ACE Trade Facilitation

This is the fourth out of seven articles published by ACE to mark 15 years of operation and celebrating the regulatory license recently acquired from the Registrar of Financial Institutions.

Trade facilitation is the Achilles heel of ACE services. NASFAM's main vision for ACE was to bring trade opportunities to rural farmers to ensure the best possible price available. In theory, this does make sense. Farmers are selling at very low farm gate prices, while end buyers are paying considerable premiums in urban areas. Create the linkages and add value for the farmers. **Well, it turns out that this is not as easy as it sounds!**

Let's say a farmer receives an SMS with an attractive price and calls ACE's 223 (toll-free number for trade and market information) to get a contract to sell 1 MT of Soya. ACE will then verify with the buyer that 1 MT can be accepted, then contact the seller to agree on an aggregation/collection point, preferably an ACE certified warehouse, but it does not have to be. ACE will then try to identify if there are other sellers close by, so that transport cost can be shared, and therefore reduced, combatting the excessively disproportioned transport costs of smaller loads. 15mt is the point where cost effectiveness is most apparent, but 5mt can also give benefits to the sellers. Less than that and it may not make sense to move the soya. The transporter goes to the collection point to collect the soya and deliver to the buyer. There is no need to complicate this example, so let's assume there is not any deduction done by the buyer at delivery.

The buyer will pay ACE by transferring to the ACE settlement account and now ACE will have to settle the seller. The easiest would be a bank transfer, but it is very unlikely that the seller in this case, a rural farmer, will have one. ACE can also settle through mobile money, but this is hardly ever requested - ACE assumes this is because it is hard to cash out in rural areas and also the cash out cost may be prohibitive for many. The farmer can then travel to ACE or ACE can send a cheque with courier, bus or staff. If there is a farmer's organisation, settling through them is a preferred option.

Logistics can easily take one week and settlement the same (depending on method). This is often not an attractive proposition to the farmers, even if the premium is 10 – 20%. When a farmer takes the decision to sell, they are usually responding to an urgent need for cash. The vendor, or rural trader as ACE prefers to call them, pay cash immediately and thereby perform all the services ACE is trying to put in place – aggregation, logistics and cash settlement. These traders are highly efficient and most of the time, they are not making huge margins – on the contrary they are getting squeezed on both fronts. Some years, it is cheaper for large urban aggregators/buyers to buy from traders delivering commodity to their warehouse in Lilongwe, than it is buying through their own rural outlets. This is really remarkable.

ACE is not trying to replace these traders. ACE wants to introduce a structured aggregation, transactional and settlement system where all the players transact – transforming the fragmented informal myriad of supply channels into a structured delivery system.

"Unscrupulous traders" is a phrase often heard. Enemies of the state. The rural traders and aggregators are often singled out and blamed for all that is wrong with the agricultural markets. However, it must be recognised that an integral part of good business skills, and some would say human nature, is to buy for less and sell for more, i.e. make a profit. It is simply not fair to weigh the morality of farm-gate pricing on the shoulders of the rural traders. **The rural prices are, and have always been, a projection of the underlying supply and demand mechanisms, not a result of the unscrupulous behaviour of the rural traders.**

There are a lot of factors which influence the prices at the beginning of the season, but there can be no doubt as to the significant role of government agricultural policies. Put simply, if policies reduce incentives for traders and processors, then demand will go down and so will prices. On the other hand, if policies increase incentives for buyers, then demand will go up and so will prices. **It is extremely frustrating for ACE, as a service provider and structured market developer, to repeatedly be undermined by policies, developed to alleviate certain problems, which actually exacerbate those problems.** The disastrous state of agriculture production and markets is to a very large extent a direct result of decades of bad policy decisions.

Numerous Governments in Malawi have justified the export ban of maize by saying that maize is the country's staple food and that Malawi will risk starving if maize is being exported. In fact, the export ban is possibly the main reason why Malawi is in a perpetual food insecurity circle. When a ban is introduced, it removes incentives for trader and aggregators, as their options to sell have been diminished. They will not be buying; demand down, prices down. With low prices, farmers will only grow the maize they need for their own use and even the smallest yield reduction will lead to Malawi as a whole being food insecure.

There is a long tradition in Malawi for the Ministry of Agriculture to issue minimum prices. Some years these are guidelines and some years they are dictates and it is a criminal offense not to adhere to them. Minimum prices based on a cost of production figure is a great guideline tool. However, some years, like this current season, the minimum prices are set very high relative to market prices. Incentives are again removed and the market prices will go down. Ironically, the more that Government try to enforce the minimum price the lower the real farm gate price will be.

Some years back Government wanted to weed out the unscrupulous elements and decided to introduce a license requirement to buy from farmers. Again, the intentions were undoubtedly pure, but the outcome had the opposite effect. Traders got stopped at roadblocks, their commodity was confiscated and, all things equal, the army of traders bringing markets to farm gate got reduced overnight; demand down, prices down.

When the input subsidies programme was introduced by the Government in 2005, the Government was bold enough to allow export the first year. That resulted in a handful of years where Malawi exported about 400,000mt of maize every year. This all ended in November 2011 when the export ban was introduced and Malawi has not exported any maize since. A perfect example how good policies can drive the agricultural production and market. **There is a real need for Government to review the agricultural policies.**

On the other hand, ACE cannot blame its poor performance when it comes to trade facilitation on Government policies. There is also a need for ACE to rethink the whole approach. Is there even a role for the commodity exchanges in the mix of the larger trader's rural outlets, the 15mt traders with pockets full of cash, and maybe throw ADMARC into the mix? **Yes, ACE still, stubbornly maybe, believes there is. But, there are some essential building blocks missing: Electronic settlement and volume on the warehouse receipt system.**

Volume on the warehouse receipt system is very closely linked to finance and article 6 will focus on this. Electronic settlement is dependent on infrastructure and scale. In the past, ACE was thinking that introducing liquid mobile money agents would be a solution. However, more recently and after brainstorming with TNM, ACE is convinced the whole electronic payment system needs to take a leap and enable a cashless transaction environment. In other words, when a farmer receives an electronic payment, he/she will have to be able to buy the goods and services needed, with the electronic payment service and thereby eliminate the need for cash all together.

ACE and TNM have designed a pilot to be implemented around a well-functioning rural warehouse, to explore if it will be possible to get everyone in that area on a cashless system. This will be hard to implement at scale, but ACE believes its needs to happen. Especially for ACE's ability to develop structured trade facilitation.

Facing these missing elements, ACE is targeting buyers, who for various reasons, need or benefit from the Warehouse Receipt System. ACE call these demand drivers, or using established commodity exchange terminology, market makers. Utilising the demand from these market makers, ACE can introduce systems and build transaction volume.

In fact, the Warehouse Receipt System and to a large extent ACE itself was built on the early demand from the World Food Programme (WFP). ACE had very little trade volume when WFP started buying through ACE in 2010. ACE developed the BVO (Bid Volume Only) auctions for WFP procurements. BVO basically means that the buyer specifies all the terms, expect the price. Suppliers will then attend the auction and compete on price. It like an open tender. In the first 3 years WFP was responsible for 75% of ACE's trade volume. ACE build the systems and structures and then manages to migrate volume away from WFP. During the subsequent years, WFPs share was less than 15% of ACE's total volume. A remarkable tale of what can be developed around a steady demand. Just imagine what could be done with the demand from Government, WFP and other institutional buyers.

Unfortunately, WFP is no longer using the BVO system, but ACE and WFP has signed a MOU detailing how WFP will procure from farmers through private sector, utilising the Warehouse Receipt System as aggregation, settlement and audit trial. ACE is also providing services to a leading tobacco company, where contracted farmers will deposit groundnuts in the selected certified warehouses. Commodity Services Limited (CSL) (a new entity in the ACE Ecosystem established to house the collateral management, monitoring and inspection requirements of the exchange) is managing the flow of warehouse receipts, with ACE linking non-contracted farmers (when needed) and settling the farmers through the settlement system. ACE has also successfully linked farmers and traders to United Refineries Limited (URL) in Zimbabwe utilising the Warehouse Receipt System.

These demand drivers are crucial for ACEs ability to further the development of structured trade. The export market has a particular appeal to ACE. The benefit of the Warehouse Receipt System to foreign buyers is obvious. They can take ownership of any commodity, in any certified warehouse and transport it out of Malawi when it is needed. For the export buyer, volume is crucial – they really need to be confident that volume is there, so they are sure of delivery.

ACE is confident that trade volume will increase if ACE keeps building more relationships with market makers, continue to develop commodity finance options and continue to promote the Warehouse Receipt System as an aggregation system for farmers. There is a critical volume which needs to be reached. ACE is not sure where the bar is, but it will be a tipping point and, from then on, buying and selling warehouse receipts will be the default way to trade agricultural commodities.