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Transnational Grain Companies: Evolution and Strategies in North America*

Highlights

This study documents changes that have occurred in transnational grain companies and how they may impact the evolution of grain marketing in the United States and Canada.

The objective of this study is to document changes that have occurred in the structure of the international grain industry and how they may affect the evolution of grain marketing. The study entailed two analytical phases. The first was to analyze changes in the structure of the grain handling and marketing sector, with a primary focus on that in the United States. The second was to conduct a series of interviews with senior executives in transnational and large U.S. grain companies.

Dynamic Changes in The World Grain Market

During the 1970s, world trade increased very rapidly. An important impact of this change was an increase in export volumes which provided incentives to expand handling and shipping capacity throughout the world grain industry, and in the United States in particular. During the early 1980s, surpluses began to grow. Decisions to expand capacity were coming on stream resulting in excess handling and shipping capacity during this period. In part, because of these surpluses and due to developments in the EC, the use of EEP and other government assistance mechanisms increased. There were several important aspects of EEP that affected both the intercountry and interfirm competitive environment. Of particular importance was that it was targeted to specific countries. In addition, it had the effect of increasing transparency, thereby mitigating advantages of some firms. The important feature of the international grain trade during the 1990s will likely be the increased privatization of grain import functions which will have important impacts on the structure of competition among firms and single seller agencies.

Structural Changes and Conduct in the U.S. Grain Marketing System

There are four major trends that are apparent in the changing structure of the U.S. grain handling sector.

Changing Composition of Firms. The composition of firms involved in the industry has changed. In addition to the entry of the Japanese trading companies in export handling in the 1970s, there are two notable changes that occurred during the past decade. One is the increased participation of regional cooperatives in the handling sector. While cooperatives have always been active in this industry, their expansion into the export sector has been noteworthy. In addition, at least in the Northern Plains they have retained the

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*This leaflet summarizes Ag. Econ. Report No. 412 prepared by Dr. William W. Wilson and Bruce Dahl. A copy of the report is available upon request from the Department of Agricultural Economics, P.O. Box 5636, North Dakota State University, Fargo, ND 58105-5636; Ph. 701-231-7441; fax 701-231-7400; or e-mail at cjensen@ndsuext.nodak.edu. This publication is also available electronically at this web site: http://agecon.lib.umn.edu/ndsu.html competitive position despite the dramatic rationalization that occurred during this period. The second characteristic is the increasing dominance of more public firms in the sector. This industry has conventionally been dominated by private firms that some have alleged have greater ability to take risks and operate with less disclosure. However, growth within the sector is dominated by firms with a greater public exposure than not. These include ADM and ConAgra (in addition to General Mills) as publicly held stock companies, regional cooperatives (Harvest States and Farmland) that report publicly, and the increasing public disclosure of Cargill's financial performance (due to broader distribution of their stock).

Vertical Integration. The United States marketing system evolved from vertically disintegrated firms linked through market transactions. However, much of the structural change within the industry has been toward more vertically integrated firms or agreements. There are likely several impetuses for these changes but some are noteworthy. These include: 1) demands for greater logistical control, 2) quality control, and 3) strategic changes to mitigate market power of firms elsewhere in the vertical market system. The first two of these are efforts to further pursue cost savings through vertical linkages.

Value-Added. A major thrust of many of these firms has been toward value-added. While value-added could simply be viewed as a special form of vertical integration, it is important that in most cases it has been for grain firms to integrate into commodity processing, or for commodity processing companies to integrate backwards into grain origination. Examples include: 1) dominance of the flour milling industry by grain handling firms, 2) dominance of the malting industry by either firms with extensive grain handling operations or by brewers, and 3) similar observations in the livestock sector. Each of these firms, particularly for regional cooperatives, has indicated that their strategic intent is to grow in areas related to adding-value to commodities.

Joint Ventures. Much of the structural change that has occurred has been in the form of joint ventures. Vertical joint ventures are particularly important because they suggest the need to create relationships to jointly exploit advantages of grain origination and off-shore exporting firms. The alternative to joint ventures would be vertical expansions, resulting in redundant assets and excess capacity, or continued use of bidding as a mechanism of vertical control. Either of these is less desirable relative to what could be achieved through a joint venture which should be intended to share benefits of repeated transactions and exploit vertical efficiencies.

Despite the consolidation in this sector, various measures of concentration suggest the industry is highly competitive. Comparison of market power at different points in the system demonstrate that generally the grain storage and handling sectors are highly competitive relative to the processing sector which is much more concentrated.

Transnational Grain Marketing Firms

Functions performed in grain exporting are much more encompassing than conventionally viewed. This is important because the vertical boundaries of firms involved in international grain trading depend on the functions they perform. Some firms are highly integrated throughout the marketing system (with a focus on executing sales through to the importer). In contrast, some firms appear to be focused strictly on the interface between export handling and the import/processor interface. Other firms that traditionally sell in FOB export positions are extensively integrated backwards.

A very important element of competition in the international grain trade is the organization of a network of suppliers and buyers. Some firms specialize in targeted markets/customers; others have a broader approach. Firms compete among each other through the composition of this network.

Evolution of the International Grain Trade. The composition of firms involved in the multinational grain industry has changed over time. In the 1960s and early 1970s, the U.S. wheat trade was dominated by six firms (ADM, Bunge, Cargill, Continental, Louis Dreyfus, and Peavey) who exported 90 percent of U.S. wheat from 1960 to 1967 and held similar market shares in the 1970s. However, this has changed radically, particularly in the past five years. Most notable are: 1) Cargill's proposed acquisition of Continental Grain Company; 2) LDC and Garnac's (Andre) liquidation of many of their handling and shipping assets in the United States, but their continued presence in international trading suggests a change in strategy, generally toward non-asset based trading firms; 3) Bunge's liquidation of many of their U.S. grain handling and shipping assets marked a reduced participation in broad scale exporting; 4) the contraction in the non-asset based trading firm sector; 5) a strategy on the part of cooperatives from around the world was the formation of *Intrade* and a joint venture with ADM for the purpose of acquiring A.C. Toepfer--the purpose being to provide a mechanism for direct exports; and 6) Farmland's acquisition of Tradigrain to conduct its off-shore marketing--the cited reason for making this acquisition was to allow Farmland to "enhance the systems' access to international customers."

Previous studies on the international grain trade suggested that entry is relatively easy, and the major sources of economies and competitive advantage were information and risk management.

Impacts of EEP on Export Firm Competition. Proliferation of EEP had some very important effects on the structure of competition among grain firms. One of the very important effects of the EEP mechanism was that it increased the level of price and demand transparency in the market, having an effect both on interfirm and intercountry competition. There were several effects of this. Competitor countries gained tremendous informational advantages relative to a less transparent system, thus making sales and marketing decisions relatively easy. Second, was that information asymmetries among grain exporting companies were reduced and those firms who had previously established informational advantages were adversely impacted. This was critical for several reasons. Foremost was that informational advantages ascribed above were mitigated. Thus, those firms/selling organizations not having extensive informational networks gained advantage relative to incumbent firms.

EEP had several other important effects. First, EEP generally favored transactions on more homogenous qualities. EEP also had the effect of mitigating incentives by individual firms to undertake market development and sales initiatives, at least among targeted countries.

Privatization of Grain Import Functions

One of the important commercial changes occurring in the international grain market is the privatization of importing functions. This has been occurring for some time, but the pace of change has accelerated in the past decade. The essence of these changes is that the *channel of influence* is changing. End users have a greater impact on purchase decisions, specifications, and terms of trade. These buyers being directly impacted by different terms of trade (e.g., with respect to quality differences, alternative logistical arrangements, and credit terms) are more capable of assessing their value in terms of cost savings, their ability to produce different products, and profits.

There are several implications of more decentralized grain import decision making. First, there is a greater tendency for smaller transactions and, potentially, shipments. Second, private importers are more likely users of hedging for purposes of price risk management. As such, purchase decisions become divorced from overall price level. In addition, buyers will have greater interest in alternative pricing options (basis contracts, maximum price contracts). Third, financing grain trade will provide both opportunities and problems. The other is for greater specificity regarding terms of trade. These include primarily quality specifications and logistics.

Though the general effect of privatization is that for more specific terms of trade (i.e., logistics, credit, etc.), the most significant change is likely that of quality requirements and specificity. Basically, when milling is privatized, end users want to say more about quality, which has great implications for the grain marketing system.

Implications for Single Seller Agencies. There are some unique implications of these changes for single seller agencies. There are at least four important issues.

- Selling Organization: Single seller agencies have typically had centralized selling organizations. This is important because a general prescription on the selling organization is for it to be compatible with that of the buying organization. Thus, when much of the world grain trade was organized with centralized buying agencies, it became appropriate to organize centralized selling. However, with greater decentralization of buying, selling agencies will have to reorganize their selling efforts, generally with greater use of country specialists, agents, and overseas offices. Regardless, the cost of sales and market development will increase relative to past sales organizations.

- Quality Specificity: An important principle of many single seller agencies years ago was that of homogeneity. Marketing fairly homogenous qualities (or quality attributes) facilitated equity among growers. In the process, selling was easy and economies of high throughput handling could be exploited. However, in recent years, trading firms/organizations have come to realize that demand preferences are highly autonomous, and treating all buyers the same is inefficient.

- Vertical Control: A major issue confronting a single seller agency is control of the vertical marketing system. Vertical control, either through contracting or integration, is essential for exploiting the demand for heterogeneity. Whether these demands can be met more efficiently through vertical contracting types of relationships or if asset integration is necessary, remains to be seen.

- Price Pooling has been one of the stalwarts of single seller agencies. However, increase in the demand for specificity instills pressure for an increase in the number of pools. An important issue is that as the number of pools increases, the risk reduction potential of individual pools diminishes. As separate pools for infinitesimally small differences in quality specificity are introduced, the advantages of pooling diminish. The effect of this would be for pooling agencies to seek alternative risk management strategies.

- Internal Distribution: One of the effects of privatization is for a reduction in individual buyer's optimal purchase size. One strategy that has emerged to exploit this difference is for export firms to make large-scale shipments to an importing country and placing the grain in storage (and in some cases under warehouse receipt). Smaller sales and shipments would be made out of these facilities to individual buyers who, operating individually, would find the smaller transaction size more efficient. This type of transaction apparently is emerging as a generalized model in several importing countries and poses opportunities and challenges for all selling organizations.

Survey Results

A series of interviews was conducted to gain insight into changes occurring in the grain industry. Some of the highlights include:

- Market Development: Each company was actively involved in market development activities. It is important that activities encompassed into the term market development varied as indicated below. It is also important that the demands for and focus on market development have escalated in the past 3-5 years--primarily due to privatization of importing and competition among firms. There were various responses as to activities included in market development. For several firms, market development was not a unique stand-alone activity, but rather was part of a longer-term plan of targeting customers, developing marketing plans, and cultivating longer-term relations as suppliers.

- Quality: All firms recognized and emphasized that demand for quality specificity has escalated in recent years, and, with the exception of one, had promoted its evolution. This was thought to be directly in response to privatization, as noted above, and reduced EEP.

- Response to Privatization*:* All firms identified that a significant shift in importing became apparent in the past 3-5 years. Most of this was attributable to the privatization of import functions. Though not mentioned directly, there was also recognition of the heretofore ruinous competition among exporters due to trading of generic commodities and terms of trade.

- Shift in Market Power: Most of the firms believed there has been a shift in market power to originators. However, there was some dispute as to the definition of origination. One view was that it involved controlling country elevator origins. The other view was control at some point intermediate in the market system (i.e., at river terminals) that assembles from multiple country origins and makes outbound shipments of blended homogenous products. Irrespective of this distinction, it was commonly recognized that most of the value-added today was at the country elevator.

- Multiple Origin Exporters: Most firms indicated that being able to originate from multiple origins was essential and fundamental to the success of export programs. Others acknowledged the advantages of multiple origin exporters.

- Market Development of Firms in Multi-Seller Markets: All firms acknowledged the changing role of market development in off-shore marketing. However, it is important that these firms all partake in market development in various degrees.