International Journal of Engineering Technology Science and Research
IJETSR
www.ijetsr.com
ISSN 2394 – 3386
Volume 4, Issue 9
September 2017

Commodity Derivatives Market in India: Evolution, Development and Growth

1. **Dr P N Harikumar**
Associate Professor and Head, Department of Commerce and Tourism,
Catholicate College, Pathanamthitta
Research Guide (K G College, Mahatma Gandhi University, Kottayam, Kerala)
2. **Manoj Narayanan K S**
Assistant Professor, Department of Commerce and Management,
Baselius College, Kottayam
Research Scholar (K G College, Mahatma Gandhi University, Kottayam, Kerala)

ABSTRACT

Commodity derivative market in India has witnessed a rapid transformation in the last decade. Although official derivative trading in commodities began in India as early as in 1875, the ban imposed by the regulators after independence had retarded the growth of commodity future market. There was a full-fledged re-thinking after the change in the economic policy. Once liberalisation and globalization became the catchwords, we could no longer shut our eyes to an active commodity derivative market, especially when the entire world slowly started witnessing an overall growth in commodity trading. Commodity future trading re-instated, National level exchanges established, electronic trading started, more commodities inducted into trading ambit , strong regulation mechanism established and new instruments permitted- all these in a span of a decade and a half. Now, 6 national level commodity derivative exchanges are functioning. With SEBI at the helm, the Indian commodity derivative market is expected to soar to heights in the coming years.

KEYWORDS

Derivatives, Commodity Futures, Options, Forward Market Commissions, SEBI,

INTRODUCTION

Derivatives are instruments created with the main objective of minimizing the risks arising on account of price fluctuations. Derivatives derive value from the value of underlying assets. Underlying assets can be either financial assets like stock, stock index, interest rate, currency etc or commodities. Thus both financial derivatives and commodity derivatives are popular. Commodities play a vital role in the development of any economy. All players in the market- producers and producer organisations, banks and financial institutions , policy makers and all stakeholders are very much interested in the price fluctuations of various commodities in the market. This is because of the far reaching impact of the volatility prevailing in commodity market. A derivative acts as an effective instrument to curtail the adverse effects arising on account of price fluctuations. The presence of derivatives in the commodity markets is expected to strengthen the activities taking place in the market as there is scope for price stabilisation and minimisation of risks that arise.

Commodities are products which are outputs of primary sector of the economy. Commodities have commercial value and can be transacted. They are considered to be separate asset class. India being pre dominantly an agricultural economy for a long, commodity market has a significant role to play. India is the second largest producer of agricultural outputs. With the change in the economic policies in the early 1990s, our country has witnessed a sea change in the consumption pattern too. Many products which were not that popular in Indian markets have now captured the markets. At present India is the leading producer of many commodities as well as the leading consumer of many commodities too.

A commodity market is a place where commodities are actively traded. With the advent of derivative trading in commodities, commodity derivative markets are now being considered as commodity markets. This is because commodity derivative markets involve trading, delivery and settlement of commodity transactions. Commodities have attracted quite a considerable interest as an investment avenue in recent years. Commodity markets have become more like financial markets in terms of motivation and strategies of participants, but the physical characteristics of commodity markets are still important. [1]

Indian commodity derivative market has a very long history. However, the first organized commodity future trading was started in cotton in 1875 by Bombay Cotton Trade Association. The policies with regard to commodity future trading have taken several turns over the years where there were several years that witnessed a ban on trading. However with the adoption of liberalisation and globalization, commodity future trading has regained momentum. Today commodity derivatives constitute 5.5% of the trade (based on value) of the secondary market.[2]

OBJECTIVES OF THE STUDY

The main objectives of the study are:

- to trace the development and growth of commodity futures market in India
- to understand the participants of commodity derivative trading in India
- to find out the latest developments and status of commodity future markets.

METHODOLOGY

The present study is descriptive in nature. The study is based on secondary data. The relevant data is taken from various research articles, books and statistics published by agencies. Details have been drawn from the websites of Securities and Exchange Board of India (SEBI), Forward Market Commission and various commodity exchanges.

LITERATURE REVIEW

In order to have an understanding on the commodity derivatives market and its important aspects, a close scrutiny of various studies and research papers was undertaken. These papers were accessed from authoritative sources. A gist of the findings of some of the studies are presented below.:

1. **Naik and Jain**(2002) pointed out that derivative markets are still not congenial for hedgers barring a few areas. Indian markets are deficient in areas like infrastructure, management, logistics, institutional linkages, information system etc. [3]
2. **Swami and Bhavana** (2009) observed that with the elimination of ban on commodities, Indian futures market has achieved sizeable growth. Commodity future market is efficient in terms of price discovery and price risk management.[4]
3. **Rajnarayan Gupta** (2011) opined that in a liberalized regime, commodity derivatives market is an integral part of an economy. The ill effects from derivative markets is on account of the improper regulation and market cannot be blamed for the same.[5]
4. **Sreebhagavath** and others (2015) observe that the growth of commodity futures market in India will lead to further developments which may facilitate nationwide commodity spot markets. It would strengthen the Indian economy to face the challenge of globalization. [6]

EVOLUTION AND GROWTH OF INDIAN COMMODITY DERIVATIVES MARKET

Commodity derivative trading in India commenced even before financial derivative trading. The first organized commodity trading centre in India, the Bombay Cotton Trade Association commenced its operations within a short span of time after establishment of the first international level exchange, the Chicago Board of Trade in 1848. There was active trading in many commodities, especially agricultural commodities. New exchanges were formed in due course and additions were made to trading commodities. After independence the Forward Market Commission was established to regulate the functions of derivative trading.

Policies in connection with commodity derivative trading had a lot of twists and turns. Critics were of the opinion that future trading actually led to widespread price fluctuation on account of unscrupulous speculation. Tougher restrictions were imposed and by 1960s, there was practically a ban on futures trading of commodities barring a couple or few. This situation continued upto 1980s. A slow change in policy regarding commodity futures was observed. The Government appointed various committees to come out with creative suggestions in connection with derivative trading. The era of LPG witnessed a thorough change in the policies regarding commodity future trading. The ban imposed was lifted and once again, active trading in commodity futures emerged. The initial years of the new millennium witnessed the emergence of National Level Commodity exchanges which permitted trading in multiple commodities. Online trading platforms were established. Many new regional exchanges, mostly specializing in single commodities were established. Of course, the regulators imposed ban on some commodities like sugar in between, but as and when situations were under control, such ban was repealed. The Government felt that the regulator FMC lacked necessary zeal and powers but curtail the fluctuations and to tame the irregularities. Besides, the market witnessed large quantum of speculative activities and even illegal trading. As early as 2003, there were talks to unify the regulators. But the NSEL scam which witnessed payment default in the national Spot Exchange in 2013 prompted the finance ministry to bring the regulator of commodity markets under its control. As a result, the Forward Contract Regulation Act was repealed; SEBI took charge as the ultimate authority of commodity trading or in other words, Forward Market Commission was merged with SEBI in September 2015. SEBI established new commodity cells and separate divisions for the monitoring and regulation of commodity trading. In the budget speech of 2016-17, Finance Minister Sri Arun Jaitley announced that trading in new derivative instruments in commodities would be permitted by SEBI, subject to conditions. In June 2017, SEBI permitted Option Trading in commodity markets with an intention to deepen the market. Initially, trading would be permitted in one commodity which is in the top 5 list of trading based on turnover of last twelve months. The developments in Commodity Markets are presented in a timeline frame below:

- 1875- Bombay Cotton Trade Association, the first organized future exchange was established to trade in cotton contracts
- 1893- Bombay Cotton Exchange Limited , an independent institution was established following the unhappiness among the members and traders of Bombay Cotton Trade Association.
- 1900- Gujarat Vyapar Mandali was established for carrying out trade in oil seeds like castor, groundnut etc.
- 1913- Establishment of Wheat Future Market by Chamber of Commerce which later spread to various parts of Punjab and Uttar Pradesh.
- 1919- For trading in raw jute and jute goods, Calcutta Hessian Exchange Limited was established.
- 1920- Future trading commenced in gold and silver in Bombay and later it was spread to Kanpur, Jaipur etc.
- 1927- East India Jute Association was established to offer future contracts in raw jute.
- By the end of 1930s, there was trading in almost 300 commodities.
- 1945- Merger of Calcutta Hessian Exchange Limited and East India Jute Association to form East India Jute and Hessian Limited
- 1950 Shroff Committee was established for recommendation of regulations in connection with commodity futures.
- 1952 to 1954- Forward Contract Regulation Act was promulgated in 1952 and Forward Market Commission was established in 1953 to regulate commodity derivative trading. Rules were subsequently framed
- 1957- Indian Pepper and Spice Trade Association (IPSTA) was established at Kochi for trading in black pepper and other spice products.
- 1960s- Suspension in trading of select commodities was imposed.
- 1966- Dantwala Committee was formed to review the role of commodity future markets. Comprehensive ban on commodity future trading was imposed by the Government.
- 1980- Khusro Committee recommended re- introduction of commodity derivative trading.

- 1980s- Trading was permitted in some commodities like potato.
- 1993-94- Kabra Committee was established to give recommendations in the modus operandi of commodity derivatives following the changes in the economic policies. It recommended changes in the FCR Act and also introduction of trading in 17 commodities. The Government later allowed trading in 15 commodities.
- 1990 to 2000 Many regional exchanges (like National Board of Trade Limited, Indore, Rajadhani Oil and Oil Seeds limited, Delhi, Coffee Futures Exchange India Limited Bangalore, First Commodity Exchange of India, Kochi) were established
- 2000- National Agricultural Policy was formulated based on the findings of the expert committee headed by Shankarlal Guru. The Government permitted commodity futures trading accordingly.
- 2002- The first National Level Exchange, National Multi-Commodity Exchange (NMCE) Limited was established.
- 2003- National Commodity and Derivative Exchanges Limited (NCDEX) and Multi Commodity Exchange Exchange Limited (MCX) were established as ANtional Exchanges. Electronic trading exchanges stated operation.
- 2006- 2008 National Spot Exchanges were established by NCDEX and MCX.
- 2007- Abhijith Sen Committee was established to examine the impact of futures trading on agricultural commodity prices.
- 2009- Indian Commodity Exchange Limited, the 4th National Level Exchange was established.
- 2010- ACE Commodities and Derivatives Exchange Limited, the fifth national level exchange was established.
- 2012- The sixth National Level exchange, Universal Commodity Exchange Limited was established.
- 2015- FCRA was repealed and FMC merged with SEBI. SEBI became the regulator of commodity derivative markets.
- 2017- Introduction of option trading in commodities on a prototype basis.

PLAYERS AND COMMODITIES IN COMMODITY DERIVATIVE MARKETS

Commodity derivative trading in India has the following major participants and players:

- **Buyers/ Sellers-** Those who deal in commodities either as sellers or buyers like farmers, farmer organisations, mining and manufacturing companies, exporters and importers and government departments are the major participants. However, traders in commodity derivatives may not be hedgers alone. They can be speculators also who trade on account of profit anticipation consequent to price fluctuations.
- **Commodity Exchanges-** Commodity derivative trading takes place through an organized exchange which determines the rules and regulations of trading. Clearing houses are established to settle the transactions. In India, there are National Level Exchanges and Regional exchanges. These exchanges deal either in multiple commodities of single specialized commodity. Electronic trading is in vogue now in most of the exchanges. There were as many as 23 regional and 6 national exchanges. However, the stringent conditions imposed by the regulator have resulted in the withdrawal of quite a few exchanges from futures trading recently. Apart from the 6 national exchanges mentioned earlier, the major regional exchanges that function at present are: India Pepper & Spice Trade Association, Kochi, Spices and Oilseeds Exchange Ltd., Sangli, Hapur Commodity Exchange Ltd. and Rajkot Commodity Exchange Ltd., Rajkot.
- **Intermediaries-** To facilitate the smooth trading of commodity futures, various intermediaries like commodity brokers, depositories, warehouses etc operate in the market.
- **Regulators-** Upto September 2015, Forward Market Commission was the statutory regulatory authority of commodity derivative markets in India. It was under the Ministry of Consumer Affairs and Public Distribution. But once the scam in the National Spot Exchange Limited was unearthed, the Government felt that FMC was weak to perform the regulatory function. With the intention of bringing the regulator under the purview of the finance ministry and also to bring in uniformity in regulatory activities, FMC was merged with SEBI. SEBI is now the apex authority as far as commodity derivatives is concerned.

) **Commodities-** The major commodities traded in Indian commodity derivative markets are broadly categorized into agricultural commodities and non agricultural commodities. Agricultural commodities include food grains like wheat, maize, bajra and edible oilseeds like mustard seed, soya bean oil etc. Spices like turmeric, pepper jeera etc as well as commercial crops like rubber are also traded. Energy products like natural gas, crude oil and metals like gold, copper etc are also traded in various commodity exchanges.

PRESENT STATUS OF COMMODITY DERIVATIVE TRADING IN INDIA

The following tables present the status of various aspects commodity futures trading in India over a period of 6 years from 2010-11 to 2015-16

Table 1- Number of permitted commodities.

Year/Month	Agriculture	Metals other than Bullion	Bullion	Energy
		MCX		
2010-11	23	8	3	8
2011-12	23	8	3	7
2012-13	23	8	2	7
2013-14	13	6	2	2
2014-15	10	5	2	2
2015-16	7	5	2	2
		NCDEX		
2010-11	28	6	3	7
2011-12	26	5	4	7
2012-13	21	2	2	3
2013-14	26	2	2	3
2014-15	25	2	2	3
2015-16	20	2	2	1
		NMCE		
2010-11	17	5	2	0
2011-12	21	5	2	0
2012-13	14	5	2	0
2013-14	14	5	1	0
2014-15	14	0	0	0
2015-16	13	0	0	0

Source: SEBI Handbook of Statistics 2016

Agri commodities are pre dominantly traded in NCDEX. MCX is the leader in metals and energy based on the number of traded commodities.

Table 2- Product Segment wise percentage share in turnover

Year/Month	Agriculture	Metals other than Bullion	Bullion	Energy
MCX				
2010-11	1.2	25.5	52.5	20.8
2011-12	1.3	17.4	63.9	17.5
2012-13	1.8	21.1	52.5	24.6
2013-14	2.0	20.0	49.5	28.5
2014-15	2.1	24.6	41.5	31.7
2015-16	2.2	26.7	36.7	34.4
NCDEX				
2010-11	78.7	2.6	5.0	13.7
2011-12	91.9	1.7	1.6	4.8
2012-13	97.4	0.5	0.1	2.0
2013-14	99.3	0.0	0.5	0.1
2014-15	96.3	0.0	3.6	0.1
2015-16	98.0	0.0	2.0	0.0
NMCE				
2010-11	59.0	33.0	8.0	0.0
2011-12	50.0	41.0	9.0	0.0
2012-13	60.0	36.0	3.0	0.0
2013-14	87.0	9.0	4.0	0.0
2014-15	100.0	0.0	0.0	0.0
2015-16	100.0	0.0	0.0	0.0

Source: SEBI Handbook of Statistics 2016

In MCX, bullion and energy derivatives constitute the major share of turnover where as in NCDEX, agricultural products rank first in the segment wise share. In NMCE, both agricultural derivatives and metals were major contributors upto 2012-13, however at present, agricultural commodities are the sole contributors.

Table 3 Turnover and open interest details of 2015-16

Exchange	Total Turnver in (Rs- crore)	Average daily open interest value(Rs-crore)
All India	**6696381**	-
NCDEX	1019588	6894
MCX	5634194	9479
NMCE	29368	36
Rajkot Exchange	1976	NA
Hapur CoC	11192	46
IPSTA	63	NA

Source: SEBI Annual report 2015-16

International Journal of Engineering Technology Science and Research
IJETSR
www.ijetsr.com
ISSN 2394 – 3386
Volume 4, Issue 9
September 2017

It is very clear from Table 3 that MCX constitutes 84% of all India turnover for the year 2015-16 followed distantly by NCDEX with 15% . The average value of open interest is also high in case of MCX.

CONCLUSION

The last decade has witnessed innumerable developments in the commodity derivatives trading in our country. A proper structural system with regulators has been created for commodity trading. There has been tremendous change in the volume of trade as well as value of trade. A vibrant commodity market will help investors hedge their commodity risk, take speculative positions in commodities and exploit arbitrage opportunities in the market. To strengthen the market and deepen the activities, SEBI has recently permitted option trading in commodities. With a proper vigil which SEBI is expected to exercise, the Indian commodity derivative market is expected to have a bright future.

REFERENCES

1. Dietrich Domanski and Alexandra Heath Financial Investors and commodity Markets, BIS Quarterly Review, March 2007, pp 53-67
2. SEBI Annual Report 2016-17
3. Gopal Naik and Sudhir Kumar Jain(2002), "Indian Agricultural Commodity Futures Market: A Performance Survey", Economic and Political weekly, Vol. 37, No. 30, pp.3167-3173.
4. Swami Prakash Srivastava and Bhawana Saini , (2009), "Commodity Futures Markets and its Role in Indian Economy", Indian Journal of Agricultural Economics, Vol. 64 No.3, pp. 398
5. Rajnarayan Gupta , Commodity Derivative Market in India: The Past, Present and Future , Analytique Vol VII, No 2 , April- June 2011,pp 4-9
6. Shree Bhagwat, Angad Sigh Maravi, Ritesh More, Deepak Chand, Journal of Business Management & Social Sciences Research (JBM&SSR), Volume 4, No.2, February 2015,pp 215-231
7. SEBI Handbook of Statistics 2016
8. SEBI Annual Report 2015-16
9. Prabina Rajib, Commodity Derivatives and Risk Management, Prentice Hall of India2014- Chapters 1 and 2, pp 1 to 64
10. www.fmc.gov.in