Future of Grain Industry Structure: Our Brief Outlook

In our last article we addressed the question of "who" would be best positioned to take advantage of contract-sales opportunities from direct-channels -- large, small, or all producers. And before getting into this topic, we had also noted the persistent consolidation trend since the 1940s, with the number of farms shrinking by half in the last 30 years alone. Looking into the future, we expect this consolidation trend to slowdown, but coupled with a movement from small to middle sized farms.

"Scale" brings specific advantages in agricultural production: large farms are able to afford the latest technologies more easily (lease or purchase) and utilize their equipment, devices, and systems more effectively. They also have an advantage in sectionalizing their farms to diversify and shift to higher-value crops. However, at some point scale-economies are exhausted; in fact, there is scope for mid-size farms (sub 10,000 acres, even smaller) to realize the same advantages much larger ones do.

On a related matter, there is a tendency to view direct-contracts as the exclusive domain of mega-farms, but this is a false-perception. Most contracts will be too large for any one producer to fulfill, as was the case with opportunities we pursued in the past, and such contracts will have to be procured from multiple sources. The hypothetical example we gave in our last article involved 5 very large and 50 smaller producers fulfilling a contract by committing a reasonable portion of their output.

As trade-facilitation efforts start bearing fruit, we can expect many more contracts like this to emerge, contracts of various sizes with most if not all requiring purchases from various sources, in turn giving rise to a new breed of "consolidators". They may be buyers setting up procurement companies, or producer-collectives forming to perform the same contract fulfillment functions (sourcing, handling, shipping, etc.) thereby capturing a larger share of supply-chain margins on producers' behalf.

We saw this happen in the early stages of pulse export-trades, initiatives from both importer and producer ends, which we will get into below, but similar trends will take hold as other containerized specialty-crop trades develop. We will see the emergence of a multitude of entities engaged in procurement, consolidation and contract-fulfillment, on behalf of buyers or producers, or grain-companies to their own right – serving specific or multiple trades, including grades of staple-crops.

As these new trades develop and grain exports diversify through direct-sales and containerized-shipments, not only will new companies get into the act, but also existing grain companies, currently focused on bulk-trades, will turn more of their attention to these new channels. In whatever manner the grain-industry structure evolves, we can be certain of one thing: a market-driven industry will form, more diverse and competitive, serving the best interests of producers with higher margins.

Future of farm consolidation

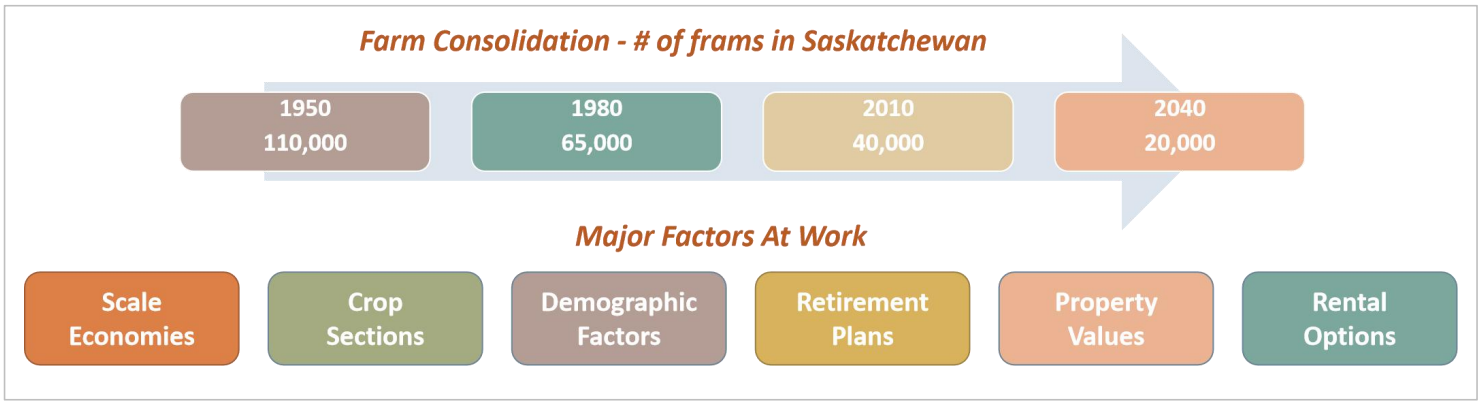
The evidence from Saskatchewan clearly shows the consolidation pattern over time: 140,000 farms in the early 1940s down to less than 25,000 by mid-2010s, down more than 60% in the last 25 years alone. Despite any statistical evidence of this trend abating, we sense that the pace of consolidation will slow down, at least by half, leaving about 20,000 farms by 2040 -- a rough estimate, not an exact prediction. We must understand the causes of this trend before passing judgment on the future.

This persistent consolidation is not merely driven by scale-economies, as economists would define. There are other factors at play, demographic trends and retirement considerations among them. The rural population is aging and younger generations are moving on to other professions, while retirees are looking at their properties as investments rising in value, hanging on to ownership even after they stop farming. This gives rise to rental-practices with more farmland worked under management.

With all these factors in play, predictions are difficult, and even if available from informed sources, precise forecasts are not very useful for our purposes, as long as we get the gist of where trends are headed. We do not see consolidation coming to a halt, let alone reversing itself, but a slowdown seems on the horizon. We will see fewer farms at the small-end (sub-5000 acres) and more in the mid-range, large enough to realize similar productivity levels (crop-yields) as today's mega-farms.

From our perspective, more important than farm-size is "yields", which will rise across the board as a result of advances in agronomy and technology. This will allow about 25% increase in export volumes in the next 20 years. Even if bulk-export volumes hold their own, there will be room for containerized grain exports to more than triple to 15-20 MT range -- requiring more container capacity than is currently returning empty across the Pacific but still feasible within prevailing trading patterns.

From our perspective, however, bulk-trade volumes holding their own is a big *if*. Accommodating growth coming from yield-increases may be the easy part of the challenge; coping with the decline in bulk-trades would be much more difficult, requiring more fundamental changes in our transport-systems. The silver-lining is that new exports will be much higher in value, justifying more logistics investment.



New breed of consolidators

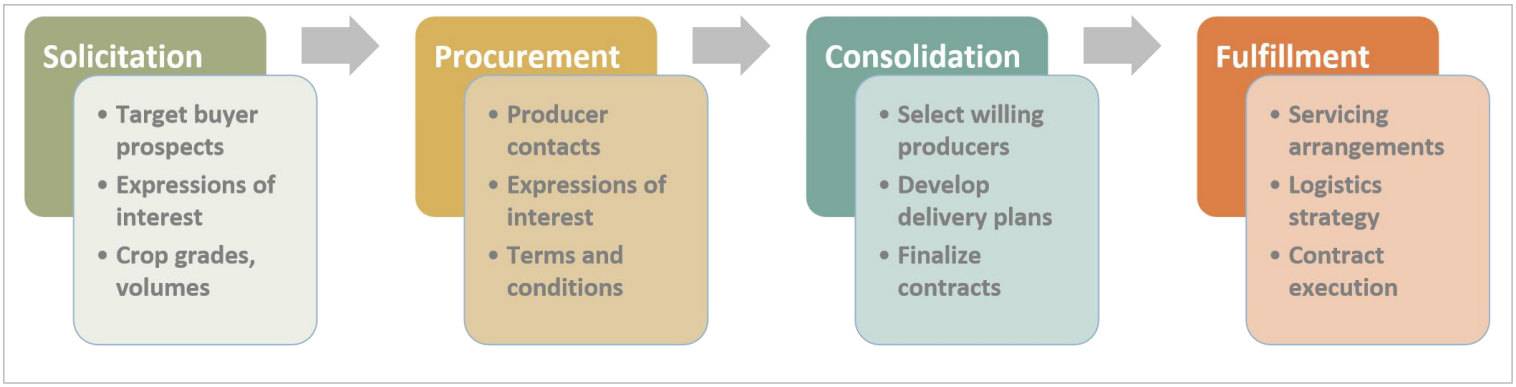
Unlike the current industry structure where producers' output is consolidated and traded in bulk, the vision we have is a grain-economy where producers grow more specific grades or varieties of crops that end-users need and purchase through direct-channels. This, however, does not imply that all transactions take place between individual producers and buyers. There will be intermediary-channels facilitating these trades, acting independently, or on behalf of buyers or sellers.

The healthiest way our producers can shift to more specialty, high-value crops is through contract-sales involving large and steady volumes, not small or spot sales that pose more risk and uncertainty. Accordingly, we will aim our trade facilitation efforts at steady contracts, too large for any one producer to fulfill, thus requiring intermediaries, what we refer to as "consolidators" looking after procurement, handling, and shipping functions that come with fulfillment of large export-contracts.

We saw the development of these types of channels as pulse-trades got underway, offering much higher value opportunities to producers than staple-crops exported through bulk systems. The most successful initiative in these trades was a local company, AGT, in partnership with a major overseas buyer. Riding on the success of exports to the Middle East, AGT expanded its scope, went through a corporate restructuring, and is now pursuing other global markets to expand pulse-exports.

At the early stages there were also a number of producer-initiatives, setting up facilities to clean, grade, and ship pulses to end-markets. After successive mergers, a sizeable entity emerged but ran into financial trouble (ironically canola related), and its assets were bought by Scoular, a very old US grain-company with considerable global reach and transport capacity. Thus, in pulse-trades we saw the emergence of export-consolidators from both ends, importer and producer, with many yet to come.

As in pulses, high-value and containerized trades, we expect to see the emergence of a new breed of company to perform the consolidation, processing and shipping functions to fulfill export-contracts. They can emerge from producer-ranks, buyer initiatives, or local entrepreneurial start-ups to serve the new trades we envisage -- specific grades of wheat, durum, barley, or other crop varieties that are in demand.



Existing grain companies' response

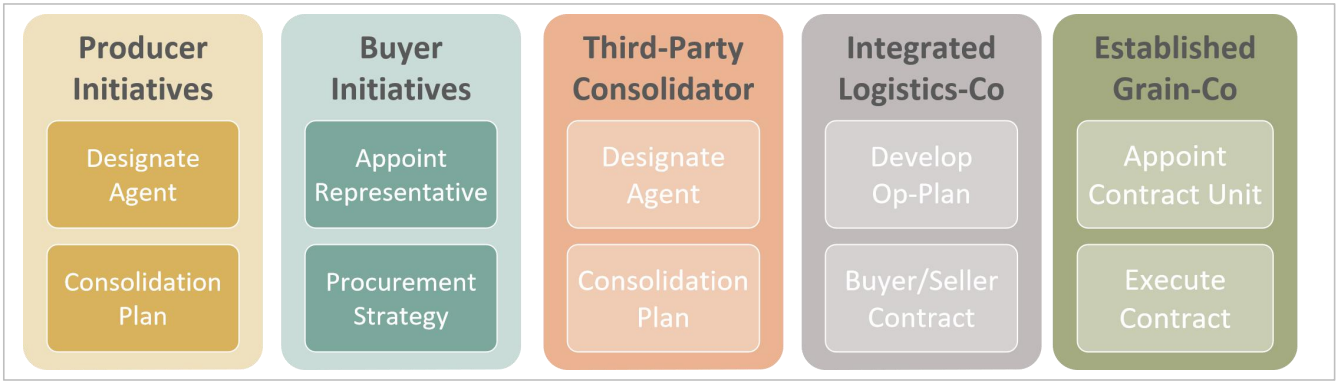
The new breed of companies will not have emerging trades all to themselves; the new opportunities will not go unnoticed to already established grain companies now engaged in bulk-trades. Many of them have vested interests in bulk-systems, huge capital investments in terminals, which they cannot easily walk away from. But if bulk trade volumes start to decline, as we anticipate they will under global pressures, all these companies will be looking for other opportunities in more specialized trades.

Largest among them is Viterra, which came into being through the consolidation and privatization of wheat-pools, creatures of CWB-era. Glencore, a global commodity-giant, took Viterra over with some of the assets shed to Richardson. The latter, a very old Canadian company founded in the mid-19th century, became much more formidable in grain trades in the post-CWB era. There are many others, Paterson and P&H among the most prominent and oldest, both dating back to early-1900s.

There are numerous other global giants with a presence in Canadian agriculture -- Cargill, ADM, Louis Dreyfus among the best known names. Not all these giants may have significant stakes in bulk-export trades, but G3 does -- joint-venture between Bunge (major US grain company founded in early 19th century) and Saudi investors that bought CWB assets. All these companies have the financial resources, industry knowledge, and global connections to step into specialized crop trades in the Prairies.

Two examples we had cited in a previous article, custom-mixes for breakfast-cereals and animal-feed, were open to major grain companies stepping in as consolidation-agents. Cargill, a global giant, was a shareholder in one of the targeted buyers, China's largest cereal company, thus was likely to get involved in its procurement efforts. Also, the feed-company we were targeting (largest in the world) had an equity stake in a US grain-company, Lansing (since taken over by Andersons).

What we are trying to convey here is that there is no shortage of grain-companies that could step into newly emerging export trades. But unlike the bulk-trades that incumbents control, and producers are captive to, emerging containerized trades will be contestable by a multitude players, including producer or buyer initiatives, or entrepreneurial start-ups, making grain-export trades so much more competitive.



Impacts on competitive landscape

If the new trades we are talking about, and trying to facilitate, are open to all the world's agricultural-giants, as well as the principal custodians of our bulk-systems, then what is going to change for the producers? The short answer is a great deal. As export trades shift from bulk to direct channels, the overall industry structure will be fundamentally transformed, to give producers more choice in what they grow and how they sell their crops, thereby put them in a position to realize higher margins.

Let us first look into the nature of bulk-trades. First, the very act of consolidation in bulk is a value-losing proposition, as there is less scope for crop-differentiation by specific attributes, the main source of value in grains. Thereby, we lose out on the prime advantage we have in differentiating ourselves in world markets, our ability to grow higher value crops with specific attributes. We stick to staple-crops while we could be leveraging our know-how, science and technology to grow other varieties.

Second, bulk-systems with terminals (inland and coastal) are very capital intensive, and the way the system was privatized left it in the hands of a few companies with an interest in large trades. They are motivated to generate large volumes of a few staples that can be traded in bulk; they incentivize producers to grow these staples. This is the low-value, low-margin trap that producers are now captive to; they have the freedom to grow what they wish but not the channels to export through.

Our producers have the capacity to grow highly differentiated crops, even to buyer specifications, which can be sold directly to end-users and shipped to their door-steps with crop-integrity intact (identity-preserved). Our mission is to facilitate these types of sales and logistics channels for producers to reach out to end-markets to sell much higher-value, differentiated grades or types of crops, instead of the low-value export-staples that go into bulk-trades, with more security but squeezed margins.

If producers can be connected with end buyers, why are we then talking about the need for intermediaries or consolidators to get involved in what we call direct-sales? There are risks associated with direct-sales; producers cannot afford to fall captive to any single buyer by committing all or large portions of their output, while they need steady orders to rely on. The latter come with large-contracts, which in turn require sourcing from multiple producers, thus requiring consolidation by intermediaries.

If global agricultural-giants, including the custodians of our bulk-trades, can step in to perform these functions, how will the new system be different than what we have now? The answer is simple, unlike capital-intensive bulk-systems, consolidation or contract-fulfillment functions can also be done by producer-coops, buyer-agents, or other start-ups that can step into the act to contest any undue market power held by corporate-giants. Export markets will be more accessible and competitive, with a multitude of intermediaries or consolidation-agents for producers to choose from.