‘Cream of the crop: the use of grain warehouse receipt in agricultural finance’

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Workshop Summary

Product Based Value Chain Finance Using Grain Warehouse Receipts

Speaker 1 - Calvin Miller, Senior Officer Agribusiness and Finance, FAO

What is a Value chain?

A value chain is the full range of activities required to bring a product or service from conception through the various stages of production and delivery to final consumer. It includes all key actors: producers, suppliers, wholesalers, and retailers and consumers. Value Chain Finance (VCF) describes the financial products and services flowing to and through a value chain to address the needs of those involved in the chain. It is a comprehensive way of using the value chain and making finance and marketing decisions based on the structure and nature of the value chain and those involved in it.

One of the things spoken of in VCF is different types of business models. These can be producer driven, buyer driven, integrated or facilitator driven (where a third party intervenes). FAO and partner organizations play a facilitative role, helping to bring together some of the buyers, producer organizations, in particular building capacities needed within a value chain and in the macro environment within a country. The focus of the FAO is to build on what is currently in the country and help make it happen.

When speaking about value chain financing we can break it into five different types of products:

- Product financing
- Receivable financing
- Physical asset collateralization
- Risk mitigation products
- Financial enhancements

With warehouse receipts we are talking about using the physical commodity as collateral.

Warehouse receipts

For those who have difficulty in obtaining credit due to being unable to offer sufficient loan collateral, warehouse receipts provides a solution. This collateralized commodity transaction, where the crop itself provides
collateral is known as Warehouse Receipt Financing. The system allows the borrower to use an asset such as grain, or other commodities as negotiable collateral. Using grain as an example, the harvested crop is stored in a licensed warehouse that will issue a receipt. This receipt forms the basis of financing and proves the commodity is physically in the warehouse and can then be taken to a financial institution where it can be used to request a loan. If the borrower defaults on payment obligations the creditor now owns the collateral and may dispose of the property.

Lessons

In order for the WHR system to be successful it is critical to understand the value chain, the market, and the value chain clients and partners. It is also important to assess the risks, competitiveness, relationships and processes, rationale and needs for financing by those in the chain. Warehouse receipts are one useful way financial services are structured according to the business model, the strengths and assets of the value chain participants and linked with participatory support services, e.g. warehouse managers.

The International Experience and Future Development Opportunities

Speaker 2 - Krassimir Kiriakov, Grain Warehouse Receipts Specialist

Market deficiencies

There are some common deficiencies on the inception phase that are widespread in the environments that have been approached, such as lack of trade routes and underdeveloped domestic commodity market infrastructure, lack of reliable storage facilities (in some countries you may have storage in good physical shape, but the producers are not trusting of the owners of the facilities), lack of reliable commodity quality standards, limited access to short term financing, and lack of reliable market information.

WHR system advantages

Once the warehouse receipt system has been successfully implemented there are a number of advantages that have been found. For example, once good infrastructure has been put in place with licensed and well regulated warehouses, all participants in the value chain are able to become more serious players in the market. This ultimately results in gradual positive changes in attitude of the financial institutions. In order to achieve this effect warehouses must meet financial and technical criteria, good regulatory functions, and there must be trust between producers, warehouses and financial institutions. This gradually creates transparency on the market. The WHR system also provides increased access to short term credit, develops new financial instruments, attracts additional capital through the value chain, and reduces the participants risk on all levels of the value chain.

Core elements of WHR system

There is a methodology of implementation that needs to take into account core elements of the system, although each approach will need to be adjusted to the specific country, market requirements, and relationships between participants. Before the system can be implemented there must first be a political will for such reforms to take place. The political will of the government to draft legislation and implement it is the first necessary precondition. Without this, all other steps and efforts will not be successful. This legislation creates a status of the warehouse receipts as a special security document and the trust that is needed between players is backed up by legislation. The warehouse receipts need to be supported by strong legislation in order to be recognised as a security paper. Another key factor in building trust is through licensing and inspection of warehouses, as the warehouse acts as a bank for the producer who is storing their assets. Licensing and inspection is fundamental for the integrity of the whole system. Another important structural component needed is financial performance guarantees, which is targeted to back up the system if there is a default on the site of the public warehouse. For example, if for some reason the commodity is missing, the warehouse goes bankrupt or if the commodity is mishandled beyond recovery.

FAO support for WHR system

• Creating an enabling environment - This is all the work that must be accomplished before the implementation of the system, such as creating draft law and providing technical assistance on the
whole process, starting on the concept note which explains all the structural components and providing initial guidance

- Assisting in project implementation - from providing training, consulting, creating specific tools such as electronic registers, and creating comprehensive manuals
- Creating a knowledge centre - The FAO has also through the EastAgri webpage (http://www.eastagri.org/sector_detail.asp?id=38) and documents been able to create a resource centre, where those trying to implement the system in other places can access good literature, reports, case studies etc.

Future development opportunities

- Central and Eastern Europe – WHR systems were successfully implemented first in Hungary, Czech Republic, and Slovakia, moving over to the Balkan countries. This has been replicated in larger markets like Ukraine and Russia, with Serbia being one of the latest projects
- Central Asia – Some of the countries have commodity markets with high liquidity in some products, showing new market opportunities. For example, Indonesia has high liquidity in rice, coco, coffee and corn and Vietnam with rice and coffee. These areas require further assessment.
- Africa – Regulatory supervision functions as used in Eastern Europe and America that use a government structure to supervise warehouses and execute inspections are not working here due to lack of trust in governments. Alternative ways are being sought for producer organizations to feel they can safely leave their commodity in the warehouses, such as using private surveying companies or private institutions to take over warehouses and control them.
- Latin America – A new approach based on pre-crop receipts is being tried out to assess and implement.

Warrantage in Niger: Adaptations for a developing country

Speaker 3 - Emilio Hernandez, Agricultural Finance Officer, FAO

Some country facts

The use of Warehouse receipts, or warrantage as it is known locally, has become very popular in Niger. Niger is one of the poorest countries in the world and forms part of the LDC list of the UN. The agribusiness development environment poses serious constrains with shortages of adequate agricultural inputs due to heavily distorting government interventions and low communication infrastructure, which disrupt the input of agriculture and then the output of agriculture. It is then surprising to hear that in this difficult context that Warehouse receipts have become such a popular financial product in the Marketplace.

The local adaption

Warehouse receipts have been adapted to the local conditions. There are not big facilities of storage or specialised storage managers, so producer organizations have built simple but safe warehouses to store the stock and decide, based on member requests, to make group loan requests to a lender backed by the bulk of cereal etc. Loans are then distributed to individuals of the group based on their contribution to the stock. The loan maturity is predominantly four months. Each farmer pays back the group, which then pays back the financial institution.

Why do WHR work in Niger?

- Production systems in Niger are rain fed, which makes the timing of high and low price peaks predictable by the agricultural calendar. There is a high price peak around August and a low peak around November, which drives farmers to take advantage of the price differential. As it’s predictable it can be pursued every year. This provides farmers, traders and lenders strong motivation to profit through the use of storage
- There is an extremely strong and constant demand for cereals that come from neighbouring Nigeria, which is able to absorb any surplus that Niger is able to produce. There is no problem finding the market outlet. The challenge for Niger is to produce the surplus
- The constant demand for cereal imports from Nigeria has created stable business opportunities. Farmers have worked steadily through their organizations to benefit from these opportunities by building storage facilities and making joint loan request
MFI’s, through their participation, have learnt the dynamics and values of cereals, leading to their acceptance of them as collateral

*How do agricultural households use Warehouse Receipts?*

Loans are used almost exclusively for trading activities (household goods and livestock products), small commercial enterprises (food stands, tea shops, brick-making) or vegetable production. Farmers are able to access a loan to finance these *short term* activities, which means that they can generate cash while they wait for cereal to gain price. The loan is repaid with the revenue from these extra activities and, most of the time, the stock commodity is not used to repay the loan to the financial institution. Therefore, the value of warranitage is that it enables smooth cash-flows for agricultural households trying to benefit from cereal price differentials over time.

*Conclusions*

In a country with weak legal frameworks and agribusiness development environment the WHR System can work if some preconditions are met. There needs to be stable agribusiness opportunities, which then motivates farmers to effectively strengthen their organisations, and lenders to learn about the complexities of agricultural markets. This is not easy to replicate, however, as not all countries you are trying to help have a neighbouring country, as Niger does with Nigeria, that can absorb their production surplus.

**Legal Framework for Warehouse Receipt financing**

*Speaker 4 - Philine Wehling, Associate Legal Officer, FAO*

The FAO Development Law Service was invited to present its current review of legal frameworks for warehouse receipt financing worldwide, which will be published in the form of a comparative legal study.

*Purpose and methodology of the legal study*

Sound legislation governing warehouse receipts may attract potential creditors and expand access to agricultural credit. The study presents and analyses the legal frameworks for warehouse receipt finance in selected countries worldwide, with a view to providing guidance to countries for designing warehouse receipt legislation tailored to their specific needs.

Following the methodology of a comparative legal analysis, the study presents country case studies on the legal frameworks for warehouse receipt financing. In order to examine legislation enacted under various agricultural, economic and legal conditions, both developed and developing countries representing a wide geographical distribution were selected. Reviewed countries include the United States, Canada, Brazil, Argentina, France, Germany, Kenya, South Africa, Tanzania, Uganda, Kazakhstan, India, and the Philippines, among others. The study compares and analyzes the legal frameworks of these countries, including their implementation in practice, identifying advantages, constraints and good practices and drawing conclusions that may assist countries in designing warehouse receipt legislation.

*Overview*

A legal review of legislation across different countries is currently being undertaken. The purpose of this study is to advise governments on how to devise sound legislation on warehouse receipts that is adapted to the specific country conditions. We follow the methodology of comparative legal analysis, which his generally structured into two steps. We first prepare a country review where we describe the legal framework for warehouse receipts in various countries. In the second step we compare the results of these country reviews and analyse them to draw the best practices.

*Key pillars of warehouse receipt legislation*

While the basic legal concept for warehouse receipt financing is largely the same in every country with a warehouse receipt system, there are several key characteristics of warehouse receipt systems that are variable and shaped by and dependent upon the specifics of the legal framework in each country. These key elements of warehouse receipt legislation are explored in the context of the country case studies, and include:
• Receipt details: Warehouse receipts are documents that represent specific goods, or a specific quantity of goods of a certain quality, deposited in a specific warehouse. Accordingly, legislation typically specifies minimum information that must be included in the warehouse receipt, for example the name and location of the warehouse in which the goods are stored.

• Receipt format: Depending on the legal tradition of a given country, warehouses generally issue receipts that fall into one of two categories: single receipts or double receipts. Warehouses in the United States, for example, usually issue single receipts, while many countries with a civil law tradition provide for double warehouse receipts.

• Trading of receipts: The legislation determines whether warehouse receipts shall be negotiable and defines the rules for their trading to other parties.

• Registration of receipts: The legal framework may establish a registration system and define the rules and procedures for receipt registration. A centralized registration system adds system transparency and allows creditors to assess the status of pledged goods.

• Separate guarantees: The legislation may allow additional guarantees to be recorded on the warehouse receipt, in order to make the warehouse receipt a less risky and more attractive form of collateral.

• Regulation of warehouses: Through the regulation of warehouse organization and operation, a legal framework can strengthen creditors’ confidence in warehouse integrity. Common approaches include establishing a licensing system for warehouses, subjecting warehouses to regular inspections, and establishing an indemnity fund.

• Settlement and release of stored goods: In general, a buyer or creditor may retrieve goods from a warehouse by presenting the receipt to the warehouse operator. The legislation determines the conditions for the release of goods from a warehouse.

• Execution and priority of obligations: To attract potential creditors, it is important to ensure that if the debtor defaults, the creditor may quickly seize and liquidate the underlying stored goods, and recover the debt. Likewise, the receipt holder’s ranking in the priority of obligations vis-à-vis competing creditors needs to be determined.

• Penalties: To increase creditor confidence in warehouse receipts, legal frameworks for warehouse receipts usually contemplate penalties in particular for violations committed by warehouse operators or owners, and for those who commit fraud related to receipts.

As the regulation of these key elements varies from country to country, the study compares and analyzes these elements and their implementation in practice. This will allow a country that wishes to establish or reform a warehouse receipt system to compare the contextual factors with its own, and to assess the aspects of the system’s legal design that would or would not work under its own specific conditions. The final conclusions of the legal review will be presented in the forthcoming legal study.