



THE INVESTORS AWARENESS ABOUT COMMODITY MARKET-AS AN INVESTMENT OPTION

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ABSTRACT

India being an agricultural economy the commodity markets is still in its nascent stage. The commodity trading was banned for more than 40 years. Despite this draw back the commodity futures market has grown tremendously in the last few years and has been looked upon as one of the important investment destination. It is also forecasted that the commodity markets will continue to see bull trend in the near future, as the demand for the commodity increases due to increasing population and shrinkage of the agricultural land. However, with all the profitability and benefits in trading in the commodity markets the general public, even the educated investors are not aware of the existence as well as the knowledge of trading in the commodity market. This paper tries to look at the reasons for the absence of knowledge among the investors about the commodity as an investment option. This paper tries to provide few suggestions to increase the awareness about the commodity markets.

KEYWORDS: Commodity, Derivatives, Risk, Trading, Forward Contract.

INTRODUCTION TO COMMODITY MARKET

Brief history of Indian Commodity Market:

Commodity refers to any good that possesses a physical attribute (Chatani, 2010). Every product that is produced (or grown) must eventually come to market place where it can be bought and sold (Chatani, 2010). Commodity market is extremely liquid, risky and complex by nature. Futures market is central place for buyers and sellers around the world who meet and enter into commodity futures contract. Pricing is mostly based on an open cry system or bids or offers that can be matched electronically. The commodity contract will state the price that will be paid and the date of delivery. Almost all futures contract end without the actual physical delivery of commodity.

The history of organized commodity derivatives in India goes back to the nineteenth century when Cotton Trade Association started futures trading in 1875, about a decade after they started in Chicago.

Over the time derivatives market developed in several commodities in India. Following Cotton, derivatives trading started in oilseed in Bombay (1900), raw jute and jute goods in Calcutta (1912), wheat in Hapur (1913) and Bullion in Bombay (1920).

However many feared that derivatives fuelled unnecessary speculation and were detrimental to the healthy functioning of the market for the underlying commodities, resulting in to banning of commodity options trading and cash settlement of commodities futures after independence in 1952. The parliament passed the Forward Contracts (Regulation) Act, 1952, which regulated Commodities contract all over India.

The act prohibited options trading in Goods along with cash settlement of forward trades, rendering a crushing blow to the commodity derivatives market. Under the act only those associations/exchanges, which are granted reorganization from the Government, are allowed to organize forward trading in regulated commodities. The act envisages three tier regulations:

(i) Exchange which organizes forward trading in commodities can regulate trading on day-to-day basis;

(ii) Forward Markets Commission provides regulatory oversight under the powers delegated to it by the central government.

(iii) The Central Government- Department of Consumer Affairs, Ministry of Consumer Affairs, Food and Public Distribution is the ultimate regulatory authority.

The commodities future market remained dismantled and remained dormant for about four decades until the new millennium when the Government, in a complete change in its policy, started actively encouraging commodity market. After Liberalization and Globalization in 1990, the Government set up a committee (1993) to examine the role of futures trading.

The Committee (headed by Prof. K.N. Kabra) recommended allowing futures trading in 17 commodity groups. It also recommended strengthening Forward Markets Commission, and certain amendments to Forward Contracts (Regulation) Act 1952, particularly allowing option trading in goods and registration of brokers with Forward Markets Commission.

The Government accepted most of these recommendations and futures' trading was permitted in all recommended commodities. It is timely decision since internationally the commodity cycle is on upswing and the next decade being touched as the decade of Commodities.

Commodity exchange in India plays an important role where the prices of any commodity are not fixed, in an organized way. Earlier only the buyer of produce and its seller in the market judged upon the prices. Others never had a say.

Today, commodity exchanges are purely speculative in nature. Before discovering the price, they reach to the producers, end-users, and even the retail investors, at a grassroots level. It brings a Price transparency and risk management in the vital market.

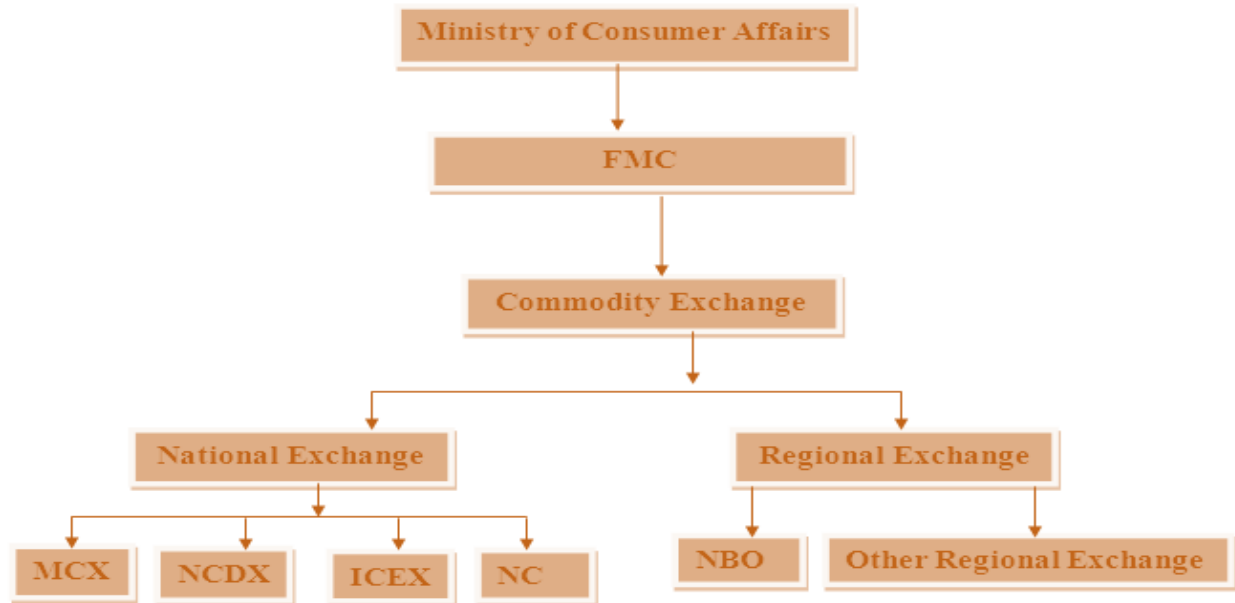
A big difference between a typical auction, where a single auctioneer announces the bids and the Exchange is that people are not only competing to buy but also to sell. By Exchange rules and by law, no one can bid under a higher bid, and no one can offer to sell higher than someone else's Lower offer.

That keeps the market as efficient as possible, and keeps the traders on their toes to make sure no one gets the purchase or sale before they do. Since 2002, the commodities future market in India has experienced an unexpected boom in terms of modern exchanges, number of commodities allowed for derivatives trading as well as the value of futures trading in commodities, which crossed \$ 1 trillion mark in 2006. Since 1952 till 2002 commodity derivatives market was virtually Non-existent, except some negligible activities on over the counter trading basis.

In India there are 25 recognized future exchanges, of which there are three national level multi-commodity exchanges. After a gap of almost three decades, Government of India has allowed forward transactions in commodities through Online Commodity Exchanges, a modification of traditional business known as Adhat and Vayda Vyapar to facilitate better risk coverage and delivery of commodities.

The three exchanges are: National Commodity & Derivatives Exchange Limited (NCDEX) Mumbai, Multi Commodity Exchange of India Limited (MCX) Mumbai and National Multi-Commodity Exchange of India Limited (NMCEIL) Ahmedabad. There are other regional commodity exchanges situated in different parts of India.

Structure of commodity futures markets in India



Commodity Exchange: A commodity exchange is an association or a company or any other body corporate organizing futures trading in commodities for which license has been granted by regulating authority.

Commodity Futures: A Commodity futures is an agreement between two parties to buy or sell a specified and standardized quantity of a commodity at a certain time in future at a price agreed upon at the time of entering into the contract on the commodity futures exchange. The need for a futures market arises mainly due to the hedging function that it can perform. Commodity markets, like any other financial instrument, involve risk associated with frequent price volatility. The loss due to price volatility can be attributed to the following reasons:

1. **Consumer Preferences:** In the short-term, their influence on price volatility is small since it is a slow process permitting manufacturers, dealers and wholesalers to adjust their inventory in advance.
2. **Changes in supply:** They are abrupt and unpredictable bringing about wild fluctuations in prices. This can especially be noticed in agricultural commodities where the

weather plays a major role in affecting the fortunes of people involved in this industry. The futures market has evolved to neutralize such risks through a mechanism; namely hedging.

National Commodities & Derivatives Exchange Limited (NCDEX): National Commodities & Derivatives Exchange Limited (NCDEX) promoted by ICICI Bank Limited (ICICI Bank), Life Insurance Corporation of India (LIC), National Bank of Agriculture and Rural Development (NABARD) and National Stock Exchange of India Limited (NSC). Punjab National Bank (PNB), Credit Rating Information Service of India Limited (CRISIL), Indian Farmers Fertilizer Cooperative Limited (IFFCO), Canara Bank and Goldman Sachs by subscribing to the equity shares have joined the promoters as a share holder of exchange. NCDEX is the only Commodity Exchange in the country promoted by national level institutions. NCDEX is a public limited company incorporated on 23 April 2003. NCDEX is a national level technology driven on line Commodity Exchange with an independent Board of Directors and professionals not having any vested interest in Commodity Markets. It is committed to provide a world class commodity exchange platform for market participants to trade in a wide spectrum of commodity derivatives driven by best global practices, professionalism and transparency. NCDEX is regulated by Forward Markets Commission (FMC). NCDEX is also subjected to the various laws of land like the Companies Act, Stamp Act, Contracts Act, Forward Contracts Regulation Act and various other legislations. NCDEX is located in Mumbai and offers facilities to its members in more than 550 centers throughout India. NCDEX currently facilitates trading of 57 commodities.

Multi Commodity Exchange of India Limited (MCX): Multi Commodity Exchange of India Limited (MCX) is an independent and de-mutualized exchange with permanent reorganization from Government of India, having Head Quarter in Mumbai. Key share holders of MCX are Financial Technologies (India) Limited, State Bank of India, Union Bank of India, Corporation Bank of India, Bank of India and Canara Bank. MCX facilitates online trading, clearing and settlement operations for commodity futures market across the country. MCX started of trade in Nov 2003 and has built strategic alliance with Bombay Bullion Association, Bombay Metal Exchange, Solvent Extractors Association of India, pulses Importers Association and ShetkariSanghatana.MCX deals with about 100 commodities.

National Multi Commodity Exchange of India Limited (NMCEIL): National Multi Commodity Exchange of India Limited (NMCEIL) is the first demutualised Electronic Multi Commodity Exchange in India. On 25th July 2001 it was granted approval by Government to organize trading in edible oil complex. It is being supported by Central warehousing Corporation Limited, Gujarat State Agricultural Marketing Board and Neptune Overseas Limited. It got reorganization in Oct 2002. NMCEIL Head Quarter is at Ahmadabad.

Review of Literature

Naik, Gopal and Jain Sudhir Kumar(2002), emphasized that agricultural commodity futures market has not fully developed as competent mechanism of price discovery and risk management. The study found some aspects to blame for deficient market such as poor management, infrastructure and logistics. Dominance of speculators also dejects hedgers to participate in the market.

Desgupta, Basab (2004), described the monopolistically competitive nature of the Indian Commodity Derivate market which stabilizes the spot price. Result showed the comovement among future prices, production decision and inventory decisions.

Ahuja, Narender L. (2006), concluded that Indian commodity market has made enormous progress since 2003 with increased number of modern commodity exchanges, transparency and trading activity. The volume and value of commodity trade has shown unpredicted mark. This had happened due to the role played by market forces and the active encouragement of Government by changing the policy concerning commodity derivative. He suggested the promotion of barrier free trading in the future market and freedom of market forces to determine the price.

Roy, Ashutosh (2006), suggested the participation of banks in the commodity futures market for effective commodity price risk management as financing by banks could provide efficient hedge against price risk.

Bhattacharya, Himdari (2007), pointed out that significant risk returns features and diversification potential has made commodities popular as an asset class. Indian futures markets have improved pretty well in recent years and would result in fundamental changes in the existing isolated local markets particularly in case of agricultural commodities.

Nath, Golka C. and Lingareddy, Tulsi (2008), emphasized that trading in commodity futures contributed to an increase in inflation as result showed that during the time period of future trading the spot price of selected commodities and their volatilities had posted remarkable increase.

Kaur ,Gurbandini and Rao, D.N. (2010), The commodity spot and future prices had closely tracked each other in selected agricultural commodities and no significant volatility has been found in the prices of future and spot contracts of those agricultural commodities.

Brajesh, Kumar and Pandy, Ajay (2009) Observed that commodity futures market in India provide higher hedging effectiveness in agricultural commodities as compared to non agricultural commodities and price risk management role of Indian commodity futures market has also increased with increased activity in market.

Senthil D (2012) investigated the investor's behavior in terms of goals, preferences, factors influencing while selecting the schemes, service expectations etc.,. The study found that the investor's main goal is wealth appreciation and suggests that the mutual fund companies should control the charges to be paid by the retail investors and bring the expense to a reasonable level.

Kumar, Brajesh and Pandy, Ajay (2013), investigated the short run and long run market efficiency of Indian commodity futures market. They had tested four agricultural and even non-agricultural commodities for market efficiency and unbiasedness. The result confirmed the long run efficiency of commodity futures prices and inefficiency of futures prices in short run prices. He found many factors like lack of participation of trading members, low market depth and thin volume with Government's interference in Commodity markets etc., as major evils for inefficient price risk management.

Objectives of this study

The main objective behind this research work is to find out the investor's awareness and perception about commodity future in the current market scenario. It was conducted to find the potential of commodity future in the coming near future.

- To understand the level of awareness among the investors and public about the existence and operation of commodity markets
- To gauge the investors willingness to participate or invest in the commodity markets.
- The initiatives to be taken to popularize the commodity trading among the general public.

Research methodology

In this study both primary and secondary data has been used. The primary data is collected by the observations and interactions of the author with the investors and general public. Secondary data has been collected from books on commodity markets, details of survey conducted by the government agencies, Government websites and MCX, NCDEX and NMCE.

Data collection methodology:

Primary data has been used to carry out the research successfully. The secondary data has been collected from NCDEX and MCX. For the purpose of gathering primary data structure and questionnaire was designed to collect data from the general investors. (Questionnaire attached)

Limitations of the study

1. The study was limited to a small part of the Bangalore city (North).
2. The survey is purely based on the personal interactions and observations of the author.
3. The study also has the limitation of time, place and resources.
4. The study cannot say as totally perfect as it is subjected to any alteration.

Data Analysis and interpretation:

1. Majority of the people under survey (70%) were not aware of existence of the commodity market as an investment avenue as most of them were uneducated as compared to (30%) of the people who exhibited minimal level of awareness about the existence of the commodity market.
2. Most of the participants (60%) under survey were aware that like shares market there is a place for investment in commodities like agricultural and non agricultural commodity. As compared to a smaller percentage of people around (40%) showed that they were aware of the commodity market as an investment option.
3. Around 80% of the sample segment was not aware that there is a bull trend in the commodity market. i.e., they were not able to comprehend that the returns in the commodity market is higher as compared to the stock market and rise in the demand for commodities will increase the returns.
4. Most of the participants (60%) under survey prefer to invest in the less risky investments which provides higher returns and only (40%) were not likely to invest in the commodity market due to high risk, unawareness about the market and not handy with trading techniques and procedures.
5. 90% of the survey sample expressed their concern that there should be continuous and massive awareness and advertisement about the existence of the commodity market.
6. 85% respondents were interested in learning about the trading system and methodology of trading.

Findings of the study:

1. **Not aware of the existence of the commodity market:** Almost (70%) of the people from whom data was collected were not aware of the existence of the commodity market.
2. **Not aware of the existence of the investment option:** Many (60%) persons amongst the sample data are not aware that the commodities futures market is an option available for them to investment.
3. **Existence of bull trend:** 80% participants were not aware that there is an existence of bull trend in commodity market which can increase the profitability of their investments.

4. **Investment preferences:** Most (60%) of the investors prefer least risky investment which gives higher returns. That is why majority of people are interested in investments other than commodity market. Very less number of people showed their interest in investment in commodity market. Main reason for this is lack of awareness and complete information about commodity market.
5. **Advertisements:** Majority of the respondent (90%) felt that there should be various awareness programme and the advertisements should be more informative. And it is the failure of commodity market's advertisement campaign to attract people's attention; as majority of people are not aware about commodity market.
6. **Methodology of trading:** 85% of the respondents were not exposed to the trading methodology details as to whom to approach to become an investor in the commodity exchange.

Suggestions to make Commodity market as a level playing field for all stakeholders:

- 1) Continuous awareness should be created among the general public about the existence of the commodity markets through advertisements.
- 2) Creation of awareness among farmers and other rural participants to use the futures trading platform for risk mitigation.
- 3) Contract specifications should have wider coverage, so that a large number of varieties produced across the country could be included.
- 4) Development of warehousing and facilities to use the warehouse receipt as a financial instrument to encourage participation of farmers.
- 5) Development of physical market through uniform grading and standardization and more transparent price mechanisms.
- 6) Contract sizes should have an adequate range so that smaller traders can participate and can avoid control of trading by few big parties.
- 7) Setting of state level or district level commodities trading helpdesk run by independent organization such as reputed NGO for educating farmers.
- 8) Warehousing and logistics management structure also needs to be created at state or area level whenever commodity production is above a certain share of national level.

- 9) Removal of restrictions in movement of certain goods from one state to another. These needs to be removed so that a truly national market could develop for commodities and derivatives.

Conclusion:

Commodity market in India is still in a nascent stage. It should be given a helping hand by the concerned authorities to increase its depth. The infrastructure facilities like warehouses; transportation etc. should be improved so that the genuine buyers can take physical delivery of goods instead of settling transaction in cash. This may also control speculation to an extent. There is also an urgent need for an independent regulator for these markets. Instead of bureaucratic Ministry of Consumer Affairs & Food, professional agency likes Forwards Market Commission (FMC) needs to be at the helm. Apart for these more products like Commodity Options need to be introduced. This will further help deepen the market & would help in increasing the popularity of such exchanges. This will finally lead to a wider investor base & lesser power in the hands of ruthless traders & speculators.

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Questionnaire: A simple questionnaire was prepared to understand the awareness of the public about the existence and operations of the commodity market by Jyothi.J , Assistant Professor. The information provided will be kept confidential and will be used for the research and understanding the investor's preference only.

1. Name:
2. Gender:
3. Qualification: UG: PG: Others specify:

4. What would be your choice of investment avenue please specify_____?
5. Do you have the habit of investing in share or commodity market: Yes/No
6. Are you aware existing of commodity market : Yes/No
7. Are you aware that you can investment money in the commodity market: Yes/No
8. Are you aware of existence of bull trend in commodity market: Yes/No
9. If you are educated about the commodity market will you be interested in investing in commodity market: Yes/No
10. Do you feel there is lack of propaganda about the commodity market: Yes/No
11. Are you interested in the learning about the trading methodology: Yes/No