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***“SOME SPECIFICS OF AGRICULTURAL COMMODITIES MARKETING AND PROCESSING IN UKRAINE”***

As a result of agrarian and land reforms, the agricultural sector in Ukraine is getting increasingly stronger. Gross volumes of output are growing, the sector’s infrastructure is becoming more efficient, while Ukrainian products are becoming more competitively on the global market. Accounting for almost 13.4% of the nation’s GDP, farming is an important sector of the Ukraine’s economy.

Ukraine has considerable potentials for further development of farm and agribusiness sectors. Fertile soils, large areas of arable lands, and favourable climatic conditions provide the necessary natural prerequisites, making the country a leader in crop and livestock production. Moreover, Ukraine’s good geographical location—including relative proximity to important markets, including former USSR and Middle East countries—allows it to export agricultural commodities in considerable volumes.

In parallel with quantitative changes, considerable qualitative changes in approaches and methods of operating farming business are getting more observable in the national farming sector. Ukrainian farmers develop their professional qualities and skills recognizing their outmost importance for running viable businesses.

Land reform and the introduction of the right to private land ownership created the necessary institutional basis to advance agrarian production. For example, the new Land Code laid new legislative grounds for regulating land market and strengthening legislatively established principles of private ownership in rural areas.

Along with the primary production, processing of food products is one of a few economy sectors in Ukraine demonstrating a robust growth over the last years. This has effected an increase of output, expanded product mix and better quality of locally produced goods. Growing domestic demand and consumption have strengthened domestic processing industry and urged new market players to enter and increase competition, generated qualitatively new relationship between processors and raw material suppliers, and gave birth to new marketing strategies.

Notwithstanding these notable achievements in farming and agribusiness sectors, there is a great need to further production, financial, and legal relations in the industry. In particular, we are talking here about more and better marketing opportunities for agribusinesses, strengthening finance and insurance services sector, and streamlining regulation of the farm lands market. The first step to address these issues, is to have full and impartial information and undertake deep analysis of the development specifics of farming and agribusiness sectors in Ukraine. Results of the analysis would be instrumental in strengthening the groundwork for adopting policy decisions, which would allow policymakers to address in a timely fashion most pressing issues of agrarian reforms both at the regional and national levels.

In order to understand positive changes that have taken place in the agrarian sector of Ukraine, and outline most problematic issues facing farmers in their work, the International Finance Corporation's Agribusiness Development Project conducted a number of sociological studies such as "*Development of Farming and Agribusiness Sectors in Ukraine*" and "*Specifics of Agricultural Produce Processing and Marketing in Ukraine*"<sup>1</sup>. They allowed us to investigate the national agrarian sector, and in particular, its food supply chain embracing "production-processing-marketing" and define the most urgent problems in agricultural marketing.

### **Agricultural commodities main distribution channels**

In a market-driven environment profitability of farming sector equally depends on the organization of production process, and on how effectively the agricultural output is marketed. In the final account, it is the producer's ability to gainfully sell produced output that is the key to his/her farming activity's effectiveness. Therefore, prior to answering question "*What and how much produce to grow?*", Ukrainian producers need to have a clear picture of to whom they shall sell their products and what price they can expect at the market.

Since the system of government procurement of agricultural output is no more existent, farmers need to make extraordinary efforts to establish distribution channels. Establishment of effective distribution channels makes sure that the output is sold timely and at good prices. How do producers market their produce and how do they rate importance of these channels?

To respond on these and some other questions of agricultural marketing, we would like to share with you some findings of "*The Development of Farming and Agribusiness Sectors in Ukraine*" study. According to the study, private family farmers recognize **wholesale companies** as their major distribution channel for grain and oil crops, while for agricultural enterprises (former collective agricultural enterprises), the most important channel is represented by processing companies. In 2004, 31% and 33%, respectively, of all grain and oil crops were marketed by these categories of farmers through the stated channels.

**Wholesale** and **retail** farmer markets also rank high among most important distribution channels. Although the proportion of output sold through these channels in 2004 was smaller than the year before, wholesale and retail markets appear to be particularly important for private family farms. In our view, popularity of these channels may be explained by the possibility for farmers to obtain better prices without intermediaries. Meanwhile, marketing through retail and wholesale markets does not allow selling big consignments of produce.

Such distribution channel as **government institutions** (e.g. armed forces and educational institutions) do not play any longer any substantial role as it was the case during the soviet time. Approximately 7% of the overall volume of grain and oil crops produced primarily by big agricultural enterprises is marketed to these institutions.

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<sup>1</sup> Survey "*Farming and Agribusiness Development in Ukraine*" was conducted by the Ukraine Agribusiness Development Project in December 2004-January 2005 and polled 400 farmers in five Ukrainian regions. It was last in a series of four nationwide studies to investigate the development of farm and agribusiness sectors in Ukraine. Survey "*Specifics of Agricultural Produce Processing and Marketing in Ukraine*" was conducted in November 2002-February 2003 and studied 100 processing enterprises. Analytical report on the surveys findings are posted on the Ukraine Agribusiness Development Project's site: [www.ifc.org/ukraine/agribusiness/](http://www.ifc.org/ukraine/agribusiness/)

**Agricultural commodities exchanges and trade houses** remain a rather weak and, in general, undeveloped segment of the agrarian market. According to the survey data, only 4% of grain and oil crops marketed by big agricultural enterprises and 2% –by private family farms are sold via exchange markets and trade houses. This provides evidence that this segment of the farm market infrastructure is generally underdeveloped.

There are some differences in marketing different agricultural commodities. Specifics of marketing vegetable produce slightly differ from those of marketing grain and oil crops. Retail markets appear to be the top choice marketing channel for vegetables, which may be explained by smaller aggregate volumes of grown vegetables. 33% of vegetables grown by private family farms and 24% of those produced by agricultural enterprises are marketed via retail markets.

Analysis of the sales data over last years allows discerning certain diversification of distribution channels. First of all, direct **sales to supermarkets** began shaping as a distribution channel. Although the volume of produce marketed via supermarket chain is insignificant (1% for private family farms and 2% for agricultural enterprises), the fact that at least some of the produce is distributed through supermarkets, is doubtlessly positive.

#### **Criteria in choosing a distribution channel and distribution channel profitability**

What criteria do commodity producers use to choose a specific distribution channel? A good price for produce and stable sales remain primary criteria for choosing a particular channel. Thus, 79% of the surveyed producers of grain/oil crops and 67% surveyed vegetable-growers recognize price as the decisive factor for choosing a particular customer.

This choice made by farmers may be explained by the fact that in most cases cash revenues from sale is practically the only source of their income, while they badly need cash to refill working capital and reinvest into operations.

**Stable sales** as a factor for choosing a particular market ranks second among most important factors. This was admitted by 60% of grain and oil crop growers and by 52% of the surveyed vegetable producers. Stable sales allow producers to correctly estimate future volumes of output and with a greater degree of certainty plan their financial activity. Other factors such as reputation of customer, transportation of produce by buyer, possibility of prepayment, and not very high demands of buyers to produce quality appear to be less important.

Discussing criteria of choosing a distribution channel, it is crucial to emphasize some variations in criteria preferences observed between agricultural producers. Thus, the possibility of transportation/storage of produce by buyer appears important for a bigger number of private family farms than agricultural enterprises. This was reported by 20% grain and oil crop growing private family farms, vis-à-vis 7% of agricultural enterprises with similar specialization.

Considering the above-stated data regarding the most important distribution channels for agricultural produce, and taking into account the fact that better prices is by far the most important factor for choice of a distribution channel, one can understand farmers' perceptions of each distribution **channel's profitability**.

In perception of respondents, **retail and wholesale markets** are most profitable distribution channels for agricultural produce. Thus, 11% of respondents recognize retail markets "*highly profitable*", while another 64% admit they are a "*profitable*" distribution channel. As for

wholesale markets, respectively, 29% and 44% of respondents called this sales channel “highly profitable” and “profitable”.

Official statistics supports findings of this survey in that producers obtain best price and highest profit per unit of output when they sell their produce via farmer markets. Meanwhile it is important to remember that it may be more difficult to sell large batches of perishable product via wholesale and retail markets in a short period of time. In these conditions, shipping large quantities to traders and food processing companies may have much better outlook.

Sales of grown produce to the government was recognized as the least profitable of all: only 4% of respondents called this channel “*highly profitable*”, 31% - “*profitable*” against 58% and 7% of respondents who perceived this channel “*not very profitable*” or “*unprofitable*”.

### **Payment for delivered product**

Another issue of agricultural marketing is **forms and schedule of payment** for the delivered output. Today, payment for produce is made predominantly upon delivery to the end customer. 90% of grain and oil-crops growers are paid only upon delivery. This is equally true for both private family farms and agricultural enterprises. Only 13% of grain and oil producers and 6% of vegetable growers receive prepayment, which can be considered as short-term crediting. For other commodities, these figures are much lower. In the case, with vegetable growers, a lower percentage of receiving prepayment may be explained primarily by the fact that a considerable portion of vegetables is sold via farmer markets, where payment is made no earlier than the customer buys the produce.

Main explanation of why producers are not prepared to sell produce for deferred payment is, naturally, their scarce working capital. Many producers fund their operations at their personal expense, with limited external resources. Under these conditions, deferral or delay of payment even for a short period of time may adversely affect reaching their income benchmark.

How much are the producers willing to sell output for **deferred payment**? Findings show that most producers are reluctant to sell for deferred payment. Main explanations include their need to receive cash, lack of trust to the supplier and, consequently, the fear that they will not receive payment at all. Over 70% of the surveyed private farms (71%) note, they are absolutely reluctant to sell produce for a deferred payment. The portion of those who would agree to sell produce with no more than 2 weeks deferral equals 25%.

Bad need for cash, which producers want to have to pay for inputs and repay loans, is the main explanation why most of produced output is sold immediately after harvest.

**Uneven supply of produced commodities** on the market in the course of the marketing year remains one of the major problems of agrarian marketing. A considerable portion of agricultural produce is marketed immediately after harvest (44% of produced grain and oil crops and 58% of vegetables are sold in the period between June and September). Meanwhile, sales of big volumes of produce over a short period of time results in rapid decline of market prices. Certainly, it eventually affects producers’ revenues.

What forces producers sell their output immediately after harvest? Bad need for cash appears to be the key explanation of this practice. This was reported by overall 76% of agricultural enterprises that market their output immediately after harvest, and even a bigger portion of

private farmers: 83%. Producers need cash badly for two reasons: (i) to repay loans and (ii) pay for inputs supplied earlier.

Second most frequently cited force driving producers to quickly sell their produce is lack of storage facilities. This problem appears particularly acute for private family farms, which generally have fewer assets and in less apt shape.

It is important to note, that on-going contracts closed by producers with buyers appear to be the explanation of quick sales only for 13% of agricultural enterprises and 3% of private farms.

### **Main requirements for sale of produce**

One of the preconditions of a mutually beneficial cooperation between producers and buyers of agricultural produce is **producers' awareness of buyers' requirements to the quality of particular produce**. The better producers are informed about requirements, the less they are likely to encounter problems with buyers. Thus, given the emergence of new market segments and distribution channels for agricultural produce, producers are required to dedicate more time, resources and efforts to search information about buyers' and consumers' preferences and establish distribution channels.

Today, the elicited data demonstrate that producers are best aware of requirements to produce presented by wholesale companies and processors. As noted earlier, farmers have most developed relationship with these two primary categories of counteragents. It is also important to note, that agricultural producers appear to be better aware of these requirements than private farms. Notwithstanding, both agricultural enterprises and private family farms report lack of skills with regard to marketing their produce to large supermarket chains and exports. Only 18% of the surveyed agricultural enterprises and 4% of private family farms stated they were familiar with "*rules of the game*" in the Ukrainian agriculture output export market.

Another issue in farm marketing that present some interest is an understanding of how well **producers are prepared to meet requirements of buyers** regarding quality of produce, schedule and size of shipments, presale processing (e.g. grading) and packaging. The level of preparedness could be determined on the following scale: "*not prepared*", "*prepared*" and "*fully prepared*". Where producers were not sure about their answer, they could choose option "*difficult to answer*". It is important to note that this question did not include any specific quantitative rating indicators regarding compliance with such requirements.

Findings demonstrate that farmers predominantly chose "*Difficult to answer*". This relates to all main categories of requirements. A possible explanation of these results may be unspecified quantitative benchmarks with regard to buyers' requirements.

Meanwhile, the elicited data allow making the following conclusions. First, in addition to being generally hesitant regarding rating of one's own preparedness to meet buyers' requirements, nearly one fourth of the surveyed agricultural producers express partial preparedness to meet the requirements. Second, notwithstanding insignificant proportion of producers fully prepared to meet buyers' needs, this quantity includes a slightly bigger share of agricultural producers. Speaking about specific requirements, a very insignificant number insignificant number of agricultural producers (particularly, private farms) are ready to market their produced commodities packaged, which is required by supermarket chains.

Findings of another study (*“Specifics of Agricultural Produce Processing and Marketing in Ukraine”*) clearly demonstrate that the quality of raw material supplied for processing, is the decisive factor influencing the choice of supplier. In 90% of all cases, the quality of raw material is the key for signing a contract between a processor and a particular supplier (farmers, individual households, traders and wholesale companies, others). Second most important factor is price for raw material, which reported by 80% of respondents in the sample. The availability of needed amounts of raw material and timely deliveries are the other two important factors, influencing the decision of processors to buy raw material.

Speaking about **the quality of raw products**, most of the processing businesses irrespective of their specialization tend to believe that no tangible change in raw material quality has happened lately. At the same time, from 30% to 40% of surveyed processing enterprises admit that the quality of raw products has improved. Better quality of raw material was recognized, specifically by businesses in fruit and vegetables processors and in the dairy sectors.

Despite the positive trend to better quality of raw material, nevertheless, 74% of the surveyed processing plants still encounter the problem of its low quality. As proved by the obtained data, the problem of low quality stands more acute for the businesses in vegetable and dairy sectors, which is pointed by 84% and 78% of the surveyed enterprises. The practice of processing enterprises get them to think that the following three primary factors affect the quality of raw material supplied for processing: storage conditions, bad crop varieties/unproductive breeds of cattle, and conditions of raw product delivery.

### **Problems of agricultural marketing**

It is evident that it takes farmers time and effort to develop effective distribution channels and enter new markets. Meanwhile, in the process, they do encounter certain problems. What are those particular problems producers face and how painful these problems are for them?

Findings of survey studies are presented in Table 1. As may be observed from the table, **low purchasing prices** is the highest ranking problem. It is a concern for 90% of the surveyed private farms and 78% of agricultural enterprises. Of note, low selling prices were recognized the gravest problem in three previous yearly surveys. Thus, in 2001, 79% of private family farms and 91% of agricultural enterprises emphasized this was the largest problem for them.

In our opinion, the problem of low selling prices is the derivative of several objective and subjective factors. Agricultural production is a sector of human activity where prices for output tend to fluctuate greatly. This is particularly true for the crops which domestic prices are affected by global market prices. Moreover, today purchasing capacity of Ukrainian citizens, albeit growing, is still lower than in other countries. Also, we shouldn't neglect the fact that the cost of production in agricultural sector in Ukraine in many instances is very high. All these factors prevent Ukrainian producers from obtaining desirable price.

**Table 1. Main problems with agricultural marketing and their acuteness for producers, % of overall number of responses.**

	Private farms				Agricultural enterprises			
	Very big concern	Not a big concern	Not a concern	Difficult to answer	Very big concern	Not a big concern	Not a concern	Difficult to answer
Lack of large batches of commodity	22%	40%	32%	6%	19%	43%	34%	4%
Transportation problems	35%	36%	28%	1%	23%	50%	24%	3%
Few purchasing organizations	39%	33%	27%	1%	37%	30%	30%	3%
Problems with packaging	12%	33%	53%	2%	11%	38%	47%	4%
Lack of information on sales markets	26%	34%	38%	2%	29%	39%	28%	4%
Low demand for produce	52%	22%	24%	2%	51%	26%	19%	4%
Storage problems	54%	32%	13%	1%	30%	48%	19%	3%
Low selling prices	90%	7%	2%	1%	78%	16%	4%	2%

In addition, in many instances agricultural producers can't yet enter new markets and take advantage of more profitable distribution channels. This last inefficiency also affects market prices for output.

The **problem of storage** also remains outstanding. Private family farms seem to be particularly concerned about storage of their produce. It was reported by nearly over a half (54%) of the surveyed farmers. As was noted earlier, lack of storage facilities forces most producers market their output shortly after harvest. As a result, huge supply of freshly harvested produce in the market brings down prices. This may serve another explanation of why so many producers are bothered with low product prices.

The **problem of transportation** should be noted among other problems. It stands particularly acute for private farmers, reported by over one third (35%) of these, who tend to have weaker asset base, primarily, lack transportation vehicles.

A **limited number of purchasing organization** represents a concern for 39% of the surveyed private farms and 37% of agricultural enterprises. However, we would dare to assume that this problem may be a derivative of producers' lack of information about selling markets. The lack of information was recognized as a problem by 26% of private farms and 29% of agricultural enterprises.

Buyers of agricultural raw products also state they face a number of external and internal barriers, though the latter may differ from those said by farmers. External barriers stem from **inefficiencies of regulatory environment**. Most frequently, businesses face problems related to the attraction of external financing. **High interest rates on commercial loans and limited**

**access to long-term loans** rank highest among the worst problems. Another a large barrier to processing enterprises operations is instability of the legislative framework.

While instability of legislation is a matter of concern for many respondents, answering the question “Are there any specific resolutions, laws or clauses hindering/restricting development of your business?”, most of them said “No”. Those, who believe that such legislation does exist (36% of the surveyed businesses), bear in mind, first of all, clauses related to tax implications and VAT refund.

**High production cost of outputs** is a serious problem for 48% of the surveyed businesses. This high cost may be explained by both high prices for energy resources, specifically distinguished by respondents among external obstacles, and by the need for upgrade of production facilities.

The survey findings in the area of **enterprise staffing** came somewhat by a surprise. A lack of skilled personnel is a large barrier for 21% of businesses, and a very large barrier for 16% of respondents. It is interesting, that only 10% of businesses do not regard the lack of qualified staff as a problem, while additional 19% noted that this question is irrelevant. As for the excessive low-skilled staff, the majority of respondents do not believe it is a problem or note that this question is irrelevant.

Thus, resuming all the above-said, we have to underscore that an effective agricultural marketing is the key part in farm operation management. Profitability of the farm sector, as a bottom line of their operation efficiency is a derivative on how effectively the agricultural output is marketed.