

## TECHNICAL SUMMARY



### The Use of Warehouse Receipt Finance in Agriculture in Transition Countries

by Frank Höllinger, Lamon Rutten, and Krassimir Kiriakov, Working paper,  
FAO Investment Centre, St. Petersburg: FAO 2009.

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## Introduction

The following is a summary of Höllinger, F., Rutten, L., & Kiriakov, K. (2009). *The use of warehouse receipt finance in agriculture in transition countries*. (Working paper, FAO Investment Centre). St. Petersburg: FAO.

Farmers, traders, processors, and exporters seeking access to finance are often unable to meet banks' demands for collateral. The use of stored commodities as collateral is one way of overcoming collateral constraints and enhancing agricultural lending. It also improves the efficiency and transparency of commodity marketing by providing independent grading and quality certification.

This study discusses possibilities for warehouse receipt finance in the agribusiness sectors in Eastern Europe and Central Asia (ECA). First, it provides an overview of the different types and applications of warehouse receipt finance, and discusses key issues and core elements of a warehouse receipt financing system. Then the study reviews the current status of warehouse receipt financing in a number of ECA countries and sets out possible areas for further support.

## Types of Warehouse Receipt Finance

Farmers, traders, processors, and exporters deposit goods in a warehouse where the warehouse operator issues a receipt for the stored goods. The receipt can be used as a form of portable collateral to request a loan from a financial institution. At maturity, the farmer sells the commodity to a buyer who then either pays the bank directly, or pays the borrower who then repays the bank.

Warehouse receipt finance can be provided under different warehousing arrangements:

- *Private warehouse:* manufacturing (processing) and warehousing take place under the same roof and are controlled by the same company. The warehouse is just a part of the overall company operations, which may be manufacturing, wholesaling or retailing. It is very risky to use commodities in private warehouses as collateral for loans since there is little assurance that the goods are really present.
- *Public warehouse or terminal warehouse:* large storage area that serves many businesses. This type of warehouse can be typically found in a port or major transit center. It is owned (or rented for a long period) and operated by a warehouse operator, which stores commodities for third parties for a fee and acts as the commodities' custodian. Public warehouse operators often issue warehouse receipts that are acceptable as collateral by banks. However, the quality of the receipt as collateral depends on the regulatory systems in the country, and the financial status and integrity of the warehouse operator.
- *Field warehouse:* an arrangement where a collateral management or credit support company takes over the warehouse of a depositor or a public warehouse by leasing it for a nominal fee, and becomes responsible for the control of the commodities to be used as collateral. As the field warehouse is on or near the premises of the firm depositing the commodities, there is little disruption in the firm's day-to-day business.

In warehouse receipt finance, the bank shifts its credit risk from the borrower to the entity issuing the warehouse receipt—the warehouse operator. To avoid cases of fraud, especially in countries with weak public warehouses, banks need to have a careful accreditation process in place to approve the warehouse operators from whom they will accept receipts. Sometimes banks bypass the problem by working with an acceptable international collateral management agency.

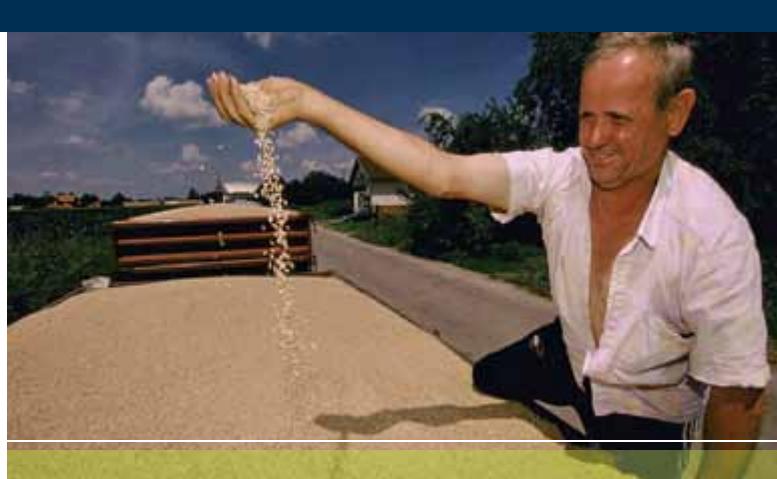
### Core Features and Enabling Conditions

A well-developed system of licensed public warehouses and the use of warehouse receipts for storage and marketing improves the transparency and efficiency of commodity marketing as commodities are independently graded. For financial institutions, warehouse receipts constitute secure collateral so that, in case of default, the lender has easy recourse to the commodity and can liquidate it without delay or high transaction costs.

The core elements of a well-developed warehouse receipt system are:

- an enabling legal and regulatory framework;
- a regulatory and supervisory agency;
- licensed and supervised public warehouses;
- insurance and financial performance guarantees;
- banks familiar with the use of warehouse receipts.

The legal status of warehouse receipts varies across countries: it either provides the lender with a pledge on the commodity or is used to shift ownership (title) of the commodity to the



lender. The use of warehouse receipts as a pledge instrument is more common but entails higher risk for the bank, as the transfer of the warehouse receipt does not automatically imply a transfer of possession. On the other hand, ownership-based warehouse receipt finance is often structured as repurchase agreements (repos) where, strictly speaking, the lender purchases commodities from a client against cash and specifies the date and amount at which the borrower can repurchase the commodity.

Warehouse receipt finance can be arranged under three main different warehousing arrangements: private warehouses, public warehouses (also called terminal warehouses) and field warehouses. Field warehousing operations require relatively little oversight as banks can choose collateral management and credit support companies they trust. Banks may also have an accreditation process for evaluating the operational standards and credit standing of potential partners. In addition, banks may have a system of allocating set credit ceilings to certain collateral managers. On the other hand, public warehouses need to be approved and monitored by a regulatory agency to ensure good performance. Such an agency creates a transparent and enabling environment for the use of warehouse receipt finance as well as reduces transaction costs for users. In a private warehouse, manufacturing and warehousing take place under the same roof, and are controlled by the same company.

In ECA countries, warehouse owners interested in offering public warehousing facilities are usually not part of large integrated groups and, therefore, banks want the operator to bear a greater risk by using insurance or creating an indemnity fund. Warehouse operators must insure their premises and the goods therein, as well as have indemnity insurance protecting the depositor and bank against theft, fraud or negligence by the warehouse operator's staff. If warehouse receipts are not issued by reputed international warehousing companies or collateral managers, the credit quality of the local warehouse operator can be upgraded by using insurance bonds or letters of guarantee or by developing indemnity funds.

For warehouse receipt financing to work, there needs to be conducive government policies and sufficient market incentives for participants. Commodities that can be stored with minimal quality losses and shrinkage over several months, have predictable seasonal

price fluctuations, and can be liquidated easily, work best for warehouse receipt finance. A reputed quality certification and grading system should also exist to determine the quality of the commodity. Governments should limit their interventions in commodity markets, as a certain level of price fluctuation is needed for warehouse receipt financing to function effectively and attract participants.

## Current Status of Warehouse Receipt Finance in ECA

Table 1 provides an overview of the current status of warehouse receipt system development in ECA countries, and the potential impact of a fully functional system. However, some smaller countries in the Balkans, the Caucasus and Central Asia do not have

**TABLE 1:** Development of key elements of warehouse receipt systems in selected ECA countries

Country	Overall Level of Warehouse Receipt Development <sup>1</sup>	Existence of			Future Potential
		Proper Legislation	Licensing and Supervision	Performance Guarantees	
<b>Countries with a fully developed warehouse receipt system</b>					
Bulgaria	High	Yes	Yes	Yes	Good
Kazakhstan	High	Yes	Yes	Yes	Good
Hungary	High	Yes	Yes	No	Good
Slovakia	High	Yes	Yes	Yes	Good
Moldova	Medium	Yes	Yes	Yes	High
Lithuania	Medium	Yes	Yes	Yes	Good
<b>Countries with a partially developed warehouse receipt system</b>					
Poland	Low	Yes	No	No	Limited
Russian Federation	Low	Not final	No	No	High
Romania	Low	Yes	No	No	Limited
Ukraine	Medium	Yes	Yes	No	High
Turkey	Medium	Yes	Yes	No	High
Croatia	Low	Draft	No	No	Medium
Serbia	Low	Draft	No	No	High

<sup>1</sup> Authors' assessment

warehouse receipt legislation in place. The economies of several of these countries are, in general, poorly developed and their banking systems weak. Governments continue to play a large role in commodity production, trade, and finance.

The greatest benefits from a warehouse receipt system can be expected in those countries that are major producers of storable agricultural commodities such as grain, sunflower seeds, and sugar. The Russian Federation, Ukraine, and Turkey present the highest potential, given the size of their grain markets. Ukraine and Turkey, require limited, more focused interventions aimed at introducing missing structural components (e.g., performance guarantees) or at training and awareness raising among private sector participants. Others, such as the Russian Federation, Serbia, and Croatia, require full-scale assistance programs, including completion of the legal framework.

## Next Steps for Warehouse Receipt Finance in ECA Countries

1. *Feasibility studies and regional workshops:* an in-depth assessment of the current situation should be conducted in those countries that have initiated improvements of their warehouse receipt systems and where key government and private sector stakeholders express interest in the completion of these efforts.
2. *Policy dialogue and awareness raising among key stakeholders:* government officials, commodity market participants, and financial institutions need to be fully aware of all the short- and long-term benefits of a properly functioning warehouse receipt system and its advantages over localized, bilateral, and private arrangements.
3. *Technical assistance and implementation support:* countries should be assisted to introduce legislation and develop capacity in warehouse receipt finance among local commodity sector participants and financiers. Representatives of all major private stakeholders should be involved in drafting the key legal provisions.
4. *Training and capacity building for users:* understanding of financial institutions and market participants in how to use warehouse receipt finance should be enhanced to build trust in the system.
5. *Investment support:* initial capitalization of indemnity funds may require public seed funding. Investment programs could also support the upgrading of public warehouses in rural areas.



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