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Policy Brief No. 2

Warehouse Receipt Financing: Tackling the Financial Needs of Smallholder Farmers in Pakistan

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ABOUT THIS BRIEF

MEDA's **INNOVATE** project is a three-year initiative assessing the potential of non-traditional finance to stimulate agricultural innovation adoption among smallholder farmers in South Asia, South America and East Africa.

As an INNOVATE partner, Pakistan Microfinance Network (PMN) conducted research on WRF in Pakistan as related to Smallholder Farmers (SHF). This brief is based on the case study completed by PMN in December 2019: [Warehouse Receipt Financing: Tackling the Financial Needs of Smallholder Farmers in Pakistan](#).

It specifically looks at the needs of SHF to adopt WRF and the partnerships and technical assistance required to engage them. This information is particularly important for Financial Service Providers (FSP).

ENGAGING FSPS IN WAREHOUSE RECEIPTS FOR SMALLHOLDER FARMERS

In Pakistan, interest in Warehouse Receipt Financing (WRF) began in 2014, yet it is still in the very early stages of development. There are currently no warehouses that extend storage offerings to smallholder farmers (SHF); nor are there financial service providers (FSPs) that offer credit to SHF relying on electronic warehouse receipts as collateral.

KEY FINDINGS¹

PMN's research uncovered that many FSPs in Pakistan have limited engagement in agricultural credit, especially for SHF. Currently, only a few offer WRF products to large farmers and none to SHF. At the time of PMN's research, the government had not yet passed regulations allowing financial institutions to accept warehouse receipts as collateral. As of December 2019, however, the law changed -- FSPs are now allowed to accept receipts as collateral and the State Bank of Pakistan (SBP) is encouraging them to do so.

Key findings from PMN's research include the following:

- **Limited Use of Formal Financing by SHF:** Only 21% of respondents utilize formal financing. Others do not due to collateral requirements (agricultural passbooks or land titles), high interest rates, inappropriate design of products, and/or lack of credit history.
- **Equal Use of Formal and Informal Finance by SHF:** Of those interviewed, 22% use formal loans and 23% utilize informal lending services.

1. PMN, [Warehouse Receipt Financing: Tackling the Financial Needs of Smallholder Farmers in Pakistan](#), 2019.

2. As of December 2019, the government passed laws that allow for FSPs to accept these receipts.



- **High Informal Finance Usage by Women SHF:** Almost half of women SHF (44%) use friends and family for loans.
- **Lack of Existing WRF Loan Product for SHF:** There is no FSP currently offering a WRF loan product for SHF. In 2017, Habib Bank Limited (HBL) piloted a loan product for large scale farmers in Punjab, but SHF were not included in the pilot. The National Rural Support Program (NRSP) piloted a product the same year, but no loans were given against warehouse receipts.
- **Demand for WRF High from Larger SHF:** Those SHF owning 10-12.5 acres of land are highly interested in WRF (70%), due to the size of the loan they perceive they can receive.
- **FSPs believe SHF want to stay with the Aarhi System:** FSPs interviewed feel SHF are more comfortable with accessing finance from a middleman (known locally as an aarhi) and trust them more than formal banks.
- **Low level of interest of FSPs to engage SHF in WRF:** Those FSPs interviewed are not interested in engaging in WRF with SHF due to the high risks associated with agriculture.

RELEVANCE TO INNOVATE LEARNING THEMES: POLICY AND REGULATORY TRANSFORMATION

Warehouse Receipt Financing is supported by the government of Pakistan and the State Bank of Pakistan (SBP), which allows for FSPs to utilize warehouse receipts as collateral. FSPs can now consider offering loan products to SHF that are based on this form of collateral. Such offerings will require partnerships between the FSP and collateral management companies (CMCs), as well as any other relevant parties to ensure that SHF are equipped to engage in WRF.

Recommendations for Financial Service Providers

The recent regulatory changes by SBP to allow banks and microfinance institutions (MFIs) to accept electronic warehouse receipts as collateral, could encourage FSPs to expand their work with SHF. A review of best practices reveals that utilizing warehouses prevents distress sales and low prices, allowing farmers to time product sales to receive the best rates. This policy change will allow FSPs to expand offerings to existing customers, as well as attract new clients, and enable SHF to improve their incomes and access better markets, which in turn will provide more secure loan repayments.

PMN's research did not review existing agriculture loan products being offered to SHF by FSPs, nor did it determine potential WRF loan parameters for SHF. As a result, FSPs interested in developing a WRF loan product would need to conduct their own market research for their specific SHF target market. This would allow them to determine if their current loan products could be adapted or if a new WRF product would need to be developed to meet SHF needs.

Partnerships between FSPs and CMCs to provide SHF with access to warehouses will provide new opportunities for FSPs to gain additional SHF clients as well as other customers, such as traders and processors. FSPs will also be able to expand their reach into rural areas, yet not have all the associated costs of servicing remote clients. Loan-related activities could be done at the warehouse or via the CMCs if they have the capacity to do so.

Here are some key recommendations for FSPs to consider and potentially pilot in order to meet smallholder farmer demand for WRF:

- **Design Appropriate Loan Products:** FSPs should design new loan products that accept the warehouse receipt as collateral and meet the needs of the farmer at the time of crop storage. Such potential loan products will require parameters that are accessible, appropriate and affordable for SHF, as well as relevant to the WRF framework, such as:

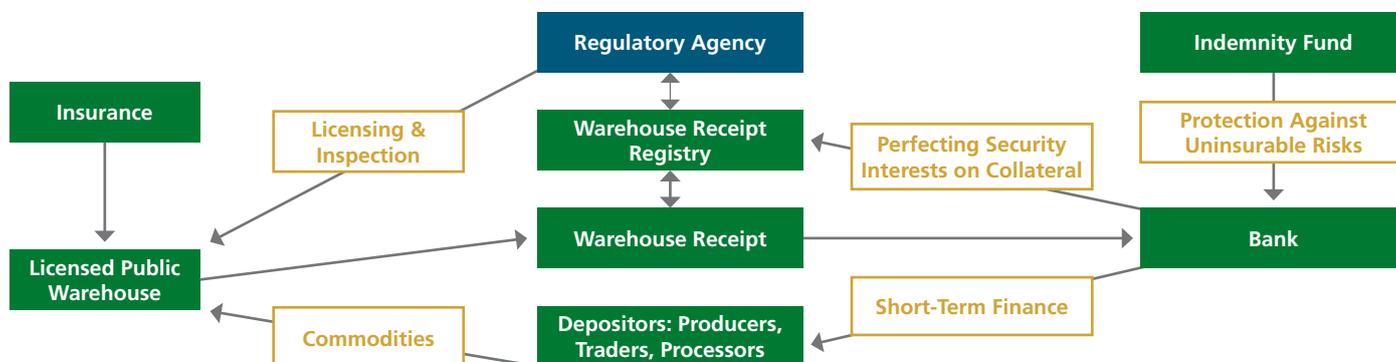


- **Loan Amount:** Traditionally, the WRF amount is a percentage of the value of goods stored. However, SHF have low volumes which would result in a small average loan size. It would need to be determined how this loan size could meet the needs of SHF.
- **Loan Use:** Such a loan product would need to allow SHF to use the loan for inputs and other activities required to prepare for the next crop rotation. Interviewed SHF stated that the primary loan uses are fertilizer (23%), inputs (20%) and land preparation (19%).
- **Gender Considerations:** Given the higher barriers for women SHF in agriculture, products should be inclusive of their unique needs: accessibility, knowledge/literacy, mobility, and others.
- **Target Geographic Areas near Warehouses:** Initially, loan products may target SHF that are within closer range of the warehouse.
- **Identify Client Target Market:** Determine SHF client eligibility and criteria related to land holding size, crop type, crop quality, location, etc.
- **Advocacy/Training Campaigns in Partnership with Relevant Government Agency, such as Extension:** Provide training to farmers on WRF so that they understand the concept and model, the partners, and the key benefits.

- **Partner with Insurance Company for Crop Insurance:** Underwriting risk in case of production or market failure of the SHF crop will be key. PMN's research did not investigate the type of insurance that would be relevant to SHF and their specific crops. More research is required on the role and potential of crop insurance within this type of model for SHF.
- **Establish Evaluation Criteria for CMCs/ Warehouses:** FSPs could establish internal evaluation criteria that determines their requirements for a CMC partner. FSPs could also consider working with the government to develop national criteria for CMCs based on best practice operating standards and credit standing.

Recommendations for State Bank of Pakistan and Relevant Government Ministries

This new regulation allowing electronic warehouse receipts as collateral is an important first step in adjusting the agriculture finance landscape and serving the needs of farmers. This is a key opportunity for the SBP and the government to design innovative initiatives to ensure a well-developed WRF system, such as shown in the chart below:³



3. Adapted from: FAO and World Bank, [The Use of Warehouse Receipt Finance in Agriculture in Transition Countries](#), Working Paper, 2009, p. 24.

Some potential areas to consider are:

- Training Campaigns for FSPs:** This initiative requires that FSPs, including those currently working in agriculture finance as well as those interested in expanding into agriculture, have a thorough understanding of WRF in order to succeed. It is important for the development of the warehousing framework and overall system that all partners have a secure knowledge of the model and each other's roles. Technical assistance can also be provided to FSPs to establish efficient WRF procedures within their institutions and maintain low administrative costs.
- Training Campaigns for Farmers:** It is important that farmers receive training on WRF so that they understand the concept and framework. Extension agents from the Ministry of Agriculture may be best suited to provide this training and can work with FSPs to organize such sessions for their clients.
- Training and Technical Support to Warehouse Operators/CMCs:** As this is a new concept for many in Pakistan, it is also important that the government provides CMCs with technical support. This will ensure that their establishment and business management practices follow best practice guidelines to ensure that the CMCs grow and are sustainable.
- Funds for WRF Pilots:** Given the low number of WRF pilots that have taken place in Pakistan, it is key to support FSPs in piloting WRF products with relevant partners and farmers. Such funds could require diverse target markets and regions, in order to determine how to best adapt the model to different contexts. Learnings from the pilots should be shared with the industry and all relevant stakeholders.
- Support Funds for Farmers:** Given the locations of warehouses, it is important for the government to consider offering support for transport and warehouse costs to farmers, especially SHF. This may be subsidized via the pilots mentioned above, provided through loans, or as a separate fund that farmers can access. For adoption of WRF to take place, this may be a necessary incentive to encourage farmers to change their behavior and begin accessing and utilizing warehouses.
- Exchange Trips:** Organize and implement exchange trips that expose FSPs and other industry stakeholders to successful WRF models operating in other countries, such as India. This allows decision-makers to be exposed to real life experiences that can assist in determining next steps on replicating and scaling WRF in Pakistan.
- Indemnity Funds:** It is important that FSPs and the farmers depositing their goods are protected from any issues that may arise at CMCs/warehouses. This type of fund safeguards farmers from theft, fraud or negligence by warehouse staff. The specific format of such a fund would need to be determined by all partners. For instance, it could be provided by the SBP for FSPs to access, or by the government agency that is working directly with CMCs.

- Accreditation Process for CMCs / Warehouses:**
 As referenced earlier, the government may consider instituting an accreditation process for the CMCs that evaluates their operation standards and credit standing.
- Adjust Warehouse Requirements to meet needs of farmers, especially SHF:** The relevant ministry, such as Ministry of Agriculture, should ensure that warehouses can and do meet the needs of SHF. They cannot take a one-size-fits-all approach. Instead, they must have options for the range of farmer types that seek to access warehousing. This may mean that certain requirements, such as deposit levels, are adjusted for SHF so that they can use the service.
- Warehouse Receipt Registry:** The government may consider establishing a central electronic warehouse receipt registry that can track all receipts issued by CMCs nationally. CMCs should also be required to have their own internal registries that track the receipts they approve. This allows the government to execute the required regulatory and control functions needed over the receipts.

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