

BUILDING LONG-TERM RELATIONSHIPS WITH SPECIALTY CROP PRODUCERS

by Corinne Alexander, Purdue University

One of the major challenges for specialty grain buyers is developing long-term relationships with producers in which both parties understand each other's needs. Production contracts are not new. They have been used since the 1920s, and contracting is now the norm for many specialty crops.

For instance, a 2002 corn and soybeans survey by Ag Education & Consulting LLC found that in Illinois 87 percent of white corn, 83 percent of high oil corn, and 82 percent of high starch corn are produced under contract. Under these contracts, the producer makes most of the production decisions. The one exception is that the buyer often requires that the producer plant hybrids or varieties from an approved list. Almost all specialty crop contracts are written on a yearly basis, and therein is the challenge of transforming a yearly contract into a long-term relationship.

From the perspective of the buyer, contracts serve two important functions. First, contracts provide an assurance that the buyer will have an adequate supply of the specialty crop. Second, contracts allow buyers to specify their quality requirements, which are generally more stringent than the commodity market standard of grade number 2. Often processors require lower levels of foreign matter and stress fractures, and some specify non-genetically modified (GM) purity levels.

From the perspective of the producer, specialty crop contracts tend to be part of their portfolio of crops. The Large Commercial Producer Survey conducted by Purdue University surveyed producers with \$100,000 or more in gross sales and found that if producers contract, they tend to contract only a portion of their acreage (figure 1). Most pro-

ducers contracted less than 25 percent of their acreage, and less than 1 percent contracted more than 75 percent of their acreage.

Overwhelmingly, producers enter contracts to generate additional revenue. In a survey conducted by Purdue University of Indiana specialty crop producers, 92 percent contract for additional revenue (table 1). Other reasons included market access (37 percent), access to seed (28 percent) and to reduce price risk (21 percent).

On the flip side, producers leave contract relationships when the additional revenue is less than expected or when the expected additional revenue does not cover the expected additional costs of producing the specialty crop. The Ag Education & Consulting LLC survey asked Illinois producers about the risks associated with specialty crop contracts (table 2). The top three risks all result in producers receiving lower than expected revenues from specialty crop production: 1) lower than expected premiums (39 percent), 2) lower than expected yields (25 percent), and 3) crop rejection due to quality (22 percent). The key

word here is *expected*. When the contract is realized, if the additional revenue is *less than expected*, the producers are disappointed and may be reluctant to continue contracting.

Many producers have experience producing specialty crops under contract. For some, the contract experience has been positive and they received the additional revenue they expected when they entered the contract. For others, the contract experience has been negative in that the expected additional revenue did not materialize. In 1999, focus groups were conducted with

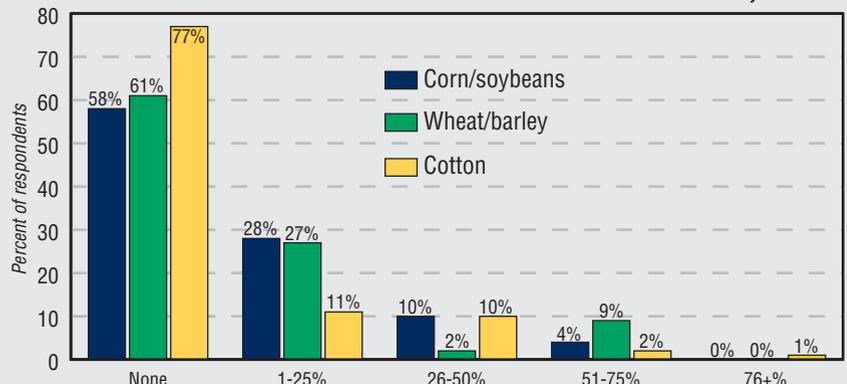
Table 1:

REASONS PRODUCERS ENTER CONTRACTS	
Reason	Percent of Respondents
Additional Revenue	92 percent
Access to Market	37 percent
Access to Seed	28 percent
Reduce Price Risk	21 percent
Access to Technology	14 percent
Reduce Input Costs	12 percent

Source: "Specialty Corn and Soybeans: Production and Marketing in Indiana," Purdue University (2002)

Figure 1:

PERCENT OF CROP ACRES CURRENTLY PRODUCED UNDER CONTRACT, 2003



Source: Large Commercial Producer Survey conducted by the Center for Food and Agricultural Business, Purdue University.

producers who had previously contracted to deliver high oil corn and viewed their experience as negative for two reasons. First, several of the producers had purchased seed that did not contain an adequate number of pollinators and, consequently, the oil content of the corn was not enhanced and the corn did not receive a premium. Second, over a three-year period the premiums for oil content had declined, and the producers had no reason to expect that premiums would improve.

These mixed experiences are reflected in the LCP survey, which found that producers believe contracting will continue to become more common in the future but that they are less enthusiastic about contracting for their own operations. More than 60 percent of corn/soybean producers and wheat/barley producers (but only 22 percent of cotton producers) agree that, "In the

future, more agricultural products will be produced to specification under contracts with buyers." That said, they appear to be taking a wait-and-see approach because they are less positive about the likelihood of increasing contracting for their own operations. Figure 2 shows that only 34 percent of corn/soybean producers and 47 percent of wheat/barley producers anticipate producing more products under contract in the next five years.

Long-term relationships are easier to maintain when the value generated by the specialty crop is large enough for both buyers and producers to be better off; they are also easier to maintain when the value is stable or increasing. One business model that is commonly used by food-grade processors is the qualified-supplier model. With the Starlink episode, where GM corn not approved for human consumption was found in taco shells on grocery store shelves, identity preservation became critical for food-grade corn processors. Producers were now required to present seed receipts, and the processor field staff now used GIS to map their fields and surrounding fields, as well as tested the corn in the field, in the grain bin, and every truck load before delivery. As a result, there was an intense period of learning, where both the buyers and the producers had to learn how to provide food retailers with a guarantee of Starlink-free corn. This processor has been increasing production, and because the producers have learned how to meet the processors

needs for identity preservation, the processor offers all new acreage to their current producers. Notably, this processor has a very low turnover in producers, and one explanation is that the qualified-supplier model offers producers the expectation for this relationship to increase in value.

The second foundation for a long-term relationship is communication. An anecdote that clearly illustrates the importance of both value and communication comes from buyers of non-GM soybeans. In contrast to the previous example where high oil corn producers experienced premiums that steadily declined, the premiums in the non-GM soybean market have been increasing from around \$.05 to \$.10 per bushel in 2000 to around \$.35 to \$.50 per bushel today. The quality standards for non-GM soybeans are extremely stringent at 99.5 percent purity and, as a result, a non-trivial portion of the non-GM soybeans produced fails to meet the requirements. The buyers are upfront about the difficulty of producing non-GM soybeans and tell the producer the current failure rate. When the market was first developing, the failure rate was above 30 percent of the loads delivered. Today, as the producers have improved their methods for identity preservation, the failure rate is on the order of 12 to 17 percent. The information on failure rates allows the producer to compare his performance relative to other producers, and more importantly, allows the producer to form an accurate expectation of the additional revenue (a \$.35 premium with a 17 percent failure rate translates into a \$.29 premium).

Specialty grain buyers face significant challenges in maintaining long-term relationships with producers. Grain buyers who are successful at having producers contract with them every year attribute this to offering the producer a valuable relationship and clearly communicating the risks and challenges. If producers have good information, they can form accurate expectations and are much less likely to be disappointed with the relationship. **AM**

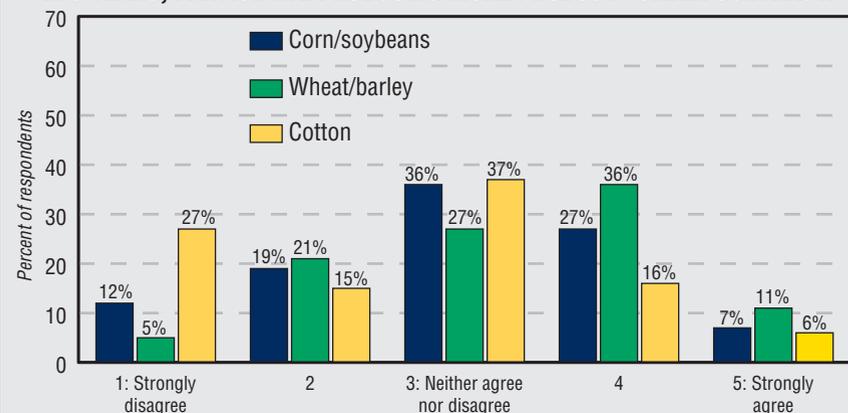
Dr. Corinne Alexander is assistant professor in the Department of Agricultural Economics at Purdue University.

Table 2:

PRODUCERS' PERCEPTIONS OF CONTRACT RISKS	
Risk	Percent of Respondents
Lower than expected premiums	39 percent
Lower than expected yields	25 percent
Crop rejection due to quality	22 percent
Additional capital investment	12 percent
GMO contamination problems	8 percent
Contract default	7 percent

Source: "Risks of Growing Value-Enhanced Corn and Soybeans in Illinois," Ag Education & Consulting, LLC (2002)

Figure 2: PRODUCER AGREEMENT WITH THE STATEMENT: "IN 5 YEARS, I ANTICIPATE PRODUCING MORE PRODUCTS UNDER CONTRACT."



Source: Large Commercial Producer Survey conducted by the Center for Food and Agricultural Business, Purdue University.