PGDM (IB), 2015-2017
INTERNATIONAL COMMODITY MANAGEMENT
Subject Code: IB-307
TRIMESTER –III, End Term Examination, MARCH - 2016

Time Allowed: 2 hours, 30 minutes **Max Marks: 50**

Roll No:

Instruction: Students are required to write Roll No on every page of the question paper, writing anything except the Roll No will be treated as Unfair Means. In case of rough work, please use answer sheet.

Sections	No. of Questions to attempt	Marks	Marks
A	3 out of 5 (Short Questions)	5 marks each	3*5 = 15
B	2 out of 3 (Long Questions)	10 marks each	2*10= 20
C	Compulsory Case Study	15 marks	15
		Total Marks	**50**

SECTION A

Answer ***any three*** questions from this section.

Q.1. Why should speculators and arbitrageurs be allowed to participate in trading on commodity exchanges?

Q.2. Explain the meaning of standardization in relation to exchange-traded derivatives.

Q.3.What are the failings of the existing spot market design for agricultural commodities in India?

Q.4. What can be the reasons for the use of OTC contracts even though they suffer from counter-party risk?

Q.5. Assume you bought 5 contracts for sugar on NCDEX on a given day. If your purchase price was Rs. 2500 per quintal, what is the exposure? If the price closed at Rs.2480 for the day, what is the mark-to mark adjustment to your margin deposit?

SECTION B

Answer ***any two*** questions from this Section. Each question carries 10 marks.

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Q.1. An automobile manufacturer has entered into a contractual agreement to export automobiles two months hence to dealers in the East European market. He will need to purchase large quantities of steel as raw material for the automobile production to start in time to honour the export agreement.

a) What risk is the automobile manufacturer exposed to?
b) In what way could he manage his risks in the absence of commodity derivatives market? How can he use the commodity derivatives market to manage his risk?

Q.2. a) What are OTC derivatives? Why some derivative contracts are traded OTC?
b) What is the difference between physical and cash settlement?

Q.3.a) What are the significant features of the commodity exchanges in India?
b) What can be the justification for commodity derivatives exchanges getting into spot trading of commodities?

SECTION C

Read the case and answer the questions given at the end.

Shubh Sugar Co.

Shubh, is a major sugar manufacturing company located in Uttar Pradesh, and was established in 1935. Ever since the company started its operations, it has used the medium of sugar agents to sell its sugar in the open market. The agents are appointed by the sugar company after screening them for their financial health and credibility. Many of the agents of the company have been working with the company since its inception. Sugar, being an essential commodity under the Essential Commodities Act, is regulated by the Government, more particularly, the Sugar Directorate in the Ministry of Food. Since sugar is produced over a period of 5-6 months during the sugarcane crushing season, and is sold over a period of 12 months, the food ministry regulates the sale of sugar during the year by regulating the quantity that can be sold by each sugar mill through a monthly release mechanism, whereby it directs each sugar mill to sell a specific quantity each month. The government tries to manage the price of sugar by varying the quantity of sugar released each month-releasing larger quantities when prices move high, and lower quantities when prices fall. Nevertheless, there are significant price fluctuations during the year, with prices moving in relation to the demand vis-a-vis supply released by government orders, market expectations of oversupply/undersupply in the country (sugarcane being an agricultural crop, its production varies from year to year due to agro-climatic reasons, as well as economic reasons-farmers growing less sugarcane if other crops are more remunerative, and vice-versa).

Shubh sells sugar to agents at prices negotiated bilaterally between the agents and the company's sugar sales team. Initially, the sugar agents purchased sugar from Shubh at the spot rates, which they then sold in the open market at the prevailing prices. Sometimes, the agents had to stock sugar for months to get a good price. Anyway, the agents acted as speculators and market makers for the sugar manufacturer. This method of marketing continued to be in vogue

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in the sugar industry till forward contracting in sugar was permitted under the Forward Contracts Regulation Act. Sugar sales are now done in the spot market, and up to one month forward. The sugar is then sold by the agents in the open market at prevailing rates. This allows the company to lock in sugar prices for up to one month into the future.

In 2008, MCX and NCDEX launched sugar contracts for futures trading. The management has to decide if Shubh should hedge its sugar sales through futures trading on these exchanges. The Head of the sales team is strongly in favour of continuing with the existing system of selling sugar using forward contracts. He says, "We have a dependable and experienced network of agents, and have managed to hedge our sugar prices quite well in the past. I see no reason to experiment with futures. These are speculative contracts, and not meant for producers like us." However, some others in the company feel that sugar agents have caused a lot of inconvenience in the past. The Finance Head says, "But we must develop an alternative platform for hedging. These sugar agents have often caused us problems in terms of delaying payments. We lose a lot of money that way, even if we are assured of the price. Of late, many of them have not been picking up contracted sugar from our godowns, so we end up in a situation where we have no storage capacity for the new sugar getting made in our factory. Moreover, with futures contracts on the exchange, we can hedge our sugar for up to 6 months forward." The Sales Head says, "Yes, I am aware of these issues, but I still think the forward contracts we negotiate with our sugar agents give us more flexibility in the contract terms. We can evolve some other system to discipline the sugar agents to make timely payments, and to pick up their purchased lots of sugar. As for the exchange-traded futures, let us wait and watch how much interest is shown by the market, and use the price signals for our own sales. Moreover, the prices for future months on the exchange reflect the market's perception on demand/supply balance in those months, which is difficult to estimate as sugar is a controlled commodity. Further, the delivery centres mentioned in the futures contracts are so far from our factory that our realisation after freight will be much less if we deliver sugar on the exchange. In this situation, even if we sell on the exchange, we will always have to square up the contracts and continue to sell the monthly quota in the physical market through our agents."

Q.1. Enlist the advantages Shubh have by forward selling of sugar. What will be the consequences of a sugar agent defaulting on payments?

Q.2. Why does the sales head feel that sugar futures will be speculative in nature?

Q.3. Do you think that hedging through futures can be used by Shubh, in spite of government regulated monthly sales quotas?

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