SCBF 2019-07 **03.10.2022**

Warehouse Receipt Financing

1. DEVELOPMENT RELEVANCE

Economic and poverty context

With a population of 47 million (2022), Uganda has substantial natural resources, including fertile soils, regular rainfall, substantial reserves of recoverable oil, and small deposits of copper, gold, and other minerals. Agriculture vital to the Ugandan economy, employing 72% of the workforce. The country's export market slumped after the South Sudan conflict but has recovered thanks to record coffee and gold exports. Uganda has a small industrial sector that is dependent on imported inputs such as refined oil and heavy equipment. Overall, productivity is hampered by a number of supply-side constraints, including insufficient infrastructure, lack of modern technology in agriculture, and corruption.

Table 1[1]: Uganda Population and economic indicators	
Population in million (2021)	***47***
GDP growth *(2021)*	**3.4%**
Inflation *(2020)*	**3.8%**
Life expectancy at Birth *(2020)*	**64**
Foreign direct investment (net) (% of GDP) *(2020)*	**2.3%**
Personal Remittances (% of GDP) *(2020)*	**2.8%**
Unemployment Total (ILO estimate) *(2021)*	**2.9%**
Economic Freedom Index[i] (Rank among 186 countries) *(2021)*	**61.3**
Poverty indicators	
GDP per capita (USD) *(2020)*)	**858**
Gini Index (0= equality 100= inequality) *(2017)*	**40.5**
International poverty rate (*2017;* at 1.90 USD/day)	**49.4%**
Poverty Headcount ratio *(2019)*	**41.0%**
National rural poverty headcount rate *(year)*	**n.a.%**

Uganda's economic growth has slowed since 2016 as government spending and public debt have grown. Despite Uganda's budget being dominated by energy and road infrastructure, the country relies on donor support for long-term drivers of development, including agriculture, health, and education. The largest infrastructure projects are externally financed through concessional loans, but at inflated costs. As a result, debt servicing for these loans is expected to rise.

Oil revenues and taxes are expected to become a larger source of government funding as oil production starts in the next three to 10 years. Over the next three to five years, foreign investors are planning to invest $9 billion in production facilities projects, $4 billion in an export pipeline, as well as in a $2-3 billion refinery to produce petroleum products for the domestic and East African Community markets. Furthermore, the government is looking to build several hundred million dollars' worth of highway projects to the oil region.[2]

Financial-sector context

Uganda has a diverse financial sector which includes large international banks, local banks, cooperatives, Savings and Credit Cooperative Organisations (SACCOs) and micro-finance institutions (MFIs). Formal institutions are less prominent in rural areas and only serve 14% of the population there. Informal institutions serve about 12% of the rural population, leaving the rest unbanked. 62% of Uganda's population has no access to financial services. Of the 12 million "bankable" people, only about 4 million people (33%) have a savings account.

Uganda has a well-developed financial sector, though it is undercapitalised. This limits the financial sector's ability to meet development finance needs of rural and micro enterprises, which are at the core of Uganda's economy. Short-term loans offered by micro-finance institutions are not a solution to address the need for larger value and longer-term loans that businesses require. The country's capital markets are also not developed enough to play a significant role economic development. Only a limited number of financial instruments are available for savings mobilisation, liquidity management and portfolio diversification.[3]

The Bank of Uganda established four tiers of banking services in July 1999. Tier 1 includes commercial banks, Tier 2 includes credit institutions, Tier 3 covers microfinance deposit-taking institutions (MDIs) and Tier 4 includes all other types of creditors. Many of the largest MFIs are registered as Tier 3 institutions and are required to follow regulated capital adequacy ratios. Tier 4 MFIs also include SACCOs, for-profit MFIs, NGOs and private lenders.[4]

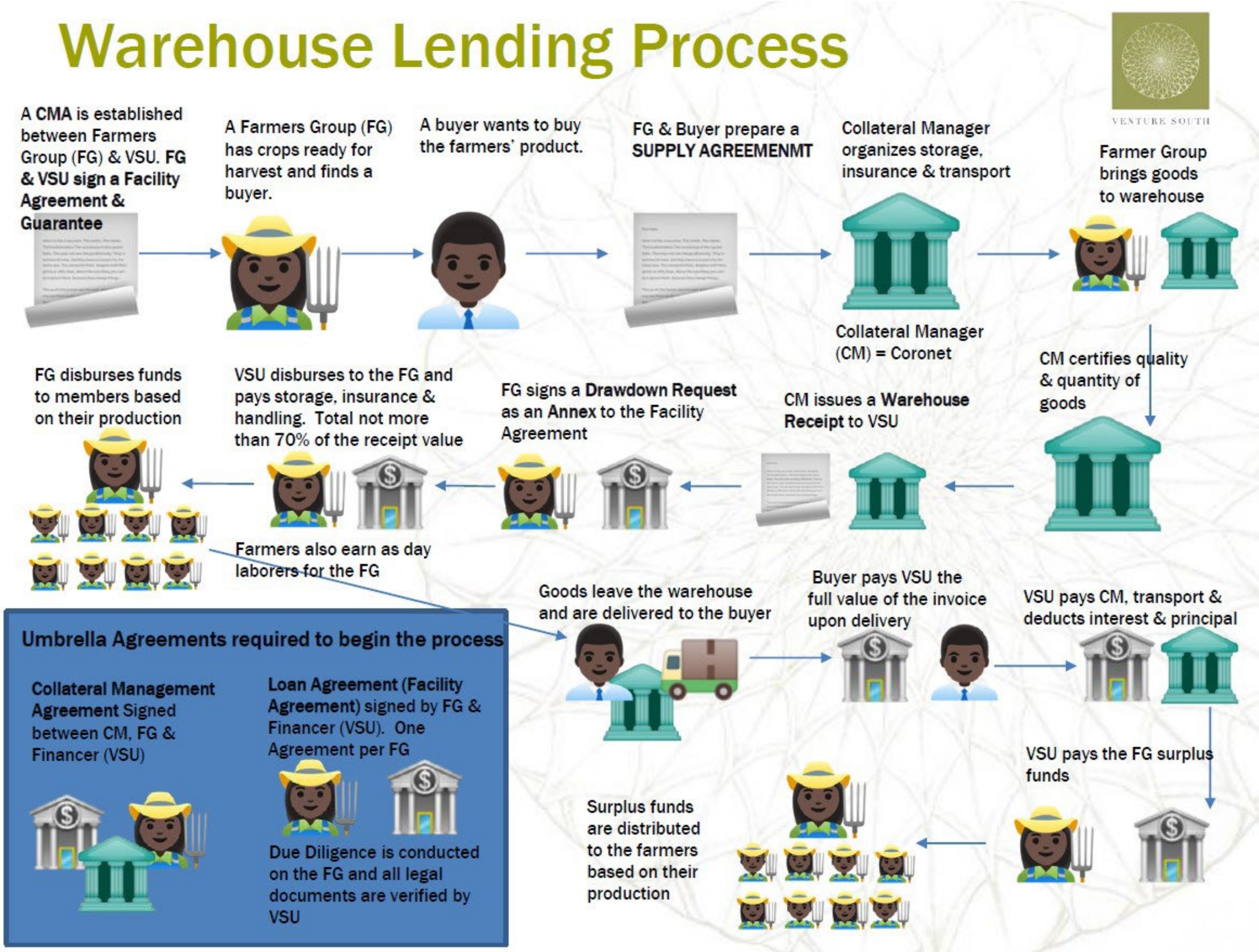
[1] The World Bank Group (2022). World Development Indicators database. Washington, DC. http://data.worldbank.org.
[2] The World Bank Group (2022). World Development Indicators database. Washington, DC. http://data.worldbank.org. Accessed Jan 2022
[3] The Financial Sector in Uganda - ABC Capital Bank Uganda
[4] Micro Finance Sector In Uganda - Success Essays

Partner financial institution(s)

Venture South Uganda (VSU) Limited, an affiliate of Venture South International (VSI), is a specialised lender to SMEs active in the solar energy space, agricultural finance and renewable resources. Based in Uganda, it is an impact investor that provides commercial lending to SMEs with a compelling business model. It provides finance in the form of collateralised, asset-backed loans, loans for inventory and short-term liquidity. Biashara na Fedha (VSK), VSI's Kenyan subsidiary, is the majority shareholder of Venture South Uganda Limited (VSU).

VSU Limited covers Mbale and Lira for loans

Coronet is a Ugandan company which verifies the quality and quantity of products that are stored in warehouses. They provide buyers with independent verification of the products against required standards. Their services are covered by the producer organisations (coops) and they store goods in their warehouses. Coronet controls the goods deposited in the warehouse (collateral management) and consequently ensures that the quality of the goods does not depreciate due to tampering or other forces. They are in daily contact with buyers and sellers, but do not provide financing. Coronet is the only company in Uganda that provides collateral for smaller volumes of agricutlure produce.



2. INTERVENTION APPROACH

Project review and design

This project began with considerable time dedicated to product design and preparing a growth plan. Venture South worked closely with the collateral manager to agree on the concept and design. Each step of the process was reviewed to determine each party's responsibility. The project team decided to focus Lira, Mbale and Fort Portal in order to avoid being spread out across the country.

The COVID-19 pandemic slowed down operations as travel was restricted, both internationally and locally, making field visits more complicated. While the desk work could continue as usual, in-person client visits and new client acquisition had to be undertaken around the pandemic restrictions. This meant scheduling phone calls in lieu of in-person meetings to explain how the lending works and its benefits to new clients. Given the number of legal documents and complexities of working with a collateral manager, it took a long time to conclude client discussions and gain management-level approval.

Main activity areas (goals, targets, resources & time frame) and outputs

The loan documents and developing a client-base were the primary outputs. Warehouse lending involves several parties – the lender, the borrower, the collateral manager and the buyer. Establishing good legal documentation and operational procedures which clearly laid out responsibilities of each party was a critical step. Loan application forms were developed, and funding was secured. The team visited numerus cooperatives around Lira and Mbale, including discussions with a major grain buyer in Jinja. A detailed operations flow was established and is included at the of this document for reference.

Warehouse worker sorts dried chillies

The team also developed a business plan and financial projections, including refinement of outreach targets, the number of loans determined by the average loan size, and other KPIs indicated in the project application. A Collateral Management Agreement was developed to outline the responsibilities of the borrower, collateral manager and creditor. Time was taken to talk with clients and understand problems they face. For example, clients indicated that weather plays a big role in the agricultural value chain because it can make it take longer for crops to dry, which can slow down sales. Price fluctuations also mean that clients want to hold on to goods longer or sell them sooner depending on which way prices are moving. Wholesalers require crops to be dried before they can purchase. Coffee, for example, can take several days to dry and be sorted by grade/quality. Consequently, the team developed repayment over a period of time rather than on a specific date, as is the usual practice in in lending. The team also took the time needed to ensure that legal requirements were operationally possible.

The collateral manager (Coronet) was also involved in the loan process to ensure they were comfortable with the client, the crop and the warehouse. If the collateral manager was not comfortable, the team did not proceed with the client. The collateral manager also had a staff member located at each warehouse every day to ensure the integrity of the goods held there. Goods could not be moved from the warehouse without authorization from the creditor and collateral manager. Clients also required time to get comfortable with collateral managers, as most small agricultural cooperatives do not generally engage collateral managers due to cost implications. However, clients came to appreciate the collateral managers as they provided a security to the lenders. Collateral managers also assisted with transport and insurance besides their broad market knowledge.

3. RESULTS ACHIEVED AND NOT ACHIEVED

Client-level

VSU worked with four cooperatives and SMEs, primarily in the coffee and chilli value chain. The cooperatives have around 1,000 to 3,000 members each, with a combined membership of over 5,000, with at least 60% women farmers. It is difficult to estimate whether all 5,000 members directly received funding from the loans extended to coops. However, some members reported selling 10 times more to the coop while others could not sell anything. Additionally, the members who did sell through the coop got increased prices, in turn financially strengthening the coop. It is worth noting that VSU was not able to meet all the financing needs of the coops. As the programme continues growing, the team envisions meeting the additional financing needs.

Coffee farmer (left) with Coop Manager

Individual farmers sell to the coops based on their individual production capacity. The coop the aggregates the produce and sells it to large buyers. This is one of the primary advantages for farmers as it allows them to get a better price for their crop. The prices are generally 10% to 30% higher compared to what the farmers would get if they sold directly to the traders who purchase at farm gate prices. The coops also hire men as day laborers and women to clean and sort the agriculture products, opening up an additional income channel for the farmers. The coops also pay bonuses to their members at the end of the season.

In addition to providing farmers better prices for their crops, the loans enable cooperatives to grow their business. For instance, they provide the coops with the financing they need to purchase and sell larger volumes of crops. The coops also create rural jobs for coop managers, transporters, collateral managers and day laborers. The coops are primarily taking market away from small traders who pay low prices to farmers. The importance of increased income to farmers cannot be overstated. A typical farmer will produce 20 to 40 kgs of coffee per week or 1,480kg per season. At current prices, which equals to around UGX 230,000 per week or UGX 17,020,000 per season (US$ 60.5 to 121/week or US$ 4,479 per season). The loans provided by VSU contribute to increasing the incomes of rural families.

The volume of produce sold correlates to the size of loans made by VSU. Loans generally started off small and then grew as the coop developed their repayment history and proved their procurement/sales capacities. As can be seen in the below table, the value-added price over the parchment price averages around 30%. This is additional income which comes to rural areas, farmers and coops which is otherwise lost when sold at the farm gate. That 30% increase comes back to farmers in the form of day labour and profit distributions from coops.

	Number of Loans	Product	Loan Value UGX	Loan Value $	Total Kgs	Value of Coffee	Value Value	Value Added	Value Added $
Client 1	3	Coffee	UGX 100 000 000	$ 28 169	25 990	UGX 454 825 000	$ 128 120	UGX 148 143 000	$ 41 730
Client 2	3	Coffee	UGX 180 000 000	$ 50 704	29 139	UGX 504 813 500	$ 142 201	UGX 176 094 100	$ 49 604
Client 3	16	Coffee	UGX 1 235 000 000	$ 347 887	194 127	UGX 2 718 483 300	$ 765 770	UGX 1 071 221 200	$ 301 752
						Chili	**Chili**		
Client 4	15	Chili	UGX 171 000 000	$ 48 169	12 957	UGX 203 115 000	$ 57 215	UGX 60 150 750	$ 16 944
Total	**37**		**UGX 1 686 000 000**	**$ 474 930**	**262 213**	**UGX 3 881 236 800**	**$ 1 093 306**	**UGX 1 455 609 050**	**$ 410 031**

Total number and value of loans made during the project

The table above also shows a premium of US$ 410,031 over the price of goods at farm gate. This premium is earned by the coop and stays in the rural community. These funds are used to pay day labourers, local transporters, earn a profit for the coop and pay a dividend to coop members. The local communities would not benefit from this income had the agricultural products been sold directly at the farm-gate.

Partner financial institution-level

Venture South Uganda benefitted tremendously from the support provided by the SCBF grant. Developing a new loan product allowed VSU to diversify from its solar loans into a new niche with high impact potential. The company provided 37 loans (against a target of 60) for a value of US$ 474,930. The main difference in the lower number of loans was that loan duration was initially expected to be one week, but it was extended up to one month, thereby reducing the number of loans. These loans are picking up now and will increase significantly in the coming weeks. Based on the success of the first loans, existing clients have introduced the VSU offering to associated cooperatives and partners, which could potentially become VSU clients. These introductions have also been key to developing relationships with wary farmers. The project also enabled VSU to raise US$ 200,000 of fresh funding, of which US$ 175,000 has already been disbursed. The company is now engaging with other funders who have expressed interest in investing larger sums.

Client (left) with Collateral Manager

One of the most important developments emerging from this SCBF co-funded project is with the Uganda Commodity Exchange (UCE). UCE is developing warehouse receipts which will be tradable and used as security to creditors to extend loans on goods held in UCE warehouses. This is common practice in mature economies but does not yet exist in Uganda. As such, it is a development which could have a positive impact on farmers as well as the Ugandan agriculture markets in general. Making warehouse receipts freely tradable – similar to stocks on a stock exchange – can inject more money into the market and create opportunities for farmers to earn higher prices without relying on middlemen. The agricultural stock held in UCE warehouses, secured by tradable warehouse receipts, could become even more secure and provide VSU an opportunity to expand its lending to cooperatives already holding stock in UCE warehouses. At the time of writing this report, tradable warehouse receipts have not gone live but will soon, with Venture South becoming an active player in the market. Further SCBF support might be required to realise this potential idea.

Coffee Quality control officer talking to Coronet consultant (left)

4. LESSONS LEARNT

- In line with common practice, loans were initially established with fixed repayment periods. This was found to be impractical because of unpredictable weather and fluctuating crop prices, as well as transport/logistical challenges. This meant that clients incurred additional late fees even though the situation was beyond their control. This resulted in two key changes:
    - Repayment conditions were adjusted to allow clients to repay the loan over a period of time (one month). Penalty interest would not take effect until the fifth week.
    - As the loan repayment period was extended from one week to one month, the number and value of loans reduced, because the funds could not be rotated as quickly.
- Despite the many advantages of borrowing, it took time to develop new clients as the coops are wary of debt and working with a collateral manager.
    - **Learning**: coops need to clearly see the benefit from an offering before it can be scaled-up. The advantages that coops experienced as part of this project, allowed other coops to see the value of VSU's loans and seek them out.
- The loan value was established at 70% of the value of the Goods Received Notice (GRN). This prudence was validated with price fluctuations in the market. While VSU did not finance maize, the maize market was dramatically affected when Kenya temporarily closed its border to Ugandan maize and prices plummeted. The chilli value chain was also affected international buyers stopped procuring from Uganda due to quality issues. Consequently, prices dropped and VSU stopped lending for the chilli crop.
    - **Learning**: diversification of agriculture product and lending at values below the value of the GRN is appropriate and necessary.
- Even though loans were in high demand, it took time and effort to gain farmers' trust and expand the client-base.
    - **Learning**: it is critical to work with people who have strong ties to the rural communities and can act as 'product champions' or advocates in their local communities.
- The lending approach works best with a steady volume of trade. If the client only sells a small amount of produce each month, setting up this lending programme and creating a relationship with the collateral manager may not be worthwhile. Additionally, traders with very small margins, are not best suited for this type of lending.
    - **Learning**: it is critical to focus on rural coops who can provide value-added services (such as drying, sorting and grading) and can sell in bulk to reliable buyers.