

ACE - The Future

This is the seventh and final article published by ACE to mark 15 years of operation and celebrating the regulatory license recently acquired from the Registrar of Financial Institutions.

It is fair to say that it has been a struggle for ACE to carve out a space as a service provider in the agricultural value chains. The model was always based on high volumes and low commissions, but in a fragmented and highly volatile environment this model has proven unsuccessful. In essence this has always been ACE's predicament. ACE has, however, filled its bag with highly valuable lessons and is now eager to move into the future with a new model to service and further develop structured trade in Malawi.

The pivotal ingredient moving forward is services built on and developed to de-risk agricultural production and markets. The risks embedded in agriculture facing both producers and agribusinesses, are the same risks ACE has been battling with for 15 years. It is very clear that the agricultural industry cannot progress and develop further to ensure the productivity, food security and economic benefit Malawi desperately needs, without a new range of risk mitigating tools being made available. ACE will concentrate its efforts on developing and making these tools available to the industry and at the same time building ACE's services on these.

There is a reason why none of the few commercial farmers that Malawi has, are producing any maize, soya, peas, groundnuts or beans for the commercial markets. It is simply too risky. Commercial farmers concentrate on seeds, tobacco and other niche crops where production is backed by a production contract and a reputable buyer. A commercial farmer needs to have a guaranteed price and that is simply not possible for the grain and pulses cash crops in Malawi. So Malawi's production of these crops are dependent on small scale producers, who are faced by the same risks, but not the same opportunities. **Each year millions of small scale producers risk their time, energy and little resources they have to produce, based on the hopes and dreams that the price will be good.** Sometimes the price will be good, but the harsh reality is that most years the price will be below the cost of production leaving it impossible for the farmers to evolve their business in any way.

The fact that farmers are willing to sell their produce at prices below cost of production is the very reason growers cannot get agribusinesses to give them production contracts at fair prices. Why would processors issue production contracts when they know that they are likely to be able to buy their requirements cheaper from the small scale sector? This is the industry predicament. The obvious result being, that nothing will develop to commercial scale.

In developed markets, producers can hedge their price risk by accessing futures and options, but that is not available to farmers in Malawi. This inability to hedge prices is also the main bottleneck for the availability of agricultural finance in any post production processes, leaving many operators with weak balance sheets incapable of accessing finance. This again narrows the markets, reducing demand for produce and therefore one of the main reasons for low post harvest prices. We have to find solutions to address these inefficiencies and ACE intends to spearhead these efforts.

The regulatory license process, was for ACE an opportune time to adapt its structure and put in place a model for the future. The crucial element for ACE is to have a strong industry mandate and support. One of the findings in IFPRI's recent [study](#) of the commodity exchange landscape in Malawi, was that ACE had support in both the banking and agri-industries. This was encouraging to learn. Even if ACE has struggled and failed to scale its services described in this series of articles; **the**

message from the industry was clear: “We need what ACE is trying to do and we support ACE as the entity to do it.”

ACE made a proposition to the industry: Sign a commitment to use ACE services for USD 25,000 over the next 3 years and ACE will convert this commitment to equity at the end of the 3 year period. It felt natural to promote ACE's services rather than an outright equity investment, and the added advantage is that ACE will end with the right shareholders, meaning the companies who actually use the exchange and therefore have a self-interest in supporting and developing ACE. The IFPRI findings about support was right, with ACE managing to get commitments from 14 companies, a good mix of banks, traders, processors and warehouse operators. After the first 12 months, USD 105,000 of the total USD 350,000 had been fulfilled which is a very satisfactory and promising start. There were some conditions in the licence granted to ACE, one was for ACE Trust to hold a maximum of 40% ownership in the licensed exchange. ACE will meet this condition by transferring 60% ownership to the committed shareholders who meet the commitment

Another issue ACE wanted to tackle with the new model was to better distinguish ACE's development efforts from the commercial activities. ACE Trust has always been the entity implementing development activities with the main objective being the integration of farmers into structured trade and the services of the commercial Exchange. **It was never ACE's vision to build a sustainable NGO, it has always been the vision to develop a sustainable commodity exchange.** Over the years, these lines have blurred and perhaps ACE has lost its focus at times. With most funding coming through ACE Trust, the main focus has been to implement the ACE Trust activities and meet the targets and expectations of the development partners, which did not necessarily align with those of a commercial Exchange.

Although ACE Trust have been very fortunate partnering with supportive development partners, it has still been a challenge for ACE to align multiple development partners' (often short term) targets with ACE's longer term sector transformation goals. There is a need to call out to development partners to support Malawi's industry institutions such as NASFAM, FUM, CISANET, AICC and of course ACE who are all working for similar aligned objectives and all struggling with funding. These institutions, including ACE, have all at times been reduced to being implementing partners for the donors' 3 to 5 year projects, jumping from project to project to stay alive, all the while the main transformational strategies are being neglected. **It has to be the other way around! Support strong institutional strategies and then the implementation of these from project to project.**

ACE comprises of three entities. ACE Trust overseeing the developmental and inclusivity of structured trade, and the commercial entities of the ACE Ecosystem are ACE Africa, the licensed commodity exchange and Commodity Service Limited (CSL). While ACE Trust will continue to implement inclusive rural activities, the commercial entities will develop and offer the risk mitigating services to the industry. The first of which was the collateral management services under CSL. One of the main lessons from past experience was ACE's successful inspection of physical stock through the forward contract modality. Banks were very happy with the service ACE provided, but there was always a call from banks for ACE to provide traditional collateral management, as opposed to the inspection services ACE provided. The difference is where the liability lies. In ACE's system under the Warehouse Receipt System, the liability was with the warehouse operators, but after 2017 banks wanted ACE to take liability for the physical stock. This is not a traditional activity for a commodity exchange and the main reason ACE had refused previously. However, 2017 made it evident that it was needed. The foundation of the new ACE model was therefore the incorporation of CSL in 2018 to meet the banks' request and offer the full suite of collateral management services.

The future vision is still that full liability of physical stock has to be with the certified storage operators, but until such a time where the storage operators can back their exposure with financial guarantees, there is a need for third party collateral managers to be integrated with the Warehouse Receipt System, the two go hand in hand - **The Warehouse Receipt System protects the legal title to the stock, whilst the collateral management keeps eyes on the physical.**

Another condition in the license granted to ACE was the potential conflict of interest that could arise by integrating CSL and collateral management into the Exchange model. Internally, ACE has erected a Chinese Wall between the entities in terms of ownership and responsibility. Externally, ACE has no intention to try to monopolise collateral management under the Warehouse Receipt System. In fact, ACE's vision is to integrate all collateral managers into the Warehouse Receipt System. So, if you are a collateral manager, please join our efforts!

It is clear that the Registrar of Financial Institutions wants to achieve an open and inclusive market system. The third and final condition in the license granted to ACE is to ensure that the ACE model and especially the trade function under the Exchange meets the criteria set out in the IOSCO principles. The third condition emphasizes the potential conflict of interest of having trade, receipt and settlement functions under one roof. This condition will require dialogue with the industry and the Regulator, as it touches on the central components of the ACE model. **However, the core element of this regulatory concern is fully aligned with the ACE vision, to establish a fully inclusive and transparent market system.**

Alongside the 3 ACE ecosystem entities, ACE called for the establishment of the Structured Trade Task Force and articulated 6 intervention areas to take centre stage. The task force is a modality to unify and combine industry and develop partner's efforts in a systematic approach. The work that is needed to be done to bring forward the structured trade agenda is too encompassing for ACE, or any market entity, to take on alone and there is a real need to combine efforts. Unfortunately, ACE has so far received little support for this agenda and again would like to call partners to engage.

ACE identified 6 areas where efforts should be focused under the Structured Trade Task Force.

- Design and implement risk mitigation and management tools for agricultural value chains
- Design and implement price risk management tools for agricultural production, trade and financing
- Design and implement structured trade finance solutions with financial institutions and industry to support inter-regional and global trade flows
- Promote good agricultural trade policies including enabling Government market interaction such as market interventions and food procurement
- Work closely with the Registrar of Financial Institutions to ensure a quality regulatory regime and a sound and enabling framework for warehouse receipts
- Design and promote large scale private sector investments that promote rural inclusion, structured trade and regional integration

ACE is truly excited to experience the increased focus the Registrar of Financial Institutions has already manifested, by the development of an ambitious road map for the commodity exchanges and market functions. The recent operationalization of Malawi Agricultural and Industrial Investment Corporation (MAIIC) whose objectives are fully aligned with the objectives of the Task Force, is also very welcome. The now well-established Export Development Fund (EDF) and Malawi Investment and Trade Centre (MITC) are also continuing to developing their offerings in this space. It is safe to say that the ingredients, institutions, and political will is present. Whether it will succeed

will largely depend on our ability to align efforts and work together to push the wagon along the road laid out by the Registrar of Financial Institutions.

As these industry solutions materialise, it will be paramount that rural farmers are prepared and ready to be included and integrated. The ACE Ecosystem will work towards this and ACE Trust will continue implementation of rural activities directly and through partnership with other organisations working with farmers across Malawi, to ensure that the benefits of a commercially vibrant agricultural market will benefit the millions of farmers across Malawi.