Collateral Management in Agriculture Finance in India

AgriFin (April 2013) | This article was contributed by Vivek Thoopal, Head of Business Development (Collateral Management), National Collateral Management Services Limited (NCML), For additional information, please contact the author at: vivekthoopal@gmail.com (mailto:vivekthoopal@gmail.com)

The Indian agri commodity market, being highly fragmented, is characterized by a large number of participants including farmers, several layers of aggregator, processors and traders. Before the advent of professional Collateral Management entities, access to finance and consequentially holding capacity for the above entities was difficult due to poor balance sheet quality and credit history. While banks were keen to identify lending opportunities within this segment to meet their priority segment obligations, a high level of non-performing assets and heavy supervisory costs dissuaded their efforts. Moreover the flow of credit remained skewed in favor of the developed and urban pockets.

Over the past 8 years collateral management services have brought about a transformation by allowing banks to almost ignore the borrower's financial strength and rely solely upon the warehouse receipt issued by the agency. This form of lending by banks is in contrast to the traditional lending in the form of working capital, with credit facility based on the balance sheet of the borrowing entity, and is more secure due to the collateral manager's services. The current collateral management processes in India are rudimentary but effective and more importantly in line with the domestic market practices. The collateral manager after a survey enters into a lease agreement and takes custody of the storage facility containing the commodities. The collateral manager guarantees the quality and quantity of the agri based collateral, provides price information required for margin call and aids in disposal of the commodities, if necessary. The collateral manager also ensures that the commodities are adequately insured for natural calamities and burglary, though these risks are not underwritten by the collateral agency.

The loans against agri collaterals are typically short term (8 months to 1 year), self-liquidating, and one of the most secure products in a bank's portfolio. For the borrowers the willingness of a collateral manager to provide services in a variety of storage facilities, including the godown in his backyard (field warehousing), makes this the easiest method of procuring low cost finance.

The greatest challenge in providing these services arise from the logistics complexities of securing numerous warehouses spread across the remote parts of the country. Currently NCML is one of the two major collateral management companies in India. The company manages commodities of over $1.5 billion through 900 bank branches across 18 states and 3500 storage structures. It was also the first private company to issue a negotiable warehouse receipt, allowed under the Warehouse (Development & Regulation) Act, 2007. However, very few warehouses are registered with the warehouse authority, as required by the act which is still in a nascent stage of implementation. Extensive risk profiling, audit planning, and manpower management is required to ensure the security of the collateral especially due to the thin margins involved. As the industry remains manpower intensive, key risks to a collateral management agency remains the vulnerability of the personnel deputed to supervise the storage, inflow and outflow of commodities. Several levels of audit based on the risk profile of godowns are deployed to mitigate the above risk. Collateral management in India is unique in several respects. The idea of a specialized structured solution for a large client has been adapted as a retail product catering to the agriculturists and caters to even loans as low as $2000 for the marginal farmers. The client base is predominantly small ticket with an average loan size of approximately $40, 000. Of course, at the other end of the spectrum loans of up to $10 million are facilitated through this product. But, of the approximately 35,000 borrowers who use NCML's collateral management services, less than 10% avail large ticket finance.

Borrower's profile varies by commodity, but is usually small or medium enterprise/entity. For instance, financing against paddy is availed by processors, mustard seed by traders, and chili by producers. Irrespective of the borrower's profile, collateral management fees are usually paid by the financial institutions. In that sense the collateral manager acts as an agent of the financial institution.

Technology plays an important role in the management of the thinly spread structures. The system not only ensures that the issuance and release of the warehouse receipt are centralized but also keeps all relevant personnel updated in real time on the status of the collateral. Collateral management in India has witnessed tremendous growth and acceptability in recent time. The initial thrust was driven by the Reserve Bank of India's (India's central bank) regulations which require 18% of a bank's loans be directed towards the agriculture sector. The product, which started around the year 2004 and employed by 2 new private sector banks, is now being used by about 40 financial institutions to disburse loans of over $5 billion. This figure is expected to grow four-fold and reach $20 billion within the next five years.

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