THE HINDU BusinessLine

Commodity Classroom

From open outcry to exchanges

Sujay Valanju

Towards a more structured form of trading

What is the history behind commodity trading? How did it all begin?

The Indian commodity market has its roots in a barter system, wherein there was an informal exchange of agricultural produce.

During those days, trading of agri-commodities was between producers and buyers at a designated location that later came to be called the 'mandi'. Modern day trade still happens through these mandis, albeit with proper infrastructure facilities for logistics, grading and assaying, sanitation, mandi office building, etc. The year 1875 marked the first milestone in the history of Indian commodity trade with the establishment of the Bombay Cotton Trade Association. Prior to that, at a global level, it was after the establishment of an organised trading platform by the Chicago Board of Trade (CBOT) in 1848 that the concept of trading on an exchange-based platform came into being.

Handkerchief and more

Like every market form, commodity trading, too, evolved gradually as a part of human innovation and commercial acumen. There were two main ways of commodity trading. First, was the 'handkerchief method' — here, the trader and the buyer did some quick finger moving under a handkerchief and agreed on the price for the commodity. The other was the open outcry method.

Here, the details of a commodity such as its physical characteristics — colour, size, type and weight — were called out loudly for all the buyers to hear, on the basis of which a buy or sell order was made.

This was considered to be the fair trading methodology as information about the commodity and its price discovery was loud enough and out in the open for all to hear. Interestingly, the above two methodologies are still prevalent in some of the Indian mandis.

With the advent of economic liberalisation, the need for a more structured form of commodity trading was felt, which resulted in the establishment of the regional commodity exchanges whose objective was to aid the commodity price discovery.

However, due to the absence of a national platform, a further need was felt to establish a nationalised exchange.

3 major exchanges

In 2002, the Centre allowed the introduction of commodity futures. This move witnessed establishment of three major nationalised commodity exchanges with the approval of the Forward Markets Commission (FMC) – the then regulator. These were: the National Commodity & Derivative Exchange (NCDEX) — originally promoted by ICICI Bank, National Stock Exchange (NSE), National Bank for Agriculture and Rural Development (NABARD), Life Insurance Corporation of India (LIC); the Multi Commodity Exchange of India (MCX) and the National Multi Commodity Exchange of India (NMCE). NMCE was launched in 2002 as India's first online, demutualised commodity exchange by a group of Indian commodity-based corporations and public agencies. In the next column, we will learn about derivatives and commodity futures trading and how to open a commodity trading account.

The writer is Senior Manager, NCDEX

(This article was published on November 6, 2016)