

## 15 years of unregulated operations comes to an end.

On Friday the 26<sup>th</sup> April 2019, the Agricultural Commodity Exchange for Africa (ACE Africa) handed in the application to the Registrar of Financial Institution, for a license to operate a trade platform, a warehouse receipt system and a clearing house; all to continue the development and promotion of structured trade in Malawi. On the 1<sup>st</sup> of April 2020 ACE Africa was granted the license which is an imperative milestone in ACE's endeavour to establish and develop structured trade in Malawi.

To mark this occasion ACE will release a series of 7 articles about the structured trade journey and in-depth information about the Warehouse Receipt System, the Market Information System, finance and trade facilitation. The articles will be published in the Weekend Nation, this being the first.

- 1) The early years
- 2) Market Information System
- 3) The Warehouse Receipt System
- 4) Trade Facilitation
- 5) Chithumba
- 6) Agricultural Finance
- 7) The Future

We hope you will enjoy reading about our journey so far. Please join the debate on each article on Facebook #Agriculturalcommodityexchangeafrica

### The Early Years

It was 15 years ago when National Smallholder Farmers' Association of Malawi (NASFAM) took the initiative to start an agricultural commodity exchange. The model was adopted from ZIMACE in Zimbabwe where a group of committed agribusinesses were behind a young and thriving exchange. However, the model did not develop easily in Malawi and trade volume were very low. The markets in Malawi were much more fragmented than in Zimbabwe and the Malawian agribusinesses, whose equivalent in Zimbabwe were driving ZIMACE, were never as active in Malawi. **The early conundrum can be described as a regular Chicken/Egg situation. Farmers were reluctant to aggregate if ACE didn't have a firm buyer lined up and buyers were reluctant to commit if ACE didn't have commodity aggregated and ready for inspection.**

NASFAM and ACE realised that establishing an Exchange was not going to solve the problems alone. ACE Trust was therefore incorporated in 2007 to implement structured trade projects in partnership with a wide range of development partners. These partnerships started laying the foundation of the many necessary building blocks for successful structured markets in Malawi.

The stars aligned for ACE in 2010, when the World Food Programme (WFP) implementing the Purchase for Progress programme, wanted to utilise ACE as a new procurement modality. With WFP, ACE now had a steady buyer and a solution to the Chicken (or the Egg) problem. At the same time, ACE qualified for a grant from the Alliance for a Green Revolution in Africa (AGRA), to train, establish and promote aggregation and collective marketing for selected farmer groups. With AGRA, ACE now had funding to stimulate the supply side and a solution to the Egg (or Chicken) problem.

The modality WFP used was the online auction – a Bid Volume Only (BVO) auction, which means that the buyer specifies all terms and volume but not the price. ACE invites all interested suppliers to offer prices and available volume, against these terms on the online auction. After the auction, the

buyer can select the best suppliers (right volume, right location and right price) and ACE will issue the contract and delivery can begin.

Under the AGRA project ACE managed to promote farmer aggregation. It was small volumes, between 10mt and 30mt, but it was the beginning. The commodity was quality tested and maintained, the farmer groups accessed the BVO actions and managed to win some of these auctions by offering 1 kwacha lower than the large traders. **ACE felt we had cracked the nut and found a solution to smallholder farmers market access.**

One problem... this was not scalable. ACE had spent considerable project funds to handhold the farmer groups, ensuring safety of commodity stored in community sheds and assistance with rebagging, handling and logistics. There was no way ACE could handle these processes at scale. ACE knew private sector had to be the key. However, both NASFAM and ACE had been rejected, in the years leading up to 2010, when trying to get private sector to offer warehouse space and services. It seemed private sector were operating at full capacity doing their core businesses.

Farmers World was a founding member of ACE together with NASFAM and in 2011 Farmers World had taken their new Lilongwe silos into operations and they had excess capacity. They came to ACE and offered storage space and other services to farmers. This was the birth of the Warehouse Receipt System in Malawi. In 2011 we only had 6 deposits but managed to successfully store, finance and trade the warehouse receipts and provide the depositors with **30% profit compared with selling their commodity early in the season instead of storing.**

By 2012 all ACE activities centred around what ACE later would define as the 3 pillars of ACE – **Market information, Trade Facilitation and Warehouse Receipts**. A pathway of structured trade had emerged. Firstly, a farmer would register on the market information system and receive market information on SMS. The main vision was to empower the farmers and to ensure that they knew the urban prices before having to sell to local vendors - therefore (hopefully) negotiating a better price more aligned to the market.

With communication now established the second step was to facilitate the farmer actually selling to the best price in the urban centres. This trade facilitation was the central idea for starting the Exchange, but as in the early years, ACE really struggled getting volume of trade. We will analyse this in a later article, but **the main problems are coordination of volume, logistics/transport and settlement of cash**. It has only been in the last couple of years that ACE has seen promising progress with trade facilitation and part of the solution has been very strategic and targeted training and capacity building with regular communication and structured follow ups.

The 3<sup>rd</sup> step of the structured trade ladder is the Warehouse Receipt System (WRS). ACE needed the receipt system to be able to ensure and guarantee the performance of the seller and thereby build trade volume on the exchange. It was however, not the prospect of finding an immediate buyer which caught the attention of the farmers and traders; it was access to finance. Very early on, First Capital Bank (FCB) (then First Merchant Bank) offered to provide finance against a warehouse receipt. A depositor would deposit commodity in a certified warehouse and request finance from FCB. FCB would disburse 70% of the market value to the depositor.

**This was new in Malawi; with a flick of a switch all Malawian farmers could now access finance.**

Well, in theory, all had access. In reality FCB had a market risk. If market price would drop below the 70% FCB would lose its collateral. It went well – depositors had profit year after year and ACE always ran out of finance before we ran out of depositors. However, it didn't end well, in fact it went horribly wrong. But that story is for another week.

Other private sector partners actively joined the development of structured trade. Rab Processors offered storage space and opened their rural Kulima Gold shops as deposit points for the warehouse receipt system. National Bank, CDH and EDF started financing warehouse receipts and engaged in the development of receipt finance modalities. It all slowly started to take shape.

With the ACE rural model materializing, ACE Trust was able to establish some vital and game changing partnerships with USAID, EU and Common Fund for Commodities. Large grants were made available and ACE continued to lay bricks on the still moist foundations. The focus was on development of the trade platform, building warehouses in rural areas, training and capacity building of farmers, service delivery and promotion of the structured trade approach to Government, financial institutions and other stakeholders.

More recently, ACE has worked with Government of Flanders and GIZ to bring scale to the rural strategy and further drive the development of structured trade. A key focus has been to fully engage with the Ministry of Industry, Trade and Tourism (MoITT) when in 2014 they laid a roadmap to regulate the commodity exchange industry. First, the Warehouse Receipt Act, gazetted in January 2018 and then the Commodity Exchange Directive of April 2018. These two legislations are the regulatory framework for the Commodity Exchanges, Warehouse Receipt Systems and Clearing Houses. With the license now granted, ACE will become a self-regulating organisation (SRO), with authority from the Registrar of Financial Institutions to regulate industry and stakeholders utilising the services of ACE.

As we look back on the past 15 years, one thing that really stands out is partnerships. There would have been no ACE today without all the support and joint initiatives. So many in Malawi and internationally has been involved in this process – far too many to mention here; but you know who you are and we hope for your continued support in the era to come.

Dear reader, we hope we sparked your interest and that you will join us over the next weeks; to read, to dwell and to discuss the many important topics we will go through. The next article will be published on our Facebook page the 23<sup>rd</sup> April 2020.