Riding the Wave of Change*
Contracting in Specialty Crops And
Implications for Grower Credit and Finance

Presented By:
Mechel S. Paggi
Director

* Apologies to the Produce Marketing Association
Multiple Demands on Specialty Crops

- Quality:
  - Taste
  - Freshness
  - Temperature
  - Shelf-Life
  - Nutrition
  - Consistency

- Quantity

- Costs

- Specific Requirements:
  - Packaging
  - Pallets
  - Size
  - Tailor-made

- Tracking & Tracing

- Safety: Microbial and Pesticides

- Flexibility

- On-time delivery
Contracts as share of purchases by Retailers

Source: FreshTrack 1999
Supply Purchase Options for Mega Stores

Percent of Sales for grapes, oranges, grapefruit, and CA & FL tomatoes

- Daily Sales: 20% (1994), 7% (1999)
- Short-term Contracts*: 48% (1994), 41% (1999)

* One year or less
Global Market Influences

Global Retail Players → Global Brands

Growing Role of Private Labels

Retail-Supplier Contracts/Partnerships

Declining Role of Spot Markets
What do we know about the use of Contracts in Fruits and Vegetables?

• Not well Documented

• Census Data Reported Suggest 32% of F&V with 6% in production contracts and 27% in marketing contracts (1997 reported in 2001)

• Wise people estimates: almost all processed vegetables and about ½ the fresh vegetables. Contract use is fruits, common but not known

• We do have some information on pricing linkages and some detail regarding existing wine grape contracts
Price to Growers Linked to Downstream Prices
California Survey Data, 2001

[Bar chart showing the percentage of various types of produce (Fresh Fruit, Fresh Veg, Processed Fruit, Wine Grapes) linked to downstream prices. The chart uses two colors: light blue for 'Yes' and dark blue for 'No'.]
Use of Contracts in Wine Grapes

- Written Only: 70%
- Oral Only: 11%
- Both: 9%
- No Contract: 10%

Source: UC-Davis, Ag Issues Center
Price Determination Provisions in Wine Grape Contracts

Reference Price 28%

Maximum 7%

Per Acre Price 2%

Minimum 12%

Other 4%

Stated in Contract 25%

Negotiated Yearly 22%

Source: UC-Davis, Ag Issues Center
Table 1. Quality assurance instruments for fresh-market commodities

<table>
<thead>
<tr>
<th>Commodity</th>
<th>Firms</th>
<th>Input Control</th>
<th>Monitoring(^a)</th>
<th>Quality Measurement</th>
<th>Residual Claimancy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asparagus</td>
<td>3</td>
<td>Seed variety, fertilizer, labor, plants, pesticides, financing</td>
<td>20</td>
<td>Self-measurement, government, at market</td>
<td>Yes</td>
</tr>
<tr>
<td>Broccoli</td>
<td>2</td>
<td></td>
<td>0</td>
<td>Government</td>
<td>Yes</td>
</tr>
<tr>
<td>Carrots</td>
<td>1</td>
<td>Variety, harvest</td>
<td>1</td>
<td>Government</td>
<td>Yes</td>
</tr>
<tr>
<td>Grapefruit</td>
<td>3</td>
<td></td>
<td>2</td>
<td>Self-measurement, third party, government</td>
<td></td>
</tr>
<tr>
<td>Grapes</td>
<td>5</td>
<td>Labor</td>
<td>30</td>
<td>Self-measurement, third party</td>
<td>Yes</td>
</tr>
<tr>
<td>Lettuce</td>
<td>3</td>
<td>Variety, fertilizer, plants</td>
<td>9</td>
<td>Self-measurement, third party, government</td>
<td></td>
</tr>
<tr>
<td>Onions</td>
<td>2</td>
<td>Variety, harvest</td>
<td>1</td>
<td>Self-measurement, government</td>
<td>Yes</td>
</tr>
<tr>
<td>Oranges</td>
<td>2</td>
<td></td>
<td>20</td>
<td>Self-measurement</td>
<td>Yes</td>
</tr>
<tr>
<td>Potatoes</td>
<td>2</td>
<td></td>
<td>12</td>
<td>Government</td>
<td>Yes</td>
</tr>
<tr>
<td>Squash</td>
<td>1</td>
<td>Plants</td>
<td>9</td>
<td>Self-measurement</td>
<td>Yes</td>
</tr>
<tr>
<td>Peaches</td>
<td>3</td>
<td>Pruning, harvest</td>
<td>10</td>
<td>Government</td>
<td>Yes</td>
</tr>
<tr>
<td>Tomatoes</td>
<td>3</td>
<td>Plants, planting, harvest</td>
<td>100</td>
<td>Self-measurement, government, third party</td>
<td></td>
</tr>
</tbody>
</table>

\(^a\) Monitoring is measured by the median number of reported annual visits to a typical grower's field. In the appendix, we include the exact question used to elicit this number.
<table>
<thead>
<tr>
<th>Commodity</th>
<th>Firms</th>
<th>Input Control</th>
<th>Monitoring</th>
<th>Quality Management</th>
<th>Residual Claimancy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Almonds</td>
<td>1</td>
<td>Seed, fertilizer, labor</td>
<td>1</td>
<td>Government</td>
<td>Grower choice</td>
</tr>
<tr>
<td>Cabbage</td>
<td>1</td>
<td>Variety, seeding rates, harvest, labor</td>
<td>Yes</td>
<td>Self-measurement, third party, government</td>
<td>No</td>
</tr>
<tr>
<td>Carrots</td>
<td>2</td>
<td>Variety, seeding rates, harvest, labor</td>
<td>9</td>
<td>Self-measurement</td>
<td>No</td>
</tr>
<tr>
<td>Celery</td>
<td>1</td>
<td>Labor</td>
<td>15</td>
<td>Self-measurement, third party, government</td>
<td>No</td>
</tr>
<tr>
<td>Grapes</td>
<td>24</td>
<td>Labor, pesticides, pruning, harvest</td>
<td>6</td>
<td>Self-measurement</td>
<td>No</td>
</tr>
<tr>
<td>Onions</td>
<td>2</td>
<td>Variety, harvest</td>
<td>6</td>
<td>Self-measurement</td>
<td>No</td>
</tr>
<tr>
<td>Oranges</td>
<td>2</td>
<td></td>
<td>25</td>
<td>Self-measurement</td>
<td>No</td>
</tr>
<tr>
<td>Potatoes</td>
<td>1</td>
<td></td>
<td>25</td>
<td>Government</td>
<td>No</td>
</tr>
<tr>
<td>Peaches</td>
<td>2</td>
<td></td>
<td>25</td>
<td>Government</td>
<td>No</td>
</tr>
<tr>
<td>Tomatoes</td>
<td>22</td>
<td>Variety</td>
<td>Yes</td>
<td>Third party</td>
<td>No</td>
</tr>
</tbody>
</table>

* Monitoring is measured by the median number of reported annual visits to a typical grower's field. In the appendix we include the exact question used to elicit this number.
The Lender Pyramid of Concerns

Influence of Contract

Weak

Strong

Ability to Honor Contract

Repayment Potential Enhanced

Substantial Price Risk Profile

Stable, well established Spot Market

Weak Spot Market

Short-term Operating

Long-term Capital/Equipment

Loan Type

?
Implications for Policy

• Marketing and to lesser degree production contracts are the future, if not the present, for specialty crop growers

• Contracts can provide a positive influence on lenders decisions to provide short-term operating capital loans, limited influence on long-term loans and may be especially important for producers on the margin

• The perishable nature of products, quality and food safety demands lead to robust list of concerns associated with contracts in the specialty crop industry

• One size does not fit all, specificity related to the nature of the product and/or enterprise must not be lost in any discussion related to proposed regulation schemes