

## Uplifting small farmers through village aggregation centers and access to formal credit

Pakistan's current wholesale markets are ill-equipped to preserve quality. This negatively impacts farmer profitability. The quality of the product is not preserved as the traditional markets lack the appropriate infrastructure and expertise (see figure on existing eco-system). Non-transparent pricing is the norm because of the concentration of market power among certain intermediaries. Small farmers are the biggest victims of this archaic system. This note proposes an avenue for increasing the participation of small farmers in the upcoming EWR regime which addresses the above-mentioned systemic issues.

**Background:** The EWR regime Since the market mechanism does not reward quality, it does not incentivize the farmer to adopt and invest in efficient agricultural practices to preserve crop quality. As such, while Pakistan annually produces over 50 million

tons of storable agri-commodities (wheat, rice paddy, rice, cotton, maize, sugar and oilseeds), it is estimated that 20% of its value is lost due to lack of proper drying and storage facilities. While there is a limited capacity of modern mechanical drying (needed for paddy and maize) and silo storage facilities in Pakistan, they mostly exist within leading milling/processing facilities and are not accessible to farmers.

The electronic warehouse receipts-based financing regime (EWR) preserves crop quality, reduces post-harvest losses and increases Pakistan's exportable surpluses. Under a warehouse receipts-based financing regime, any owner of an eligible commodity (paddy, rice, maize etc.) can get it tested, mechanically dried (wherever required), and stored into an accredited warehouse/silo facility. **The warehouse operator will issue them a warehouse receipt which can be used as collateral to secure bank financing.** The warehouse operator charges a fee for storing the produce until it is withdrawn by the depositor after paying storage charges and bank mark-up (if the produce is stored under bank lien). **The prospect of receiving bank financing creates a strong incentive for all stakeholders to preserve its quality so it can pass the testing requirements for proper storage. This will help to reduce Pakistan's high post-harvest losses.**

Pakistan Agricultural Coalition has guided pilots with wheat, rice paddy and maize with the support of SECP and State Bank of Pakistan. Multiple pilots were needed since each crop has unique characteristics and supply chain. Using the results of these pilots, the Securities & Exchange Commission of Pakistan (SECP) notified the Collateral Management Companies (CMC) Regulations in July 2019. Under these regulations, SECP has registered a CMC called Naymat Collateral to accredit warehouses and serve as a repository of the electronic warehouse receipts issued by these warehouses. State Bank of Pakistan has adjusted its prudential

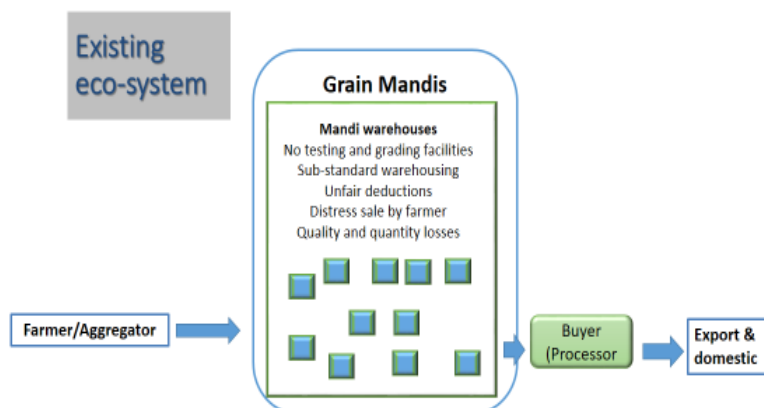


Figure 2. How the EWR regime works

- Naymat/CMC accredits warehouses and warehouse operators
- Any commodity owner gets it tested for entry to accredited warehouse
- Warehouse operator issues EWR in Naymat's software repository
- Bank lends 70% of commodity value against the EWR as collateral
- After price appreciates, EWR can be traded on PMEX or sold outright

regulations for all types of lending to allow EWRs to be used as collateral by banks. The EWR regime (see figure 2 above) has achieved a strong proof of concept.

Commercial players have led the EWR regime's proof of concept. **EWRs have been issued for agri-commodities worth more than Rs. 11.5 billion for rice, rice paddy, and maize (not wheat due to its strict government control). Interloop-backed Momentum Logistics, Karandaz-backed NRSP APC, Raaziq International, and Matra Asia are the leading warehouse operators. HBL and Bank of Punjab have spearheaded lending against EWRs and loans are disbursed within 24 hours of the issuance of an EWR (rather than the traditional 6-8 weeks).** And a third of the volumes have been brought in by 'farmer-cum-traders': farmers who now are now able to avoid distress sales of their harvest. They stock their commodity in accredited warehouses and get loans against them for the next crop. Warehouse utilization under the EWR regime has steadily improved for rice and maize.

**Scale-up of the EWR regime and inclusion of small holder farmers.** Around 90% of Pakistan's farms are small holdings (less than 12.5 acres) which therefore, produce smaller volumes. Therefore, it is difficult for them to participate in the EWR regime because their outputs are often less than a trolley load and also due to higher transportation costs (including bagging and de-bagging) from farm to the testing facilities. For better risk management, it is recommended that each farmer place only a portion of their output in the warehouse receipts regime. **Therefore, small farmers are better off accessing this regime in aggregates. Otherwise, small farmers have no alternative but to sell to the nearest aggregator or in the mandi at the time of harvest—this is basically a 'distress sale' since prices are the lowest at the time of harvest.** *It is clear that an aggregation model for small farmers to access the warehouse receipts regime must be developed.*