

### Farmers' conundrum: how to escape the margin-squeeze

As part of our interim trade-facilitation efforts, we had identified four priority areas. With our last two articles, we addressed malting-barley and specialty-wheat; we will get to the other two, cereal-mixes and feed-mixes, in the coming weeks. As we were closing our 4<sup>th</sup> volume of articles, we thought we would pause and reflect on our first year online with this *information-portal*, and our plans going forward, which will be a transition from this interim phase to our new trade-platform, *Prairie Grain Mall*.

The fundamental problem we are trying to fix is the *margin-squeeze* producers suffer exporting overseas through bulk-channels. Their hands are tied, as they are captive to these channels, and they must export their surplus – they produce twice what can be consumed domestically or sold to the US. The most effective way to alleviate this *margin-squeeze* is to open direct-sales channels, like the ones across North America but fulfilled in containers instead of trucks or railcars. These channels will not only free producers from their captivity to bulk-channels but also yield higher margins.

When we first embarked on this initiative, we had sensed considerable skepticism about the viability of containerized exports through direct-sales. Part of it was historical-conditioning, in the belief that bulk-systems were the only and most cost-effective way of exporting grains overseas. But we have since managed to overcome much of the resistance by showing how container-supply problems could be solved, and more importantly, how trade-risks could be avoided by farm-gate payments.

With the progress we have made in the last year, our following growing and their engagement deepening, we now feel that the “validation” of our mission has been accomplished, and we are on to the “execution” phase. Our existing information-portal was not suitable, at least inadequate, for this purpose; thus, we had designed a new platform, the *Prairie Grain Mall*, a virtual-marketplace foreign buyers could visit online to get to know the virtues of the Prairie grain-economy and be exposed to production-sources where they could procure a huge variety of quality crops.

In the meantime, a tragic war had broken out with Russia invading Ukraine, posing significant risks to global grain supply. Ironically, we saw a window of opportunity behind this travesty with pent up demand for grains at high prices, but only bulk-traders were going to benefit from this tragic twist of events. Rather than waiting for our new platform, we rushed into a phase we called interim-trade-facilitation to cultivate direct-export opportunities that could yield higher margins for producers.

We are pursuing these opportunities by reaching out to overseas buyers directly, but we can offer no guarantee that we can deliver results for this year's stocks, even in select crop-domains where we see immediate opportunities. Still, we believe this is a worthwhile effort to go through in the interest of producers. We were hoping that this would not delay the introduction of our new platform, but it is going to, which we now postponed into next year – we will report on this front in our next article.

### Our mission in the cause of grain-producers

Our mission is motivated by a naked reality: despite huge advances on the production front and all the market-reforms, producers are barely making ends meet. The quest to privatize the grain-industry and liberalize grain-trades had been in the cause of freeing farmers to sell their crops through any channel they wished. Coupled with the freedom to grow what they wanted, which they already had, this was supposed to ensure their prosperity in a grain economy driven by market competition, but things have not worked as intended – something has been amiss.

As crop sales were freed from CWB's single-desk system – wheat-barley only a decade ago but other crops earlier – domestic and cross-border trades had started functioning competitively, leaving reasonable margins behind for producers. But the surplus, roughly half of what was produced, still had to be exported to overseas markets. These exports had remained largely captive to bulk-channels, limiting export-proceeds from grain-trades, and squeezing margins left to producers even more. This was the reality of our liberalized grain-sector, but in self-interest the private grain-companies have been in denial, and governments largely oblivious.

While a segment of the producer community was calling for the CWB to be brought back, our solution was not reregulation or nationalization but a market-driven approach to free producers from their captivity to bulk-systems in exporting overseas. What we were proposing – direct-sales through containerized-channels – would bring about a market-driven environment like the one in domestic and transborder grain-sales. As across North America, overseas buyers would compete among themselves and share with producers the higher margins left behind from eliminating intermediaries, consolidators at source and distributors at end-markets.

What had made direct-sales possible across North America were truck or rail-car deliveries from production-sources to processing-plants. This could not happen in overseas-trades where there were oceans to cross, but there were containers that could facilitate intermodal transfers, from trucks to railways to shipping-lines. However, grain producers were tricked into viewing bulk-systems as a *celestial dictum*, the only way of transporting grains over long distances, particularly where oceans were involved – most were unable to relate to containerization as an option.

The grain community at large had been conditioned to think that bulk-consolidation always offered the least cost means of transport – perhaps a logical proposition in a time when containerization had not taken hold in North American grain-trades. But it has happened in Europe and Asia; both cost and quality-preservation advantages were not difficult to relate to and were quickly capitalized on. The bulk-systems our producers are captive to have become a relic inherited and embraced by their private custodians, and are being perpetuated in the self-interest of their inheritors.

Supporters of privatization had believed the only evil hanging over the grain-economy was the single-desk system, thus they celebrated CWB's abolishment as

the ultimate panacea to liberate the grain-economy. Unfortunately, they overlooked an equally serious problem: captivity of overseas grain-exports to bulk-systems, the control of which had now fallen into the hands of a few private grain-companies with little incentive to engage in price competition in procuring grains from producers to consolidate. It was natural for this *oligopsony* to ignore the problem in self-interest, but ironic that governments (federal or provincial) would not own up to it either.

In embarking on this initiative, we were confident of our diagnosis: the value-trap producers are in needs to be resolved. The solution is opening direct-export channels that would yield higher farm-gate prices. As in anything new, there might be some initial resistance, but producers would rally behind this cause in self-interest once security and higher margins can be demonstrated. What is needed is a *trade-facilitation* platform to connect producers and overseas-buyers to negotiate direct-sales, while enabling the *handling-and-logistics* solutions to fulfill those direct-sales.

As a platform we had the necessary experience, both in Canada and overseas, to tackle the logistics challenges, and found a leading transport company in Western Canada to partner with us. We had designed the trade-facilitation platform, but it was going to take investment-capital to develop it. Rather than local investors familiar with the grain industry but not attuned to internet-trends, we wanted to partner with a tech-investor with experience in online-platforms, not just e-commerce but also facilitation-platforms – an *Ali Baba* solution for grain-producers.

Based on our experience in new technology ventures and serving private equity investors in advisory capacities, we could foresee the challenges in raising funding for an early start-up. Though our business-concept was easy to relate to due to market realities, we knew that investors were going to look for “validation” from the primary stakeholders we were planning to serve, grain-producers. Being familiar with producer sentiments, we did anticipate some resistance, or at least reluctance.

Thus, we held back on rushing into the investment phase, and instead started with an *information-portal* with our own resources to see what traction it would get from producers. This is the initiative you have been following since our launch a year ago. The reception has been quite gratifying, far exceeding our expectations from a portal of ideas and concepts – we feel we have articulated the problems producers face and we have outlined our proposed solutions aimed at increasing their margins.



### Validation of producer interest and support

Our information-portal was designed quite broadly to relay our views on Prairie agriculture – its virtues as one of the most advanced grain-growing regions in the world with a highly diversified crop-mix and high-quality export-offerings. We outlined our approach to trade-facilitation coupled with integrated grain handling-logistics solutions – farm-gate to end-market deliveries in containers, without having to rely on any consolidation through bulk-systems or trading-intermediaries.

Our focus on the *margin-squeeze* in our earlier articles attracted a lot of attention from the producer community, as they had been feeling this squeeze in their bones for so long. Many crops had been dropped from the CWB's net much earlier, and a whole decade had passed since the agency's abolishment, but they had not seen much improvement in their revenue yields. We were not sure, however, whether producers were fully aware that the squeeze was coming from their captivity to bulk-systems and their custodians – they were going to need more convincing.

The timing of our launch, not intentional but fortuitous, helped the reality to sink in. Year to year survival with thin margins was not enough in this business; the drought they were experiencing was not a one-time event but a recurring one with perhaps more regularity under the effects of climate-change. They needed to put away the surplus of the good years to cover the bad years. The 2020-21 crop-year had been the best on record but had left little behind in contingency funds to make up for the 30% drop in their output in 2021-22 – for some areas even much worse than that.

What made matters worse in 2021-22 was the dangerous habit that had come with market-freedom: playing futures markets and entering advance sales-contracts. These came with commitments to deliver whether producers could harvest those crops or not. Advance sales had become a routine means of finance, but producers had not grasped the potential liabilities. In cases where grain-companies decided to enforce contract-clauses some producers faced insolvency; even those not directly affected turned against these grain-companies, looking for alternative channels.

As if the 2021 harvest was not bad enough, in its aftermath there was yet another blow: huge cost increases for inputs for next crop-year, at least for those who had survived. Also, the prices producers got for the surplus they had from domestic and transborder sales did not reflect any scarcity-premium, which one would expect in a drought-year to compensate for lower crop-volumes, at least partially. Markets were not working, at least not for everybody along the supply-chain, but some like the grain-companies, had enough market-power to look after their own interests.

Sad to say but all these factors had helped our cause as a wakeup call that the *status quo* was not safe. We were not sure whether the risks of captivity to bulk-trades had sunk in, but we sensed a rising awareness that alternatives must be considered. As to the viability of the alternative path we were advancing, there were doubts but at least the willingness to consider was there, thus we were encouraged to press on.

**Trade risks:** We sensed early on that first and foremost producers were concerned with trade-risks that they believed would come with direct-sales to foreign-buyers. This was a legitimate concern since revenue loss from even a single container-load (\$10,000-20,000 depending on crop) would seriously harm a producer’s finances.

Initially, we took a risk-reward-tradeoff approach, coupled with insurance options, but then stiffened our position: not to consider anything less than farm-gate payments in full. In time, as buyers earn producers’ confidence, terms could be loosened to LOCs or other guarantees, but initially we made upfront payment an ironclad rule for all trades we would facilitate, in sales or fulfillment capacities. Also, all handling-and-logistics costs beyond farm-gates would be on buyers’ account.

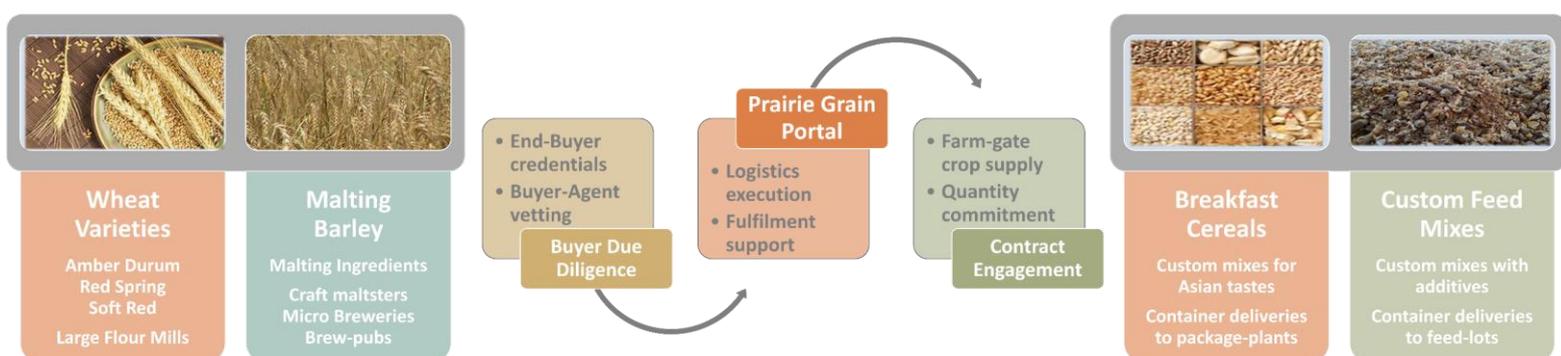
Moreover, we added another condition to the trades we were willing to promote or facilitate: a willingness on the part of the buyer to pay a meaningful premium over what producers were getting from local grain-companies, measured not in cents but dollars per bushel. After all, we were unabashed producer-advocates in our mission.

**Container supply:** Availability of containers in the Prairies and costs of shipping them to export markets were on top of producers’ concerns in reacting to our mission – understandable in view of the difficulties they encounter when in need of one, and the brainwashing they have been getting from the advocates of bulk-transport.

As in trade-risks, we decided to take an equally stern position in these matters, at least to start with until they warm up to the concept to take on these challenges for even higher trade-margins. In any trade we facilitate, all the handling-and-logistics burden falls on the buyers, who are more experienced in this domain from their procurement efforts elsewhere in the world. Prairie producers could focus on prices they get at farm-gates, all the rest to final delivery falling on buyers’ shoulders.

We view container-supply as an operational challenge we can take on, while based on decades of experience in this domain, we are confident of net cost-savings from containerized shipments over bulk-shipments. The whole world is shifting in this direction in view of savings from eliminating consolidation and distribution costs.

*With this approach, we are confident of overcoming producer-resistance to direct-sales: all producers need to worry about is prices they get at farm-gates. This “validates” our concept, but we face another formidable challenge to worry about.*



### Remaining challenge: attracting buyers

If the main resistance to direct-sales to overseas markets stem from trade-risks and container-supply concerns, and we have found ways of overcoming this resistance, why are overseas buyers not lining up to procure grains from the Prairies? The answer is simple and contrary to what we assume or believe in: the world knows very little about the virtues of our grain economy, other than the fact that we are a major producer and exporter of grains. Moreover, it is not easy to uncover much information about our grain offerings, even in today's online-information-age.

Even those of us engaged in this domain in professional capacities struggle; it is not easy to gather or compile data for analysis or reporting. If you are not willing to take our word for it, go online and see what you can find in the way of crop varieties that are grown across the Prairies, output volumes over time, export trends, and most importantly where and how to procure – other than through bulk-channels that dominate grain-trades and lie at the source of the problems we are trying to solve.

As the 5<sup>th</sup> largest grain-exporter, we take it for granted that the whole world knows us and what we produce, but the reality is that there is little visibility into our grain economy other than what we export in bulk. At the receiving end of bulk-trades are the counter-parties who distribute grains through wholesale channels. End-users may not even know that the grains they process are *grown-in-Canada*, let alone be aware that they can buy those grains, in the varieties and grades they need, directly from production sources and get them shipped to their doorsteps at lower cost.

With the advent of intermodal-systems that made containerization of grain-trades possible, many end-users have abandoned bulk-channels and started procuring what they need from production sources. Like corporate buyers in our own backyard, feed-companies, flour-mills, bakery-chains, or food-processors across Asia Pacific are procuring what they need directly, not from us but from Central Asia, Eurasia, or Europe, and getting them shipped in containers. In North America, we still have not woken up to the same potential, continuing to consolidate in bulk to export.

The production end of our grain economy is the most advanced in the world, be it in agronomy, farm-inputs, or farming-methods, the results of which are evident in the variety and quality of crops we grow. Our classification-and-grading systems, as well as quality-assurance practices, are the envy of the world. But at the marketing end we fail to promote ourselves in end-markets, as a premium source of a huge variety of crops that can be bought directly from producers to end-users' specifications and delivered with crop-integrity, in quantities they need to their facilities in containers.

We knew this was going to be a challenge in opening direct-sales channels. The portal we launched last year was to feel out producer sentiments and their appetite for utilizing new direct export-channels that would yield higher margins for them. Beyond that "validation", the challenge was going to be a "promotional" one to recast our global image and develop a new platform to facilitate grain-trades.

We conceived and designed this new platform, the *Prairie Grain Mall*, with *virtual-stores* and *virtual-pavilions* to promote the virtues of the region’s grain-economy to attract overseas buyers to procure the grains they need directly from primary production sources. Visitors will be able to browse through this platform as if they were walking through an exhibition-hall to get to know our grain-economy.

The main purpose of this initiative is to recast Canada’s global image from one of a bulk-exporter to a land of advanced-farms where a huge variety of quality crops can be bought and delivered directly to end-users. In this vein, we focus on production sources, advanced farming methods they deploy, and the crop-varieties they grow.

Production Sources: First and foremost, we will bring attention to our farms, which rather than collection points of bulk-systems will be displayed as *virtual-stores* where buyers can browse through looking for the crops they need. We provide the visual tools and the support for individual producers to set up their own stores and update the contents to promote themselves – crop-varieties, farming-methods, machinery-equipment, technology-systems, storage-capacity, together with the stock-levels they expect to have or already have in storage. We will provide the search-tools for buyers to find the type of farms they are looking for to meet their specific needs.

Farming Methods: The advanced state of Prairie agriculture will be evident from the individual farm-profiles we display, but we will reinforce this image through *virtual-pavilions* on various science-and-technology themes. The region has the world’s richest mineral-base for farm-inputs (fertilizers, nutrients, and pesticides). Latest machines are in action with GPS for position-tracking and automated-guidance, and variable-rate-spreading devices to apply the desired amounts of inputs. Information-system applications behind the scenes, coupled with big-data uses, allow integrated activity planning and management systems for highest yields and best crop-quality.

Crop Varieties: Another virtue of the Prairie grain economy is its diversity, offering a huge variety of high-quality crops, which we will convey through *virtual-pavilions* on all crop-domains. The wheat-pavilion will display the types and grades we produce for all conceivable end-uses, while the barley-pavilion will showcase the varieties for malting and other uses. We will also have pavilions for primary oilseeds, canola and soybean, as well as pulses (lentils, peas, beans) that we have become so well known for. There will also be pavilions to promote the cereal varieties we produce, as well as many other specialty-crops we are not known for but could export much more of.



In addition to these main pillars of the *Prairie Grain Mall* we described above, there will be many other *virtual pavilions* on select themes or on special interest topics to extol the collective virtues of the region's grain sector, like the following key ones:

**Agronomy Research:** The region's agricultural research capacity is unmatched, with programs and labs at the service of not only producers but also buyers. Advances in seed-strains, and their adaptation to local soil conditions, contributed greatly to yield and quality improvements, and will continue to drive diversification to new crop-varieties. Applied-scientists are also actively involved in field-operations, guiding best-practices in seeding, fertilizer-chemical applications, and harvesting methods.

**Crop Classification:** We first started developing classification-and-grading systems in our staple-crop domain, wheat; varieties evolved over time with attributes suitable for specific end-uses. These efforts were coupled with rigorous sampling and testing practices to ensure quality-compliance in what we exported. The same traditions were followed in barley, especially for malting, as well as in more recent crop domains – canola, soybean, and pulses, all grown in numerous varieties and grades.

**Quality Assurance:** We have deregulated grain-trades but not safety or quality. The entire grain-chain is regulated from seeding to servicing to exporting, with licenses issued to every agent along the way who are subject to regular inspections. Grain traders or exporters are also licensed, to ensure that all sales-transaction are in accordance with the classes and grades as designated. Our identity-preservation regulations are the world's envy, with strictly enforced compliance in exports.

**Sustainability:** Governments are also active in furthering the cause of sustainable-agriculture, some even claiming that Prairie agriculture has turned into a carbon-sink, obviously a great feat in combating global-warming. Farming is irrigation-free in most parts of the region; both resource-requirements and carbon-emissions are closely monitored to ensure that the sustainability-record is not just maintained but improved, with a lot of attention being paid to fertilizer-use and alternative-fuels.

In addition to these virtual stores and pavilions, the *Prairie Grain Mall* will have a trade-facilitation layer, a platform for producers to post *crop-offers* and prospective buyers *purchase-requests*. Grain-trades do not easily lend themselves to one-click-sales; platforms taking this approach have not been very successful. But there is still scope for nurturing trade-relations with a consultative-approach: connecting buyers and sellers to pave the way to contract-negotiations, what we hope to achieve.



### Where are we at with our mission?

Earlier this year, six-months into the launch of our information-portal, we had gained enough confidence from the interest and following we had generated to declare the “validation” phase a success. Also, as the seeding season was ending, we had made enough progress with the conceptual design of our new trade-facilitation platform, with a fully qualified team lined up to proceed with actual development efforts. Our goal was to introduce a working prototype online before the end of 2022.

In the meantime, Russia had invaded Ukraine and by the Spring it was evident that this was not going to be a quick affair like the invasion of Crimea in 2004 but a long-drawn-out war. The consequences of this senseless but dreadful conflict were difficult to predict, as Russia seemed determined to annex all of Ukraine, while the Western Allies were equally determined to prevent this from happening. The two countries engaged in the war, Russia and Ukraine, were among the top-10 grain producers in the world, together exporting more than double our export volume.

A prolonged war was going to diminish Ukraine’s production capacity, which has already shrunk by 30-40% but much worse can be in store. Export routes are in jeopardy, with the Black Sea route already at the mercy of Russia, which could soon be cut off altogether. In theory, Ukraine has rail access to markets to both its west and east, but all are in danger including its domestic rail-lines and can all be cut off if the war were to escalate. Russia’s own system is intact, in fact expected to yield a record volume this year, but trade-boycotts could easily hurt its exports. In total 15-20% of global grain exports could be in jeopardy, creating a severe supply shortage.

The war had naturally thrown global grain trades into a frenzy, with fears that grain shortages could threaten global food security. Early in the Summer, the outlook on our own 2022-harvest was quite bullish; though there was a long growth season ahead, when a lot could go wrong, many industry watchers were hoping for a harvest almost as good 2020, a record year. In July, Agriculture Canada’s crop-outlook was calling for 44 MT of exports in 2022-23, 40% more than the year before.

In an article we published in June, we concurred with the promising volume outlook but warned producers not to drool over high margins in view of the feared global shortages. While our bulk-exporters might realize higher prices, there was little reason for producers to expect premiums from higher export-proceeds. In view of a bullish supply-outlook, North American grain-prices were lower than those observed in global markets. The grain companies had no reason to pay any more for crops destined to export-markets than what producers were getting from domestic or transborder sales – in fact, likely less as there was nowhere else to sell the surplus.

Our plan coming into June was to launch the new platform later in the year, starting overseas promotions into 2023, but with no real expectations of catching much of the 2022-stocks. But based on the 2022-harvest outlook and all the pain carried over from the last drought-year, we amended our plans: rather than wait for our

new platform, we decided to embark on an interim-strategy. We have since outlined the elements of this strategy in our last two articles on malting-barley and specialty-wheat – we have also embarked on a canola-initiative, which we will report on soon.

Though our resources for direct marketing efforts are limited, we have designated agents to pursue the opportunities we are targeting in South Korea and Japan, as well as in second-tier markets, Philippines and Indonesia. In China, where we see the greatest potential, we are building a team to pursue the opportunities we have identified more rigorously. In view of the harsh stance China has taken against Australia (sanctions as well as bans), prospects for Canadian imports look good but we cannot say Canada-China trading relations have normalized yet. Though we are reaching out to corporate buyers, all grain imports to China are subject to quotas that are in the hands of the government, which nobody has any influence over.

We outlined the terms and conditions of the direct-sales we are trying to facilitate. As long as post-farm-gate fulfilment chores are taken care of, which we are shouldering together with our lead-logistics-partner and other service-providers, we do not see any resistance from producers as long as they get secure payments at farm-gates with a meaningful margin over what they are offered by local grain companies. Once we identify prospective buyers, we shoulder the consolidation burden at the farm end, together with all the project-management functions in fulfilment. We are confident of the long-term viability of these direct-channels, though still unsure of what we are going to be able deliver for this year's crop.

Naturally, this is not the way we intend to operate moving forward; we want to move to our new platform as soon as possible. We had made considerable progress in our design-efforts earlier in the year, but these interim trade-facilitation efforts to achieve early results set us back. Earlier this year, we had taken some initiatives to raise seed-funding for our development efforts in the hope launching a prototype-platform before year-end. Unfortunately, these fell through as there is no appetite on the part of public agencies to contemplate these types of initiatives, not believing that there are any problems in grain-trades, already liberated and functioning well.

This persistent denialism of the *margin-squeeze* our mission is driven by will be the subject of our opening-piece to the next volume of articles. This upcoming article will be aimed at producers, reiterating our fears that their captivity to bulk-exports will continue to haunt them unless they try to pursue the type of direct-sales channels we are committed to facilitating. We have given up on public agencies for support in the cause that we are pursuing in the interests of struggling producers – we will address this inexplicable conundrum in more detail in our next article.

The reality is that we still need investment finance to develop the trade-facilitation platform we have designed, and to this end we will turn to private-equity to see our mission through. Every year that goes by this *margin-squeeze* puts producers in greater danger – thus, our determination to introduce our new trade-facilitation platform as early in 2023 as possible, with whatever external funding we can get.