, while most deliveries can be made directly by truck or rail.

If market conditions favor producer interests, the obvious question is why we do not stick to North American markets instead of worrying about exporting to overseas markets. The answer is equally obvious: North American markets are mature with limited growth potential, while we produce twice as much as they can absorb. Thus, we must either dramatically cut back on production, which would not be palatable to anyone, or try to pursue overseas markets through similar channels and on equally favorable terms as across North America – *precisely what our mission is all about.*

In contrast to multi-channel North American markets, overseas exports are mostly in bulk, with several drawbacks for producers. First, large grain-companies, custodians of bulk-systems, have too much market power. They entice producers to grow crops that suit their trading interests at low prices by offering secure, reliable, and even advance payments. In the absence of alternative export channels, producers have little choice but accept the terms, leaving behind precariously low margins to subsist – *thus, the captivity to bulk-trades that we are determined to free producers from*.

Second, bulk-trades limit diversification to higher-value crop grades or varieties. Our bulk-systems are well compartmentalized, but compared to containerized-IP loads, there are limits to the varieties and grades that can be handled in bulk. While bulk-traders claim that the variety is dictated by global demand, it is evident that they are driven by volume rather than variety. The key to value-driven diversification in global grain markets is containerization, which our bulk-traders have little interest in – *thus, producers are denied a chance to shift to higher value specialty crop exports*.

Third, bulk-systems date back to the single-desk export era, when transport costs were indeed much lower in bulk than containerized intermodal shipments. Through privatization, the new owners became invested in a highly capital-intensive system, which they now are driven to utilize as much as possible to generate returns on their investment. As a result, they are motivated to do everything in their power to sustain the captivity of our grain exports to bulk, including hindering containerization – *thus, our exporters are denied of higher margins, and importers of cost savings*.

Fourth, the type of crops that lend themselves to consolidation and bulk-trading are under increasing pressure from emerging grain-regions that have lower production costs than we do. Our more advanced and high-cost producers are incentivized by bulk-traders to continue to grow the same crop varieties that we may no longer be competitive to sell into global markets. Our grain-companies seem to be in denial, but even our traditional exports are in jeopardy, in fact already declining in volume – *thus, producers must face up to this reality and diversify through other channels*.

We acknowledge that grain-companies, despite their stronghold on bulk-exports, are price-takers from global markets. In the absence of alternative channels, however, they hold considerable market-power over producers, not just over purchasing-prices but also crop-choices, discouraging producers from crops that do not lend themselves to bulk-handling. But oblivious to realities, grain-companies seem to expect the world around them to change instead of adjusting their own practices.

It is generally assumed that global price pressures can be absorbed by producers, but there are limits to how much producer-margins can be squeezed; at some point low-price crops cease to be viable to produce in Canada. Even our principal export-crop, wheat, is under pressure; even high-grade varieties are now available from Eurasian sources at lower prices. In this case, we can go even further up the grade or quality scale, but like all specialty-crops, these types of wheat require containerization.

There is a false sense of security in our grain-economy: we have always been on top of the grain-world and that we cannot be displaced, a comfort that is reinforced by the advances we see in our production capacity. But we stand by our moto, and what may sound like a slogan is meant as a serious warning – *specialize or perish*. If our grain-companies do not wake up to competitive realities in global markets, our producers must shoulder the burden of the *paradigm shift* we are calling for – wean off their dependence on bulk-trades, embrace diversification and containerization.

Elements of a hopeful paradigm-shift

We are calling for a paradigm-shift in overseas export markets, but despite the radical sound of it, what we are calling for is not much different than the model that is already in place across North America and works in producer-interests. Perhaps the only substitution is "containers" instead of direct truck or rail shipments, as in this case there are oceans involved. The basic model has three basic elements:

Diversification: If producers are afraid of change, we would remind them of what they have already gone through. Most of what they exported was wheat and barley, and heavily weighted towards the former. To escape the CWB-monopoly, many of them saw virtue in canola, shifting to it in search of higher margins but not entirely, just as a rotational alternative to wheat. Then came the pulse-revolution with a much higher value-proposition, but still in single-digit share of our export-volumes.

Even after all this diversification, two crops still account for 75% of exports, wheat 50% and canola 25%. This was a huge improvement, a much healthier mix than what our neighbor to the south, US, must contend with, 3 bulk crops (corn, soybean, and wheat) accounting for 90% of its grain-exports, all in bulk. Still, our bulk-exports are in jeopardy with increasing competition from low-cost emerging grain-regions, particularly canola which we are too exposed to, with a 65% global market share.

What we are calling for is further value-driven diversification, to make our export-portfolio much less vulnerable from a high-cost production-base. Decline in canola-exports is inevitable, but in wheat we can not only retain but increase exports with more grades or varieties in the mix. We have huge growth potential in pulses, as well as oil-seeds like soybean, and coarse grains like oats, whether for feed or food uses. There are many other specialty crops that we grow but export little of.

Containerization: Still living in a bulk-warp, we have not quite grasped the benefits that come with containerization. Believing that this is still an expensive means of transport, we do not realize the efficiency improvements that have been achieved in intermodal systems, not to mention benefits of smaller but more frequent deliveries that reduce storage or stocking costs at destination. While we stick to bulk-systems, grain-trades within the EU and across to Asia are already largely containerized.

We may have the best classification-systems and compartmentalized bulk-systems, but shipments do not end until final delivery – how can we ensure product integrity at the receiving end? We do not realize the extent of quality differentiation and preservation that can be achieved through containerized grain-export deliveries. We may have full trust in our bulk-systems but cannot convince buyers that specialty-crops they pay a premium for can be IP-delivered in any other way than containers.

We can relate to producers' ambivalence to containerized grain shipments from the Prairies after decades of struggling to get empty containers. But after working on numerous intermodal projects in Asia, dozens of both inland and coastal terminals, we have difficulty relating to these concerns. They are either misguided or myths propagated by industry lobbies, both railways and bulk-traders with vested interests. We see no difficulty in pulling containers inland by working with the shipping-lines to properly plan and manage container-flows, as done in most parts of the world.

Direct-sales: Earlier we noted the abundance of direct-sales channels in North American grain-markets, and their virtues in protecting producer interests. Only if corporate-buyers can reach out to production-sources to procure what they need, and get them shipped directly, grain-markets work effectively to satisfy the interests of both parties to trade-transactions at fair prices and terms. The challenge is to establish similar channels to overseas markets to reduce dependence on bulk-trades.

In this vein, we must recognize the power of *information* in facilitating the formation and functioning of markets. To pursue direct-sales opportunities, producers must learn more about end-market conditions to identify export opportunities that they can respond to with the crop-choices they make, a burden historically left in the hands of grain-companies in a bulk-dependent trading-system. This is an essential requirement of a value-driven diversification strategy in search of higher margins.

For actual sales to materialize, however, trade facilitation efforts must go beyond identifying market opportunities. Sellers and buyers need to connect to be able to engage in transactions, where the challenge is much greater overseas than within North America. Prospective importers know little about our production sources and crop varieties that they can start procuring directly from farms, like corporate buyers do routinely across North America. Providing the necessary visibility into our grain-economy is indeed a challenge, a burden that befalls on grain-interests collectively.

In many ways, we try to do this on producers' behalf through our *farm-profile* and *grain-mall* initiatives. But there is also a burden that falls on producer-associations and public-agencies in recasting the Prairie-image on the world stage as a leading source of grains where overseas importers can reach out to procure a huge variety of high-quality crops directly from highly advanced production sources, without having to rely on intermediaries. We will come back to these issues in our next article.