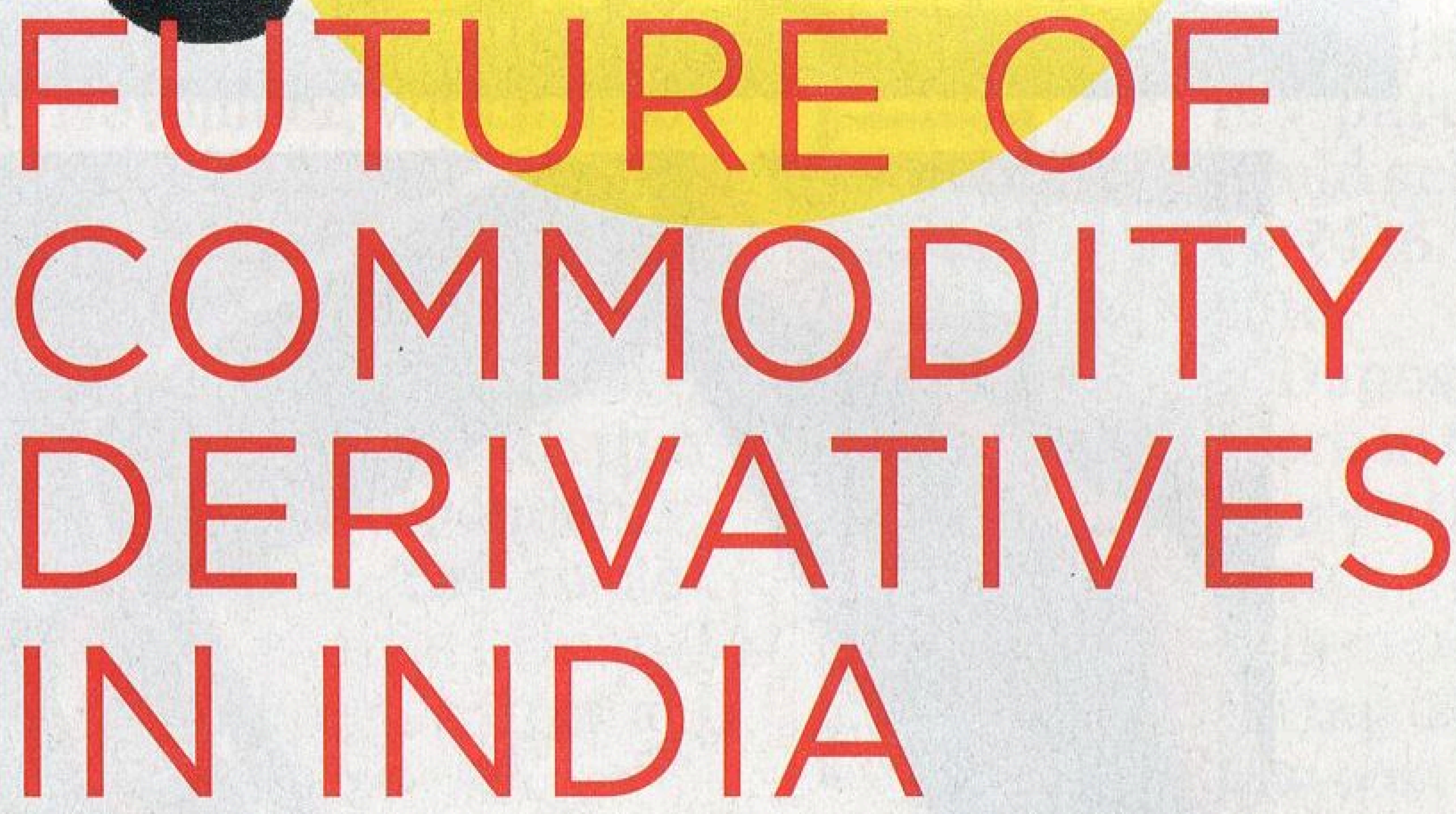


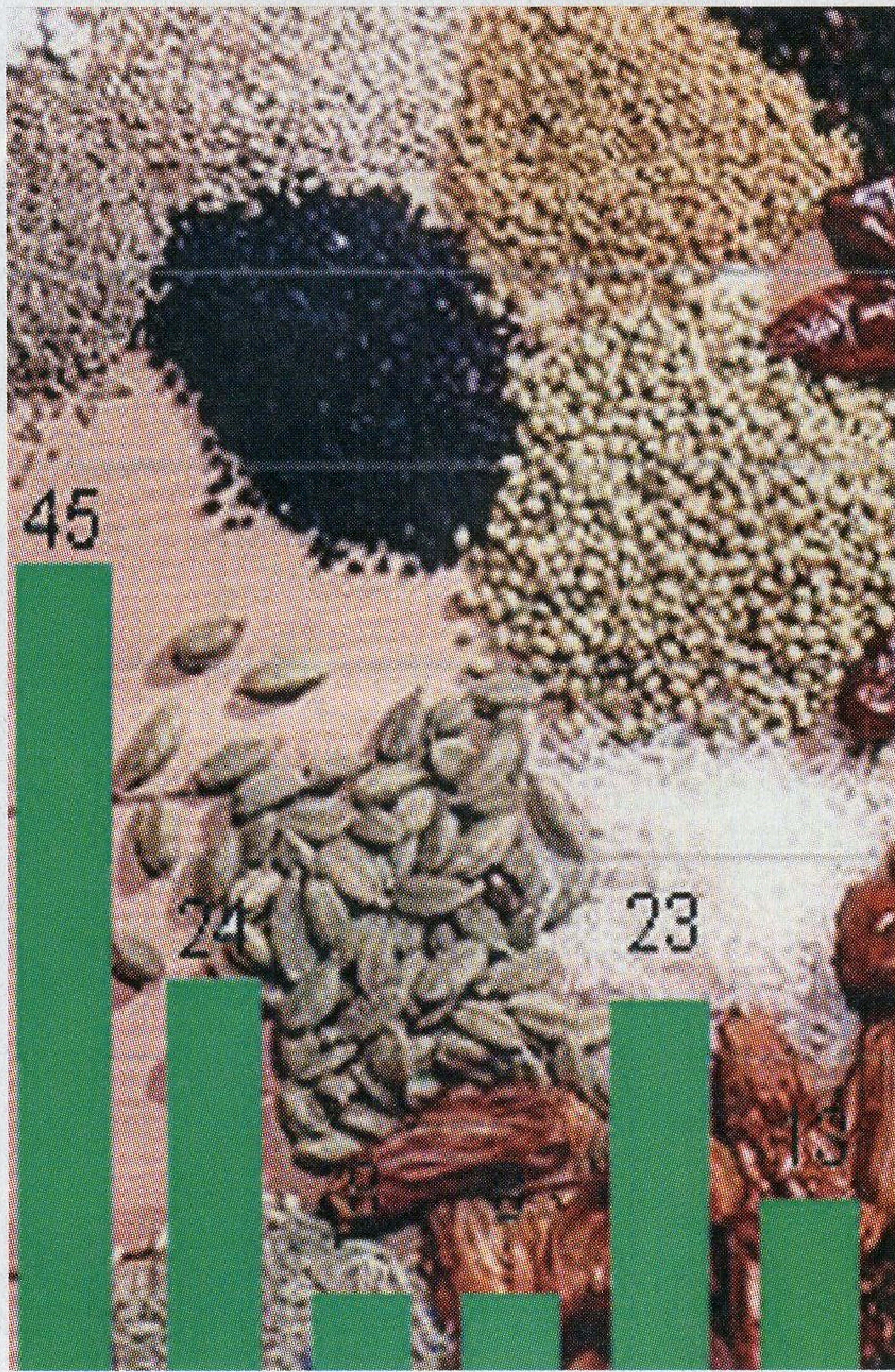
FUTURE OF COMMODITY DERIVATIVES IN INDIA

By Abhilash S Nair

THE derivatives trading in India targets at two factors: better price risk management and greater information. Two derivative instruments that serve the above purpose and are available in India are futures and options. A futures contract is an agreement between two parties to buy or sell a specified quantity of an asset, at a pre-specified time in the future, at a price agreed upon at the time of entering into the contract, on a futures exchange. In India, futures and options are available on currencies and stocks. On commodities, only futures trading is available, although options trading is also expected to begin soon. Of these, the derivative trading on commodities is the one that affects the lives of farmers and has been under strict surveillance.

Author is the Asst Professor (Finance, Accounting and Control Area) at the Indian Institute of Management, Kozhikode

In every economy, commodity derivatives are introduced with two aims in mind. First, the farmer should be able to manage price risk by deciding how much to sell immediately. If he decides to sell the output later, then he can store it at a warehouse for a storage fee, and in return, the warehouse would issue a receipt. The farmer could then pledge this receipt with a bank and avail loan to finance his future activities. To maximise the loan disbursal, the farmer could sell his output on the futures exchange and thus reduce the price uncertainty. If this contract note is produced in the bank, he can avail a higher loan disbursal at a lower rate, since the uncertainty related to warehouse receipt is lesser. Thus, the derivatives market helps the farmer get a higher price, as well as the liquidity needed to finance future activities. Second, commodity derivatives range from one to nine months contracts and thus inform the farmer on the future prices of commodities, helping the farmer to decide on his cropping cycle.



Unlike stock markets, in commodity markets, chances of speculative trades are relatively lesser because settlement is based on delivery of the commodity. In other words, whoever holds the contract on the settlement date must take possession of the commodity. This procedure discourages speculators, though doesn't ensure their non-participation.