

Investor

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Commodities must share trading platform: CME chairman emeritus

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INDIA will have to launch a massive exercise to educate the public as well as companies about deriva-

tive products before such products are launched, said Chicago Mercantile Exchange's (CME) chairman emeritus Leo Melamed.

Melamed called for a common trading market for commodities "as different markets diffuse the central force of trading". He also felt that derivatives trading should not be restricted to institutions alone.

In his address at a seminar on "Future of Fund Management in India", Melamed, who was the moving force behind the introduction of derivatives trading in the US, lauded India for deciding to introduce derivatives trading through a screen-based trading system and not the open outcry mode which is followed in several developed mar-

kets even today. He, however, sought to dispel certain misconceptions which people have about derivatives. He said that a futures exchange alone is not a guarantee of economic prosperity.

"Such thoughts are naïve. Indeed, the contrary is more the case. Before a nation can contemplate a futures market, it must first reach a sufficient degree of maturity in its free market experience and capabilities. There must be a free market infrastructure in place. Similarly, a nation's cash market and institutional participants must have reached a level of sophistication, experience and liquidity that will successfully support a futures exchange", he said.

"Derivative markets cannot function without efficient cash markets. It is one of the reasons that historically there have been more failed attempts at the creation of an exchange than there have been successes," he added.

In a globalised economy, of which India is very much a part, management of risk is today at the core of every prudent financial strategy, a reality that will continue to have the greatest impact on the use and expansion of futures and options mar-

kets as well as other form of derivative markets, said Melamed. He outlined three primary functions of financial derivatives. These could, according to him, be divided into three distinct categories: risk management, price discovery and transactional efficiency. Regarding price discovery, he said that derivatives are tools that assist everyone in the marketplace to determine value. The wider the use of derivatives, the wider the distribution of price information.

Transactional efficiency is the product of liquidity. Inadequate liquidity results in high transaction costs. This impedes investments and deters the accumulation of capital. "Derivatives facilitate the opposite result. They significantly increase market liquidity. As a result, transactional costs are lowered, the efficiency in doing business is increased, the cost of raising capital is lowered and the amount of capital available for productive investment is expanded," he added.

Melamed categorically disagreed with the view of allowing only institutions to participate in derivatives trading in India, contrary to a line of thinking prevailing in Sebi. ♦