# Breaking loose from bulk-trades in the post-CWB era

We concluded our last article with a couple of pages on our three-pronged strategy: direct-sales, specialization, and containerization. Here we will take up direct-sales again, a fundamental pillar of our mission – what they are and how to pave the way for them in overseas export markets like in domestic and cross-border trades. They impose the necessary competitive market discipline where they exist, but in our overseas grain-exports bulk-trades still dominate even in the post-CWB era.

At the outset, let us make it abundantly clear that we have not invented the idea of producers selling direct – they already do it all the time. Most if not all are already engaged in it one way or another in what is sold to domestic markets and across the border to the US. Examples are widespread: wheat to flour mills, canola to crushing plants, oats to cereal companies, and the list goes on to include a significant share of what is already grown and sold through what we consider direct-sales. These sales channels benefit not only producers, but also buyers by cutting out intermediaries.

The next obvious question is, if these channels are mutually beneficial to both buyers and sellers, why they do not exist for overseas exports. Part of the reason is what we said in our last paper: while buyers and sellers are familiar with each other across North America, there is an information-gap between producers and overseas buyers. Also, producers are often conditioned to think that dealing with foreigners carries too much risk. The other part is that producers are accustomed to relying on bulk-trades since that is what they have always done, whether during or after the CWB.

Perhaps they do not need any convincing as they engage in these practices in their own backyard, but still, we keep coming back to the obvious, that there are huge benefits in shifting away from bulk-trades to direct-sales. These channels will not only yield higher margins but also allow diversification to specialty crops or grades that will fetch higher prices with even larger margins, thus better returns on land.

Like anything else in life, change brings challenges and risks, but they can all be managed through due-diligence and risk-mitigation. Even if perceived risks persist, there are export-insurance options, or insistence on irrevocable letters-of-credits, as well as deposits for grow-to-order contracts, not to mention advanced payments in full before anything is shipped. Thus, there are plenty options to cover trade-risks.

The real challenge is attracting overseas buyers to our region and exposing them to its virtues: the most advanced grain-growing region where they can procure a huge variety of quality crops to meet their needs directly from production sources. They can get those crops shipped to their doorsteps in containers with crop integrity intact, and as necessary identity-preserved. Once buyers step forward with serious intent to purchase, producers can judge whether it is worth considering what is in the offering and decide whether to walk away or enter further contract-negotiations.

**Model we are striving for**

Venturing into this portal, we had no delusions of having invented anything new or revolutionary; all we are trying to do is introduce a model that has been tried and tested in other domains, including domestic grain-trades, and thus should also work for overseas exports. This is a basic model built on *direct-sales* that tends to force markets to function more competitively, in the interests of buyers and sellers alike.

Basic Model: The grain industry is made up of numerous producers, farmers, and fewer but still a multitude of buyers – crushers, mills, processors, and others alike. Producers grow certain crops if market-prices are high enough to cover costs with reasonable returns on capital. Buyers pay those prices if they think they can make a profit in the next stage of production; if not, they look for other sources for those crops or switch to other crops. Perhaps a simplistic view, but direct transactions between producers and end-users facilitate markets to function more competitively.

It is natural to ask where the grain-companies fit into this model. The answer is simple: not all grains are ready to enter the supply-chain at farm-gates; they need cleaning, grading, and even processing, and this is where grain-companies can step in. When farming and transport-systems were primitive, grain-companies emerged to play consolidation, distribution, and trading functions, and as farms advanced and buyers developed their own capacities to procure and handle grains, the role of grain-companies changed but did not vanish. They extended their reach into various consolidation and processing functions, even into corporate or contract farming.

In the abstract this is how the grain-economy functions. Where possible, direct sales from farms to corporate-buyers set price benchmarks with no intermediaries, and where grain-companies are needed, they take their share for the value they add, but they do so in the knowledge that they can be cut out by buyers internalizing more functions, or producers doing more at their end. Where markets are effective, all players along the supply-chain get a fair share for the value they add. But markets do not always function effectively, as we saw in the past and observe even now.

Progress Made: In our last article we looked back on history to observe how WW1 had necessitated government intervention to protect producer interests. With the government pulling back prematurely, markets collapsed again forcing producers to take the matter into their own hands with the establishment of wheat-pools. When the *Great Depression* did the wheat-pools in, the government had to step back in to set up the *Canadian Wheat Board* (CWB), which became a permanent feature of our grain-economy in 1935 as a *monopsony*, a single-desk purchaser and marketer.

Membership was compulsory and the model was designed for producers to deliver their crops to country elevators where they were paid an advance, and during the year would receive the rest of what they were owed – their share of sales-proceeds less CWB's costs. The system held together well for decades, but as in any collective-model, in time cracks started forming along different fault-lines: between producing and purchasing regions, across different crop segments, among producers of different persuasions, collectivists and individualist, with many shades in between.

With political pressure mounting from Eastern Canada as well as from advocates of commercial freedoms within Western Canada, the government relented and in 1972 clawed back CWB's monopsony to only non-feed wheat and barley, in both domestic and export trades. Feed and specialty crop producers felt liberated, but discontent prevailed among many wheat-barley producers, demanding their rights to opt out. Voluntary participation was an option but was likely to be blocked by a majority of producers. Thus, CWB's monopsony prevailed over wheat-barley for 40 more years.

These were only two crops but represented a huge share of our exports, as well as a significant share of our domestic trades. The only way to escape CWB's monopsony was diversifying to other crops, initially canola being the principal one. Wheat exports did not decline in volume but shrunk in share to 50%, while canola increased to half that volume with 25% share, with other crops taking up the remaining 25% – mainly peas, lentils, and soybean. Thus, considerable diversification was already taking place, even under CWB's monopsony, but not to the region's full potential.

<u>Challenge Ahead:</u> The efforts to disband the CWB had failed in 2006 but succeeded in 2011, with its monopsony coming to an end in 2012 but allowed to operate as a grain-company for 3 years. In 2015 it vanished as a separate entity with its assets taken over by a consortium of Saudi interests and a US grain-company. In the meantime, as we discussed in our last article, a tsunami of consolidation had already gotten underway with all the wheat-pools being corporatized and merging under Viterra, which soon after was taken over by Glencore, a global commodities giant.

Since 1972 domestic and cross-border grain-trades of non-board crops had evolved and expanded, along the lines of the competitive-model we described above. Direct corporate purchases set price-benchmarks for grain-companies to follow with the value-added services they provide, be it through consolidation, handling, or processing. With wheat and barley also freed from CWB's monopsony, market competition now rules over all our grain-trades domestically and across the border to the US. But this is little more than half of the grains produced across the Prairies.

Close to half our crop-output is destined to overseas, where a very different model prevails. CWB's abolishment was expected to give rise to a competitive model like in domestic and cross-border trades. But unlike these markets accessible directly by truck or rail, overseas exports were highly captive to bulk-systems that had now fallen into the control of a handful of private grain-companies, basically a *private-oligopsony* replacing CWB's *public-monopsony*. Instead of higher margins expected from private traders, producers came under an even tighter margin-squeeze.

**Barriers in the way**

In this new industry structure that has emerged in the post-CWB era, at least in the overseas export domain, producer interests are not served well. The captivity to bulk-systems, gateways to which are controlled by too few trading-interests, hinder crop-diversification, and squeeze producer-margins. But these conditions are not an outcome of open price-collusion among grain companies; they stem from the nature of bulk-systems that were privatized with no regard to competitive implications.

There is no point trying to break up the custodians of bulk-systems or to regulate the pricing of the bulk-systems themselves. Grain-trades can be made much more competitive by opening alternative channels to bulk-trading so that producers are not captive to bulk-systems. In our case, we are trying to do this through direct-sales, a practice that we know from experience can facilitate grain-markets to work more competitively, as we observe from our domestic and cross-border grain-trades.

<u>Prevailing opinions:</u> Decades long struggle to get rid of CWB was highly polarized. Opponents would not tolerate any government involvement in what crops they grew or how they sold them, and regardless of the outcome, they were not prepared to budge from their staunch stance on commercial freedom. Proponents, on the other hand, never wavered from the all-or-nothing position even when CWB's existence was threatened, not even willing to consider voluntary-membership options; we did not see any movement on this collectivist-tendency even after CWB was abolished.

Politicians, the ultimate arbitrators of what happens, are too scared to go anywhere near the topic because of this unwavering polarization in producer opinions. There was no middle-ground to be found 10-20 years ago, and they do not believe there is one today. The topic is too hot for any civil servant, federal or provincial, to touch in view of the prevailing political sensitivity. Even elected officials of grain-commissions or producer-associations are reluctant to talk about industry-models, preferring to hide behind price or yield trends, or much safer topics like agronomy or technology.

Neither our approach nor the path we are pursuing touches this debate, not by any design on our part to shun controversy but because we firmly believe direct-sales is the most practical path to value-driven-diversification, thus higher-margin exports. We are often asked by our social-media followers where we stand on CWB, but the truth of the matter is we are over that. Our model would not have worked before 1972 and even after that, only for non-board grains; but from where we stand, what we are pursuing is the most practical and effective path to prosperity for the Prairies.

<u>Vested Interests:</u> Most grain-companies have done well since 1972, first with the liberation of canola and its move to bulk-trades with rapidly growing volumes, and even better since 2012 with being able to trade in board-crops, particularly overseas

exports of wheat that constitutes half our export volumes. Naturally, if successful, we will be diverting trades away from bulk-systems, thus threatening their interests. But we would be happy to divert just the proceeds of yield increases in the coming years to containerized direct-sales channels, leaving bulk-volumes where they are.

Even if the success of our mission goes beyond that to significantly reduce bulk-trade volumes, we will not be issuing any apology-statements to grain-companies, as any shift in favor of direct-sales channels will be in the interests of producers. We would also note that the new trade domains we open present new business opportunities for the same grain-companies that today are primarily vested in bulk-systems. It will be up to them to cultivate new export opportunities to engage in containerized overseas trades, by adding value through consolidation, handling, or logistics.

We should note that there are already containerized crop domains, like the most lucrative segment of our grain-economy, pulses. However, you would note that the type of direct producer-to-buyer exports we talk about are not prevalent in this domain and not likely to change with our efforts. The grain-companies tend to dominate these trades as there are many processing needs at the export-end, and companies at the import-end are established distributors serving highly fragmented end markets – scope for direct-sales from producers to end-buyers are limited.

Information Gap: We are not deterred by any of the above prevailing attitudes or vested interests in pursuing our mission. We firmly believe that if we are there to serve producer interests, and producers believe in our cause, none of this could stand in our way, as producers are not only our platform's constituents but also the primary stakeholders of the grain-economy at large. Political or vested-interest resistance will only be a distraction, not a material barrier to our mission's success.

Neither the government nor the grain-companies can prevent producers from selling through direct-channels to domestic or export markets, as they do now not just within Canada but across the border to the US. But there is reluctance to engage in direct-sales to overseas markets due to perceived trade-risks and lack of adequate container-logistics services. Before even getting into these challenges, which we firmly believe can be overcome, there is the information or familiarity gap between the buyers and sellers that prevents even sales-contacts from getting established.

This latter problem is what needs to be addressed first. Unlike corporate buyers across North America, overseas importers know little about the production side of our grain economy, that there is a huge variety of crops that can be procured from farms – our grain-economy is known primarily if not exclusively for its bulk-exports. Also, our producers know too little about overseas export opportunities to even consider sales prospects, let alone target buyers. In our trade-facilitation mission, this *information-gap* is the first challenge we must tackle with our *core-strategy*.

**Core of our strategy**

In its early stages, our portal is meant to be an *information-portal* that kicks off an exchange of ideas among producers about the future of the Prairie grain-economy. The main driver motivating us to launch this initiative was that overseas exports were not performing as well for producers as domestic and cross-border sales; the margin-squeeze on producers was already a problem and was likely to get tighter. The salvation was in a *value-driven-diversification* strategy, and to this end, producers had to shift away from bulk-trades to direct-sales fulfilled in containers.

We have been delighted with the response from the producer community, with our following reaching levels far beyond our expectation – through website-visits, article-readings, as well as social-media participation. With this level of interest, now we consider the main thrust of our vision validated and are moving ahead with the next phase to lay down the foundations of our *trade-facilitation* platform. We described the "path" we are going to follow in our Article-XXV (posted on our website); here we want to expand on the core elements of the strategy that will chart this path.

<u>Promotional Efforts:</u> Across North American grain markets there is no information-gap: corporate-buyers know what crops they need and where to find them at source. Overseas buyers, on the other hand, know very little about our grain-economy. Most buy our grains from wholesalers or distributors at the end of bulk-trades without even being aware that they are buying *grown-in-Canada* grains, let alone that they can procure the same directly from actual production sources in quantities they need, shipped to their doorsteps in containers, with crop-integrity intact.

To this end, we have embarked on our *farm-profile* and *regional-profile* programs, to extol the virtues of our primary production sources, farming-enterprises, and the strengths they draw from the region's research-capacity, advanced-technology, classification-systems, health-and-safety regulations, and quality-assurance programs. As we develop our *Prairie Grain Mall* platform, these virtues will be on visual display through *virtual stores and pavilions.* This will be a cutting-edge virtual stage with audio and visual features, a platform overseas buyers can visit online to get to know our grain-region, the crop-varieties it offers, and many other virtues.

We no doubt have the most diverse crop-base of all grain-regions around the world – huge variety of coarse-grains, oil-seeds, pulses, and other specialty-crops. What we produce for domestic markets is much more diverse than what we export, and our capacity goes even beyond that to specific crop-grades with special attributes buyers may be looking for. Together with our applied-agronomy and *precision-farming* capacities, combined with seed-varieties, farm-inputs and soil-conditions, Canadian Prairies are closer to rising to *grow-to-order* standards than any other region in the world – a capacity we will extol through our *Trade Mall* pavilions.

Market Research: We face yet another challenge: we know as little about global grain markets as overseas importers do about our grain economy. Putting so much reliance on bulk-exports for so long, our export strategy was simple: let farmers produce as much as they could, stock the surplus left from domestic consumption, and sell to the highest bidders on the world-stage. Market research was limited to following global crop-price trends, with a so-called strategy to sell when those prices peaked, with little effort to understand what the world was producing or consuming.

This became evident recently with the Russia-Ukraine war. We knew both sides were major grain producers and among our competitors in export markets. We had to learn from the USDA that Ukraine's exports might be down by 35% this year but were clueless about how this shortfall could be filled or its impacts on our exports. Even worse, we had been ignoring the entire Eurasian-belt extending all the way to the Pacific, and implications of yield-increases being achieved to our export position.

In finding new market opportunities, one would have thought, as the 5th largest grain exporter in the world, we would try to understand shifting global demand and supply patterns. For example, over a 20-year period to the late 2000s, our exports to China had increased more than 4-fold to become our largest export destination. All we seemed to know about China's grain needs was that China was importing more from us. To strive for an effective export strategy, we must shed this reckless negligence.

Channel Development: The above two, promotional-efforts and market-research, will constitute the main thrust of our efforts in the coming months, but our mandate will not end there. Though we do not expect to evolve into an electronic trading platform, *trade-facilitation* is our ultimate-goal. While we entice buyers to post purchase-intents, we will encourage producers (or producer-groups) to post crop-offers. Interactions between counter-parties are not likely to lead to one-click-sales online, but hopefully they will pave the way to further contract-negotiations.

As we described in our platform-development-path, we are also developing a *trade-facilitation* layer, which will sit on top of the *Prairie Grain Portal* platform. This layer will host the *purchase-intents* posted by buyers and crop-offers posted by producers with enough details to attract interest from each other. The parties can keep the posts online to attract competitive interest or take them private to pursue contract-negotiations – further involvement on our part will be up to the negotiating parties.

Until this structure becomes operational, which we do not expect before the end of 2022, we will be using the *trade-forum* on our current information-portal. In the coming weeks you will see changes introduced to this section to allow producers to post preliminary expressions of interest. In the meantime, we will leverage our Asia Pacific contacts, as well as findings of our market-research efforts, to attract buyers to the portal – currently the overseas reach of our portal is still very shallow.

**Small steps you can take**

Where producers sell their output varies greatly depending on their size, location, or crop-mix. But on average about half of what they produce ends up in domestic or cross-border markets, and the other half in overseas markets. A very large share of the latter, 85-90%, is consolidated through bulk-systems, which means they sell that portion to grain-companies. The residual may be containerized (like pulses) but still sold mostly to grain-companies, and a very small share to independent traders.

Of the other half that ends up in domestic or US markets, we know a sizeable chunk but do not know exactly how large, is sold through what we refer to as direct-sales channels. These may be flour-mills, crushing-plants, or feed-lots producers are familiar with and deliver to directly, or corporate-buyers that reach to them through procurement programs. These channels developed over time, since 1972 for most crops and since 2012 for wheat-barley, giving producers the freedom to sell direct.

In time our goal is to introduce these types of channels into overseas exports. But there are no direct-buyers nearby, and the ones who we would like to reach do not know much about the Prairies, and even less about our producers as procurement sources. Naturally, we need producer participation to promote their interests, and guide us select crop domains where we should focus our efforts. Also, we would like to start a dialogue on trade-risks producers fear might come with these channels.

<u>Participation:</u> In a fairly short time we developed a sizeable audience reading the articles we post and engaging in discussions on our social-media page. Clearly, there is interest in what we are trying to do, albeit with some reservations as one would expect in anything new that is going to directly affect participants' well-being. We firmly believe that what we are calling for is in producers' best interest, and we are delighted that the initiative has gotten underway with considerable attention.

A few months after our launch, we introduced the *farm-profile* program. Initially, there was some reluctance but in time more producers warmed up to the idea and started signing up to the program. This is a critical tool in our promotional arsenal in positioning production-units, farms, as primary procurement sources to attract overseas buyers. We would encourage everyone to sign up so that we can reach our 100+ target, a minimum threshold to migrate to our *Prairie Grain Mall* platform.

Another program we are going to initiate in the coming weeks is local-group discussions, which we hope will develop into *local-chapters*. We believe direct exchange of ideas between producers will not only galvanize support for our initiatives, but also ensure that we focus on producer needs. We also hope that through local-chapters we can foster cooperative-initiatives to demonstrate that larger crop-volumes can be consolidated to meet larger contract requirements.

Guidance: Now that we are over the conceptual stage of what we are trying to do, extending direct-sales that we engage in our own backyard to overseas markets, we must get more specific with the type of crop-sales we should be focusing on. We have some ideas in this regard, but much more importantly, we need guidance from producers: where they see the most promising crop diversification opportunities – higher value crops that their soil and growth conditions are most suitable for.

Let us start with a few ideas that we have already floated for consideration. We noted that wheat-flour trends are shifting across Asia Pacific, presenting prospects of containerized exports of special wheat grades. Breakfast-cereal demand is on the rise, like across North America many decades ago, presenting opportunities for a variety of cereal exports. Also, demand for all sorts of organic-grains is growing rapidly, albeit in smaller quantities but presenting a significant value proposition.

These are some raw ideas for consideration, but you as producers know best and can guide our priorities much more wisely. To facilitate exchange of ideas in this vein, we are restructuring and activating our *trade-forum* and invite you to participate. We will initially post some raw ideas, in the way of brief paragraphs to solicit your feedback and ask that you do the same. We hope this will trigger further exchanges, not only two-way but across all participants – a lively debate forum to participate.

Risk Assessment: From all angles – one-on-one discussions, the couple of virtual town-hall meetings held, and social-media comments – we get the impression that what worries producers most are increased trade-risks from direct-sales to overseas buyers. Naturally, local grain-company contracts that producers have relied on for years are going to look safer than new customers. But is a Japanese brewer or South Korean miller going to pose more trade-risk than an American cereal-producer?

We believe every risk-element should be identified and mitigated, but it is also a reality that all trades pose risk-reward trade-offs and generally the least risky trade tends to be the lowest margin one. There are also risks associated with bulk-trades, increasing competition from low-cost producers shrinking volumes and lowering prices. There are trade-insurance mechanisms, but also, in some ways specialization or diversification is “insurance” against squeezed margins from staple-crop exports.

Any way you look at trade-risks or risk-reward tradeoffs, the matter warrants further consideration. To this end, we have a couple more articles planned in the next month to address risk-related matters, how to assess trade-risks and mitigate them. Also, we will introduce another section to our *trade-forum* on these topics. We are finalizing its format, but it looks like the most suitable approach is for us to post brief (1–2-page) discussion pieces to open debate on specific issues, or remedies. There will be some cross-overs between different sections of the *trade-forum*, but all related and relevant to our mission – hope you will participate in all these debates.