

COMMODITY EXCHANGES IN AFRICA BEST PRACTICES

There continues to be much debate about commodity exchanges in Africa, not only regarding their need, but also their ability to make a difference in the markets in which they operate. Whilst this debate continues, a number of initiatives have been started, some of which have been more successful than others.

From the outset, it is crucial to understand the need for certain fundamentals to be existing to enhance the chances of a new commodity exchange succeeding. These include: -

- **A CLEAR OBJECTIVE**

The need to know what you want to set up and why;

This is necessary for potential participants and for the general view (inside & outside);

A business plan (prospectus) is a good way to start; and

For a futures exchange the need to provide a price risk management facility.

- **A commodity exchange needs - ENABLING POLICY ENVIRONMENTS and GOOD INFRASTRUCTURE**

The building blocks are important.

Enabling & consistent legislation must be in place:

-In agricultural policy;

-In financial policy;

-In trade policy;

-In legal policy;

And, these all need to be complimentary.

Infrastructure (storage and transport) is important.

- **A commodity exchange needs - MARKET SUPPORT (BUY IN)**

The best organization, people, systems, contracts might help, but without market support it will be difficult to sustain an exchange;

A mutual structure with monetary commitment has helped a number of exchanges;

The commitment from the financial sector (banks) is very important;

Market support is a function of value-add.

- **A commodity exchange needs – An APPLICABLE AND GOOD TRADING SYSTEM and an EFFICIENT AND SOUND CLEARING SYSTEM (Usually Futures Exchanges)**

The trading system must be requirement driven, robust, flexible and allow for growth in all aspects;

The clearing system must be reliable and efficient and ensure confidence in the trading arena.

- **A commodity exchange needs -
CLEAR RULES and CONSISTENT SURVEILLANCE to maintain INTEGRITY.**

Primary role of government is regulating the exchange; (where there is the capacity)

An exchange requires clear and balanced rules that are consistently applied;

An exchange requires ongoing surveillance;

Integrity is paramount;

Act decisively.

- **A commodity exchange needs -
The CORRECT CONTRACTS (PRODUCTS)**

The product traded must reflect reality;

Should be developed in consultation and conjunction with the market;

Balance between market initiatives and exchange initiatives.

- **A commodity exchange needs -
CONSTANT EDUCATION**

Education should be a big part of marketing;

Education should be aimed at:

-market participants, potential market participants, media, government officials, educational institutions;

Education should be ongoing;

Education should be ongoing;

Education should be ongoing.

- **A commodity exchange needs -
COMMITTED STAFF**

Exchange staff should not only be knowledgeable and good, but should also be committed;

Exchange staff should not only understand the benefits of an exchange, but also believe in the benefits.

- **A commodity exchange needs -
TO STAY IN TOUCH, LEARN FROM ITS MISTAKES, BE ADAPTABLE and
BE RELEVANT.**

An exchange serves the market and must constantly re-evaluate whether it is in touch with reality;

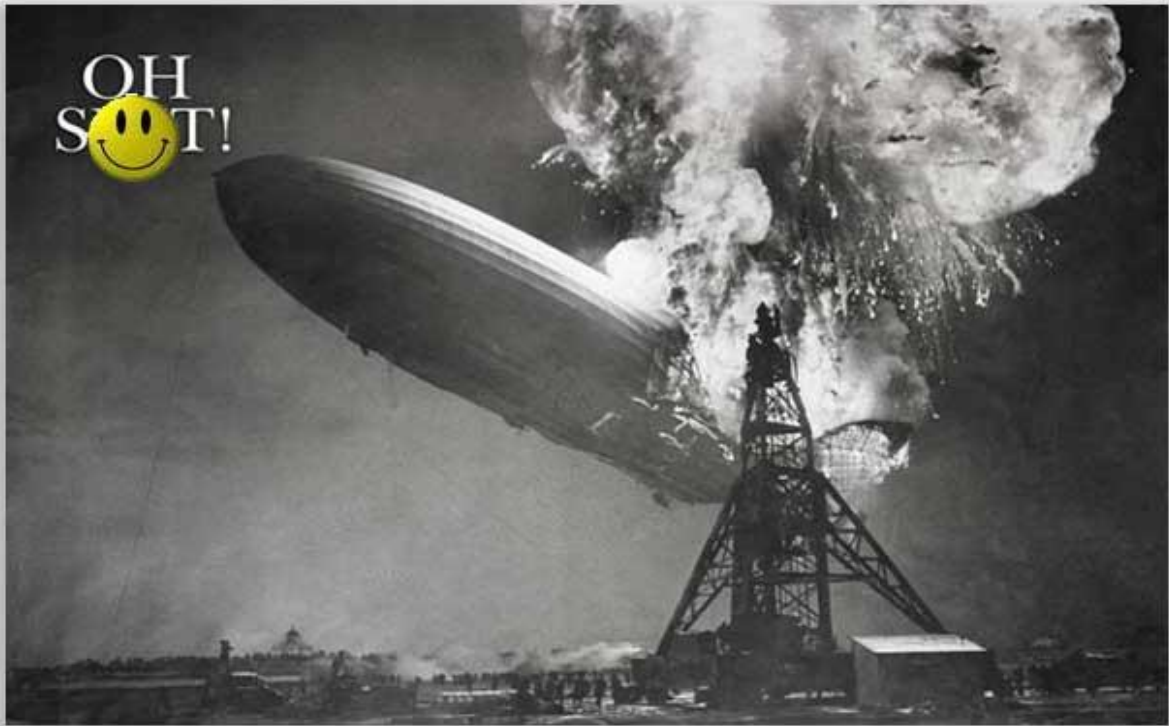
You can only force something for so long;
An exchange will make mistakes – learn from them and adapt accordingly;
But, do not change for the sake of change!

- **A commodity exchange must -
ADD VALUE**

The basic areas where an exchange can add value is in transparent price discovery, guaranteed settlement and price risk management;
If value can be added more efficiently in the absence of an exchange, it will (without an exchange);
If an exchange does not add value it will not be sustainable.

In Summary a commodity exchange must have-

Clear Objective
Enabling Policy & Good Infrastructure
Market Support
Good Systems
Rules and Surveillance
Correct Contracts
Constant Education
Committed Staff
Adaptable & Relevant
ADD VALUE



.....A commodity exchange **MUST** be prepared for the unexpected.

A commodity exchange must be prepared for the unexpected.

EXISTING EXCHANGES IN AFRICA AND AN ASSESSMENT OF THEIR SUCCESS

Zambian Agricultural Commodity Exchange (ZAMACE)

ZAMACE was established as a direct result of considerable demand by the majority of stakeholders in the agricultural sector for some form of formalised market mechanism. The Zambian commodities trading sector has been characterised by unscrupulous activity and imbalance of market information.

ZAMACE is owned and self-regulated by the agricultural industry. Currently the Exchange is owned by 4 Members. In the near future ZAMACE will operate under a regulatory structure to be governed by the Securities and Exchange Commission (SEC). ZAMACE has come too early for the Zambian regulatory regime which currently has no provision for licensing of a commodity exchange. However, SEC is in the process of studying other jurisdictions with the aim of developing a regulatory framework for commodities.

Aims & Objectives

1. To establish a working exchange to facilitate the rapid and transparent transfer of agricultural commodities.
2. To provide a credible, certified warehouse receipt service which will include regular inspection and certification of storage facilities and the maintenance of a warehouse receipt registry to allow the transparent knowledge of and transfer of receipts between broker members of ZAMACE.
3. To become the independent standards and grades facility for the industry and facilitator of an arbitration process for disagreements within the system.
4. To have broad representation of brokers, traders, farmers and food processors, financial body, included in the governance of the entity.
5. To have a small management and service provision team to ensure the commodity exchange functions and the affiliated warehouse receipt programme is maintained at a high level of quality and credibility.

N.B. *ZAMACE has been going through difficult time more recently, with members having to pay in the region of US\$1300 per month to keep it operational. They are now in the process of restructuring and membership has been reduced to four core companies. These members continue to pay monthly dues, which is supplemented by the Lusaka Stock Exchange (LUSE) which wants to have a majority shareholding in ZAMACE and a private investor. This exercise is still in progress, but ZAMACE has not conducted any trades for at least six months and the staff is working for three days a week.*

Ethiopian Commodity Exchange (ECX)

The following is an overview of the Ethiopian Commodity Exchange (ECX), providing details of the membership and trade volumes as well as other basic information. The Ethiopia Commodity Exchange (ECX) commenced trading operations in April 2008.

- Members: 450 Members, 7800 clients, 12% farmer cooperative unions-2.4 million small farmers reached
- Trading: 2010-11: 504,000 tons of commodities (coffee, sesame seed, pea beans, maize); US\$ 1.2 billion trade value; 109,500 transactions
- Warehousing: 17 delivery sites; 4.7 million bags/year graded, handled, stored, and delivered, 300,000 tons storage capacity
- Clearing: 8 partner banks; 2010-11: 14,228 Pay-in transactions from buyers and 25,796 Pay-out transactions to sellers/year, settled by 11 am next day
- Market data: Real and discrete time, push and pull technology:
- Prices transmitted in 2 seconds to 31 rural ticker boards
- Website -2000 hits/day, 2nd most visited after SAFEX);
- IVR (call-in price update): 61,000 call-ins/day
- SMS (mobile push out): 156,000 subscriber

Whilst there is evidence that the ECX has been successful in terms of the volumes and values traded, this needs to be put into perspective as the Government of Ethiopia has legislated that all coffee and sesame trades have to be conducted across the exchange floor, the only exception being producers who can sell into the local or export markets directly.

The following quotes were received from market participants over the last six to twelve months:

1. The ECX would have collapsed if the Government had not legislated that coffee **MUST** be traded across the Ethiopian Commodity Exchange Floor.
2. It is an “absolute disaster”, which has undermined the coffee trade in Ethiopia and impacted negatively on exports.
3. Under the auction system, the auction floor had samples ready for inspection by 1pm. Buyers, exporters and others could view samples and place bids on them. The trucks with the whole parcel were waiting outside, so there was no double handling and the commodity was kept in a better condition as a result. By 7pm, buyers could have twelve or more trucks delivering the commodity to their warehouses for processing. Any dispute as to weight or quality was sorted out by the auction floor, even after delivery.
4. Farmers have not and do not benefit from the new marketing system, despite claims to the contrary.

5. The coffee is owned by the traders, who buy it from the washing stations (no change from the previous system), who now HAVE to sell it across the ECX.
6. The coffee is sold sight unseen and often both the quality and quantity paid for differs from what is subsequently collected.
7. Collection is from one of three ECX run warehouses in Addis Ababa and can take up to four days to collect due to the number of trucks in the queue.
8. A flat 2% commission is charged by ECX for every contract.
9. The general feeling is that rather than enhance transparency, the ECX has made the coffee market much less transparent.
10. The price has increased on ECX, not due to demand or the fact that farmers are getting more, but due to the system. The Exchange has set a price band for coffee to be traded, which does not take into account that 20% of the weight of the bean is in the parchment), thus making the coffee much more expensive. The levels set are also at the top end of the range for coffee, which usually only occur when there are shortages elsewhere.
11. The lack of traceability has also impacted on exports as buyers look for coffee from a particular area, or even specific farms. Owing to the fact that the coffee sold on ECX is more of a generic nature, this is not possible any longer.
12. Whilst discussing the ECX with a cooperative representative in Livingstone earlier this year, the indication was that they do not use the Exchange other than for the lowest grades as they are able to achieve higher prices by selling directly into niche markets.
13. Earlier this month, we met a trader who uses the Exchange who indicated that he was now growing his own coffee in order to meet the demands of the niche market, which he has been unable to do when buying lots through the Exchange.

The ECX is certainly not an agricultural commodity exchange in the true sense of the word as it is effectively a single channel marketing system for a number of commodities. At the recent Convening of African Commodity Exchanges in Ethiopia, indications were given that the list of commodities to be legislated for mandatory trade across the Exchange was likely to be increased, to incorporate most of the commodities produced.

Perhaps the most significant fact to emerge from all of this is that despite the volumes and value of trades conducted on ECX and the commissions charged by them, it is still not self sustainable.

Finally, the quotations below are from traders and other buyers who responded to questions put to them during an independent study carried out for USAID/COMPETE to identify which market segment(s) provide the greatest opportunity to grow the value and volume of Eastern Africa coffee exports as well as define specific opportunities for the region to strengthen its position in the global coffee market and was completed in May, 2010.

Whilst not referring to the ECX specifically, some of these quotes do lend weight to observations made above. They also represent independent views on trade in coffee from Ethiopia.

Ethiopia

A high percentage of respondents (27.8%) purchase a significant volume of coffee from Ethiopia (41-60%) and about half report paying USD\$1.00 or more above market while another 37.3% reported paying \$0.51 to \$1.00 more.

While quality marks were good, 32.7% disagreed with the statement “It is easy to do business in this region” and a similarly high number (28.8%) disagreed with the statement “I am able to get sufficient information about the area or region where my coffee is grown”.

When asked about the most positive aspects of buying coffee from Ethiopia, nearly all of the responses were around unique and varied flavor profiles.

“Character, all across the board. The different regions and prep give us an entire array of flavors, aromas, and body.”

Challenges noted included inconsistency in product, price, traceability, transit times, and instability of business systems (including reliability of partners and recent changes).

(Response to greatest challenges with buying from Ethiopia): “Timely shipping, traceability, transparency, lack of direct relationships with growers”.

“The supply lines from the growing areas all the way to Djibouti port need to be totally overhauled. Shipments are regularly late by 2-3 months or even more”.

There was a strong sentiment of frustration about price not being commensurate with quality.

“...pricing tend to push them out of a lot of blends and I feel often the pricing is going to middlemen that provide little or no value in the chain. If I knew the farmer was getting most of the money, I probably wouldn't mind paying as much”

“Price. Sometimes the price is not worth the taste. Also consisting in processing (washed or natural)”.

“...price and better sorting out of defects”.

Kenyan Agricultural Commodity Exchange (KACE)

The preparatory work on the establishment of a commodity exchange in Kenya began as early as 1994 and, the Kenya Agricultural Commodity Exchange (KACE) a private sector firm, was launched in 1997 to facilitate linkage between sellers and buyers of agricultural commodities, provide relevant and timely marketing information and intelligence, provide a transparent and competitive market price discovery mechanism and harness and apply information and communication technologies (ICTs) for rural value addition and empowerment. KACE is registered as a company limited by shares. It was intended was to base the Exchange on the

ZIMACE model, but this was not possible as there was no real market liberalization, combined with continued Government interference in markets.

A re-assessment was carried out later and farmers and traders were asked what services they wanted from KACE. Farmers wanted to know where they could sell their commodities, whilst traders wanted to know where they were available to buy. Out of this, the current MIS evolved into what it is today. Government still plays a significant role in agricultural markets (particularly maize) despite the fact that they are theoretically liberalized. NCPB for their part have resisted the idea of using their storage facilities for private sector (third party) storage. However, with a radical change in the directors and a new Board having been put in place, this direction is changing and they have the go ahead to form a new agricultural commodity exchange, which it is envisaged will be a regional one for Eastern Africa, incorporating Kenya, Tanzania and Uganda initially. By their own admission, KACE is not a commodity exchange, but is an MIS provider.

NOTES:

1. MILS (Market Information and Linkage System) is the market information and linkage system that has developed over the years, with funding from CTA, Rockefeller Foundation, KMDP/USAID, AGRA, for providing market information and market linkage services. It consists of various platforms: Market Resource Centres, Mobile phone SMS, Interactive Voice Response service (IVRS), RECOTIS (spreadsheet based system of disseminating information via email), Radio (FM - Soko Hewani & KBC radio), and Internet website. KACE collects, updates and disseminates market information (mainly wholesale buying prices, offers and bids) using these platforms, targetting clients at various levels of the commodity value chains. Work on these platforms has concentrated in western Kenya (Western Province and North Rift - areas where Rockefeller/KMDP projects were implemented).
2. Soko Hewani is an FM radio program (by the West Median Services based in Bungoma, but covering an area with a radius of 200km, which covers parts of Eastern Uganda, Western Province, Nyanza Province and North Rift Valley provinces) where offers and bids are broadcasted to listeners and KACE provides further back-end information and matching of offers and bids to clients who call.
3. E-services include email/internet services, money transfer services, processing of Government forms electronically (e.g. tax forms, police forms, birth/death certificates, passport forms, etc.).
4. KACE plan is to develop a web portal to provide a wider range of agricultural information, including time series information on commodity prices, production, consumption, exports and import data for selected commodities, and in the analysis of these data to generate market intelligence (forecasts, trends, etc.). The web portal would be designed in such a way that users can choose and access modules of desired data/information on a payment basis, either subscription, or payment through mobile phone money transfer systems such as M-Pesa of Safaricom and Zap of Zain).

Malawi Agricultural Commodity Exchange (MACE)

The Malawi Agricultural Commodity Exchange (MACE) was established in 2004 as a project of IDEAA Malawi with funding from the Rockefeller Foundation through the University Of Malawi Bunda College Of Agriculture. This was after it was discovered through a situation analysis that was done for the Cassava Commercialization which was being implemented by IDEAA, that it was important to set up a commodity neutral Market Information System that would respond to agriculture market liberalization challenges faced by small holder farmers. MACE got registered as a limited company in July 2007 to take care of the business interests while IDEAA concentrates on the developmental functions.

The overall goal of MACE is to make markets work better for smallholder farmers in Malawi, which would then lead to poverty reduction and economic growth. The specific objectives of MACE include the following: facilitate linkages between sellers and buyers, exporters and importers of agricultural commodities; empower farmers with relevant and timely market information and intelligence to enhance their bargaining power and competitiveness in the market place; provide a transparent and competitive price discovery mechanism through the operations of the exchange trading floor; and harness and apply the power of ICTs as a strategic tool for rural value addition and empowerment.

MACE mandate is to provide market information and services to buyers and sellers of commodities by establishing and operating a Commodity Exchange of the highest integrity, available to Malawi as well as regional and international buyers and sellers, based upon an open free market system for the mutual benefit of the sellers and buyers; and facilitating the procurement and marketing of any commodity provided or desired by any consenting parties through the auspices of the Commodity Exchange.

MACE is based on the KACE model and has some of the same shareholders and continues to provide market information to stakeholders, but does not function as a commodity exchange. It has recently signed an MOU with ACE to collaborate in a number of areas, including working in partnership in strengthening the capacity of Agricultural Commodity Exchange Activities in Malawi.

Agricultural Commodity Exchange for Africa (ACE)

ACE was first mooted by National Small Holder's Association of Malawi (NASFAM) who identified a need to bring more order to the marketplace as well as a need for a venue where they could market their produce more easily.

ACE registered as a non-profit private company limited by shares (ACE Ltd) in July 2004. In 2007 ACE also registered as a Trust and NGO (ACE Trust) in Malawi and has now divided its activities between the two entities. The rationale is to predominantly have commercial interests

control ACE Ltd and have small operators and farming group interests be represented on the board of Trustees of the ACE Trust.

ACE has been very successful to date, with an Internet based trading platform, comprising of the main platform, the BVO (Bid Volume Only) platform developed to meet the needs of the P4P program of the WFP and now being used by other buyers and more recently the WRS (Warehouse Receipt System), which are fully integrated. ACE continues to get smallholder participation, both farmers and traders, in all these areas, which is a huge success for them given the way in which trades were traditionally carried out in the past. An example of the potential success of the WRS is expressed by a small trader below.

Mr Lawrence Chikhasu, owner of Bucow Investment, a small commodity trading company based in Mchinji was the first to take advantage of the system. “I am a businessman and I need financing to keep buying maize from farmers. The storage cost is higher than what I am used to, but my maize is secure and the quality and quantity is guaranteed – I don’t have to think about post harvest losses anymore.” Mr Chikhasu deposited 14.5 MT and received 60% of the value, being Mwk 261,000.00 at 20% interest per year. “The warehouse receipt system is making it possible for me to buy much larger volumes and keep the maize till the prices are good. I believe the price of maize will be 35 to 40 kwacha/kg early next year when I want to sell my maize; so I will earn a good premium after paying storage and interest cost.”

A Warehouse Receipting System is being implemented by ACE and collaborating partners with funds from USAID/COMPET, the European Union (EU) and Common fund for Commodities (CFC). The funds cover development of the necessary software, building of 4 rural warehouses (1400mt), developing partnerships with relevant stakeholders including insurance companies, collateral managers, warehouse operators, banks, traders and farmer organisations. The first phase of the project started in mid 2010, with the aim of developing partnerships and software, which is acceptable by all stakeholders, to run the system. The Second Phase in 2011 marked the “trial year” with the objective being to ensure that the system, including partner agreements, are to benefit all stakeholders. It is important that partner agreements were at a cost that does not eat away depositor’s margin after sale. In 2012 we aim to scale up all activities and advance receipts to rural storage centres.

Looking ahead to 2012

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- **Financial prospects:** The reserve bank of Malawi is setting up an export development fund, partly to fund agricultural export initiatives through the use of the ACE warehouse receipts. They are looking at allocating 200 million Kwacha (US\$1,212,121 at the official exchange rate) to finance such initiatives in Agricultural export marketing. Ace is looking at way to collaborate with this fund in two ways, financing receipts which will be at a more favorable interest rate on receipts marketed on the exchange for export locations, this will not only attract large traders who usually get finance at a minimum of 18% but will also encourage small holder farmers with limited critical margins. ACE is also looking at this fund to help solve some constraints that are faced with medium to small

farming organisations to export grain including transport, provision of good quality sacks, and aggregation centres.

- **Storage:** ACE intends to approach ADMARC (Agricultural Development and Marketing Corporation) to pursue the lease of some of their strategic rural warehouses to increase rural warehousing capacity to 10000mt in various locations. ACE hopes that with the backing of reserve bank, Ministry of Agriculture and parliamentary committee on agriculture will help persuade ADMARC to lease out some of their warehouses. ACE has recently received NFRA (National Food Reserve Agency) agreement to issue warehouse receipts out of their warehouses and silos. Initially ACE intends to sign a 2000mt storage agreement with them, all depositors will deposit onto this space and receipts will be issued by ACE upon receipt of NFRA issued GRNs. The agreement could see a further 3000mt storage agreement signed in time, depending on demand. NFRA storage charges are very low therefore creating more competition and higher margins to depositors. NFRA will scale this up to national sites and issuing receipts in-house in 2013 depending on performance for the pilot phase in 2012.
- **Depositors:** ACE is talking to various partners in an effort to sensitize communities and traders of the warehouse receipt system. ACE will sensitize the Farmers Union of Malawi (FUM) members in five central region districts, through the market linkages program implemented by FUM. ACE will continue to work with currently registered cooperatives to strengthen their ability to participate in warehouse receipts system, and structured trade in total including export markets.
- **Software development:** The Warehouse receipt system has been fully integrated with the exchange platforms (trade platform & Bid volume only platforms). The software is designed to allow operators to issue warehouse receipts in-house as well as electronically request finance from the banks. The software automatically calculates finance charges, storage charges according to profiles chosen by the depositor.

Market Information Systems

ACE produces a great deal of market information, not only from their own trading platform, but other information from the region as well as commentary from the European markets as well as Chicago Board of Trade and other exchanges in America.

Overall commodity exchange review

It is evident from the background notes that these exchanges operate very differently. It is very important to know these differences when discussing the concept of agricultural commodity exchanges and the potential impact these have in the markets they operate in. The different approaches can be identified as a producer, trader or government driven approach. The structure of the exchange is to a large extent determined by the approach and hence also the focus and the direction of the exchange. There are advantages and disadvantages with all 3 approaches and this section will attempt to identify these.

Different Exchange approaches

Producer or stakeholder driven

The distinction from the Trader driven Exchange approach described below is that this exchange approach is not entirely or predominantly driven by medium to large traders. Many different interests can determine the drive.

- Larger traders seeking export markets and international opportunities;
- smaller traders and farming organisations seeking greater access to markets and more and better choices;
- financial institutions, promoting financing instruments, to be closer to the market and seeking additional opportunities, and
- Broking houses looking to conduct business in an open and transparent manner for the benefit of their clients, whether buying or selling.

Whilst brokers are not directly responsible for the performance of their clients by way of security deposits or guarantees, particularly in a spot or forward market, they nevertheless have duties and responsibilities to their clients in terms of the exchange operating rules and regulations. They are not absolved from liability for their clients to perform and are in fact required to ensure that they are capable of meeting commitments, whether buying or selling. Additionally, a well run arbitration facility, which is quick and inexpensive will lend weight to the system and deal with those issues where a dispute arises.

There are 2 strategies this exchange approach can use to get volumes and become sustainable.

- 1) Organise a significant percentage of producers and get them to sell their produce through the exchange, indirectly “forcing” buyers to do use the exchange and promote transparency. This is extremely hard for two reasons:
 - a. Markets are so generally fragmented and very poorly organised and to reach enough farmers to get a critical mass of produce is a daunting task. Structures, infrastructure and storage are lacking making it very hard for most farmers to safely keep their produce; often making selling right after harvest being the only real option. It is predominantly a buyer’s market and this structure is very hard for the producers to untie.

- b. Many buyers thrive on the lack of transparency that provides considerable margins, generating good money, even on fairly low volumes. They are reluctant to buy through the exchange as it would inevitably erode these big margins.

Note: Some traders welcome the open structure. Even though they also enjoy large margins, as they are discouraged by the uncertainty the non-transparent market also bring. A non-transparent market is accompanied by high price volatility, potential government intervention on price and imports/exports and a lack of reliable information making everything even more unpredictable.

- 2) The exchange can align with a pull factor, such as a buyer of large quantities. WFP is an obvious example of this, but there are other potential buyers such as national food agencies, other donor agencies and large traders/processors. The pull will support the exchange structures and the exchange; generate the interest needed and bring more parties to participate in an open system. Suddenly the step to begin to utilise the exchange for other business doesn't seem so great for the traditional trader.

Both options are workable, but the second option is much more attainable, assuming there is a willing buyer in the market. Option 2 will also create a more dramatic change; particularly in the area of quality standards, which although spoken about are rarely used in practice.

With the involvement of large buyers such as the WFP in the market, acting as a catalyst, there is more willingness for the market to open up, when large buyers insist on using commodity exchanges. Market participant make strategies and implement structures that add value for all, which is what develops the markets and gives the structures long term sustainability. It is responsible business.

Trader Driven (ZAMACE)

A trader driven exchange exists on the basis of trade concluded within a group of large traders and, quite naturally, the exchange will seek to service the interests of this group. If this group sees benefits in using the exchange, then it will, as a result, have good volumes traded across the Exchange floor. This benefits the markets as price discovery is generated and a certain amount of transparency is introduced.

A trader driven approach will have a tendency to limit access to the exchange for third parties. When the broker/trader has full performance liability they will understandably only contract with operators they know and trust. ZAMACE is a good example of this and the members have been accused of “insider trading” by those seeking more transparency, especially producers.

All in all, this cannot be an ideal model as it exists to serve the interests of a relatively small group of individuals and will not get the necessary buy-in from other potential stakeholders.

Government Driven (ECX)

The Ethiopian Commodity Exchange (ECX) was established as a demutualized corporate entity with a clear separation of Ownership, Membership, and Management. Thus, owners cannot have

a trading stake, members cannot have any ownership stake, and the management can be neither drawn from the owners nor from the members. ECX is designed as a public-private partnership enterprise, in a unique institutional innovation for Ethiopia. At its inception, ECX is promoted by the Government of Ethiopia and this still applies to date. The corporate governance of ECX maintains a healthy balance of owner and member interests. Thus, the Management Board is composed of Owner representatives and 5 Member representatives. As Owner, the Government of Ethiopia underwrites all performance risk of the Exchange related to the Exchange operated or appointed warehousing and grading of product, trading system, market information dissemination, and clearing and settlement. Members, for their part, are liable for contract performance on their own trades as well as of their Associates and Authorized Representatives.

There are obvious advantages to an exchange set up and operated with a large stake and interest from the Government, including the volumes of trade conducted across the Exchange and the “price discovery that goes with that. However, there are also some disadvantages, including the question of price discovery as, where you have a single marketing channel, which it is compulsory to use one has to ask if this constitutes the best price opportunity or not, as the market has not really been tested.

To leave market participants with no freedom of choice really just replaces previous single channel marketing systems with a new one. The whole idea of a free market is that it is exactly what it says it is by providing participants with the freedom to choose when, where and how they want to buy or sell their commodities. In the case of Ethiopia, it has been legislated that anyone dealing in coffee (with a few listed exceptions) is required to become a member of the Ethiopian Commodity Exchange and to conduct all their business through the Exchange. Failure to do so would mean that they can no longer trade in coffee. Latest indications are that this requirement will be extended to include other agricultural commodities as well.

Arguments have been put forward that ensuring that all transactions are conducted through a single organisation, in this case the ECX; more order is brought to the market. Whilst this might be true, it can be argued that exchanges operating in countries elsewhere in the world, including India, the USA, Europe and South Africa for example, achieve the same result without having to make trade across them compulsory for all. These exchanges all operate on the basis of willing buyer and willing seller, who have the right to choose whether or not to do business through an exchange.

Aside from the lack of freedom of choice by market participants, the questions has to be asked as to whether or not the ECX provides real market transparency or not? Again, there seem to be two diverging opinions on this with the yes and no camps equally vocal in their views. Perhaps the real test of this will be whether or not international buyers will use the services of the Exchange in the longer run, although it is an open secret that buyers in the grain market are reluctant to do so in the current circumstances.

There remains an argument that the lack of freedom of choice by market participants to use the Exchange or not is a barrier to the free market. There is equally a valid argument regarding the transparency of the operations, compared to other exchanges elsewhere, as well as the lack of competition and the fact that effectively, for the moment at least, the ECX represents a form of single channel marketing. The question of the Exchange’s ability to supply the quality specified

in the contract has also been questioned, but perhaps this can be put down to the fact that although the ECX is running and administering warehouses at the moment this is not, by their own admission, their core business but has become necessary due to the lack of expertise in the country.

That the ECX has made great strides in a short period of time cannot be denied. That this has been achieved largely by “home grown” talent is commendable indeed and all involved are to be congratulated on their achievements. At the end of the day though it will not matter what people say in reports such as these or what individuals choose to think about the ECX, but it will depend on the perception of the international trading communities as to how successful it will be. At the moment the ECX is on the crest of a wave but it is still early days and the next five years are likely to be crucial to the further development of the Ethiopian Commodity Exchange.

A recent development, which was highlighted at the Convening of African Exchanges in Addis Ababa, when it was disclosed that moves are afoot to legislate that a wider range of commodities be traded across the ECX, to capture those commodities produced in high volumes that are currently excluded. However, this needs to be put into context as one of the major coffee traders, who is on the board of the ECX, indicated that he is now growing his own coffee as farmers are exempt from having to use the Exchange and he wants to get back the niche markets that were lost when the Exchange commenced operations. Add to this the fact that despite all the volumes traded, the ECX is still not self sustainable and it will indeed be an interesting few years ahead for this Exchange.

Again, an exchange set up and operated through government legislation requiring that all trades, with a few exceptions, have to be conducted through the exchange is not ideal. Transparency is compromised, true market values are probably not realised by producers and quality issues are likely to arise, as has happened in Ethiopia. Volumes are likely to be high, as there are no alternatives, but neither is there likely to be much incentive to increase production if there is only one market to sell through.

Exchange Trading Floors

Chicago Board of Trade



ACE Lilongwe, Malawi

