CHAPTER FIVE

CONCLUSIONS AND RECOMMENDATIONS

This chapter presents the major conclusions and recommendations of the study. It is divided into four sections. The first section lists out the conclusions of the analysis of data collected. It is further divided into four sub-sections, the first three sub-sections deal with conclusions for each group of respondents; they being the Participants, Administrators, and Banks. The fourth sub-section presents conclusion for all the respondents across the three groups. Second section presents the recommendations of the study and third section deals with the implications of this study. Last section discusses the directions for future research.

5.1 Conclusions:

This section covers the conclusions drawn from the analysis of the data presented in Chapter 4 and is divided into six (6) sub-sections; each sub-section covering conclusions pertaining to the respective sub-sections of the Section B of the questionnaire, as mentioned in para 3.8.1 of Chapter 3. The sub-section on ‘Snapshots’ covered in the questionnaire was not covered as each of the statements under this section was covered in any one of the balance six (6) sub-sections of the questionnaire.

5.1.1 Conclusions for Participants:

A. General Information and Views:

MCX and NCDEX were the most traded exchanges with maximum respondents associated with NCDEX. Hedgers emerged as the major players on the commodity exchanges. Cardamom emerged as top agri-commodity, gold as top precious metal and crude oil as top other commodity being traded on Indian commodity exchanges. Participants were of the view that it is not enough for commodity exchanges to provide efficient trading platforms. De-mutulised corporate structure of a commodity exchange emerged as most desirable feature, followed by nation-wide trading facility. The main
success factor of commodity exchange was that it can trade in multiple commodities. Moreover, Participants felt that farmers should have holding capacity to have best advantage in marketing of his agricultural produce.

B. Issues, Hedging & Risk:

It was concluded that market risk was the most feared risk faced by Participants in derivatives market. Study revealed that hedging on commodity exchanges was complicated for Participants. Delivery and quality related issues were the most important issues and contract sizes beyond the average farmer were the least important issues. Creating awareness emerged as the most suggested activity by Participants for resolution of hedging issues.

C. Settlement & Delivery:

Respondents felt that brokers have much less loyalty to any one particular exchange. The study revealed that there is a need for uniformity in settlement procedures across the commodity exchanges. Cash settlement emerged as the most used mode of final settlement whereas compulsory delivery emerged as the most ideal method of final settlement on Indian commodity exchanges. Study revealed that 75-100 percent of goods were cash settled and only 10-25 percent of goods were physically settled on Indian commodity exchanges. Link between an underdeveloped spot price discovery mechanism and futures prices become more tenuous which emerged as the major issue faced by respondents in physical settlement of goods on Indian commodity exchanges. It was noted that even though delivery was not mandatory, still it is very important for the Indian commodity exchanges. Indian commodity exchanges have been rated as poor for ‘delivery of goods’. Study opined that restrictions on movement of goods through the country was the main reason for Participants not to opt for physical deliveries whereas absence of grading system was the least sought reason for the same.

D. Warehousing & Warehouse Receipts:

Warehouse emerged as a very important factor for any commodity exchange, majorly for agri-commodities. Indian commodity exchanges were most associated with CWC
and SWC warehouses and least associated with private warehouses. Study revealed that majority of the Participants did not use warehousing facilities provided by Indian commodity exchanges since they were not satisfied with the warehousing services. Factors like low round the clock security, branch locations not centrally linked, lack of adequate storage space and lack of fire fighting equipments emerged as services which lacked in warehouses provided by Indian commodity exchanges. It was observed that private warehouses were the most favored ones for storage of goods. It was concluded that most important benefit of warehousing was minimization of huge wastages owing to improper storage whereas the least important benefit was that warehousing tends to cushion the price fluctuations and stabilize prices. Sorting and packing of commodities emerged as the most important subsidiary service which was rendered by warehouses. Study agreed that Warehouse receipt system as a financing option was the most favored factor but India has not fully adapted to Warehouse receipt system.

E. Inspection & Quality:

Exchange contracts emerged as the most common method of checking the quality of the commodity being traded on the Indian commodity exchanges. Study revealed that third party pre-shipment verification services would significantly reduce potential post settlement disputes/differences. It was noted that commodity exchanges should institute a system of designated surveyors to inspect and certify deliveries.

F. Regulation:

Privately regulated commodity exchanges emerged as the most preferred control mechanism. Study revealed that FMC was required to focus on customer compensation, settlement of customer complaints and ensure that brokers follow Conduct of Business Rules.

5.1.2 Conclusion for Administrators:

A. General Information and Views:

MCX and NCDEX were the most traded exchanges. Investors emerged as the major players on the commodity exchanges. It was concluded that pepper was the most traded
agri-commodity whereas gold and silver were the most precious traded commodities. Natural gas and sugar emerged as the most traded commodities other than agri-commodities and base/precious metals on Indian commodity exchanges. Study revealed that it was not enough for the Indian commodity exchanges to just provide efficient trading platforms. The main success factors of commodity exchange that emerged were that it can trade in multiple commodities; should have sufficient finance and; should run on open technology. Study opined that farmers should have proper facilities for storing of goods to have best advantage in marketing of his agricultural produce.

B. Issues, Hedging & Risk:

It was concluded that market risk was the most feared risk in derivatives market. Hedging on commodity exchanges emerged to be complicated. Complicated markets with margins and MTMs were the most important issues and contract sizes beyond the average farmer were the least important issues related to hedging. Creating awareness emerged as the most suggested activity for resolution of hedging issues.

C. Settlement & Delivery:

Administrators felt that brokers have much less loyalty to any one particular exchange. The study revealed that there is a need for uniformity in settlement procedures across the commodity exchanges. Physical delivery settlement emerged as the most used mode of final settlement. Compulsory delivery emerged as the most ideal method of final settlement on Indian commodity exchanges. Study revealed that 75-100 percent of goods were cash settled and 25-50 percent of goods were physically settled on Indian commodity exchanges. Lack of price discovery emerged as the major issue faced by respondents in physical settlement of goods on Indian commodity exchanges. It was observed that even though delivery was not mandatory on Indian commodity exchanges, still it is important. Exchanges were considered satisfactory for 'delivery of goods'. Study revealed that absence of certification system was the main reason not to opt for physical deliveries whereas non issuance of negotiable WRs was the least sought reason.
D. Warehousing & Warehouse Receipts:

Majorly for agri-commodities, warehouse emerged as a mandatory factor for any commodity exchange. Indian commodity exchanges were most associated with CWC and NBHC warehouses. Study revealed that majority of the Administrators used warehousing facilities provided by Indian commodity exchanges since they were 40-60 percent satisfied with the warehousing services. Factors like restricted access to warehouse and goods; proper segregation of goods; warehouse branches centrally linked and easy inventory maintenance emerged as the top services provided by warehouses of Indian commodity exchanges. It was concluded that public warehouses are the most favored ones for storage of goods. It was observed that warehousing plays the most important role in implementing the agricultural price policy of the Government, whereas the least important role was to cushion the price fluctuations and stabilize prices. Sorting and packing of commodities emerged as the most important subsidiary service rendered by warehouses. Study concluded that Warehouse receipt system has facilitated access to credit at lower lending rates but India has not fully adapted to Warehouse receipt system.

E. Inspection & Quality:

It was observed that the cargo inspection was carried out on a monthly basis. Exchange contracts emerged as the most common method of checking the quality of the commodity being traded on the Indian commodity exchanges. Study revealed that third party pre-shipment verification services would ensure proper settlement of physical commodities. Study revealed that grading eliminates ambiguity and disputes by setting uniform standards and grades for commodities. It was noted that commodity exchanges should institute a system of designated surveyors to inspect and certify deliveries.

F. Regulation:

Government regulated commodity exchanges emerged as the most preferred control mechanism. Study revealed that FMC is required to develop skills and procedures necessary to manage national multi commodity exchanges.
5.1.3 Conclusion for Banks:

A. General Information and Views:

MCX and NCDEX emerged as the most traded exchanges with maximum respondents associated with NCDEX. Speculators and Hedgers emerged as the major players on the commodity exchanges. Soya oil and Chana emerged as the most traded agri-commodities and; gold and Silver as the most precious traded commodities. Natural gas and crude oil emerged as the most traded commodities other than agri-commodities and base/precious metals on Indian commodity exchanges. De-mutulised corporate structure of a commodity exchange emerged as most desirable feature, followed by nation-wide trading facility. Study also revealed that it was not enough for the Indian commodity exchanges to just provide efficient trading platforms. The main success factors of commodity exchange that emerged due to this study were that it can trade in multiple commodities and should have a dynamic team, sufficient finance and good client contacts. Price transparency, price discovery and stabilization of commodities traded emerged as the top function performed by a commodity exchange. Study opined that farmers should have clear information about market conditions to have best advantage in marketing of his agricultural produce.

B. Issues, Hedging & Risk:

It was concluded that credit risk, market risk and liquidity risks were the most feared in derivatives market. Hedging on commodity exchanges emerged to be complicated. Complicated markets with margins and MTMs were the most important issues and contract sizes beyond the average farmer were the least important issues related to hedging. Promoting aggregators on the commodity exchanges emerged as the most suggested activity for resolution of hedging issues.

C. Settlement & Delivery:

Study revealed that brokers should access other markets around the world to offer their full services. Study observed that there is a need for uniformity in settlement procedures across the commodity exchanges. Cash settlement emerged as the most used
mode of final settlement. Compulsory delivery emerged as the most ideal method of final settlement on Indian commodity exchanges. Study revealed that 75-100 percent of goods were cash settled and 10-25 percent of goods were physically settled on Indian commodity exchanges. Restrictions on inter-state movement of commodities emerged as the major issue faced by respondents in physical settlement of goods on Indian commodity exchanges. It was observed that even though delivery was not mandatory on Indian commodity exchanges, still it is very important. Indian commodity exchanges were considered satisfactory for ‘delivery of goods’. Study revealed that inefficient and ineffective functioning of WRDA with no facility to trade WRs freely on the exchanges were the main reasons not to opt for physical deliveries whereas lack of proximity of warehouses and high cost of warehousing were the least sought reasons.

D. Warehousing & Warehouse Receipts:

For agri-commodities and precious metals, warehouse emerged as a mandatory factor for any commodity exchange. Indian commodity exchanges were most associated with CWC, SWC and NBHC warehouses. It was concluded that Banks do not use warehousing services provided by the commodity exchanges. It was concluded that most important benefit of warehousing was minimization of huge wastages owing to improper storage. Sorting and packing of commodities emerged as the most important subsidiary service rendered by warehouses. Study concluded that Warehouse receipt system has facilitated access to credit at lower lending rates and has enabled banks to reach out to a new segment of clients but India has not fully adapted to Warehouse receipt system. It was concluded that WR financing has contributed to market confidence.

E. Inspection & Quality:

Exchange contracts emerged as the most common method of checking the quality of the commodity being traded on the Indian commodity exchanges. Study revealed that third party pre-shipment verification services would ensure proper settlement of physical commodities with desired grade/specification. The observed preference was
for certified warehouses to issue quality certificates either using in-house labs or professionally licensed graders.

F. Regulation:

Government regulated commodity exchanges emerged as the most preferred control mechanism. Study revealed that FMC should encourage domestic financial institutions to build commodity trading desks. It was concluded that FMC should work with RBI and SEBI to encourage setting up of commodity funds, either by banks, bank subsidiaries, mutual funds or NBFCs.

5.1.4: Conclusion across the three groups of respondents:

A. General Information and Views:

Hedgers emerged as the topmost players of a derivative market followed by Speculators. *Chana* emerged out to be the top agri-commodity followed by cardamom. Gold and silver were the top two precious metals traded on the Indian commodity exchanges. Crude oil and natural gas were the leading commodities traded apart from agri, base metals and precious metals. Factors of success of national commodity exchanges were ‘trade in multiple commodities’, ‘presence of a dynamic team’, and ‘confidentiality’. There is a difference with respect to opinion of the respondents on the basic facilities enjoyed by the farmers.

B. Issues, Hedging & Risk:

Market Risk was the most dominant factor in the derivatives markets. However, credit risk and liquidity risk were also important while legal risk was not a dominant risk. Hedging is very complicated in the Indian commodity exchange. It was observed that exchanges mostly carried out surveillance, risk management, MTM and trade monitoring, closely followed by clearing and settlement. There is no uniformity in the opinion of respondents with respect to issues faced in hedging of commodities. The activities suggested for resolution of issues regarding hedging of commodities are in agreement with the respondents. Commodity exchanges should provide efficient trading platforms. There is a necessity of a nation-wide trading facility.
C. Settlement & Delivery:

There is no uniformity in settlement procedures. Cash settlement is the most preferred mode of settlement on the Indian commodity exchanges. Compulsory delivery was the most preferred mechanism for final settlement on any commodity exchange. Cash settlement is the most common mechanism for goods being traded on Indian commodity exchange. Delivery is not mandatory in commodity futures contract trading. Respondents face issues during physical settlement of commodities. There is no uniformity in the reasons cited by the respondents for not opting for physical deliveries across three groups of respondents. There is no uniformity in settlement procedures on the commodity exchanges. Physical delivery is the hallmark of a robust futures market in commodities. Physical delivery of goods is insignificant on Indian exchanges and make the futures market unstable. An efficient settlement process is required for Indian commodity exchanges. Cash settlement overcomes issues faced in physical settlements.

D. Warehousing & Warehouse Receipts:

Agricultural commodities emerged as the top commodity with requirement of warehousing as they have a huge risk of getting affected if not stored properly. CWC/SWC were the most popular choice among warehouses. Respondents were not satisfied with the warehousing facilities provided by commodity exchanges. Major services offered by warehouses are environmental protection, separate storage for hazardous goods, proximity to weighbridge and proper segregation of cargo, apart from physical inspection and inventory maintenance. There is no uniformity among the respondents regarding benefits of warehousing. Many subsidiary services are provided by warehouses. There is a lack of consensus among respondents for the importance of Warehouse Receipt System and its’ financing. Better services and infrastructure are not offered by Government warehouses. National commodity exchanges should follow stringent quality norms for storage. Warehouse receipts are a prerequisite to a futures contract.

E. Inspection & Quality:

Assessment of quality of commodity being traded is done through Exchange Contracts. The inspection of cargo is carried out monthly. Third party pre-shipment verification
services are required to ensure that physical commodities settled are of desired grade/specification and helps reduce post settlement disputes, if any. Commodity exchange should institute a system where designated surveyors could inspect and certify deliveries to reduce any settlement disputes. All parties agree with the importance of delivery mechanism for Indian commodity exchanges. Standard and quality assurance/certification procedure is required in the commodity exchanges. Uniform standards for grading and quality specifications do not exist in the Indian commodity exchanges.

F. Regulation:

Commodity exchanges should be regulated by the Government. Study suggests that though all the active players are satisfied with the delivery mechanism of the commodity exchange, they would need the mechanism to be upgraded. Warehousing is a very important factor in the commodity exchange and should be made mandatory. It was concluded that overall the respondents are satisfied with the services being provided currently by the commodity exchange.

5.2 Recommendations:

The analysis and conclusion helped the researcher to frame recommendations of the study.

1. The commodity exchanges should review the commodities being traded. Based on the data available for top five preferred commodities, the exchanges should make efforts in improving the trade conditions for those commodities in order to enhance the volumes.

2. Exchanges should ensure that multiple commodities are traded on the exchange platform to offer extensive choice to participants.

3. Exchanges should have a dynamic team with efficient front desk and back office to assist participants with resolution of their problems faced during trading on the exchanges.
4. Settlement procedures of different commodities are different. There ought to be uniformity in the settlement procedures across all commodities and all exchanges.

5. Warehousing facilities provided by the exchanges need to be upgraded.

6. Focus on developing regulatory skills of FMC; should lay down procedures to manage national commodity exchanges.

7. Exchanges should make efforts to minimize market risk for participants

8. Exchanges should have contract sizes which are within the reach of average farmer

9. Exchanges should undertake massive awareness program among the existing and potential beneficiaries about the benefits and risks of hedging.

10. Stringent norms should be drafted for brokers to maintain loyalty and confidentiality.

11. Exchanges should make physical delivery mandatory for commodities where physical deliveries are possible.

12. Exchanges should have a uniform grading/certification system for commodities to ensure uniform quality of goods being delivered.

13. Exchanges should carry out third party pre-inspection of goods before accepting physical deliveries.

14. Exchange should institute a system of designated surveyors to inspect and certify deliveries more stringently.

15. Private warehousing sector should be developed to cater to better warehousing needs.

16. CWC, SWC and other government warehouses should work on centrally linking their warehouses.
17. Exchanges and Government should promote and encourage warehousing industry to set up warehouses especially in close proximity to the agricultural producing lands and provide more sophisticated warehousing services.

18. Exchanges should encourage warehouses to get them accredited to the exchanges.

19. Warehouses should also be encouraged to provide quality certificates using either in-house labs or from professionally licensed graders.

20. Exchange should closely coordinate and work with banks and financial institutions to increase the confidence of participants.

21. Exchanges should fully adopt warehouse receipt financing system for all commodities traded for participants to have access to lower lending rates.

22. Government should ease the restrictions on inter-state movement of commodities to encourage physical storage and delivery of goods.

23. Government should develop a framework of regulations for promoting and supporting the warehouse receipt system in futures markets in India.

24. Warehouse Receipts should be made fully tradable and negotiable.

5.3 Implications of the Study:

The study has implications for the industry.

It has thrown open areas where working of Indian commodity exchanges need to be improved and how working of commodity exchanges can be made efficient. Commodity exchanges should regulate the trades and extend full support to participants. They need to work in close environment with warehouses, banks, financial institutions, supervision agencies and the government.
The role of warehousing industry in improving the availability and condition of warehouses in the country would lead to more participants opting for physical deliveries which in turn would lead to better price discovery of the commodities and better realization.

Banks and their participation on the Indian commodity exchanges would result in availability of credit facilities, negotiability of warehouse receipts and boost the confidence of the participants. It would also help in attracting farmers directly to the exchange for trading, thus removing the need for middlemen and contributing to a better price discovery of commodities.

The study has also helped identify the role that government can play in regulating the trading on these exchanges along with overseeing the working of the exchanges themselves. The government also would be required to identify the ways and means of improving inter-state movement of commodities without any significant increase to the cost of commodities. Amendments to Essential Commodities Act and more unified tax regime would enable movement of commodities across states, which would facilitate easier trading in commodities. Upgradation and empowerment of FMC would be required to provide effective and efficient leadership for the development and regulation of the market.

5.4 Direction for future Research:

The study has scope for future research in the following areas:

1. The study covers only the six national commodity exchanges of India. There are eighteen regional exchanges which are more commodity-specific. The working of these regional exchanges can be studied and compared to the working of national exchanges.

2. The study covers all six national commodity exchanges. However, indepth studies could be undertaken to analyze the overall working of any one exchange only.
3. In-depth study of a specific commodity group like agri-products or base metals or precious metals or any other derivative could also be undertaken.

4. The study focuses only on the operational aspects of national commodity exchanges in India. Future studies could focus on the regulatory mechanism or in-depth analysis on any one operational aspect like settlement; clearing; delivery; or impact of improvement in physical delivery on the price discovery can be carried out.

5. In-depth study can be carried out for comparing working of the national commodity exchanges with national equity/stock exchanges.