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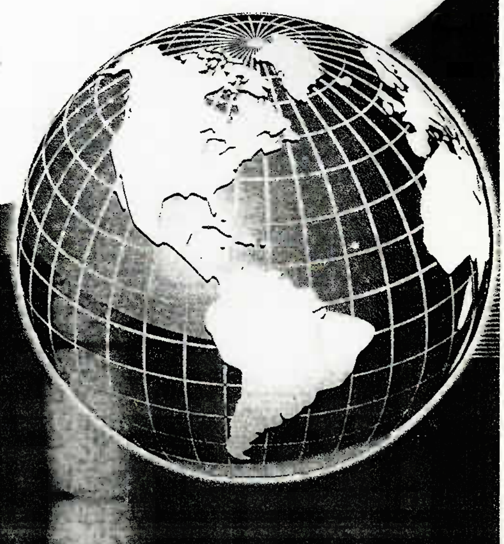

MAAZ PUBLICATIONS

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Commodity Derivatives Market in India: Growth, Challenges and Policy Alternatives

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ABSTRACT:

In the last decade, the most interesting development has been the increasing popularity of commodity derivatives in India. Presently, there are 22 commodity exchanges with 6 national and 16 regional exchanges operating in India and carrying out futures trading activities. The paper focuses on the commodity derivatives market in India and analyzes the trading pattern and trends in commodities trading in the Indian commodity exchanges. The paper also evaluates the challenges and policy alternatives to the commodity derivative market in India.

Keywords: Commodity Derivatives Market, Forwards Market Commission, Commodity Exchanges, Policy Alternatives

Introduction:

India is a commodity dependent economy wherein more than two thirds of the populace are dependent on agriculture and agricultural commodities for their livelihood. Most surprisingly, Indian commodity markets are underdeveloped; however, in recent years investing in commodities has undergone a sea change and has witnessed sturdy growth with many innovations.

In India, the commodity derivatives market plays a pivotal role in futures trading, risk sharing and information pooling, thereby, drawing extensive attention towards itself. The trading in commodity derivatives accomplishes two key functions, in particular, price risk management and price discovery, with reference to any given commodity. The commodity derivatives market offers an effective mechanism for price risk management that covers all stakeholders who are participants in the commodity trading process. The stakeholders range from the producers, traders and processors up to the exporters and importers and the consumers of a commodity. The commodity derivatives market presents trading, hedging and arbitrage opportunities to the market players. It is also useful to all sectors of the economy, as it assures stability in supply and demand positions and also eliminates the perils of price uncertainty, promotes competition and plays the role of a price guide, to the farmer and other stakeholders in the economy.

Commodities play a significant role in the economic growth of the country. After liberalization of Indian economy in 1991, a series of steps were taken by the Government to liberalize the commodity futures market and one of the steps in that direction to the setup national level multi commodity exchanges as per the recommendation of the then commodity market regulator, Forwards Market Commission (FMC).

The market has since then made enormous evolvement in terms of transparency, technology, and trading activity. Since the inception of modern electronic trading platform, combined with establishment of national commodity exchanges, India has become one of the fastest growing commodity derivatives market in the world.

Literature Review:

There have been a numerous studies on the commodity derivatives market in India.

Narendra L. Ahuja (2006) studied the commodity derivatives market and reinforced that developing countries policy makers need to allow market forces to dictate prices and price and price risk management rather than going against the tide by trying to achieve this through administered price mechanism.

Lokare S.M. (2007) carried out a study on commodity derivatives with a attempt to study its impact on price risk management and found that Indian commodity market is yet to achieve minimum critical liquidity in some commodities.
Meenakshi Malhotra (2012) advocated that there is urgent need to deliberate on issues that require to be researched so that healthy growth and development of the markets can be promoted efficiently.
Alok Kumar Mishra (2008) investigated the current status and growth inhibiters that are acting as obstacles in the Indian commodity future markets.

Majority of the studies in India on commodity markets have been mostly conceptual in nature. Hence, the paper attempts at testing the efficiency of commodity markets in India and analyzes the trading pattern and trends in commodities trading in the Indian commodity exchanges. The paper also evaluates the challenges and policy alternatives to the commodity derivative market in India.

Objectives of the study:

1. To study the present status, trading patterns and trends in the commodity derivatives market in India.
2. To evaluate the challenges and policy alternatives to the commodity derivative market in India.
   Research Methodology:
   The data required for the study is collected from secondary sources as there is no scope for primary data in the study. The secondary sources include books, journals, handbooks, newspapers, circulars, bulletins, working papers, reports, MCX website, NCDEX website, FMC website, SEBI website, NSE website and BSE website

Period of study:

The period of study is from 2002-03 to 20014-15

Commodity Markets:

The commodity markets are marketplaces wherein primary or raw products are traded. These commodities are traded on the regulated commodity exchanges. Commodity markets are akin to equity markets, however, here commodities are bought or sold instead of shares.
Commodities are broadly classified as follows:

1. **Bullion:** Platinum, Gold and Silver
2. **Metals:** Iron Nickel, Copper, Aluminum, Lead, Tin, Zinc and Steel
3. **Cereals & Pulses:** Wheat, Maize, Gram, Barley
4. **Soft Commodities**: Cocoa, Sugar, Gur, Coffee
5. **Live-Stock:** Live Cattle, Pork Bellies
6. **Oil & Oil seeds:** Soya Oil, Palm Oil, Kapasia Khalli, Soyabean
7. **Fiber:** Cotton, Kapas
8. **Spices:** Cardmum, Coriander, Pepper Turmeric, Cummin seeds, Chillies
9. **Energy:** Crude Oil, Gasoline, Natural Gas, Coal, Electricity, ATF
10. **Weather:** Carbon
11. **Others:** Almonds, Potato, Gaur Seeds, Mentha Oil, Menthol flakes

Commodity Derivatives:
A commodity derivative may be defined as a monetary instrument that is tradable on or off a designated exchange; its price is directly dependent on the value of the primary commodity or upon any decided upon pricing arrangement or index. Derivatives involve the trade of obligations or rights based on the underlying primary product however; it does not directly involve transfer of property.
Commodity derivatives are essentially trade contracts based on the underlying asset which is the commodity and the investors speculate on these, based on their expected price movements in the future. Primarily this market has three classes of participant's namely Hedgers, Speculators and Arbitrageurs.