

# Leveraging Warehouse Financing by NBFCs : A Quagmire

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## Abstract :

Agriculture is an integral part of Indian Economy. Various efforts are made by the Government of India to enhance the agriculture production and as a mission to double the income of farmers and keeping pace with it Ministry of Finance took various efforts in making budgetary provisions in the year 2020. It is a right time to foray into Farm Credit Delivery System by Non Banking Finance Companies (NBFCs) taking the benefit of three Ordinances introduced on 5<sup>th</sup> June, 2020, enabling the farmers to open their vista across country without any barriers. Warehouse Financing is mainly dominated by Public Sector Banks in India, which provides the benefits to the Farmers to get the best price of its produces besides providing the storage facility and able to earn the finance on such storages. Reserve Bank of India, from time to time, with a view to boost Credit Disbursement in Priority Sector Lending, to registered NBFCs for on-lending will be allowed upto an overall limit of 5% of individual bank's total priority sector lending. NBFCs can become real game changers for the Commodity Finance. This Article focuses on the opportunity involved in the Commodity Financing Business by NBFCs. It also provides impetuous and discusses the pros and cons in the said business.

**Key Words :** Agricultural Credit, Priority Sector Lending, Role of NBFCs, Ware House Finance

## I. Introduction :

Agriculture is a dominant sector of our economy and farm credit plays an important role. It depends on availability and easy access to adequate, timely and low costs credit from the Lenders. Farmers would tempted to avail agriculture finance if it is hassle-free, simple and without any complication. Most of the farmers are small producers engaged in agriculture activities. In absence of proper storage facility and high cost in storage of agriculture produce, farmers did not pay any heed to grow their produces at large level.

Agriculture finance plays very crucial role if the Lenders approaches the farmers and made them aware about the solution for post-harvest storing system in a systematic way, so that their produces would be preserved and after sometime when they sale in the market they get appropriate price. What happens in India is farmers tend to sell their produces immediately as the business-persons approaches the farmers and purchases their produces from the farm itself. In case, where the farmers do not get the immediate buyer, usually they approach the Agriculture Produce Market Committee (APMC) or any open market for sale of their produces. Farmers have no idea of storage and warehouses to store their goods. Storage of goods in warehouses is beneficial to farmers as it would generate the best prices of their goods. However, the businessman, middleman or agents take the benefits of this bridging situation and the make handsome profits

by storing the goods and sale later with hefty premium. Resultant effect is that farmers remain poor and down-trodden class owing to ignorance about farm credit benefits.

## II. Significance of Agriculture Finance :

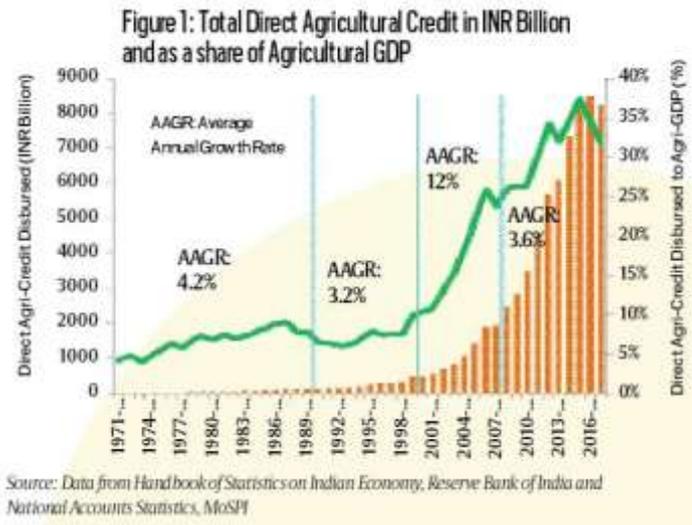
Agriculture Finance plays significant role in agrarian economy. Uptil now, due to government's backing and as a matter of compelling situation, Public Sector Banks (PSBs) used to lent money to the Farmers. Due to political agenda as well as waiver schemes, introduced from time to time, the priority sector lending remained untouched by the Private Players. However, taking into the stake of the gradual awareness amongst the farmers and utilising the farming lend by applying the various technology, the ratio of agriculture produces increasing year – by - year and as such, there is a strong demand of agriculture finance. It is right time for Non-Banking Finance Companies (NBFCs) to enter into the arena of the agriculture finance sector, particularly in warehousing financing.

Agriculture finance, if introduced in a systematic, well-planned and farmer – friendly manner, it plays a very catalytic role in strengthening the warehouse financing which has the dual benefit, to Lender as well as to Borrower/ Farmer. Agriculture Credit would reduce the regional economic disparity amongst farmers. Agriculturist would convert their traditional and conventional method of farming, if agriculture finance is accessible easily and hassle-free. To achieve the target of double turnover in agriculture produces, Green Revolution is *sine qua nun* for the country. The time has come to remove the economic and financial imbalances in agriculture industry. If, NBFCs leverage the situation and focus in Warehouse Finance it would strengthen their portfolio, improve economy, liberalise PSBs from forced and monopolised lending.

Agriculture is the main occupation in the country. Agriculture Sector offers promising prospects, both on the demand and the supply sides. Still there is a vacuum in the integrated system for the value addition, processing, cold chain, storage and product handling. Environment for agriculture marketing and contract farming is gradually taking place in the country.

## III. Agri Credit Distribution and Share of Agricultural GDP:

Figure 1 presents the absolute amount of direct institutional credit flow to the agriculture sector. Over a more than 40-year period, from 1971-72 to 2017-18, there has been a more than 1,000 time increase in agri-credit. However, as a percentage of the agricultural GDP, which should be the real measure of agri-credit growth, the rise has not been smooth. In a survey conducted by the All India Financial Inclusion Survey of 2015-16 by NABARD reported that 30.3 per cent of all agriculture households availed credit from institutional sources. It could be said that the remaining agri-households either don't need credit or they are not "bankable", or both. However, the fact that almost 70 per cent of agri-households did not avail institutional credit shows that there is much scope for the banking sector to extend its portfolio. Institutional Credit support for marketing and post-harvest storage, if strengthen, futures market and warehouse receipt financing could be a game changer for society.



Source : Indian Express

Moreover, Table – 1 shows that Agriculture plays a vital role in India’s Economy 54.6% of total work force is engaged in agricultural and allied sector activities (Census 2011) and accounts for 17.1% of Country’s Gross Value Added (GVA) for the year 2017-18. GVA of Agriculture and allied sectors and its share in GDP of the country at current prices during the last five years is as follows :

**Table : 1 - Gross Value Added of Agriculture Sector**

Items	Years				
	2014-15	2015-16	2016-17	2017-18@	2018-19**
GVA of Agriculture and Allied Sectors	2093612	2227533	2496358	2670147	2755992
Per cent to total GVA	18.2	17.7	17.9	17.2	16.0

Source : Central Statistics Office, Ministry of Statistics and Programme Implementation, Govt. of India

\*\* As per the press note on Second Advance Estimates of National Income 2018-19 and Quarterly Estimates of Gross Domestic Products for the third Quarter (Q3) of 2018-2019 released by CSO on 28<sup>th</sup> February 2019

@As per the First Revised Estimates of National Income, Consumption Expenditure, Saving and capital Formation fort 2017-18 released on 31<sup>st</sup> January, 2019.

So, undoubtedly, there is a huge scope for the future in the agricultural credit.

**IV. Dealing in commodity derivatives by NBFCs.**

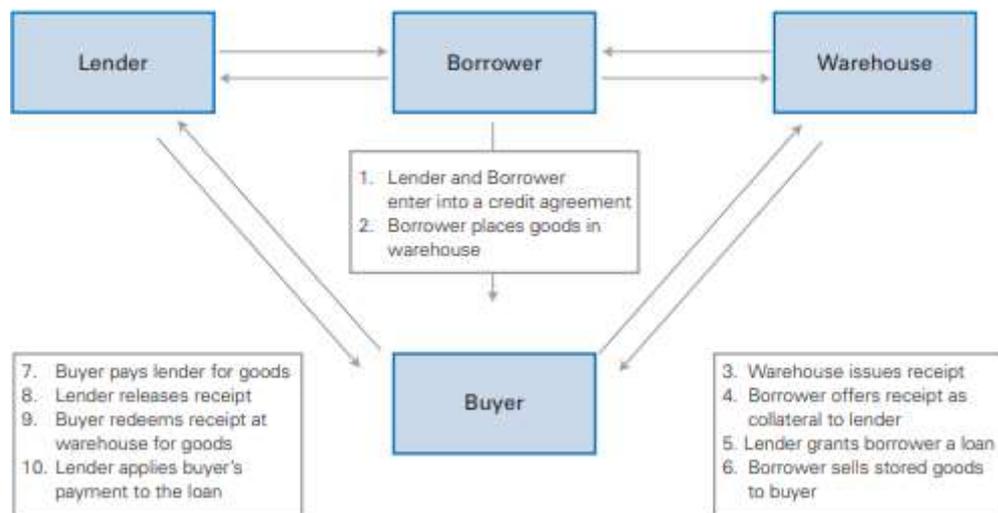
Dealing in agriculture commodities is little risky due to high price fluctuation. If the price collapse, distress in the farming community can be widespread and security obtained by NBFCs may have very limited exposure. To eliminate the risk factor, managing margin is vital for NBFCs. Constant watch on the finance would be required. To secure the farm credit finance margin between 30% to 35% is desirable against the commodity to cater the element of price fluctuation.

## V. Warehouse Receipts as a tool for Financing Agriculture commodity finance :

Warehouse Receipts are documents issued by Warehouses to Depositors against the Commodities deposited in the warehouses. Depositors are referred to as the Bailor of Goods and the Warehouse wherein the goods are pledged/stored is called a Bailee. It also referred to as the pledger and pledgee in the context of the Indian Contract Act. Warehouse Receipts (WR) may be either negotiable or non-negotiable. In case of Negotiable WR be transferred by endorsement and delivery. In that case original depositor or transferee can claim commodities from warehouse. WR can be traded, sold, swapped, used as collateral and can be listed in the futures market and commodity exchanges. WR provide farmers with an instrument that allows to extend the sales period of modestly perishable products well beyond the harvesting season. WR can be used as collateral for Short Term Borrowing to obtain Working Capital, in that case farmer need not to sale the product immediately to ease cash constraints. WR contribute to creation of cash and forward market and thus, enhance competition. It can form the basis for trading commodities. It can also be used as price – hedging instruments. The combination of this could provide the Lender with secured collateral and at the same time hedging in the market.

The Figure 2 shows the process of Warehouse Finance and the involvement of parties in it.

**Figure 2**



## VI. Determinants for Warehouse Receipt Finance :

The Collateral Management Service Providers plays very important role as ultimately Collateral Managers are physically holding the goods so tripartite agreement by NBFCs, warehouse owner and service provider i.e. Collateral Managers is very imperative, apart from lender and borrower contract, the commodities are required to be stored as collateral for financing against the Warehouse Receipts. NBFCs need to take care in the finance and the chief issues which NBFCs may come across are enlisted herewith :

- Issues related with due diligence and the services to be provided by Collateral Management Services Providers.
- Quality of Goods/ Commodities stored in Warehouse should be qualitative one and necessary certificates from testing laboratory with respect to their quality, quantity, grading, moisture and tradability, be obtained.
- Nature of goods, value, perishability, storage facility to be verified after the goods are stored and WR is issued. Bailment of goods as a security of the payment of debt and necessary agreements to that effect.
- Sanction of Loan by keeping proper margin, looking to the nature of goods.
- Periodic Inspection to be taken by NBFCs.
- Proper maintainance of Mercantile Register and drawing power to be maintained and deficit in margin above 5% be reviewed from time to time.
- Price fluctuations to be monitored by in-house experienced person .
- Extensive use of Information Technology would prevent the falling in price sharply.
- Weekly/fortnightly commodity update by Risk Management Team and assessing the possible risk involved in the particular finance looking to the market fluctuations, globally and also keeping the factors of trend of commodities geographically.
- Registration of Electronic Negotiable Warehouse Receipts.
- Geo-fencing technology to supervise the Audit Team of Collateral Management Company.
- In case of pledged goods are stolen immediate steps for reporting theft, steps for minimisation of loss and timely lodging claims from Insurance Company be taken.
- Evolution of appropriate legal, regulatory and institutional environment.
- Splitting Warehouse Receipts in case of the depositor has an obligation to transfer only the part of the commodities or looking to the fluctuation in price.
- Negotiability of Warehouse Receipts and easily exchangeable on the exchanges.

The above are not the exhaustive but the inclusive one. It may vary from farm credit to farm credit.

## **VII. Procedure for withdrawal/ liquidation of Goods :**

When farmers desire to liquidate the credit or in the eventuality of sale of goods or withdrawal of goods due care has to be taken.

- Where the Depositor or Holder of Negotiable Warehouse Receipt intends to take delivery of the Goods, he shall clear the lien on the goods and to see that dues of the warehouseman is cleared;
- The Depositor or Holder of NWR shall submit a request to the Repository or its Agent for withdrawal of the goods from his account;

- The Repository or its Agent after due verification shall forward withdrawal of goods request made electronically to the warehouseman;
- The warehouseman shall validate all information and process the request for release of goods to the depositor or holder after liquidation of all dues of warehouseman;
- In case of part delivery of goods the repository records shall be updated and balance goods shall be reflected in the Electronic NWR;
- In case of delivery of good converted in an Electronic Negotiable Warehouse Receipt is taken in full, the Electronic Negotiable Warehouse Receipt shall be extinguished and all electronic systems shall be updated;
- The Repository shall intimate the Depositor or Holder and Warehouseman about the withdrawal of Electronic Negotiable Warehouse Receipt through Electronic means, Mobile Applications or such other means as may be laid down by Authority;

The Electronic NWR may have several holders during its life time as it is transferrable and negotiable. In case of a pledge the Repository shall mark a pledge/lien on the Electronic Negotiable Warehouse Receipt in favour of Pledgee upon being instructed to do so, by both the holder of the Electronic Negotiable Warehouse Receipt and the Pledgee.

### **VIII. Registration of Ware House Receipts with Repository :**

In order to make the WR System viable, the legal system should ensure to support the pledge instruments such as WR Receipts and use it as a collateral. Keeping in mind, the legislative changes are made by the government from time to time. The Warehousing Development and Regulatory Authority formed under Warehousing (Development and Regulation) Act, 2007 (WDRA) to look after the affairs and to follow the provisions of the Act. Several Rules and Regulations are also framed. As far as the notifications issued by Ministry of Consumer Affairs, Food and Public Distribution (Department of Food and Public Distribution) dated 29<sup>th</sup> June, 2017 the Regulations consisting of Electronic Negotiable Warehouse Receipts came to be introduced. Which means a warehouse receipt issued in an electronic form. The Regulations brought in the system to promote, regulate and develop the Electronic System of Holding and Transfer of credit balances of goods deposited in warehouses through Registration of one or more repositories. Therefore, it was incumbent that every warehouse registered with the Authorities shall enrol with one or more repository registered with the Authority and shall issue Electronic Negotiable Warehouse Receipts only through Repository. Every Depositor of Goods for which Electronic Negotiable Warehouse Receipt issued shall have a client account in the Repository System. A Repository shall upon receipt of intimation from a warehouse, create and manage the negotiable warehouse receipts in Electronic Form. The warehouseman shall be responsible for creating a unique electronic negotiable warehouse receipt after correctly determining the quality and quantity of the goods deposited and entering the same all other relevant information in the Repository System. The Repository shall intimate the warehouseman and Depositor about the creation of

Electronic Negotiable Warehouse Receipt through Electronic Means or Mobile applications or such other means as may be laid down by the Authority.

### **IX. Initiative by Government in the year 2020 for barrier free farming :**

In order to achieve the double production target, various schemes for Farm Credit, Kisan Credit Card Scheme, Interest Subvention in the event of Natural Calamity, Post-Harvest Loan, Collateral Free Loans and various other schemes are formulated.

A working group constituted by the RBI was asked to examine on the aspect of (i) Reach of Institutional Credit, (ii) Ease of Credit and Inclusiveness and (iii) Impact of Loan Waivers of State Finances and Credit Discipline, Committee submitted its report and recommended to increase in Share of Short Term Crop Loans. The Working Group observed in the report that the Interest Subvention Scheme for Short Term Crop Loans has increased the Share of such loans in agricultural credit from 51% in the year 2000 to 75% in the year 2018. It also suggested for the Credit for Allied Activities, Land Reforms and Credit for Small and Marginal Framers to review agriculture credit.

In order to remove the barrier and to promote the Agriculture produces a major initiative to amend the Essential Commodities Act, 1955 was taken with a purpose to increase the competitiveness in the agriculture sector and enhancing the income of the farmers and with a view to liberalise the regulatory system, Ordinances issued by Central Government namely The Essential Commodities (Amendment) Ordinance, 2020, on 5<sup>th</sup> June, 2020. Moreover, with a view to provide for the creation of an eco system where the farmers and traders enjoy the freedom of choice relating to sale and purchase of farm produces, which facilitates remunerative prices through competitive alternative trading channels and to promote efficient, transparent and barrier free inter-state and intra-state trade and commerce of farm produces, outside the physical premises of markets or deemed market notified under various State Agricultural Produce Market Legislation, the Farmers' Produce Trade and Commerce (Promotion and Facilitation) Ordinance, 2020 came to be promulgated. Moreso, with a view to provide for a national framework on the farming agreement that protects and empowers farmers to engage with agree- business firms, processors, wholesalers, exporters or large retailers for farm services and sell of future farming produce at a mutually agreed remunerative price framework in a fair and transparent manner, the Farmers (Empowerment And Protection) Agreement on Price Assurance And Assurance And Farm Services Ordinance, 2020 was introduced.

WDRA also constantly watching on the affairs of warehouse financing and guidelines on empanelment of Inspection Agencies and Inspection of Warehouses are introduced on 26<sup>th</sup> December, 2018.

Ministry of Consumer Affairs, Food and Public Distribution in supersession of WDR Regulation – Registration of Warehouse Rules, 2010, introduced on 23<sup>rd</sup> February, 2017 the Rules namely Warehousing (Development and Regulation) Registration of Warehouses Rules, 2017 which prescribes the set of procedure and regulations to be complied with by the entity connected with the agriculture finance. It is

incumbent that the sufficient insurance coverage of the goods deposited in the warehouse be ensured against the risk of fire, flood, burglary, misappropriation and riots and strikes. The provision for infrastructure requirement for a warehouse is also given. What is more important is to follow standard operating procedure by the warehouses. Rule 27 prescribes mandatory Registration with e-Negotiable Warehouse Receipts Repository. Rule 29 prescribes the submission of the information regarding Warehouse Receipts.

WDRA in supersession of the Warehousing Development and Regulatory Authority (Negotiable Warehouse Receipts), 2011 replaced it with Warehousing Development and Regulatory Authority (Electronic Negotiable Warehouse Receipts) Regulations, 2017, aim to give wide platform for Electronic Warehouse Receipt to make it more Negotiable.

WDRA prescribes for offences and penalty and as per Section 43 (1) of the Act, 2007, it provides that any warehouseman knowingly issuing a Negotiable Warehouse Receipt without taking the actual physical delivery of goods in his warehouse or a warehouseman or an agent or servant of the warehouseman who issues a warehouse receipts without reasonably satisfying himself that the goods for which such warehouse receipt is issued have actually been received or the number, weight or grade of the goods correspondence to the number, weight or grade specified in warehouse receipt or the goods are under his actual control at the time of issuing such warehouse receipt, commits an offence and shall be punishable with imprisonment for a term which may extended to three years or with fine which may extent to four times the value of the goods or with both.

## X. Conclusion

There is a way forward in the warehouse financing taking the benefits of agrarian eco system. Present Agro Produce Marketing System is insufficient and warehouses, their management and receipts issued by the warehouses do not inspire the confidences considering the factors of fraud played with PSBs. Despite the priority sector lending, Warehouse Receipt Finance is not made so popular as it is mainly dominated by PSBs. For NBFCs it is *Laissez-fair* now. Usage of Artificial Intelligence Technique by NBFCs in the present scenario can be a significant turn around in NBFCs business. Government has paved the ways, by passing three Ordinances aiming to open up agricultural marketing outside notified markets for farmers and by removing barriers to inter-state and intra-state trade and to prevent distress sale of food grains. By legalising and facilitating the sale outside the local markets, the Centre hopes that farmers will benefit, rather than middleman. Agricultural NBFCs could cater to the entire value chain including farmers, traders, small agro processing units.

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