

Doing Business With Farmers and FOs: The Role of Commodity Exchanges

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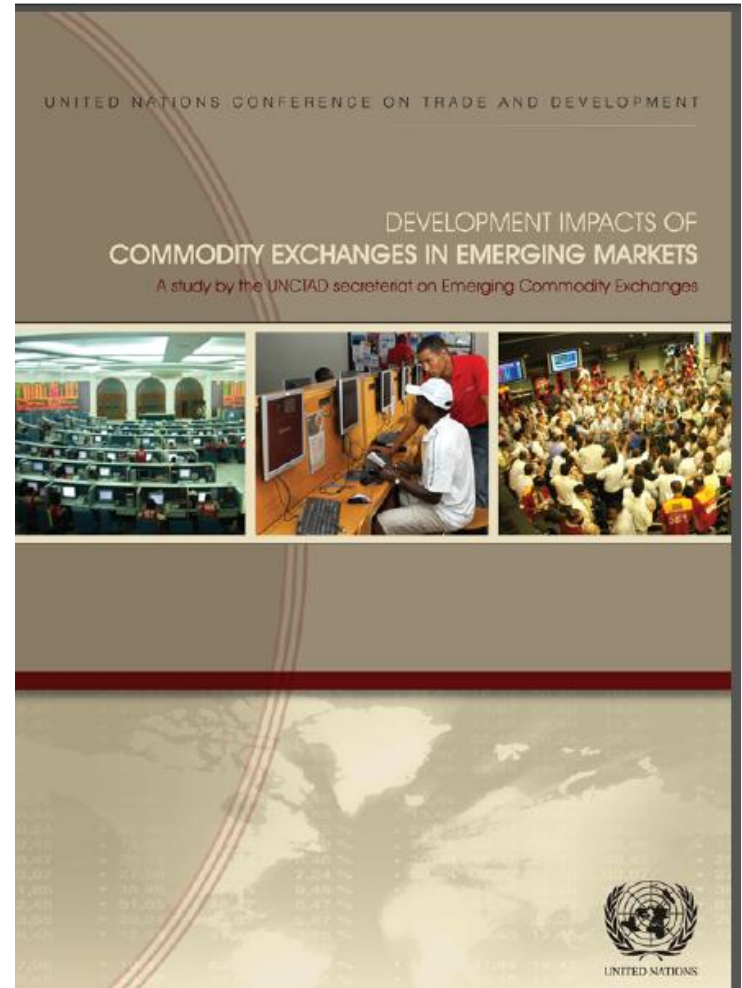
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Why an Exchange?

- Studies show more than 70 benefits
- Categories of benefit:
 - Price Discovery & Transparency
 - Physical Trade & Competitive Markets
 - Price Risk Management
 - Stimulate Agri-Investments
 - ***Financing of the Commodity***
- However, benefits are not assured
 - It is not easy to set up an exchange.... it is even harder to make it work
 - Harm can be done if key risks are not addressed



Potential Benefits: A More Detailed Look - Finance

Category	Potential Benefits from a Comex/WRS
Financing the Value Chain	<ul style="list-style-type: none">• Farmers have liquid collateral• Banks can value the collateral against a market price• Banks can easily liquidate collateral through the exchange• The system ensures collateral is pledged only once• The exchange manages performance through a defined settlement cycle, including guarantees against default• Interest rates on loans can be lower as risks are lower (especially when a position is 'hedged' through price risk management to lock in a forward price)• Liquidity to list and finance innovative products e.g. repos

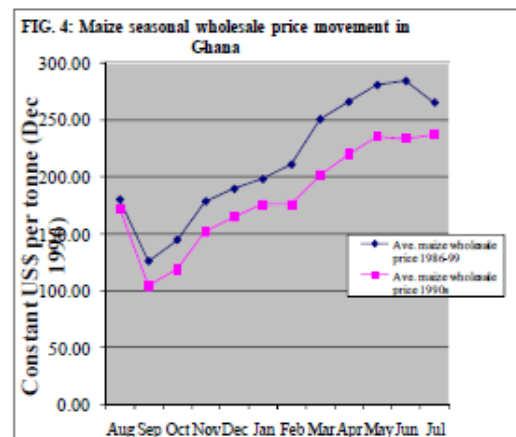
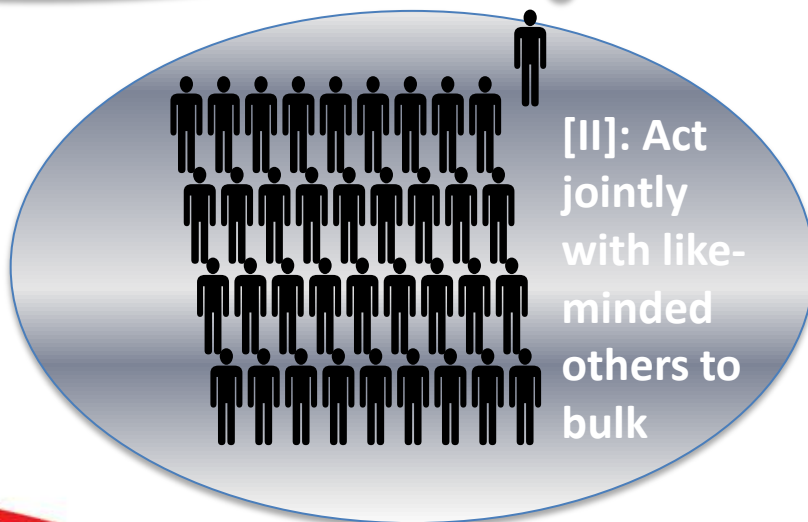


Support key aspects of the value chain finance transaction: pricing, collateral, pledging, valuing, liquidation, performance, risk management and liquidity

Village Level: Farmer Marketing Choice – Store vs Sell



**** Services may include market information, storage, warehouse receipt finance, input supply, brokerage..**



Comex: Village Level - Challenges



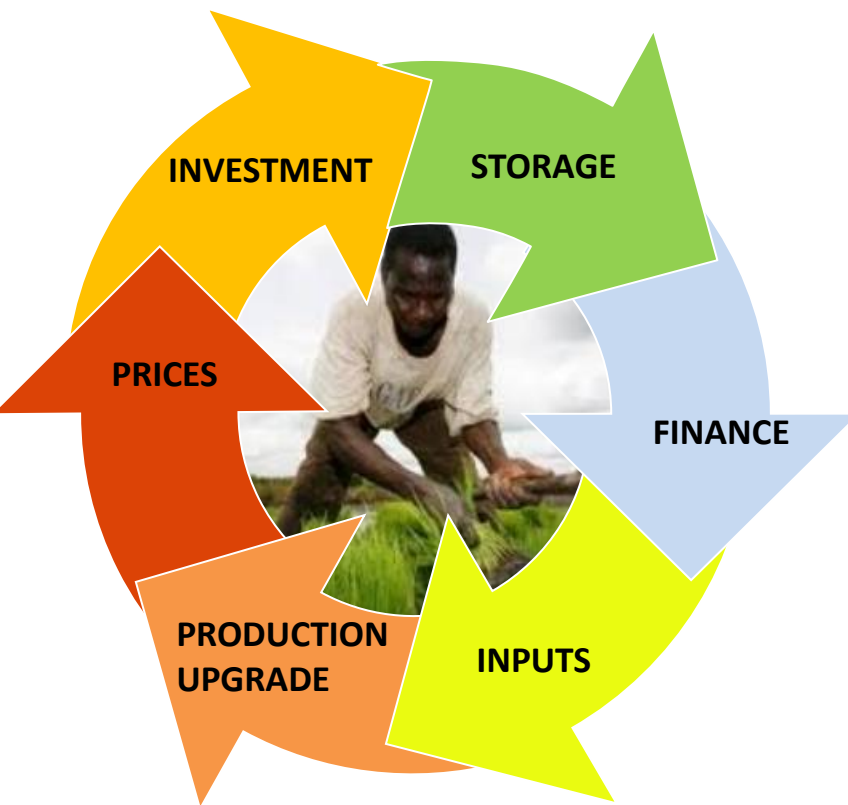
Farmer Association Warehouses:

1. Establishing farmer association warehouses in communities of sufficient condition, of sufficient capacity, with appropriate equipment
2. Management of the warehouse and quality certification as an independent, objective activity
3. Issuance and guarantee of the Warehouse Receipt, and managing the risk behind the guarantee
4. Making fees affordable and align other conditions (e.g. minimum size) with farmer requirement
5. Who provides financing? On what terms?

Aggregation:

1. Rights and obligations of farmers by bulking through an association
 - Who makes store/sell/finance decisions, and how?
 - In whose name is WHR issued? In whose name is finance taken? Who stands behind it? Who makes sales decision and when?
2. Operational, financial and management capability of farmers association

Farmer Benefits: Market-Driven Virtuous Circle



- 1) **Storage:** Farmer reduces post harvest losses, waits until later in the season for better prices and - through the WRS - accesses **finance**
- 2) **Finance:** Farmer obtains WR finance to help wait for better prices later in the season, and uses to finance next season's **inputs**
- 3) **Inputs:** Farmer deploys better inputs to improve yield and post-harvest techniques, thus achieving better quantity and quality to create a **production upgrade**.
- 4) **Production Upgrade:** Farmer's improved crop quality sells for a quality premium reflected by more attractive comex **prices**
- 5) **Prices:** Farmer watches comex prices to determine (i) when to sell, (ii) what to plant ('futures function'), (iii) lock in price ('futures function'), and thus how much can be **invested**;
- 6) **Investment:** Sale through comex generates increased income to farmer to enable **investment in next season's crop**.

Farmer income increases due to Increased Production from (1) rising yields , and (2) reduced losses; and Better Prices by (3) waiting until later in the season, (4)receiving a quality premium, and (5) receiving a market price

Africa Experience with Commodity Exchanges

JSE/SAFEX (SOUTH AFRICA)

- Created in 1994
- Commercial funding
- Developed infrastructure
- Commercial farming
- Large market
- Sophisticated banking sector took the lead in creating the market
- Electronic WRS
- Futures and options as key products

ACE (MALAWI)

- Created in 2004
- Budget Donor funding
- Underdeveloped infrastructure
- Smallholder farming
- Small market
- Banking sector only became involved later on once WRS took off
- Paper-based WRS
- WFP & NFRA Tenders / WRS financing / Spot

ECX (ETHIOPIA)

- Created in 2008
- High Donor funding
- Quite developed infrastructure
- Smallholder farming
- Medium market
- Banking sector followed via government instruction
- Electronic WRS
- Spot Market

Lessons – an Early View

- Previous initiatives in Kenya, Nigeria, Ghana and Zambia, among others, have not as yet met with success, *despite investment and political will..*
- Some Key Challenges:
 - **Misalignment with government policy** – forms of interventionism and restriction, legacy of anti-commercial mindset, a misunderstanding of an exchange's role
 - **Value needs to be created for all stakeholders:** Understandable focus on creating value for producers (the political priority) – without enough thought or focus on also creating value for traders/processors/offtakers
 - **Standardising** the commodity quality without losing its distinctiveness
 - **Insufficient focus on (i) guarantees and (ii) access to finance** – in particular through a robust model for default management ('clearing and settlement'), and a strong WRS
 - **National markets are small** – a regional market creates economies of scale that attract buyers and reduce transaction costs

African Successes – an Early View

- **CAN COMMODITY EXCHANGES WORK IN AFRICA?**
 - South Africa, Malawi and Ethiopia show a comex can work **in any African context..**
 - South Africa is a middle income country with commercial farming
 - Ethiopia is a large least developed country with smallholder farming
 - Malawi is a small least developed country with smallholder farming
- **HAVE COMMODITY EXCHANGES BEEN BENEFICIAL FOR AFRICA?**
 - In South Africa, Malawi and Ethiopia, prices are known by farmers..
 - Farmers have direct access to storage, information, finance and markets..
 - Farmers store and sell later in the season when **prices are higher, supported by Warehouse Receipt finance...**
 - .. **quality standardised** commodity is bought by processors and offtakers from farmers through the exchange for a **market price.**

THANK YOU!



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