BusinessLine
TUESDAY, JULY 11, 2017

More than a 'glitch'

Trading halts are not uncommon; NSE's failure lies in the way it handled the crisis, and the lack of an adequate back-up plan

The three-hour trading halt in the NSE's cash and derivative segment raises many critical concerns that need to be addressed forthwith. Investors transacting on the NSE were left high and dry on Monday with their early morning trades failing to go through. This was because the NSE's cash segment could not open normally in the morning due to "technical reasons" that the exchange says it is investigating. The derivative segment was also shut down immediately after as it is not possible to continue trading in derivatives while the cash segment is shut. After two false starts, trading resumed mid-day.

Trading halts are not uncommon in global stock exchanges. In July 2015, the NYSE had to suspend trading in all the stocks for almost two hours due to a configuration problem. Other exchanges such as the Nasdaq, Intercontinental Exchange and Chicago Mercantile Exchange too experienced partial or complete trading halts in the last decade. The over-reliance on technology for stock market operations globally makes such events imminent. Therefore the manner in which the exchanges handle these disruptions is important to retain investors' trust. The NSE's much touted technological prowess was nowhere in sight on Monday as the exchange struggled to sort out the bug in the cash segment. While it could be argued that the primary server was not entirely down thus dispensing with the need to activate the back-up or the disaster recovery servers, the exchange needs to have plans to handle minor malfunctions that affect one segment of trading as well. The other issue that is highlighted in this incident is the concentration of equity derivatives trading on one platform — NSE — even though the BSE also offers the facility. The BSE has insignificant presence in the equity derivative segment; almost the entire daily equity derivative turnover of ₹5 lakh crore is transacted on the NSE. This concentration of equity futures and options in just one stock exchange proved detrimental to traders who held open positions on the NSE on Monday morning. Presence of multiple pools for trading similar products has helped other global exchanges that faced similar issues in the past.

While the NSE did send circulars during the halt to keep members and other updated about the progress of repairs, they could have been a little more elaborate to ease investors' concerns. The Securities and Exchange Board of India, too needs to play a larger role in such periods to update investors about the steps being taken by the regulator to ensure that normalcy is restored quickly. The regulator should now delve into the issue to unearth the cause of the trading halt and ensure that exchanges frame standard operating procedures to be followed in such events. These should include trading back-up, channels of communication and investor redress mechanisms.

The puzzle of telecom regulation

Treating service providers and Internet companies as single or separate entities comes with much complexity

ROHIT PRASAD / V SRIDHAR

Revenues from telecom firms contribute to more than 90 per cent of the estimated ₹47,000 crore non-tax revenue of the government for 2017-18. The reduced turnover of these companies and their apparent need for a bailout threatens to derail the government's fiscal arithmetic. Is there a way out?

Integrating telephony, Internet

The fundamental reason for their distress is not the market strategy of Reliance Jio, which is merely a symptom, but the transformation the industry is going through. In the early days different companies provided voice telephony, Internet service, and Internet content and applications. For instance, in India we had Airtel, Sify and Rediff.com.

Today, however, telephony, internet connectivity and Internet content and applications have become heavily vertically integrated, either through organic growth or arm's length relationships. Successful business practices along these lines include carriers bundling Apple handsets, Netflix having strategic partnerships with carriers, AT&T providing preferential treatment of DirecTV content. Increasingly, the new model of value creation involves integrated ecosystems or "walled gardens".

In this new world, value is being captured by the anchors of the value networks, such as Apple, Google, and Amazon. On the other hand, telecom and Internet connectivity providers such as AT&T in the US and Airtel in India are relatively less profitable, even though the content provided by the Internet companies cannot be consumed without the bandwidth provided by the connectivity provider. Hence connectivity providers are attempting to become anchors of their own value networks. For instance, in the US, AT&T recently acquired DirecTV to provide a video service aligned with its connectivity offering. In India, Reliance Jio is making the most aggressive attempts to create a value network centred on itself. The fact that it is a late entrant lends an extra urgency to its efforts.

There are two regulatory approaches possible, based on two views of the boundaries of the telecom-Internet eco-system. Either we can treat telecom firms and Internet companies as belonging to the same industry, or we can regard them as different.

Not a level playing field

If we regard them as belonging to one industry, then one must keep in mind some key differences between telecom and Internet companies. The former have geographical jurisdiction, use scarce resources such as radio spectrum, and are subject to a variety of national regulations, including laws on net neutrality.

On the other hand, Internet companies operate globally and are subject to light touch regulations, in most national jurisdictions. They are not subject to net neutrality regulations unless they attempt, like Facebook, to partner with telecom companies to create walled gardens. Here also, the regulation kicks into place because of the involvement of the latter.

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The bias of search engines that arguably violates net neutrality does not, by and large, invoke regulatory censure. Although the European Commission has just imposed a heavy fine on Google, the US Federal Trade Commission (FTC) concluded that Google's practice of favouring its own content in the presentation of search results did not violate US antitrust laws.

India is also silent on the vertical integration of different layers of the Internet. However, while telecom firms have left innovation to telecom product vendors, Internet content and applications companies have to innovate constantly to remain relevant.

Net neutrality

If we aim to provide a level playing field between telecom firms and Internet companies, then we have to get rid of the current notion of net neutrality that censures the connectivity provider for directing Internet traffic but does not take a similarly scathing view of Internet behemoths who also influence internet traffic by controlling key elements of the value network such as devices or search engines.

We should also reduce the levies and payments telecom firms are charged for spectrum, keeping in mind that many of the big Internet companies hardly pay anything at all by way of taxes. The reduction in levies necessary to make them competitive can be minimised by allowing cash-rich internet companies to invest in telecom companies to create integrated value networks.

However, letting go of the principle of net neutrality can destroy competition on the Internet as new firms will find it difficult to compete in an environment of walled gardens. Hence, there is a strong case for the second regulatory approach: treating connectivity providers and Internet companies as belonging to separate industries.

If we take this view then the principle of net neutrality has to be strictly enforced – not just with respect to the connectivity providers, but also with respect to the walled gardens created by Internet companies. If we do not establish an even-handed approach to both telecom and internet companies, the former will always have an incentive to try to become like the latter, in terms of dominance in the applications layer.

Telecom firms, not being adept at innovation, will try to use the power of subscriber numbers to turn the tables, as Jio is doing. If this principle of net neutrality is established, then innovation in the Internet will be enhanced. Importantly, telecom firms will have no incentive to build market share too aggressively as they know they will not be allowed to use their subscriber base to build an applications suite which they can monetise. They will charge sustainable prices for service, reducing the resources needed for a bailout. Stronger data protection laws will also reduce the incentive of telecom and Internet companies to subsidise subscribers only to monetise their information through ads.

Perhaps both regulatory approaches discussed are extreme and difficult to adopt. What is the middle path that increases both the health of the sectors as well as is beneficial for end users?

Prasad and Sridhar are Professors at MDI Gurgaon and IIIT-B, respectively

Costly shift Integrating telephony and Internet has caused unevenness in revenue and regulation K PICHUMANI

Changing constellations in West Asia

There is hope for Qatar in its standoff with Saudi Arabia as not all GCC members have taken sides

AVIJIT GOEL

GLOBAL EYE

Barring a fleeting silver lining of Trump's endorsement and a majestic show of support during his visit to Riyadh, there is little to cheer in the Saudi kingdom. The change in guard in Saudi is an ominous foreboding akin to an overcast sky.

A popular saying in Arab desert war folklore goes: "When power, over time, decays to an assumption of power, be still." A possible reference to the Arab wars in the medieval times, when warriors fast depleted in battle against an increasingly hostile foe. It does hold a few lessons to take away, even today. Especially, today.

How Qatar gained ground

The 1990s saw major re-adjustment in Saudi and Qatar relations, with Sheikh Hamad deposing his father in a bloodless coup in Qatar in 1995 (much to the chagrin of Saudi), and asserting Qatari might and autonomy outside of Saudi domination. This, in the backdrop of technological breakthroughs allowed a global demand for liquefied natural gas (the largest reserves of which were in Qatari control). The hyper-growth in economy from $8 billion in 1995 to an astounding $200 billion in 2014 lies at the heart of Qatari confidence and assertion.

In the last decade, Saudi has accused Qatar of a slew of transgressions, from hosting and financing the "first independent-minded Arab media house" (Al Jazeera) critical of Arab monarchies, to espousing the cause of the Muslim Brotherhood, to supporting interests and groups inimical to Sunni interests. As the litany of complaints against Qatar gathered largely within the Gulf Cooperation Council (GCC), the diplomatic and economic boycott only required a little thrust, and Trump's visit to Saudi served as the perfect backdrop.

The unease gave way leading to a 'grave' and 'unprecedented' crisis in the GCC, with a Saudi-led bloc severing diplomatic ties with Qatar, adding trade and travel bans to enforce impact.

Taking on Saudi

For a country the size of Qatar, with a population of close to 2.6 million, getting onto the wrong side of a bloc comprising Saudi, Egypt, UAE and Bahrain amongst others does seem like unwelcome trouble.

However, two underplayed yet key indicators might just be the proverbial dark horses in throwing up unexpected consequences and possibly challenging a carefully built regional order.

First, it is rare to see the GCC so divided on a Saudi-led regional agenda, as now. GCC members Kuwait and Oman have advised restraint and mediation as the way forward, and not allied with either side, yet. An interesting role could be played by Oman, which has been accused similarly by Saudi in the past, of deepening relations with bête-noire, Iran. Second, a new cooperation axis of Iran and Turkey seems to be taking concrete shape.

Turkey's Erdogan recently announced a substantial increase in Turkish military advisors in Qatar, followed by Iran and Turkey sending food aid and offering air-space to the national airline, amongst others, to overcome the possible humanitarian crisis.

Riyadh's list of 13 demands to resume ties are 'non-negotiable' and include shutting down Al Jazeera and reducing Turkish military presence in the country. Qatar's acquiescing to them on 'non-negotiable' terms seems very unlikely.

Also, Qatar can count on Iran and Oman to ensure the free flow of its hydrocarbon exports through the Strait of Hormuz. If Qatar can maintain its gas sales to Asia, the Saudi bloc's action against Doha may fail to achieve any economic arm twisting. (Even the demand side is assured as all buyers of Qatari gas, including Pakistan, have declared that it shall be business as usual.)

While it remains to be seen how this deadlock resolves, the most probable solution rests in finding middle ground, and a mediating agent unaligned in the crises. A military conflagration might be unlikely, but it does sow seeds for future power constellations.

These changing power constellations might just have some rude awakenings for Saudi – Qatar might just step back when Saudi expects it to bend.

The writer is a geopolitical analyst

Holding its own Qatar's rich natural gas reserves serve to get its voice heard AFP

OTHER VOICES

The New York Times

The spoils, and profits, of conflict

According to Russian news outlets, the Syrian government has contracted with private Russian companies that have Kremlin connections to carry out security operations for the Assad regime in Syria in exchange for a share of oil, gas and mineral production in territory won back from rebels. Mercenaries and private contractors are nothing new in Middle Eastern conflicts, unfortunately, but sending private security services to fight for spoils on foreign land adds an insidious dimension to an already ugly conflict. NEW YORK, JULY 10, 2017

GLOBAL TIMES

Xi-Trump meet defies naysayers in West

Chinese President Xi Jinping and his US counterpart Donald Trump met and exchanged views on bilateral ties and the North Korea nuclear issue on the sidelines of the G20 Summit in Hamburg, Germany, on Saturday. The Xi-Trump meeting this time has demonstrated certain signs of maturity in the Sino-US relationship. Indeed, there were negative elements in the last two weeks, but the Sino-US relationship has stood up to the frictions and remained constructive as a whole. BEIJING JULY 9, 2017

the guardian

Abolishing student fees

Student funding is in a mess. Graduates now owe £100 billion. More than three-quarters of them may never repay all their loan. The abolition of maintenance grants last year leaves poorer students owing £7,000 more than better-off ones. One of the system's godfathers, the former Labour minister Andrew Adonis, said on these pages on Saturday that it was time to scrap it. Defenders of tuition fees have argued that there are hard-to-replicate benefits. Just removing fees risks being an even bigger bung to the better off. Labour needs to spell out exactly how it would work. LONDON, JULY 9, 2017

LETTERS TO THE EDITOR

Send your letters by email to bleditor@thehindu.co.in or by post to 'Letters to the Editor', The Hindu Business Line, Kasturi Buildings, 859-860, Anna Salai, Chennai 600002.

Housing for all

I was very impressed to read an article titled "Housing for all: There's a lot to be built" by Shreya Deb in today's *Business Line*. I compliment the writer for an objective presentation of the situation to make the concerned understand the challenges. I am asking my Ministry officials to examine the issues presented in the article and suggest further improvements to PMAY(Urban) at our end.

M Venkaiah Naidu
Union Minister for Urban Development

It is time high-density structures with modern amenities should be considered to replace urban slums. Aiming to provide housing for all by 2022, the Finance Minister has offered a tax sop for home-owners by extending the additional tax incentive on home loans. The housing sector, which witnessed poor sales in the last three years, was hit hard by demonetisation. To beat the slowdown, many developers got into affordable housing projects. Indeed, slums are a degrading way for people to live in.

The slum population in the country has grown 25 per cent between 2001 and 2011, during which total urban population rose 32 per cent. It is clear that unless we have a holistic housing policy which addresses the full spectrum of requirement, ranging from ownership to rental accommodation and shared housing, universal housing will remain a distant dream.

Vinod C Dixit
Ahmedabad

Small savings rates

This refers to "Stop fiddling with small savings rates" (July 10). The argument that small savings rate needs to be aligned to market-determined rates prima facie seems logical. But multiple factors are overlooked in the process. Unlike post office deposits, there is a commercial element involved in bank deposits as they are redeployed for lending purposes with a margin. Commercial banks operate in an environment where interest rates are totally deregulated by RBI and forces of demand and supply of funds come into play while fixing rates to remain competitive. Further banks' cost of funds is calculated after meeting statutory requirements such as CRR (cash reserve ratio - 4 per cent) which does not yield any return and SLR (Statutory Liquidity Ratio-20 per cent), the yield on which is flexible.

The only drawback of post office deposits is that they are not as liquid as bank deposits and are cannot be encashed freely. Banks and post offices operate under a different environment altogether and as such the interest rates offered by both are not comparable. Finally in a country where there is no social security system for senior citizens, the post office schemes are the only ones which offer better risk-free post-tax returns. As such small savings rates should not be tinkered with frequently.

Srinivasan Velamur
Chennai

The rural population which puts its hard-earned money in post office schemes will obviously feel the heat if small savings rates keep dropping in the lower interest rate regime. But people from urban and semi-urban areas with good awareness of mutual funds should not get disheartened as they still have a financial product which can provide them better results and beat inflation. We need to promote indirect investment in markets, apart from safe deposits.

Bal Govind
Noida

Vanishing firms

This refers to your editorial 'Disappearing act' (July 10). A joint mechanism of SEBI, RBI and Ministry of Corporate Affairs was developed to form a Coordination and Monitoring Committee to deal with vanishing companies. This committee is supposed to classify a company as a vanishing company when certain conditions exist.

Of what use is it to investors to classify some companies as 'vanishing companies' or delist them from the stock exchange? The promoters have swindled money from small investors and walked away. There are provisions under Section 447 of the Companies Act 2013 to take criminal action against such promoters, which should have been done by SEBI. Investors can forego their capital on account of a company's failure, but but not of fraud.

S Kalyanasundaram
Email

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Chinese checkers

How the country fights 'addictive' games

ADAM MINTER

Shareholders of Tencent Holdings, the world's biggest video game company, panicked last week. *People's Daily*, the official newspaper of the Chinese Communist Party, singled out "Honour of Kings," Tencent's biggest game, for an unusually high-profile criticism.

"Poison," the paper declared of a game played by roughly one in seven Chinese. "Constantly spreading 'negative energy." It linked the game to recent reports in which children allegedly stole money, experienced strokes and even jumped out of a high-rise window due to "addictive" game play. Tencent's stock fell by more than 5 per cent on the news. Although it eventually recovered, the incident should be a wake-up call to investors and gamers alike.

For more than a decade, China's government has sought to define and regulate internet addiction. Its willingness to target Tencent, the country's most valuable company, suggests a new and more formidable campaign is under way — one that could transform the $100 billion gaming industry. The idea that the internet could in some sense be addictive emerged in 1995, in a satirical paper by an American researcher. Today it's no joke: Hundreds of scientific papers are published on the subject each year. Yet defining internet addiction as a clinical disorder — akin to, say, heroin addiction — remains controversial in much of the world.

In China, it's been a settled issue since 2008, when a group of doctors approved an official description of "Internet Addiction Disorder". Among other criteria, an addict must spend more than six hours a day online for reasons other than work, become irritable when unable to connect and exhibit difficulty concentrating.

For the Chinese government, the perceived isolation and distraction of its youth is viewed as an increasingly urgent social problem. Immersive role-playing games, popular among students at ubiquitous internet cafes, are seen as a particular threat. As far back as 2004, state media reported that 90 per cent of juvenile crimes were related to excessive internet use.

True or not, the government has certainly responded as if an epidemic is under way. In 2004, it shut down 16,000 internet cafes to protect impressionable youth. Three years later, it required that developers install "anti-addiction" systems in their games. In 2008, it banned the opening of new internet cafes entirely. Over the past decade, some 250 internet addiction "boot camps" have opened; one has treated at least 6,000 patients using electroshock therapy.

All this probably hasn't had much effect. Very few companies have come up with effective anti-addiction measures, which is unsurprising given that users hate them and that the science of internet addiction is unsettled at best. Internet cafes remain popular, while mobile phones have provided users with more games than ever.

Tencent appears to have known it was in trouble. The day before the editorial was published, the company announced measures to make it more difficult for children to play its games. Clearly that wasn't enough. *People's Daily* later published another commentary calling for game developers to start taking responsibility for the social consequences of games.

For companies aspiring to enter the world's biggest gaming market, that's an ominous sign. The line between a fun game and an addictive one is thin, and determining which is which isn't in the typical developer's skill set. Anti-addiction regulation is sure to lead to a duller and less profitable industry. Whether it will save any young Chinese from addiction is anyone's guess. BLOOMBERG

Loan waivers can't fix farmers' problems

Farm indebtedness is a deep-rooted malady. The solution lies in ensuring decent profits for farmers' efforts

A NARAYANAMOORTHY / P ALLI

Never in recent history has the country witnessed its farmers so agitated. Why is this sudden uprising among farmers, in spite of bumper harvests? What causes such widespread protests?

Every time the country wakes up to plight of farmers, policymakers presume that a financial relief package or a loan waiver can solve the woes. If a one-time relief package can bail out the debt-ridden farmers, then the massive ₹71,680-crore agriculture debt waiver and relief scheme announced in 2008 should have produced the desired results by now. Has it happened?

Right solution?

Surprisingly, farm suicides increased in most States after the announcement of the loan waiver scheme. Data from the National Crime Records Bureau's (NCRB) clearly indicate this. During 2008, 16,196 farm suicides were reported across the country, which is an increase of about 1.13 per cent over 1998. Whereas, between 2013 and 2015, farm suicides have risen by about 7.05 per cent.

Further, the NCRB's 49th Annual Report shows the number of farmers committing suicide rose more than 41 per cent in 2015 over 2014. Farm indebtedness also did not recede since the introduction of the loan waiver scheme.

Ironically, even after nine years since the Radhakrishna Committee on Agricultural Indebtedness submitted its recommendations, indebtedness continues to trigger farm suicides.

The 70th NSSO survey (2014) confirms the worsening of farm indebtedness. The report underlined that about 52 per cent of the agricultural households in the country are estimated to be in debt. Andhra Pradesh has the highest percentage of indebted agriculture households at 93 per cent followed by Telangana (90 per cent), Rajasthan (62 per cent), Odisha (58 per cent), Maharashtra (57 per cent) and Punjab at 53 per cent.

The survey also observes that the average debt per agricultural household was ₹70,580, whereas the yearly income from cultivation per household was only ₹77,112 during 2012-13.

Real problems

The growing discontent among farmers is primarily because of poor remuneration from agricultural produce. Like all other enterprises, farming also entirely rests on profits. Analysis based on the cost of cultivation survey published by the Commission for Agricultural Costs and Prices (CACP), from 1972-73 to 2013-14, shows farmers have not earned enough profit from most of the foodgrain and non-foodgrain crops in the major growing regions right from mid-1990s.

Crop losses, which prevailed during pre-1990s gathered its momentum during after 1990s and continues to haunt farmers even today. The Situation Assessment Survey of farm households published by NSSO (2002-03 and 2012-13) also corroborate this fact.

Rising cost of cultivation is the prime reason for poor gains from crop cultivation. Recent studies including one by the CACP have found that cost of cultivation in most of crops has escalated almost four times during the first half of the current decade alone.

Some major studies have also pointed out that while all key inputs costs have increased, the abnormal increase in the wage cost in the recent years, especially after the implementation of MGNREGS, has been escalating the cost of cultivation. Wouldn't it affect the very survival of a farmer when the overall cost of cultivation of crops itself becomes unaffordable to him?

The income and the consumption expenditure of farmers remains almost the same now, with very little hope of living a decent livelihood. This is also reinforced by the latest NSSO survey, which shows that the average monthly income per agricultural household was ₹6,426, whereas the average monthly consumption expenditure was ₹6,223. Some 10 years ago, farmers received about ₹5 on a kilo onion, tomato or potato. The return remains the same even today in a normal market condition.

Will not a farmer like any other person wish to improve his standard of living and plan to save for unforeseen emergencies? At a time when educational expenses have hit the roof, how will farmers aspire to educate their children?

Practical solutions

Policy makers have been advocating that a loan-waiver will solve farmers' woes. They fail to understand that a loan waiver can at the best be an interim relief and can never be a permanent solution. All that the farmers need is remuneration for their produce that is commensurate with their efforts.

Farmers can get better remuneration only when efforts are taken to bridge the gap between ever-increasing costs of farm inputs and lower price for their produce. A market intervention scheme has to be implemented to protect the farmers from making distress sale in the event of bumper crop when the prices tend to fall below the cost of production.

Farmers' outcry is also directed towards the minimum support price (MSP) that is neither announced in advance nor is in tune with the cost of cultivation. Farmers will continue to cultivate crops only if input costs are covered.

As such, prices need to be fixed at least 50 per cent above the cost of cultivation, as recommended by the MS Swaminathan-headed National Commission on Farmers (2006). Besides, the MSP should be linked with the Wholesale Price Index to offset inflation impacts. There is also a need to improve the procurement infrastructure on a massive scale for all major commodities, without which MSP will not be useful to farmers.

The practice of fixing minimum export price (MEP) for different agricultural commodities should be abolished with immediate effect so that the excess supply can be exported. The MGNREGS must be restructured by linking it with farming work to reduce the cost of cultivation.

The Government should also make an effort towards bringing an Act giving farmers the 'right to sell at MSP' to get a guaranteed price for their produces. If these initiatives are taken swiftly and efficiently, farmers' sufferings can be abolished and there wouldn't be any demand for loan waivers as well.

Planting another crisis? Our farmers deserve a good harvest BLOOMBERG

Narayanamoorthy is Head, Department of Economics and Rural Development, Alagappa University, Karaikudi. Alli is Assistant Professor, Department of Social Sciences, Vellore Institute of Technology

5 THINGS to WATCH OUT for TODAY

- **The final** hearing on the appeals filed by Tamil Nadu, Karnataka and Kerala against the Cauvery Water Dispute Tribunal's decision on water sharing will start today. An SC bench had scheduled back-to-back hearings from July 11 for 15 working days. The SC in March had asked Karnataka to continue releasing 2,000 cusecs of Cauvery water to neighbouring Tamil Nadu.

- **BCCI** will hold a special general meeting to discuss the Special Committee report on Lodha reforms. The report wants some points to be reviewed by the SC. They include one-state-one vote, cooling-off norm for office-bearers and apex council members.

- **The Budget** session of the Uttar Pradesh Assembly begins today. The session, which will conclude on July 28, is likely to witness fireworks with opposition Congress planning to raise the issue of crime and the farmers' problems.

- **A plea** filed by the O Paneerselvam faction against the February 18 trust vote in the Tamil Nadu Assembly, won by CM EK Palaniswami, will come up for hearing in the SC today. The plea seeks to set aside the trust vote on grounds that MLAs had voted "under distress".

- **Deputy** Prime Minister of Yemen Abdulmalik Abduljalil Al-Mekhlafi will hold talks with External Affairs Minister Sushma Swaraj on bilateral ties and the situation in Yemen and West Asia. Al-Mekhlafi arrived in India on Monday on a four-day visit.

All you wanted to know about...

RAJALAKSHMI NIRMAL

SLATE

Market regulator SEBI cleared the deck for commodity options in June by issuing trading and settlement guidelines. It allowed commodity exchanges to launch options in agri and non-agri commodity futures if they pass the minimum average daily volume requirement (over ₹200 crore in agri futures and over ₹1,000 crore in non-agri futures).

What is it?

Options are derivative contracts that give the buyer the right to buy or sell a specific asset (a commodity here) at a specified price in future. The consideration for exercising the right will have to be paid upfront by the buyer; it is called the 'premium'. There are two parties to an option contract — a buyer and a seller (also called the writer) and there are two types of options: 'call' (buy) and 'put' (sell). The buyer of an option is the one who by paying the premium buys the right to exercise his option on the seller.

The seller is the one who receives the premium and is obliged to buy (in a put option) or sell (in a call option) if the buyer exercises his right. So, for a seller in an option contract, the profit is limited to the premium amount but loss can be unlimited. For the option buyer though, who will be buying a put/call option, the risk will be limited to the premium — if prices are not favourable, they can leave the contract to expire. Commodity options will have the respective commodity's futures contract as the underlying. This tool is primarily designed with hedgers in mind, be it farmers or commodity traders, who would find buying options useful.

Why is it important?

Commodity market participants have been lobbying for options for a long time. It is seen as a tool that will deepen the market by bringing in more investors.

Currently, many of these participants hedge in markets outside the country. If institutions including banks and mutual funds are given a green flag to step into the commodities derivatives market, volumes can improve materially, and reduce impact cost for hedgers and traders. Recently, SEBI allowed some institutional investors to take positions in commodity derivatives. This should improve volumes and enable better price discovery.

Why should I care?

Options are better hedging-and-trading tools than futures. Losses are limited for the buyer and costs are lower. In a futures contract, a trader will be required to pay an initial margin and also mark-to-market margin based on volatility in market price. In options, the outgo is limited to the premium the trader pays on the contract. So, if you want to lock-in to the price of a commodity you have or want to bet on, options offer a cheaper and safer choice.

You can hedge your price risk effectively with options. Say, you, as a farmer buy a put option to sell 10 tonnes of maize at ₹1,500 per quintal five months from now. If the price goes to ₹1,300 (contract becomes in-the-money) on contract expiry, the profit of ₹200 (per quintal) will be credited to your bank account.

As this happens, you will also get a 'short' position in the underlying futures contract at ₹1,300. If the price goes to ₹1,600 and the contract becomes out-of-the-money, the option contract will expire automatically and your loss will be limited to the premium you initially paid for the contract. Hedgers would do well to square off resultant futures positions as this could subject them to new price risk.

The bottomline

This option can give farmers a better future.

A weekly column that puts the fun into learning

BusinessLine TWENTY YEARS AGO TODAY

JULY 11, 1997

Lenders wary of risk norms in FSA for naphtha units

Institutional lenders in India are set to turn down the current proposals for funding of naphtha-based power projects as they do not consider the draft Fuel Supply Agreement as a bankable document. This follows a meeting between the independent power producers and lenders after a detailed analysis of the document by the financial institutions earlier this week. The issue has been further compounded by the fact that the IPPs have to reckon with the deadline of October set by the Centre for achieving financial closure. The draft FSA was given to the IPPs a little over a week ago.

Oil ministry seeks 'early' dismantling of APM

The Ministry of Petroleum and Natural Gas has called for an early announcement of an 'in principle' decision of dismantling the existing administered pricing regime governing the sector. Though an 'in principle' decision would not mean doing away with the existing system right away, but would speak of the Government's intention of letting the international prices prevail in the country. It is with this intention that the nodal authority for the sector has urged the Government for an early announcement.

Trade deficit up 19.86%

India's trade deficit increased by 19.86 per cent in dollar terms during 1996-97 as compared to the deficit during 1995-96, according to the latest monthly economic Indicator issued by the Commerce Ministry. The trade deficit for the year ending March 31, 1997 was $5,442 millions against a deficit of $4,540 millions in 1995-96. However, the increase in deficit was far less considering a rise of 95 per cent during 1995-96 against the deficit of $2,324 millions during 1994-95.

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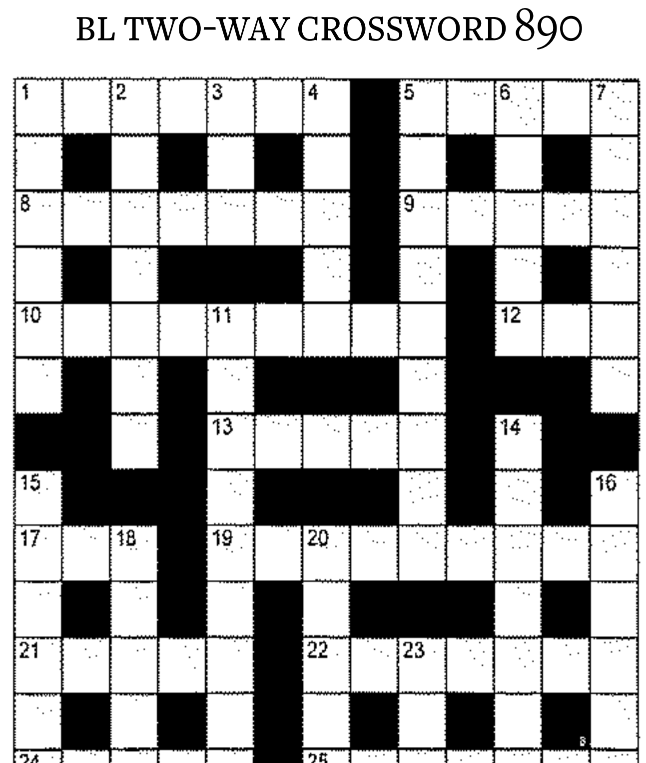

EASY

ACROSS

01. Ascribes, charges (7)
05. Ticks over (engine) (5)
08. Associate in business or game (7)
09. Stringed instrument; flower (5)
10. Passenger wagons (9)
12. Female sheep (3)
13. Dance originating in Argentina (5)
17. To tease; a bone (3)
19. Hardship, poverty (9)
21. Rebuke, scold (5)
22. Distinguished, exalted (7)
24. With a layer of dirt (5)
25. Support for board, bridge (7)

DOWN

01. Strong effect, influence (6)
02. Draw a likeness (7)
03. Weight; 100 mph (3)
04. Raise and lower shoulders (5)
05. They buy stocks, shares (9)
06. Unconfined (5)
07. Manages to do without (6)
11. In a concentrated manner (9)
14. Clear to the mind, obvious (7)
15. Strengthened, tightened (6)
16. Fragrant evergreen (6)
18. The highest happiness (5)
20. An ark, coffer (5)
23. Keen resentment, rage (3)

NOT SO EASY

ACROSS

01. Charges positioned in the semi-confusion. (7)
05. In a date fateful for Caesar, Latin does nothing (5)
08. One playing with one has right to follow wrong parent (7)
09. Flower has a part to play in Shakespeare (5)
10. Parts of train I rage about when there are limos around (9)
12. Sheep you and I turn east (3)
13. Beat will disappear in this dance (5)
17. Spare one for the wife (3)
19. Mother of invention, and sense City made of it (9)
21. Scold child for dropping fifty at start of exam (5)
22. Half of them get net in a mess when rising above others (7)
24. Study in need of make-over if it has a film of dirt (5)
25. Letters could provide support bridge-builders need (7)

DOWN

01. One Member has piece of legislation to create collision (6)
02. Show left for yachtsman on the beam (7)
03. The world of fashion starts to overtake nature (3)
04. Gesture calling for silence when on the mat (5)
05. They buy shares to sort veins out (9)
06. Mislay nothing in the middle if it's licentious (5)
07. Is merciful with the parts one uses for repairs (6)
11. In the Northeast, style changes with depth of feeling (9)
14. It is apparent I had to appear in horse competition (7)
15. Care not to finish back in bed if toned up (6)
16. Try lemon, on leaving out evergreen (6)
18. Heavenly joy Arthur achieved as a composer (5)
20. The thorax may have treasure in it (5)
23. Sat with this angry feeling of humour being ironic (3)

SOLUTION: BL Two-way Crossword 889

ACROSS 1. Gruff 4. Digests 8. Avert. 9. Tumbler 10. Did 11. Excellent 12. Lady 13. Mesh 18. Quartered 20. Cap 21. Evasion 22. Naomi 23. Tresses 24. Sheep

DOWN 1. Grandiloquent 2. Upended 3. Fetter 4. Detach 5. Gamble 6. Solve 7. Stretch a point 14. Enclose 15. Stairs 16. Grunts 17. Adonis 19. Awake