



## TOOLS FOR ENABLING AGRICULTURAL FINANCE

### WAREHOUSE RECEIPT SYSTEM; HAIRCUT FINANCING MECHANISM

#### What is it?

ACE delivers agricultural marketing and financial services to value chain participants. The warehouse receipt system (WRS) is a service that provides ACE clients with the opportunity to access secure storage and collateral finance, known as haircut financing.

The WRS requires clients to deposit their commodity at an ACE Certified Warehouse, of which there are currently 54 in Malawi; totaling over 186,000mT of capacity. Upon deposit the commodity is cleaned, graded, re-bagged and stacked. The Warehouse Operator issues an electronic Warehouse Receipt (WHR), on the ACE trade system, to the client stating the commodity type, variety, volume, quality and moisture content. This document allows the depositor access to the haircut financing facility, which is a loan facility that is currently valued at 70 percent of the value of the commodity on the date of deposit. This loan is recorded on the Warehouse Receipt which calculates interest and storage charges, providing the depositor with accurate, live, access to the Receipt status.

Once the loan has been issued the depositor receives ACE Market Information that details market prices and trade opportunities. When the depositor decides to sell then ACE facilitates the process and transaction. The buyer pays the ACE Settlement Account, which prevents default as it allows ACE to settle the storage fees, the principle and interest on the loan and the ACE trade commission. The balance is transferred to the depositor.

#### When and why to use it

The WRS should be used at the onset of the harvest season. It provides access to higher-value markets (that, according to seasonal prices trends, tend to peak later in the season when supply is lower) and to more affordable credit than otherwise available to depositor. The haircut finance allows depositors the option of selling later in the season; it gives them choice, therefore they are not forced to sell at the point of harvest. The WRS reduces post-harvest losses and creates incentives for price premiums via the sale of high quality and aggregated volumes later in the marketing season when the prices have traditionally experienced seasonal increases.

#### WRS: The Benefits

- Post-harvest losses reduced to 1 percent
- Access to higher-value markets
- Opportunity to gain price premium from aggregation, quality, seasonality

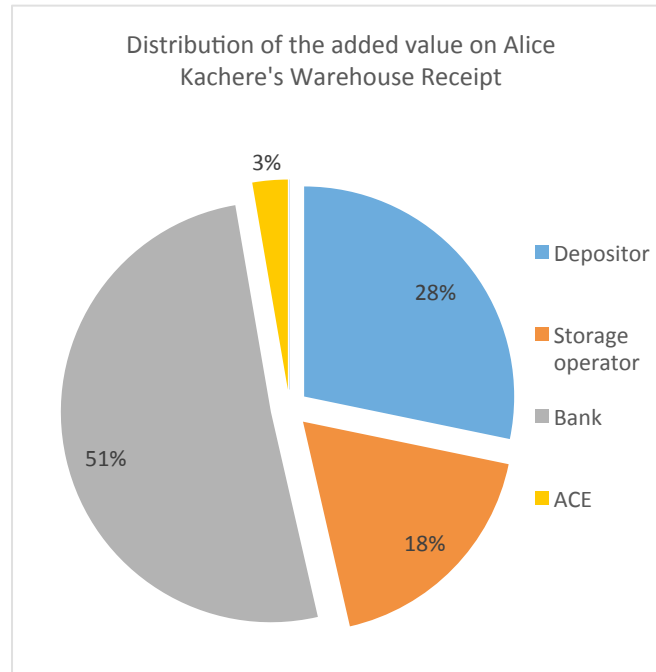
#### WRS: The Risks

- Market risk; few buyers in the market resulting in lower prices
- Price risk; volatile prices resulting in lower prices and
- Political risk; Government intervention in the market (export ban) resulting in market risk



## *The case of Alice Kachere:*

Alice Kachere has been depositing commodity in ACE certified warehouses since July 2014. In total she has deposited over 168mT of commodities. In June 2016, Mrs Kachere deposited 3.41mT of maize in Nathenje warehouse. She kept adding tonnage to her receipt until she reached a total volume of 22.34mT of maize by mid-July. Mrs Kachere decided to drawdown her receipt in December 2016. Between July and December the price for maize increased from \$214 per mT to \$339 per mT thus the total sales price was \$7,794. Therefore the total added value of the WRS was \$2,870. This added value was distributed according to the chart.



## **How to apply it**

Haircut finance can only be accessed via an ACE Certified Warehouse when commodity has been deposited and a WHR has been issued. The process of accessing a loan is as follows:

1. Depositor makes request for financing to ACE
2. ACE puts forward the request to the bank and bank approves the depositor and value of the loan (traditionally 70 percent of the value of the commodity on the date of loan request)
3. Depositor chooses the payment option; bank transfer or cheque
4. ACE facilitates payment to the depositor from the haircut finance facility
5. The break-even price of the commodity is closely monitored by the ACE trade system which is fully accessible by the bank

## **Key lessons learned and tips for applying the tool**

- A guarantee fund designed to mitigate some price risk for the banks will increase the appetite of the financial institutions to provide the haircut financing facility. It may also reduce the cost of finance, which currently stands at 35 percent per annum.
- The financial institution requires knowledge of market and price risks in order to apply the haircut appropriately. The value of the loan (percentage of the current commodity price) should vary with the commodity, the current price and the time of the year)

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