

Castor Seed Futures: Creating a Perfect Market



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Current account deficit was, is and will always remain a crucial factor for strength of any economy and India is no exception. Castor value chain participants should feel proud that they are contributing their best to narrow down this gap. The golden bean of India has been earning forex for the country since long and the quantum has only increased with time. Castor oil extracted from bean is an export oriented product and more than 75% of castor oil produced is exported to countries like China, EU and USA. With shrinking of production in China and Brazil, today India is the sole reliable supplier of castor oil to the whole world. Hence, Indian castor crop is of supreme importance to all its users across globe.

When such important is a product, then profitability of business becomes very crucial for its sustainable growth. In today's volatile market, the hypothetical scenario where one can claim that all his trades have secured margins is only when he has all raw

materials at his warehouse before accepting an order. In reality every producer, trader, processor or consumer is faced with limited capital to deploy and is operating more often with wafer thin margins rather than supernormal margins, given the challenging physical market conditions. So the question is how can we protect our margins and remain in the trade with sustainable growth. The answer is hedging!

Hedging can be done by procuring all required raw material in advance or selling all produce in advance. But where is such liquid and perfectly competitive market for castor seed, which can absorb every value chain participant intended to transact, at fair price with minimum transaction cost? Well, castor futures market offers a solution. In a competitive market economy, it is believed that the market for a product would be perfectly competitive if:

- (1) Buyers and sellers transact freely, with no control of any individual or a group
- (2) Commodity is standardized and all are aware about the grade and quality being traded
- (3) Participants have knowledge of prices and all factors affecting prices.

Futures market is closest to above three conditions when comparatively analyzed with other available

platforms i.e. cash as well as forward markets. When we discuss about castor futures market, it is among most liquid and standardized arena which caters to the hedging requirements of industry participants in an appreciable and efficient way. Further, castor futures contracts are highly liquid with 400,000 MT (approx.) of market open interest and a participant can hedge his requirement for a period of 5-6 months at any point of time. At majority of instances castor industry has an order to delivery gap within five months only. Also castor production cycle is of 5-6 months after sowing and therefore leaves a farmer with a fair idea of underlying market conditions when his produce gets ready for sale.

Types of Hedging:

1. Long Hedge: Where hedging is done by going long in the futures or buying of futures contract. Castor oil millers exercise this type of hedge when he buys futures against his demand of raw material for particular month/period and he exits his position as and when he sells equivalent quantity in cash market. Long hedge participants are processors as well as traders.

2. Short hedge: In this type, one sells futures contract against his futures buying requirements or commitments and exits from futures as and when he receives delivery in physical/cash market. Traders and consumers of castor oil are short hedge participants.

Castor futures hedging helps the cash market work better:

1. Hedging stretches the marketing period. For instance, farmer or a farmer aggregating agency need not have to wait until sown castor production is ready for market. The futures market permits them to sell futures contracts and lock in the approximate sale price some five to six months before the harvest. They can take advantage of good prices even though castor produce is not ready for market.

2. Hedging permits forward pricing of products. A castor oil manufacturer can determine the cost for castor oil by buying a castor seed futures contract, translate that to a price for the castor oil, and make

DID YOU KNOW?
Cash & Carry Arbitrage is a strategy that exploits price difference between spot & futures markets.

Castor Seed Futures trading above spot price gives cash & carry opportunity to a trader who can buy castor seed in the spot market and simultaneously sell the same quantity in the futures market.

On expiry, trader can exit by physically delivering castor on the exchange platform.

forward sales to consumers at firm price. Having made the forward commitments, the oil miller can use his capital to acquire only as much castor seed as may be needed to make the products that will fill its orders.

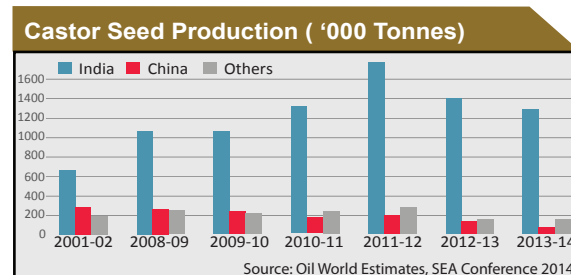
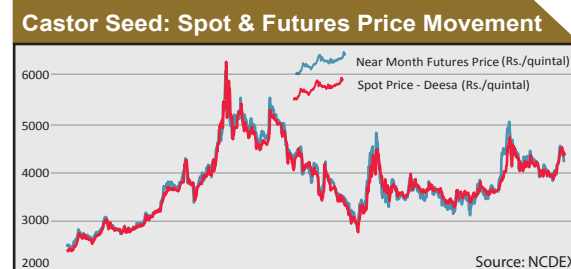
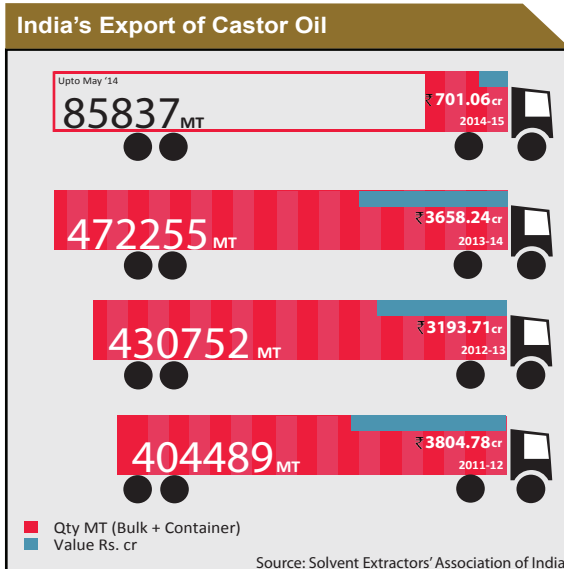
3. Hedging protects inventory values. This can be exercised for castor seed as well as castor oil inventories. Prices of both the commodities are correlated and hence castor seed contracts can act as hedge instrument for oil too. A trader or a miller with large unsold inventory can short hedge that inventory on futures platform which will protect its value in an adverse scenario.

Though futures trading in castor is not a new concept in India, online national level futures platform for castor has sensitized the value chain with knowledge of prices and underlying market conditions. Today majority of the castor value chain, be it farmers, traders or millers, base their business decisions on futures market. Futures help to determine the "correct" price for a commodity and is a good indicator of market supply-demand conditions and hence a step forward in creating a perfectly competitive market.

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