Trade Finance: Warehouse and Inventory Management in Africa

AgriFin (April 2013) | This article was contributed by Andrew Barr-Sim, Managing Director, Drum Commodities Limited, UK. For additional information, please contact the author at: andrew.barr-sim@drumcommodities.com (mailto:andrew.barr-sim@drumcommodities.com)

Structured Trade & Commodity Finance (STCF) is a crucial ingredient in the world's trade finance flows. It covers the full range of commodities from agriculture to mining, oil, metals and softs. Pre-export and agriculture finance are also now critical areas requiring funding, particularly as the need to expand agricultural production intensifies.

The participants in structured trade finance include importers, exporters, traders, growers, and manufacturers. Standard deal sizes tend to range from US $10-$30 million with shorter—maximum one year—tenors. Facilities are normally revolving.

Prior to the dramatic rise in commodity prices over the past 10 years, an importer of sugar into West Africa would have needed US $4 million for a cargo and could have possibly financed the imports himself. Today, however, the same importer might need US $10 million for that cargo and will only be able to deposit about 20% in cash, leaving the remainder of the cargo as collateral against the bank's loan facility.

This has led to the growth of the STCF marketplace despite the recent world financial crisis, new Basel banking rules on capital adequacy and so on. In this STCF sector, conventional practice is for a bank to lend to its customer with an initial deposit and thereafter to take a pledge over the product which becomes its collateral against the loan facility. The bank then requires a manager of the collateral and the term "collateral manager" (CM) emerged.

The CM is also a risk mitigant under Basel 2/3, which can enable a reduction in the bank's risk weight assets. It reduces the balance sheet cover needed. However, it is only one of a number of such risk mitigants and is another layer of comfort to the banks' credit committees. It provides "eyes and ears" on the ground for the bank and, in legal jargon, "care, custody, and control" of its product.

A Collateral Management Agreement (CMA) is normally a tri-partite agreement with the Bank, Borrower and CM. However, there are built-in conflicts of interest in the CMA as the CM negotiates the fees with and is paid by the Borrower, yet is contracted to look after the "collateral" of the Bank. The tensions here lead to many issues and it is an area the banks must urgently review and take responsibility for. Banks also need to take much greater control of the relationship managers in-country.

With global finance very tight as banks replenish their balance sheets in the post-Lehman world and Basel provides additional constrains on lending, banks are unquestionably focusing on the much larger corporates whose own balance sheets provide the requisite credit worthiness to banks for lending. These corporates are then in a strong position to use their own finance to lend to their counter-parties, thereby becoming financiers themselves. That in turn leaves the smaller players, the independents, and those with fledging businesses at the mercy of high interest rates.

Another area of focus must be the quality of CMs. The past ten years have seen some notable bank losses from STCF lending and much of these evolve around the quality and controls of CMs. Some form of global control body needs to be considered along with improved methods of regulation. While some might dissagree, it is necessary for the CM to be a pure service supplier, independent, and not have assets in the form of warehouses or trucks, for example. If a CM does, then the first and foremost focus of the CM is to fill the warehouse with products or utilise the fleet of trucks, and not to truly manage the product of the customer (the bank) on the ground.

Finally, the CM's role is wider than merely managing the products for a bank on the ground. For instance, the CM can play an important role in supply chain management. And we are beginning to see the growth of agri exchanges with warehouse management a key element for these exchanges.

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