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## Literature Review on Commodities Market: A Theoretical Concept

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### Abstract

The commodity Derivative markets in India witnessed a phenomenal growth since liberalization of commodity markets in the year 2000. This process was followed by setting up of the commodity exchanges leading the Indian commodity markets to be at par with the International Commodity markets. At present, the Indian commodity markets have an exhaustive list of commodities available for trading. The present study reviews the available literature and work done by various researchers on the commodity markets in India. The various themes on which the review has been done are origin and development, role of Exchanges, Regulatory mechanism, Performance of commodity market and Commodity Risk Management. The study aims at providing related information to the stakeholders of commodities market like investors, policy makers, and academicians.

**Keywords:** Commodities, Exchange, Derivatives, Commodity derivative market

### 1. INTRODUCTION:

The commodities market, in India was for the most part underdeveloped in the years prior to 1990's. The Essential Commodities Act (ECA) of 1955 and the Forward Contracts (Regulation) Act (FCRA) 1952 restricted the trade in commodities, futures contracts and forward contracts to only certain items. The

economic reforms of 1991 paved the way for the formulation of an expert committee headed by Prof. K. N Kabra; to deal with the development of the sector. The committee gave its report in the June of 1993. This led to the reintroduction of futures which were earlier banned in the year 1966. Agricultural commodities in addition to silver were permitted under the commodities trade. With the

introduction of the National Agricultural policy of 2000, there were substantial reforms in the domestic and external commodities market reforms that led to the elimination of all kinds of unnecessary controls and regulations in the agricultural commodities market.

## 2. Objectives of the study

The present study aims to understand the current status of commodity markets in India with special focus on commodity derivatives. The study is done with major objectives as stated below:

- To study the origin and Development of Indian Commodity markets
- To study the role of regulatory mechanism in commodity trading
- To study the role of Exchanges in commodity markets
- To study the commodity risk management
- To study the performance of Indian commodity markets

## 3. Research Methodology

The present study is descriptive in nature and relating to commodity markets in India. Secondary data is collected from the books, articles,

research and academic journals, newspaper articles, websites. Also, various reports and records issued and maintained by the Government of India are also used in the study.

## 4. Review of literature:

Though there was little literature obtainable regarding specially to commodity derivatives, even the studies related to the contribution on the topic is talked about here.

**Shunmugam & Debojyoti Dey (2011)** made an attempt to summarize studies that were undertaken in the field of Indian commodities trade. However, their main focus was on the effect of spot prices and the eco system on the commodity prices. They established that the commodity markets in India were very efficient and that stakeholders had reaped the benefits from the markets. They suggested that for the better improvement of the markets in the future, there need to be infrastructural support.

(“Taking Stock of Commodity Derivatives and their Impact on the

Indian Economy” International Journal of Management and Social Science, Vol.1, No.1, January June 2011, pp 8-16)

**Sanjay Sehgal, Namita Rajput, Rajeev Kumar Dua (2012)** conducted empirical tests to study the effect of trading activities of futures on spot prices of seven agricultural commodities. It was established that both the markets are interlinked and that any disturbance in the trading activity would affect both the markets. According to them, the main reason for spot price volatility was the sudden increase or decrease in the volume of futures trade.

(“Futures trading and spot market volatility: Evidence from Indian Commodity markets” Asian Journal of Finance and Accounting, Vol.4, No.2, December, 2012, pp 199-217)

**Luciano Gutierrez (2013)** in their study aimed at evaluating whether there was any deviation in the commodity prices from their

intrinsic value during the 2007-08 spike. For this purpose the bootstrapping method was used. He suggested that the cause of the high prices registered in 2007-08 may have been caused because of the behavior of the positive feedback traders who had high expectations of future price increase. However it was stated that there was a need for further study to clearly identify which factors may have affected the price dynamics of agricultural commodities.

(“Speculative bubbles in Agricultural commodity markets” European Review of Agricultural Economics, Vol 40, Issue 2, March 2013, pp 217-238)

**Prashanta Athma & K P Venu Gopala Rao (2013)** made an attempt to evaluate the temporary relationship between the future prices of the Multi commodity Exchange of India Limited (MCX) and the spot prices. Some of the tools that were used to test the data were the Cross Correlation function, 3 days moving

average, Augmented Dickey-Fuller Test Statistic, Johnson Co-Integration Test, Multiple Regression, Granger Causality and the Vector Error Correction model. The analysis of the data showed that both the futures market and the spot markets are efficient in transmission of information and price formation. Comdex is an index of commodities exchange that revealed that the average spot prices are smaller than the average futures prices. It is because the futures markets include both perishables and non perishables. It was found that futures took the lead in the markets as suggested by the CFF plot, multiple regression. Similar results were obtained from the Granger Causality test and the Vector Error Correction Model. In the end it was concluded that availability of Comdex for the public was a canvas to hedge their risk on a large scale.

(“Commodity Derivatives in India: A study of MCX Comdex” International Journal of Marketing, Financial Services & Management Research, ISSN 2277-3622 Vol.2

No.6, June (2013))

**S. Selvanathan & V. Manohar (2013)** undertook a study to understand the trends in online trading of commodities in India. They observed that the benefit of online trading included convenience, low transaction costs, boundary spanning, risk management and improved communication. They concluded that in spite of the above benefits online trading had never taken off the way it was expected to. This they believe could have been caused by the economic conditions of the traders.

(“Online trading-An Insight to Commodities trade with special reference to India”, International Journal of Business Management and Social Science Research, Vol.2, No.6, June 2013, pp 75-84)

**M Venkateshwari & G Ravindran (2014)** examined the performance, trends, growth and progress of two national commodity exchanges: MCX and NCDEX. They evaluated the two exchanges on the criteria of volume of trade, value of

the traded commodities in the exchange, number of contracts entered by the participants in the market and the awareness programs conducted. The compound annual growth for the two exchanges was high and the awareness programs conducted for farmers was greater in number than those conducted for non-farmers.

(“Commodity Derivatives Exchanges in India: A study of Select Exchanges” International Journal of Business Management and Social Science Research, Volume 3, issue 2, February 2014)

**Nidhi Aggarwal, Sargam Jain & Susan Thomas (2014)** assessed the efficiency of the futures market in Indian regarding risk management and price discovery. Their study concluded that while the government intervention to stabilize the price fluctuations was replaced by reformed commodity markets to improve their efficiency, the government intervention in the working of the commodities markets

was a barrier to the efficient working of the commodity futures markets.

(“Do futures markets help in price discovery and risk management for commodities in India” Technical Report, IGIDR, WP-2014-020, June 2014)

**Irfan Ulhaq & K Chandrasekhara Rao (2014)** used the time series method to evaluate the efficiency of the agricultural commodity futures markets in India. The test was conducted on ten Indian commodity markets. The results showed that all then ten markets under consideration were efficient in the long term, but failed on a few parameters in the short term. This they believed could be attributed to the dynamic lag structure and their slow adjustment to the long term equilibrium.

(“Efficiency of Commodity Markets: A study of Indian Agricultural Commodities” Pacific Business Review International, Vol 7, Issue 2, August 2014, pp 94-99)

**Bhaskar Goswami & Isita**

**Mukharjee (2015)** in their study made a comparison between returns on commodity investments and other investments like the stocks, government bonds and treasury bills. They concluded that the different investment opportunities available were in line with the theory of high return high risk. In their study it was found that of all the investments, common stocks gave the highest rate of return but was inefficient in handling against risk at times of inflation and this was the area in which commodity investments had a higher pedestal.

(“How Attractive is the Commodity Futures in India” International Journal in Management and Social Science, Vol 03, Issue -07, July 2015, pp 444-453)

**Shree Bhagwat & Angad Singh Maravi (2015)** focused mainly on the powers, functions and limitations of the Forward Markets Commission (FMC). Their analysis showed that there would be a greater role to be played by the FMC in the

future. They also focused on the steps to be taken up by the government of India to better empower the FMC.

(The Role of Forward Markets Commission in Indian Commodity Markets”, International Journal in Management and Social Science, Vol 4, No.12, Decemeber 2015, pp1-13)

**E. Kalaivani & A Lakshmi (2015)** examined the effect of commodity risk on the business process. They stated that a business’s financial performance is unfavorably impacted ny the fluctuations in the commodity futures prices. They believe that consumers of commodities like cloth manufactures, airlines, transportation companies and food manufacturers are vulnerable to rise in prices.

(“An overview of the commodity risk management to the Business process, International Journal in Management and Social Science, Vol 4, Issue 6, June 2015, pp 6-9)

**Angad Singh Manavi (2015)**

evaluated the agricultural commodities market and said that the market was showing signs of positive growth over the years. It was suggested that the commodities market should trade in all agricultural commodities as food security in India was very crucial.

(“Performance Appraisal of Indian Agricultural Commodity Market” International Journal in Management and Social Science, Vol 4, No 2, April 2015, pp 1125-1135)

**Sandeep Sehrawat (2015)** explained the benefits of trading in commodities futures exchanges especially for the agricultural sector. He concluded that for the betterment of the agricultural sector, strengthening of the commodity futures was more important than its restrictions.

(Impact of Futures Contract on Agricultural Commodity Prices: An Indian Perspective” International Journal in Management and Social Science, Volume 5, Issue 3, March 2015, pp 3740-3744)

**Rijukoruth and J. Mohamed Zeyavudheen (2015)** studied the performance and growth of the commodity derivatives market in India. They examined the impact of futures prices on spot prices and found that there were high levels of cointegration. They advocated that there was a need to continuously monitor every movement of the market by the government.

(“Review of Agricultural Commodity Financialisation in India” International Journal in Management and Social Science, Volume 5, Issue 5, May 2015, pp 1-4)

**Gouri Prava Samal, Anil Kumar Swain & Minakshi (2015)** studied in detail the productivity, production and export trends of the turmeric products in India. They compared the futures market with the spot market and found that the futures turmeric market dominated the spot turmeric market. They also said that the free flow of information from the futures market to the spot market

helped in the price discovery of turmeric in the spot market.

(“Dynamic relationship between Spot and Futures prices of Turmeric – Evidence from National Commodity and Derivatives Exchange Ltd (NCDEX)” Asian Journal of Research in Business Economics and Management, Vol 5, No 1, January 2015, pp 53-73)

**Elie Bouri, Naji Jalkh, Peter Molnar & David Roubaud (2017)** assessed the relationship Bitcoin and commodities. Their objective was to see whether Bitcoin could act as a hedge, diversifier and a safe haven to protect against the daily movements in commodity prices of energy in particular and other in general. Their results showed that Bitcoin was indeed a safe haven and a strong hedge against movements in both the commodity indices.

(“Bitcoin for energy commodities before and after the Decemeber 2013 crash: diversifier, hedge or safe haven?” Journal of Applied economics, Vol 49, issue 50, March 2017, pp 5063-5073)

**Panos Fousekis & Vasilis**

**Grigoriadis (2017)** used the monthly spot prices for the period between 1990 and 2015 and the nonparametric copulas to examine the intensity and the means of price leakage for quality differentiated coffee beans. Their findings were that there was a price interrelationship that was stronger among Arabica beans than amid the individual Arabica and the Robusta beans. There was a systematic co-movement in the prices under both positive and negative price shocks. It meant that the shocks are the same magnitude but of opposite signs were being transmitted from one market to another.

(“Joint price dynamics of quality differentiated commodities: copula evidence from coffee varieties” European Review of Agricultural Economics, vol 44, Issue 2, 1<sup>st</sup> April 2017)

**Joseph P Janzen, Aaron Smith & Colin A Carter (2018)** developed a autoregression model of structural vector of commodity futures market to examine the causes of recent spikes in the prices of cotton, one in



2008 and the other in 2011. The objective of the study was to understand the level to which busts and booms in cotton prices can be attributed to comovement with other commodities. The rational expectations competitive storage model was also used to identify shocks to cotton precautionary demand from shocks of current levels off demand and supply. They concluded that the spike in the 2008 cotton prices were driven mainly by precautionary demand forces and the 2011 prices were mainly because of shortfall in supply.

(“Commodity price Comovement and Financial Speculation: The case of Cotton” American Journal of Agricultural Economics, Vol. 100, Issue 1, Jan 2018)

## 5. CONCLUSION

The review of literature has shown that studies exist in the areas of structures of organizations of commodities market and its share analysis, integration of markets and

so on. There are other studies that focus on commodity futures function, regulations related to the commodity derivatives market and studies related to the present scheme of rules and regulation in the commodity derivatives market in India. However, the level of awareness investors contain associated with the commodity markets has not been dealt with. Hence, an investigative study on the level of awareness investors have towards commodities market in Guntur District, Andhra Pradesh, India is assumed to be crucial in this emergent commodity trade market. There has been very little work pertaining to study of commodity exchanges, predominantly with respect to the current study’s objectives that is attempted to be carried out. Indeed, this chapter is an attempt to analyze existing literature related to all aspects of commodities exchanges, and trading mechanism.

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