Mystery of overseas direct-sales

Our mission is to open direct-sales channels to overseas export markets. These channels can not only provide higher-margins for producers, but also create further diversification opportunities to higher-value crops. Direct-sales channels are prevalent in domestic and transborder trades, but do not exist in overseas trades, which remain just as captive to the bulk-system just as they were in the CWB-era.

Plenty of explanations have been offered as to why direct-sales through corporate purchases are common in North America but unheard of in our exports to overseas. However, they often boil down to "myths" and "fallacies", and when half of our grain output ends up overseas, we see this as a topic in need of further consideration. The prevailing view in this regard is that direct-sales to overseas markets entail too many trade-risks, thus our producers are urged stay away from them in self-interest.

If true, this would undermine the essence of our mission, that the path to producer prosperity is through direct-sales. When we began our platform, we were aware of these widely held views, and believed them to be at best misguided, and at worst, self-serving misinformation propagated by today's grain industry and its vested interests in bulk-trades, not producers. Here we try to debunk many of the myths and fallacies being used to explain away the obvious gap in our overseas exports.

We start with a discussion on the nature of our producers, cautious but not averse to change in self-interest. If they can see better prospects in direct-sales to overseas and figure out a way of dealing with the trade-risks, they will jump on them. What holds them back is that there are no buyers in sight to be trading with. This takes us to a major part of our mission, closing the *information-gap*, which lies at the heart of the problem – overseas buyers know very little about our producers or their virtues.

Then we turn to another problem that we must confront, all the misinformation that is propagated by vested interests -- claims that direct-sales to overseas are too risky for producers to even contemplate, let alone engage in them. We then turn to the trade-risks that direct-sales pose, which we believe can be managed and mitigated by selecting reputable and trustworthy buyers, and pursuing a diligent approach to contract negotiations to secure term-and-conditions to protect seller-interests.

Finally, we turn the guns on bulk-trades, where we see the real risks for the future of our grain economy. The industry has been oblivious to the increasing competition we face from emerging grain producers that are continuing to improve not only their yields but also quality standards from a much lower cost-base than ours. As a region, we are in denial, but our bulk exports are coming under increasing pressure, making diversification to higher value crops even more urgent. The shift to direct-sales channels may not be just a quest for higher margins but a necessity to survive.

Myth of producer resistance to change

Looking forward, we are calling for a paradigm-shift in the way we export grains to overseas markets. This is of great significance to the Prairie grain-economy, as about half of what we grow ends up in overseas markets. This share is likely to grow even larger into the future as we are still achieving yield-increases, thus output growth, while domestic grain consumption, even across North America, is relatively stable.

The shift we are calling for, away from bulk-trades to directs-sales, is value-driven – higher producer-margins from what we already export, and diversification prospects to higher-value crops. What we are calling for is by no means radical, not even new, as such direct-sales are prevalent in domestic and transborder trades, where the other half of what we produce goes. Then, why don't the same practices extend to overseas – are these trades inherently riskier, or are producers too risk-averse?

Before even getting into the overseas end, let us first look back on our own farm heritage to understand producers' attitudes to change; after all, they are the ones to decide whether to make a shift to direct-sales, or remain captive to bulk-trades. Historically, we cannot ignore the legacy of the CWB-era when producers were not exposed to market-risks. The public-monopsony shouldered all the marketing and sales responsibilities, while producers got an equalized share of the proceeds.

With the memories of two world-wars and the Great Depression, and the pains they had inflicted on the grain economy, CWB's legitimacy was hardly questioned, in fact its scope expanded in the post-WW2 era to the entire grain spectrum. As of the early 1970s, however, cracks started to form, as feed-grains and specialty crops were gradually dropped from the monopsony's net. But our single largest crop, wheat, together with non-feed barley, remained in the net until CWB's dissolution in 2012.

Over this 50-year unwinding period, producers' market exposure increased greatly as they diversified to so called non-board crops, while also taking on more trade-risks as they started to engage in direct-sales, be it to crushing-plants, food-processors, feed-lot, or others. They did not have these direct-sales options with wheat, which maintained its status as the largest volume crop in terms of both output and exports.

Over this period overseas exports more than doubled in volume but one thing did not change, the captivity to bulk-trades. Perhaps this is understandable for wheat, as it has only been a decade since its trades have been liberalized, but canola exports have been growing for decades, now as much as half of wheat exports, and still all in bulk. Together these crops account for 75% of our grain exports; with other crops in the mix, bulk-trades account for roughly 85% of our grain-exports. Most of the residual are pulses and specialty-crops that are exported in containers but again mostly through grain-companies, not direct-sales that we are trying to introduce.

This stark revelation raises fundamental questions about the feasibility of our core mission, with skeptics dismissing it as utopic, given that they have not taken hold in any serious way in the past. This reality has not escaped us, but there are no mysteries as to why this is the case and how to change the *status quo*. We will come back to the main obstacle next, but first let's try to understand producers' attitudes to change by reflecting on what they have gone through in the last half a century.

Producers are not all cut from the same cloth, but they all know what is in their best interest and can be extremely cautious. But we are intentionally not using the word *conservative*, not just to avoid political connotation but even its dictionary definition does not apply – averse to change or innovation. The track record of the last 50 years reveals the opposite: producers embracing scientific and technological change, diversifying to new crops, and even adapting to events like CWB's dissolution.

The producer community was sharply divided over the future of CWB towards the end, and to a lesser extent still is. Half, perhaps even more, wanted to retain the monopsony, but not because they were all die-hard collectivists; they believed CWB had served their interests well over their principal crop, wheat. But over the previous 3-4 decades, only a handful of them had opposed dropping feed-grains and specialty-crops (even canola being a niche crop back then) from CWB's monopsony.

The embrace of canola was not instant; it took time to accept the suitability of this oilseed to Prairie soil and growth conditions. The next wave with pulses, a true bonanza in terms value per acre, did not come instantly either. The last 50 years of crop diversification, often taken for granted or underestimated, is a clear testament to the producer community's willingness to adapt, but in a careful and cautious way, as any deviation from tradition may bring risks and/or unintended consequences.

Another shift to note was to direct-sales channels across North America. Producers embraced feed-grains being dropped from CWB's net, as they saw the prospects of selling them to feed-lots down the road, or to feed-companies that could distribute them more widely. Producers also saw that cereal companies could reach out to farms to buy oats or other cereal crops. They knew canola could be sold to nearby crushing-plants but exporting the same to overseas was a different matter.

When volumes ramped up with export potential, producers felt more comfortable selling canola to local grain-companies as there were neither any buyers knocking on their doors, nor any grade-differentiation potential not to consolidate in bulk. When wheat was freed, like canola, they turned to direct-sales in North American markets. They also saw the grade and quality differentiation potential to be selling direct to overseas markets, but there were no buyers around. And there lies the challenge, attracting credible buyers of wheat, as well as other crops, that producers would be comfortable doing business with on their own turf, not somebody else's overseas.

Main challenge: attracting buyers

The essence of the above story is simple: producers are not resistant to change, but they are wise and cautious, be it in switching to different crops or shifting to new sales-channels. With regards to crop diversification, the Prairie's record speaks for itself: there was always hesitation, or fear of new crops, but once that was overcome, producers jumped on canola, pulses, or other specialty-crops when they saw the market potential. With respect to sales-channels, the minute certain crops were freed from CWB's monopsony, producers started selling direct to end-users if the margins were better than what they got from grain traders or consolidators.

Many industry observers contend that producers are staying away from direct-sales to overseas markets because they find them inherently risky. Naturally, vested interests in grade-trades would like to perpetuate this assessment, and even some producers go along with it though they have no experience in this domain. The part we cannot relate to is how can anybody pass judgement on something that does not even exist – how can trades be deemed risky when there are no buyers in sight, let alone purchase offers on the table to be able to objectively assess their risks?

We can relate to some of the producer-perceptions as they are based on dealing with opportunistic traders looking for one-off deals, and often do not follow through with their purchase-offers. But we do not see any corporate buyers visiting the region to scout for serious procurement opportunities from primary-sources. Even if they pass by, all they can find are grain-companies that are focused on consolidating on their own account to export in bulk, with no desire to deal with corporate-buyers.

We have also observed this scene from the other end, living in Asia Pacific for more than a decade. Trade delegations come and go but mainly to extol the virtues of our staple crops, and how they are consolidated and shipped in bulk-vessels across the ocean. If the topic was pulses, you may see reference to containers, but still with no evidence of primary production sources, farms, where buyers could procure a huge variety of quality crops and get them shipped to their doorsteps in containers.

Given the bulk domination of our grain exports perhaps these promotional practices are not surprising, but what is surprising is how little effort we make to change the agenda to bring more visibility into our grain-economy. Most overseas end-users of our grains – millers, processors, or others – buy them through distributors, who in turn buy them from grain-companies at the receiving end of our bulk-trades. End buyers may not even know that the grains they process are *grown-in-Canada*, let alone know anything about their producers. Our farms are regarded as mere collection-points of bulk-systems, not actual primary production sources where end-users can reach out to buy the grains they need, even get them *grown-to-order*.

Let us contrast this warped view of our grain economy as seen from overseas, to what buyers and sellers at the end of our domestic or transborder trades did as those trades were freed from CWB's monopsony. Producers knew where the buyers were, and the buyers knew where the grains they needed were grown. It did not take long for trading relations between buyers and sellers to form, to negotiate and execute contracts; deliveries could be arranged by truck or rail as appropriate. Also, there were no barriers for the same direct-sales channels to form across the border.

How can these trade-linkages be formed between buyers and sellers that are an ocean apart? Intermodal systems are there to facilitate containerized trades, to replace shipments by truck or rail, but buyers need visibility into our grain economy and what it has to offer to the world. Only through a promotional "window" can interest be generated from corporate-buyers from all around the world to look at the Prairies as procurement grounds, not just the origin of grain-trades in bulk.

This is what our virtual *Grain Mall* platform is intended for. Prospective buyers can see what we have to offer right from primary production sources, our farms – among the most advanced in the world, offering a huge variety of crops for buyers to procure and get them to wherever they want in containers, with crop integrity intact, and as necessary identity-preserved. They can post purchase-requests that interested producers can respond to, all online, and if there is sufficient interest on the part of both buyers and sellers, they can proceed with contract negotiations.

This is how we intend to bridge the *information-gap* that currently holds back direct-sales channels from forming to overseas markets, like channels that formed with ease earlier in domestic and transborder markets where buyers and sellers were familiar with each other. Online acquaintances or interactions are not going to lead to instant sales, but at least parties will get to know what each other wants to form the basis for further discussions or negotiations. This open platform will also allow buyers to see what the options are, and the sellers to test the market for their crops.

The fact that certain market-channels do not exist is not a logical basis to conclude that there is no demand or supply for those channels. Markets do not form without "information", not a novel discovery on our part but a well-known fact. Historically trades used to get started through expeditions, how traders met, negotiated, and made fortunes. Now we have the Internet to connect people and pave the way for many new trades to emerge and flourish; all we need to do is look around us.

However, we refrain from characterizing our initiative as a trading-platform, as in essence it is a *trade-facilitation* platform. Unlike merchandise, stocks, or crypto-currencies, grain-trades do not easily lend themselves to one-click-sales. All we hope to do is provide the online channels for buyers and sellers to connect, exchange information, and negotiate towards developing a contractual framework to trade.

Fear-mongering over trade-risks

Above we talked about the absurdity of claiming that there is no need for certain trades if they do not already exist, like direct-sales of grains to overseas markets. As we stated, many trades do not exist due to lack of connectivity between buyers and sellers, which in most cases is due to lack of information. Our initiative is aimed at providing an *information-bridge* between Canadian grain-producers and overseas-buyers, and thereby establishing connectivity between them to facilitate trades.

An even more absurd proposition is that certain trades, like the ones we are trying to facilitate, do not exist due to trade-risks. The absurdity of this claim is even more obvious: if buyers and sellers do not even know each other, let alone have ways to connect and negotiate, how can we possibly pass *a priori* judgement that trade-risks are too high? The answers can only lie with fear of the unknown or misinformation propagated by vested interests, those who stand to lose from new trading practices.

It is evident that most of our overseas grain-exports are captive to bulk-trades, 85% from the West Coast. The only crops that escape this captivity are pulses and specialty-crops that are exported in containers out of necessity, as they do not suitable to bulk-consolidation. We contend that there is much greater potential for containerization of those crops that are currently exported in bulk. What stands in the way is the lack of direct-sales channels, even though those channels could yield higher margins for producers, and diversification prospects to higher-value crops.

Bulk-trades are in the hands of a few grain-companies that have a vested interest in consolidating large volumes of staple-crops to move them through the bulk-systems, the gateways to which they have control over, individually or collectively. Unlike in the CWB era, producers are not legally captive to these grain-companies but there are too few of them to be engaging in aggressive price competition over what crops producers have for sale, at their own farm-gates or delivered to country-elevators.

This is by no means an illegal act of conspiracy among grain-companies, not even a sinister ploy to collude; it is a natural outcome of a highly concentrated, typically referred to as an *oligopolistic,* industry structure. A handful of grain companies came to control a bulk-system that consisted of CWB and wheat-pool assets that were privatized with no regard to competitive implications for the grain-economy or its constituents, particularly the primary producers whose margins are squeezed.

To be objective, we also must remember that collectively producers were complicit in this outcome. Firstly, they voted for the corporatization of wheat-pools, which were provincially organized producer-cooperatives. Furthermore, as shareholders, they voted for the merger of three provincial wheat-pools and later the sale of the merged entity to a global commodity-giant. Also, the debate over CWB was far too

acrimonious to seriously consider more practical options like voluntary marketing boards, government or producer owned, which could have played a competitive role. Leaving those bygones aside, the grain industry structure ended up in what we have now, highly oligopolistic and one that does not serve producer interests well.

The theoretical solution may be breaking up grain companies, but this is neither very practical nor very effective. The root-cause of the problem is the bulk-system, the capacity of which a handful of grain companies share in different ways. Again, there is a theoretical solution, turning the system into a regulated public-utility, that all grain shippers have access to, but this is even less practical than breaking up grain-companies. Instead, our solution is simple: leave the exiting bulk-system alone, and create more competitive channels, direct-sales for containerized grain-trades.

These channels are prevalent in domestic and transborder markets, imposing the market-discipline for grain-trades to function more competitively. What holds back these channels from forming in overseas trades is the *information-gap*, our core mission to bridge. But there is also a great deal of misinformation that comes from vested interests in grade-trades, causing misapprehension among producers. They hold back from even contemplating direct-sales to overseas in the fear that these types of sales are inherently too risky. This is another obstacle – mainly the fear of the unknown – we must overcome as we try to bridge the information-gap.

These fears arise from the procurement process grain-traders engage in. Purchasers focus on staple-crops that trade in large volumes, wheat and canola, with very small margins to bargain over – they are price-takers from global-markets and have very little to negotiate over purchase-prices. Their main interest is in enticing customers to grow more of the crops they are interested in, with advanced payments. They spend more effort dissuading producers from selling to domestic and transborder markets, where they know there is competition from corporate purchasers, as well as from switching to specialty-crops that can be exported through other channels.

Dissuasion often takes the form of talking about risks of alternative crops, in terms of both growth-risks and price-volatility. Though prominent corporate buyers are difficult to put down, there are always examples to cite from some industry corner about delayed payments or missed purchases to provoke distrust over direct sales. The argument always comes around to how local bulk grain traders can be trusted for large purchases, advanced payments, and reliability from one year to the next.

If a producer cites higher margins from specialty-crops or corporate-sales, their comeback is always: if you miss a payment on one truck or container load, it will set you back far more than lesser margins we offer. A salesman from bulk-trades will never miss a beat raising the risks associated with higher-margin trades, thus not surprising that direct-sales overseas are perceived too risky to even contemplate.

Identifying risks and dealing with them

Leaving the critics aside and coming back to our own turf, direct-sales to overseas, we do not deny that there are trade-risks – only fools would. The challenge is to identify and assess those trade-risks in a risk-reward framework grounded in the real-world, not in a jungle of vested-interests. Nothing in life, let alone commercial-trades, comes risk-free, but unlike proponents of bulk-trades who are in denial of the risks they themselves face, as we will come back to next, we are here to deal with them, to manage and mitigate them in a quest for higher producer-margins.

We take our kudos from experience, not rhetoric we hear from vested interests. The first challenge is attracting overseas buyers to our region, to deal with them on our own turf. Let them reveal what they need and put offers on the table, though in our case that may be online. Then producers themselves can scrutinize the credibility of both the buyers and their offers, assess the risks from their perspective, and decide whether to go through a contract negotiating process, or go on to another prospect.

Buyer selection: The first rule of the game is to avoid opportunistic traders; to avoid wasting time and facing the predictable risks down the road, focus on only credible corporate buyers. You will find that industry leaders from the Asia Pacific region are as sophisticated and honorable as those you deal with in North America; rotten ones can be identified as easily as the opportunistic-traders and dismissed. Sounds like a truism, but it is at this very early stage that you have the best chance to eliminate trade-risks; thus, proper due diligence into buyers' credibility is of huge importance.

Crop choices: Through direct-sales channels, diversification prospects may be as attractive as higher margins from what you already grow. But initially focus on the latter; the former may come later as you become more familiar with overseas buyers. There are just as many opportunities in our staple-crops to pursue through direct-channels – durum or other grades of wheat, malting barley, oats and other cereals, to name a few. For all these crops, you would have already eliminated the less desirable buyers upfront and would be dealing with credible industry leaders.

Competing buyers: Once you are into the process, with a prospective buyer at the table for a particular crop-trade, it is important to attract others to express interest to create a competitive dynamic. Bear in mind that we are reaching out to a large, diverse region; we can find competitors from the same, or across different countries. Having an expression of interest from one major flour-miller is going to get the attention of others; a malting barley initiative in one country is going attract interest from other countries, while the same is going to be true for cereal-producers.

Order volumes: No single producer is going to be able to fulfill a viable contract order, and viability is defined as not just a one-time order for 10 containers, but the same volume sustained weekly throughout the year. This is how you are going to

attract the most credible corporate-buyers, with large and sustainable volumes. Thus, there is a consolidation-imperative, and it is best that you tackle this among fellow producers, rather than leaving it to the buyer to set the stage for you to compete among yourselves, a sure way of eating into each other's margins.

Payment terms: A credible buyer may be reluctant to put a large down-payment (unless it is in safe escrow) but is not going to shy away from paying for loads as they are ready to ship (cash transfer or secure LOC) with sample test results sent to them to ensure that they are getting what they are buying. This not unusual in foreign trades; you can ignore any fears being stoked otherwise. If the buyers want to lock down what you expect from an upcoming harvest, partial payments can also be asked; if they do not follow through, you will have the option to sell to others.

Legal scrutiny: Rather than relying on informal contracts, you must seek legal counsel to deal with contract details, be it over delivery/payment terms or quality-standards defined by Canadian regulations (most advanced and trusted in the world), with a formal authority designated to arbitrate if necessary. When in doubt about buyer's intentions or credibility, it would not be unusual to ask for an escrow deposit. All contracts should have dispute-resolution provisions, drawn up under Canadian jurisdiction, with the buyer represented by Canadian counsel as well.

Export insurance: Regulations dictate that all shipments go through CGC-licensed grain-exporters, an onerous requirement but likely to be loosened with direct-sales becoming common place. In the meantime, you must ensure EDC export-insurance eligibility. There may also be complications at the import-end, particularly in sticky or unreliable jurisdictions, which you no doubt will be receiving legal advice on, but you must ensure that you are paid in full before any export load leaves Canada – any risk in this regard should be the importer's responsibility, built into your contract.

This is a brief overview of the contract process that we are sure experts much more qualified than us can guide you on legal and regulatory details. We do not see the trade-risks the same way as others might, or those with vested interests claim. The process is straightforward and if you are diligent with buyer selection and contract details to ensure compensation before you ship, there is little to worry about other than where to sell what might be leftover in the event of a contract-breakdown.

Naturally, you are not going to go through this process if you can get a similar price from a grain-company that you can deliver to down the road. There must be a material price difference to be enticed to go through this, but the so-called trade-risks associated with contracts with foreign buyers are blown out of proportion. We do not see a difference between selling to a US company and one in Japan or South Korea, other than the fact that shipments to the latter go in containers and take a bit longer. If you have concerns over doing business with other countries in Asia Pacific, including our largest grain-export destination, China, you can stay away from them.

Risks posed by bulk-exports

Our mission to reduce producers' captivity to bulk-trades was primarily motivated by a two-prong reality: their margins were being squeezed, and diversification potential to higher value crops being held back. But there was yet another, more serious concern looming in the background: the bulk-trades that producers were captive to were facing increasing risks in global grain markets. We raised this matter in several articles, but perhaps we have not paid as much attention to it as it warrants.

Overseas exports are of critical importance to the Prairie grain economy. About half of what we produce is consumed domestically or exported to the US, and the other half to overseas, but these two halves have very different dynamics. The first half consists of mostly domestic trades (about 90%) with a smaller transborder share (about 10%). These two sides of the first half are part of the highly integrated North American economy, where grain-trades are competitively guided by market forces.

Demand for grains in North America has been growing, but only modestly, while our production has been increasing much faster, driven by yield increases. So far, our overseas exports have been growing to absorb the surplus, roughly doubling in 25 years. But at the supply end, unlike in manufacturing where output can be curtailed to overall demand, in the grain economy output is driven differently. The land area is fixed, but output grows as yields increase, driven by scientific and technological advances – farmers grow as much as they can in the hope of selling all they produce.

Until now we have been lucky, and the world has needed ever more quantities of grains; we have been able to sell our surplus at good enough prices not to worry about what we could not consume at home and had to export overseas. We have been taking this for granted, paying little attention to global production and consumption trends, believing that we could increase our export volumes without adjusting our production levels, or to where and how we exported our grain surplus.

A striking example of our complacency over our export position is the China-factor. The US used to be our largest grain-export market, 20% of what we exported. In just two decades, from the mid-1990s to mid-2010s, China took that position with 20% of a much larger total export volume, accounting for roughly two-thirds of our export growth over that period. We paid little attention to why China was importing so much more; all we knew was that they were buying more. Our trade-relations with China soured for different reasons, but China was shifting to other grain sources.

There was a huge region to its west, what we coined *The New Grain Belt*, stretching from Ukraine to Kazakhstan, across Central Asia and Russia to the north. Leveraging *Belt-and-Road Initiatives*, China was investing in rail-systems, road-networks, irrigation-projects, and providing expertise to revive agriculture in this region to

meet its grain needs. More land was being put to grain-production, while achieving not just yield increases but also crop-quality improvements. This was going to put our exports in jeopardy, not only to China but also to the entire Asia Pacific region.

We had been terribly concerned about these and many other developments around the world that were likely to threaten our bulk-exports. In fact, our outlook going into 2022 was quite concerning, and we feared it would likely to turn even scarier in time. Little attention was being paid to export sales in January, believing that our stock levels were safe, particularly with the drought effect from the previous year. Even with lower stocks, actual export-sales to mid-January were down significantly from the same time the year before – wheat down 40%, durum 35%, canola 45%.

We thought that only a miracle could save us, but in the end, it was a tragedy that did, the Russian invasion of Ukraine, throwing grain markets into panic with prices rising in fear of shortages. But naturally we cannot be sinister enough to expect wars to save us from disasters every year. We must pay attention to the vulnerability of our bulk-exports to competition from emerging regions, as both their yields and quality-standards increase. We cannot hope to compete from a much higher cost-base. Our only salvation is in diversifying to higher-value crops, which in turn will dictate a shift from bulk to direct-sales that can only be fulfilled in containers.

Our complacency in this vein is also fueled by the similar position the US is in, just as dependent on bulk-exports with an even less diversified export portfolio than ours – three crops (corn, soybean, and wheat) accounting 90% of its exports, compared to two crops (wheat and canola) 75% of ours. The US produces 6-times more grains than we do but its exports are only 4-times higher, thus while we export half of what we produce, the US only quarter. Our grain-export-volume to GDP ratio is three times higher than US – thus our economy is much more dependent on grain exports.

Let's look at the dark-scenario of tightening grain prices under competition from emerging regions. Our grain traders are price-takers from global markets, but they have the market power to squeeze producers even more than the hit they get from global markets. We observe that producer-margins are already too thin; for many, they are inadequate to cover costs, let alone provide return on their capital tied in land, facilities, and equipment. Any further margin-squeeze will threaten them with insolvency, thus making large segments of our farm economy simply unviable.

In most of our articles we approach our mission with emphasis on "pull" factors: higher-margins and diversification-prospects from direct-sales. But as we discussed above, there is also a "push" factor to consider: the threats that our bulk exports face in global markets. Perhaps this will further motivate producers to take direct-sales channels more seriously, and even give bulk-traders a cause to also consider paying more attention to higher-value specialty-crops to be exported in containers.