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COMMODITY DERIVATIVES MARKET IN INDIA: THE PAST, PRESENT AND FUTURE

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Abstract

India has a drag out history of trading in commodity derivatives as it is one of the pinnacle producers of various commodities. The rundown of commodity derivatives market in India dates back to bygone times but the first organised market was entrenched in 1875. Till 1970's the commodity market was quite popular but its development was hindered due to certain limitations and regulations introduced by Indian government. However, by mid 1960s government took a radical step by boycotting derivatives trade altogether. In recent years the limitations have been removed for the smooth operation of commodity trading. Commodity market has occupied vital position in Indian economy since the establishment of Forward Market Commission in April 2003. Since its contradiction, the flourishing and prevailing trend shows vigorous rise of the market, although the actual success path will depend upon the bias of the policy makers and the ability of the regulatory mechanism. The current study makes an overview of the Indian commodity derivatives market and ponders its sustainability. The study deliberates the evolution of the market, its present status and the eventual possibility.

Keywords: Commodity Derivatives, Indian government, Evolution, Commodity Trading, Forward Market Commission.

Introduction

Commodity Derivatives made their advent before financial derivatives in the world and too in India. Even in ancient India, trading in Commodity Derivatives took place in an informal manner but the market took its formal shape in the late nineteenth century. The individuality of the Commodity Market in India goes ahead to olden

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period. These markets control the vigorous production and resource appropriation in the primary sector, forward with pricing. The tremendous accomplishment of this structure was the formation of the focused market. The main impulse of this market is to present a mechanism. To resolve the anticipation of the prospective production and consumption it shall be brought to carry on the current prices. Hence, this market entrenched a hook up among the present and future production and also in consumption cycles, thereby aiding the inter-temporal flowing of prices.

Commodity trading is a provocative option for those who wish to transform from traditional options like shares, bonds and portfolios to modern options. Relatively the entire commodities have been characterized for future trading by the government. Commodity trading is a proficiency, which investors can seek for investing their money. The Indian commodity market has undergone lot of modifications due to dynamic global economic scenario; thus driving up many opportunities in the process. Demand for the commodities both in domestic and global market is anticipated to grow by four times than the demand currently is by the next five years.

In a short span of time, the turnover of the Commodity Market in our country has grown imaginably. With biased market participation, it to a great extent, favours the speculators. The future market leaves vary to be needed as a useful tool of risk management and price discovery for the gain of the traders, growers, processors and other stakeholders. In addition, the policymakers have considered over the analysis containing the discipline of checks and balances. The founding up of the commodity future market in India was a significant drive taken with a wish to become better domestic market efficiency. It ancillary helps the price discovery process and supports for price risk management in commodities. The control of Ministry of Finance has brought FMC as a regulatory body in September 2013. Currently in six National Exchanges and 11 Commodity specific exchanges more than 146 commodities are traded.

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Objectives of the Study

1. To study the evolution and organizational structure of Commodity Exchanges in India.
2. To analyze the performance of Commodity Exchanges in India (2010 – 14).
3. To provide a detailed overview of the challenges prevailing in the Commodity Market.

Research Methodology

The present study is based on the analytical and descriptive research. The National level commodity exchanges in India namely NMCE, MCX, NCDEX, ICEX, ACE, and UCX were selected for the study. The study mainly depends upon the published secondary data. Secondary data are collected from the books related topics, articles, reputed journals; newspapers articles, websites, various reports and records issued and maintained by the Government of India are also used in the study.

Past: Evolution of the Commodity Derivatives Market in India

The beginning of trading in commodities in India dates back to distinct dates. In 1875, when Bombay Cotton Trade Association was entrenched the organised futures market in India was loomed. In 1900, the futures trading in oilseeds started when Gujarati Vyapari Mandali (today's National Multi Commodity Exchange at Ahmadabad) was entrenched. In 1920, the futures trading in gold began in Mumbai. There were many commodity future exchanges during the first half of the 20th century including Calcutta Hessian Exchange ltd., which was established in 1927. These exchanges mainly traded in jute, sugar, pepper, potatoes, turmeric, etc., Despite, India's history of commodity futures market has been fierce. To rim the regnant speculation in 1939, the Government of Bombay has banned options. As a result of price controls by the government in mid 1940s, trading in forwards and futures became challenging. In 1952 the Forward Contract Regulation Act was passed. This framed the regulatory guidelines on forward trading.Government of India suspended forward trading in several commodities like edible oil, jute, cotton, seeds, etc., during in late 1960s. To safeguard the farmers getting benefited the Government extended to purchase agricultural commodities at Minimum Support Price (MSP). The Government also tried to regulate agricultural products by storage, transportation and distribution. These measures depleted the agricultural commodity markets in India.

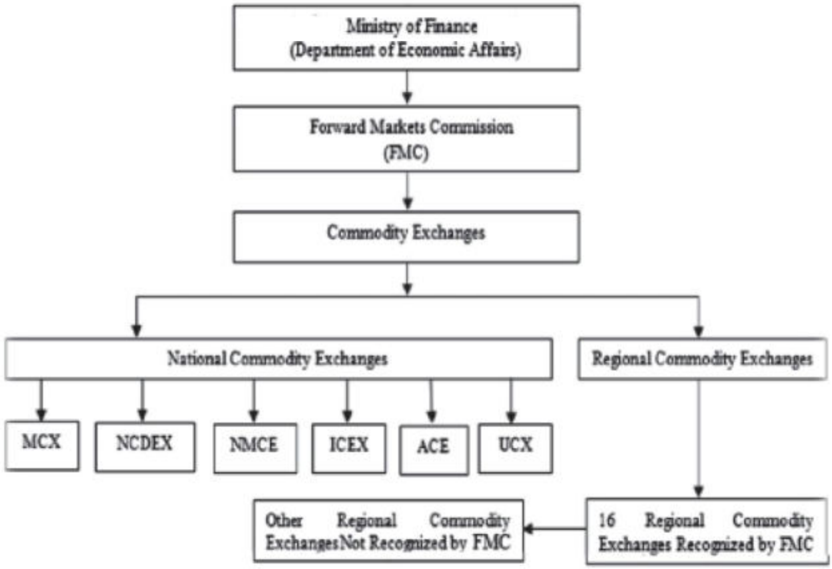
Though, Indian markets did not literally bloom over the successive four decades, regulators considered markets in generic with impression and derivatives markets notably as the province of crafty speculation. During this period, Price Control was a paramount element of economic policy. This unduly regulated nature of the economy did not offer well for the progress of these markets. The futures trade was totally banned to give adequate powers to government for price control in 1966. In 1979 following the Khusro Committee report a few selective commodities saw a reintroduction of futures. Different committees were been appointed by the government (Shroff Committee in 1950, Dantwala Committee in 1966 and Kabra Committee in 1993) to regulate forwards and futures trading in India. But in early 1990s the real leap came with the liberalization of the Indian economy. To look into forward markets in 1993, the Kabra Committee was appointed. World Bank in club with United Nations Conference on Trade and Development (UNCTAD) carried a study on Indian Commodities Market in 1966. The study finally appraised the scope for forward and futures trading in India and suggested steps to modernize futures trading. Despite, the commodity futures market made an authentic carryon in initial 2000s with formation of nationwide Multi Commodity Exchanges (MCX).

Commodity Derivatives Market in the Last Decade

The Commodity Derivatives Market has refined much in size of both network and volume during the last decade. At current, there is a two-tier framework for Commodity Exchanges in India: Regional and Country-Wide. Regional exchanges are permitted to have only a fixed number of contracts whose participation is local. Multi-Commodity electronic Exchanges are countywide National Exchanges with a dematerialized ownership pattern. The commodity exchanges under the Forward Markets Commission are divided into national and regional commodity exchanges. At present, there are 6 national level commodity exchanges and 23 regional level commodity exchanges operating in India and carrying out futures trading activities in as many as 146 commodity items (Figure 1). As per the recommendation of the Forward Markets Commission (FMC), the Government of India recognized the 6 National Level Commodity Exchanges i.e., MCX (Multi Commodity Exchange), NMCE (National Multi Commodity Exchange), NCDEX (National Commodities and Derivatives Exchange), **ICEX (Indian Commodity Exchange Ltd.), ACE (ACE Derivatives and Commodity Exchange Ltd), UCX (Universal**

Commodity Exchange Limited)

Figure 1: Structure of Commodity Exchange



MCX has emerged as the largest exchange in the country which is an independent and de – mutualised exchange based in Mumbai. MCX started its activities on November 10, 2003 and today it holds a market share of about 84.3% of the Indian commodity futures market and has more than 709 registered members operating through over 580,000 trade terminals (including CTCL) covering over 1700+ cities and towns across India as at the end of 2015 - 16. MCX offers numerous commodities across different segments such as bullion, ferrous and non-ferrous metals (non–agricultural commodities) and a number of agricultural-commodities on its platform. In 2015, the futures contracts on Gold, Silver, Copper, Crude Oil offered by MCX ranked amid the top 20 global futures contracts in their various segments. MCX has definite important alliances with prominent exchanges across the globe.

NMCE is India's first most advanced demutualised, electronic Multi- Commodity Exchange in Ahmadabad. NMCE is promoted by commodity- pertinent public institution viz., National Agricultural Cooperative Marketing Federation if India (NAFED), Central Warehousing Corporation (CWC), Gujarat State Agricultural Marketing Board (GSAMB), Gujarat Agro-Industries Corporation Ltd., (GAICL), Punjab National Bank (PNB) and National Institution of Agricultural Marketing (NIAM), Neptune Overseas Ltd., (NOL) acquired equity of the Exchange to set up that linkage. Contracts exchanged on NMCE are based on commodities that is., food grains, clued cash crops, spices, plantations, oil seeds, metal and bullion among others.

NCDEX is a self – governing and demutualised online Commodity Exchange established in 2003 at Mumbai. NCDEX is encouraged by national level institutions like NABARD, LIC, PNB Bank, NSE, Indian Farmers Fertilizer Co. Ltd., (IFFCO), CRISIL Ltd., Goldman Sachs, Canara Bank and ICE. NCDEX contracts on a host of agricultural commodities besides energy products, metals, gold and plastics.

ICEX is incorporated in 2009, which has entrenched a translucent, time-tested and dependable trading platform. In Mumbai it has its headquarters and many regional offices across the country, which wraps agricultural province with an open minded to stimulate farmers, traders and actual consumers' participation to hedge their position across the vast price fluctuations. ICEX is promoted by Reliance Exchange Next Infrastructure Ltd., and MMTC Ltd., India bulls financial Services Ltd., Indian Potash Ltd., KRIBHCO and IDFC between others as its participants. It contracts with commodity trading of base metals, bullions, agricultural commodities and energy.

ACE was set up in 2010. At Ahmadabad it has registered office and at Mumbai its corporate office. ACE is build up by The Haryana State Cooperative Supply & Marketing Federation Ltd. (HAFED) is a top State Co-operative service and marketing institution, beneath the support and sponsorship of the Government of Haryana and Kotak Mahindra Group, Corporation Bank, Bank of Baroda and Union Bank of India. It promotes trading in oil and oilseeds, Guar Gum, Sugar, pluses and in fibres.

UCX was set up in 2012. It is boosted by institutions such as Indian Farmers Fertilizer Cooperative Ltd., (IFFCO), IDBI Bank, Rural Electrification Corporation Ltd., (REC), ,NABARD and COMMEX Technology. The Exchange assist the progress of futures trading in gold, silver, turmeric, channa, mustard seed, rubber, refined soya oil, soya bean, and crude oil.

SJCC Management Research Review
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Vol: 6 No : 1 June 2016, Page No: 1-13

Even as resolve drives are slowly taking frame, turnover in the Indian commodity futures market has raised several times over. The sum value of trade in the Commodity Futures Market has increased extensively in the last few years (Table 1).

Table 1: The share of various Exchanges in the total value of trade from 2010-14

Value in Rs. Cr. and % of the Commodities Traded

EXCHANGES	2009-10	2010-11	2011-12	2012-13	2013-14
MCX	6393302.17 (82.34)	9841502.90 (82.36)	15597095.47 (86 .05)	14881057.12 (87)	8611449.07 (84.89)
NCDEX	917584.71 (11.82)	1410602.21 (11.81)	1810210.1 (9.99)	1598425.87 (10)	1146328.09 (11.3)
NMCE	227901.48 (2.94)	218410.90 (1.83)	268350.95 (1.48)	176570.86 (1)	152819.01 (1.51)
ICEX	136425.36 (1.76)	377729.88 (3.16)	258105.67 (1.42)	169897.14 (1.00)	85664.19 (0.84)
ACE	--	30,059.63 (0.25)	`138654.61 (0.7 6)	172010.18 (1)	46756.74 (0.46)
UCX	--	--	--	--	73013.19 (0.72)
Others	89540.33 (1.14)	70636.83 (0.59)	53686.98 (0.3)	48878.92 (0.01)	28764.69 (0.28)
GRAND TOTAL	**7764754.05 (100)**	**11948942.35 (100)**	**18126103.8 (100)**	**17046840.09 (100)**	**10144794.98 (100)**

Source: *www.fmc.gov.in (Forward Markets Commission)*

The table undoubtedly shows the proportion of various commodity exchanges in the total value of trade from the year 2009-10 to 2013-14, which proves an increasing trend value of traded commodities in 2009-10 to 2011-12. It was Rs. 7764754.054 crores in 2009-10 this increases to Rs. 18123103.78 crores in 2011-12. The value of trade Rs. 17046840.09 crores in 2012-13 was decreased to Rs. 10144794.98 crores in 2013-14. The overall value of trade in the MCX traded was 82.34% and raised its share to 87.00% from 2009-10 to 2012-13, correspondingly share in value of trade decreased to 84.89% in 2013-14. At the same time the NDEX share in value of trade decreased from 11.82% to 9.99% by the 2009-10 and 2011-12, similarly share in

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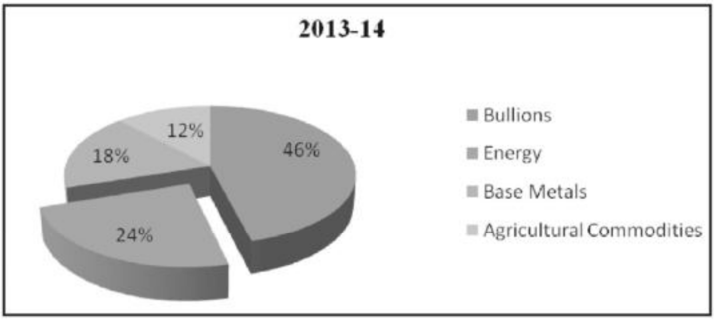
value of trade 10.00% to 11.30% was increased from 2012-13 to 2013-14. Thus it clearly shows MCX has recorded the highest turnover in terms of value of trade from 2009-10 to 2013-14 followed by NCDEX, NMCE, and ICEX. MCX recorded the maximum turnover in terms of amount of trade from 2010 to 2014 followed by NCDEX and NMCE where its main competitor is NCDEX.

In current, futures contracts are feasible for over 100 commodities across the country. The sum of commodities traded in Futures Exchanges is tired into two groups, viz., Agricultural Commodities and Non-Agricultural Commodities. Non-Agricultural Commodities are farther categorized into, base metals, bullion/ precious metals, energy and polymer products. Agricultural Commodities are further categorized into oil and oilseeds, cereals, fibres, plantations, pulses, spices and others that include mentha oil, guar seeds, sugar, potato, etc. Still, of complete contracts accessible, only a less have been traded vigorously and obtained major quantities including gold, silver, copper, crude oil, mentha oil, soya oil, guar seed, channa, urad and jeera. There has been diversity in the harmony of trade. At the beginning, agricultural commodities overshadowed the market; bullions took up the second place. In 2004-05, for occurrence, 69% of the total volume of trade was in agricultural commodities and remaining was in bullions and metals. Despite, the significance of agricultural commodities has declined distinctly in following years while that of bullions has increased (Figure 2).

Figure 2: Share of Commodity Groups in Trade Volume



In 2013-14, bullions filled the first position with 46% share succeeded by Base Metals with 24% and Energy with 18%. The share of agricultural commodities in futures trading has fallen to the level of 12%.

Future of the Futures Market and Regulatory Issues

The Indian Commodity Futures views have been emerging and the National Commodity Exchanges have made a big advancement since their initiation, with the quantities rising with every succeeding year. The turnover by the Indian Commodity Exchange has escalated 120 times later the introduction of electronic trading in 2003, conceding to the Forward Markets Commission (FMC), the Market Regulator. The MCX is the world's largest exchange for trading in silver, the second largest in copper, gold and natural gas and the third largest in futures of crude oil. Nonetheless, as a whole, only one fifth of the total volumes of commodities are traded in India. The size of the underlying physical commodity trade is of 30 - 40 times lesser than the future market in commodities. The commodity price risks can spread across the market very slightly when the multiplier is greater. So, it is very clear that there is a wide scope for upturn in the volume of Commodity Futures Trading in India. In current years, the commodities have endorsed fierce price volatility by the Indian Economy and subtlety of prices of commodities to global influences. This has exhibited all the stakeholders to price shocks from primary producers to end – users. For precedent, in 2010, the immense volatility in international prices of ultimate commodities was emulated in the Indian prices. The MCX has progressed in distinct contract denominations to hold the needs of varied market participants, pasturing from all types of traders such as speculators, hedgers to arbitrageurs and investors.

Despite the fact, India has to cap a wide space to be able to harness the probable in many commodities, it has significant opportunities to foster consumer demand and uncover veiled consumption. Though having compelling aids, commodities trading has been mostly restricted to trading houses, large corporate and High Net worth Individuals (HNIs). The main reasons which depress retail investors from effective participation in commodities trading are inadequacy in closeness. Besides, the ongoing tax regime is also not favourable for investors. Conclusively, the institutional and policy – level issues are related with commodity exchanges which have to be forwarded by the Government in regulation with FMC. This will assist to take required measures to lay the way for a necessary expansion and for further progress of the Commodity Futures Market. The FMC has proposed several measures to trigger active trading activity in commodities. Stride such as raising the ban on futures trading in commodities, favouring recent exchanges which offer modish infrastructure and systems and expelling legal complications to captive more participants have raised the scope of Commodity Derivatives in India. This has promoted the spot market and futures market in the country. The trading volumes are booming while the list of commodities traded on the National Commodity Exchanges also goes to expand.

The FMC has extended its attempts to broad way the market by tasking various managerial steps to facilitate hedgers' participation and further popularize in agricultural commodities. These comprise introduction to Alternate Futures Settlement Mechanism, Exchange of Futures for Physicals (EFP) and Introduction of primitive delivery system in selected commodities. In extension, attempts have been made to evolve an aggregation model in collusion with the commodity exchanges to push participation of farmers.

The Commodity Market is at a crossroad where investment in education and research is essential to continue their success. The MCX has been taking varied actions to regularly evolve markets through unceasing modernisation, research and education focused on widening attention of the modern trading mechanisms simplified by Commodity Exchanges. The MCX, in club with the FMC, conducted 95 joint awareness programmes over January – October 2010 for physical market participants for hedging against price risk. To broaden and excavate our commodities market for the future, policymakers demand to enhance the institutional infrastructure through market – friendly policies on enabling of institutions- such as banks and mutual funds, taxation and the plan to setup trading in options and intangible commodities.

Conclusion

The current study is a thorough check into the past, present and future status of progress and developmental policy opportunities for commodity exchanges in India. India is commonly an agricultural economy; as a result, fluctuations in commodity prices have always been a primary burden for the producers as well as the consumers. In India, more than two-third of the one billion populations rely upon on agricultural commodities. For agricultural liberalization Commodity Futures Markets are a part and parcel of a list. Many agricultural economists understood the requirement of liberalization in this sector. In spite of achieving that liberalization Futures markets acts as an instrument. Nevertheless the recent effort by the Government to authorize National level Multi-Commodity Exchanges has actually given; an attempt in the arm-commodities includes all kinds of goods. The present study was undertaken with respect to all six National level Commodity Exchanges in India namely NMCE, Ahmadabad; MCX, Mumbai; NCDEX, Mumbai; ICEX, Mumbai; ACE, Ahmadabad; and UCX, Mumbai. In India, thus these exchanges are carrying on substantial role in trading activities.

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