

Business combination and its types

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Business combinations are combinations formed by two or more business units, with a view to achieving certain common objective (specially elimination of competition); such combinations ranging from loosest combination through associations to fastest combinations through complete consolidations.

L.H. Haney defines a combination as follows:

“To combine is simply to become one of the parts of a whole; and a combination is merely a union of persons, to make a whole or group for the prosecution of some common purposes.”

Causes of Business Combinations:

(i) Wasteful Competition:

Competition, which is said to be the ‘salt of trade’, by going too far, becomes a very powerful instrument for the inception and growth of business combinations. In fact, competition, according to Haney, is the major driving force, leading to the emergence of combinations, in industry.

(ii) Economies of Large-Scale Organization:

Organisation of production on a large scale brings a large number of well-known advantages in its wake like technical economies, managerial economies, financial economies, marketing economies and economies vis-a-vis greater resistance to risks and fluctuations in economic activities. Economies of large scale operations, thus become, a powerful force causing increased race for combinations.

(iii) Desire for Monopoly Power:

Monopoly, a natural outcome of combination, leads to the control of market and generally means larger profits for business concerns. The desire to secure monopolistic position certainly prompts producers to join together less than one banner.

(iv) Business Cycles:

Trade cycles, the alternate periods of boom and depression, lead to business combinations. Boom period i.e. prosperity period leading to an unusual growth of firms to reap rich harvest of profits results in intense competition; and becomes a ground for forming combinations.

Depression, the times of economic crisis-with many firms having to only option to close down-prompts business units to combine to ensure their survival.

(v) Joint Stock Companies:

The corporate form of business organization is a facilitating force leading to emergence of business combinations. In joint stock companies, control and management of various corporate enterprises can be concentrated, in a 'small group of powerful persons through acquiring a controlling amount of shares of different companies.

(vi) Influence of Tariffs:

Tariffs have been referred to as "the mother of all trusts". (A trust is a form of business combinations). Tariffs do not directly result in combinations; they prepare the necessary ground for it. In fact, imposition of tariffs restricts foreign competition; but increases competition among domestic producers. Home producers resort to combinations, to protect their survival.

(vii) Cult of the Colossal (or Respect for Bigness):

In the present-day-world, business units of bigger size are more respected than units of small size. Those who believe in the philosophy of power and ambition, compel small units to combine; and are instrumental in forming powerful business combinations, in a craze for achieving bigness.

(viii) Individual Organising Ability:

The scarcity of organizing talent has also induced the formation of combinations, in the business world. Many-a-times, therefore, combinations are formed due to the ambition of individuals who are gifted with organising ability. The number of business units is far larger than the skilled business magnates; and many units have to combine to take advantage of the organising ability of these business brains.

Objectives

Eliminates Competition

Business combination helps in eliminating the tough competition among firms in market. In presence of a competition, many businesses are not able to earn suitable profits. They come together and set up their combination to work together for achieving common goals.

Proper Management

It leads to proper management of all business units that merged together into one unit. Small business cannot afford the services of quality managers which affects their performance. Combination of these units together enables them in hiring management experts.

Attains Monopoly

Acquiring market dominance is another major objective of business combination. Several businesses by forming a combination attain a monopoly position and enjoy a larger share in market.

Economy Scale

Business combination assist in availing the benefits of economies of scale. Small business units by merging together purchases large amount of raw materials at cheap rate and carrying out their production activities at a large scale. This brings down their cost of operations and increases their profit level.

Solves Capital Problem

It helps in overcoming the capital problems. Small business units lack funds for growing their activities. By associating with other units they easily gets funds for large scale production, buying advanced machinery and carrying out research activities.

Economic Stability

Combination of business impart them greater health to face crisis. By joining as one unit they can easily overcome times of political and economic instability.

Improve Product Quality

It leads to enhance the quality of products and level of production by firms. Combination enables them in sharing ideas, knowledge and technology with each other which results in better production. By combining the efforts they come up with new and advanced products in market.

Business Combination Types and Forms

Business combinations are of the following types:

(i) Horizontal Combinations.

(ii) Vertical Combinations.

(iii) Lateral or Allied Combinations:

Lateral combination refers to the combination of those firms which manufacture different kinds of products; though they are allied in some way.

Lateral combination may be:

(a) Convergent lateral combination:

In convergent lateral combination, different industrial units which supply raw-materials to a major firm, combine together with the major firm. The best illustration is found in a printing press, which may combine with units engaged in supply of paper, ink, types, cardboard, printing machinery etc.

(b) Divergent lateral combination:

Divergent lateral integration takes place when a major firm supplies its product to other combining firms, which use it as their raw material. The best example of such combination may be found in a steel mill which supplies steel to a number of allied concerns for the manufacture of a variety of products like tubing, wires, nails, machinery, locomotives etc.

(iv) Diagonal (or Service) Combinations:

This type of combination takes place when a unit providing essential auxiliary goods / services to an industry is combined with a unit operating in the main line of production. Thus, if an industrial enterprise combines with a repairs workshop for maintaining tools and machines in good order; it will be effecting diagonal combination.

(v) Circular (or Mixed) Combinations:

When firms engaged in the manufacture of different types of products join together; it is known as circular or mixed combination. For example, if a sugar mill combines with a steel works and a cement factory; the result is a mixed combination.

Forms of Business Combinations:

By the phrase 'forms of combinations', we mean the degree of combination, among the combining business units.

According to Haney, combinations may take the following forms, depending on the degree or fusion among combining firms:

(I) Associations:

- (i) Trade associations
- (ii) Chambers of commerce
- (iii) Informal agreements

(II) Federations:

- (i) Pools
- (ii) Cartels

(III) Consolidations; Partial and Complete:

(a) Partial Consolidations:

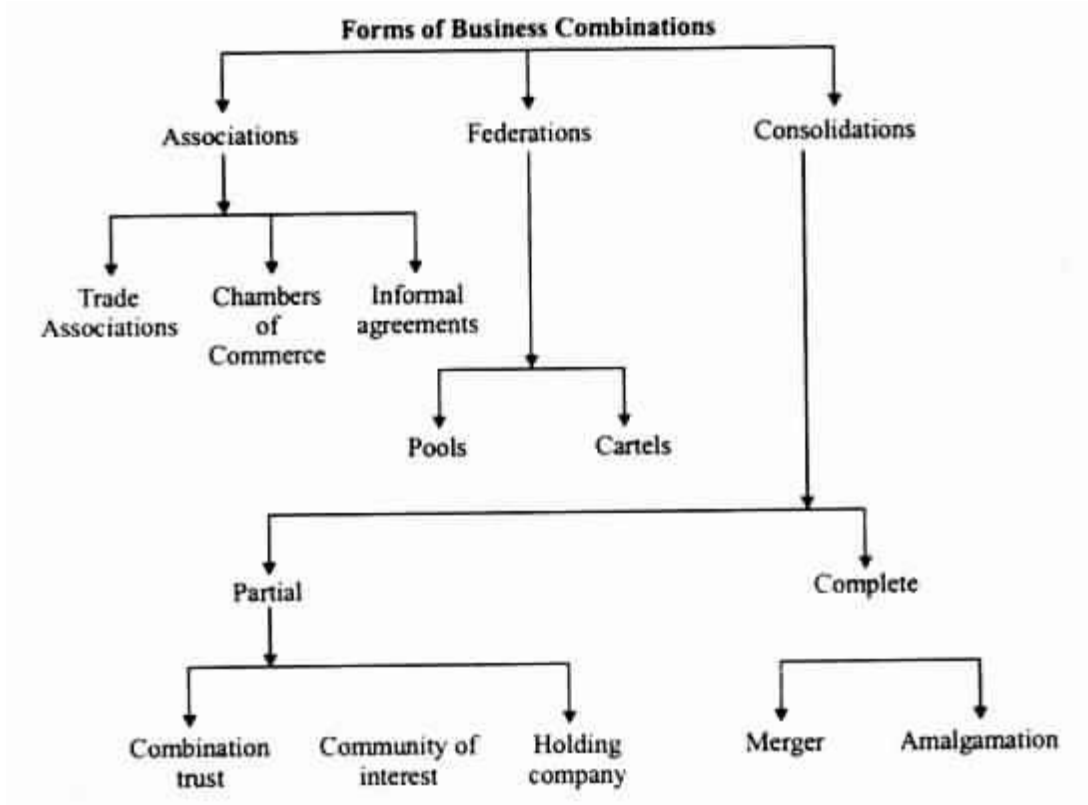
- (i) Combination trusts
- (ii) Community of interest
- (iii) Holding company

(b) Complete Consolidations:

(i) Merger

(ii) Amalgamation

The following chart depicts the above forms of business combinations:



Rationalization and Automation

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Rationalization

Rationalization refers to doing things on a rational and scientific basis. If the loan application of a customer in a branch of a bank is considered by the branch manager himself and not forwarded in a time-consuming and wasteful procedure to the head office, this is Rationalization.

Rationalization and Automation are independent to each other. The involvement in increasing and large-scale use of machinery and the consequent displacement of labor is called Automation.

It is possible to conceive of rationalization taking place in an establishment without any significant resort to automation and capital-intensive devices. Both will depend upon the nature of the technological development and the considerations which are consciously brought to bear upon practical policy in the matter of the choice of techniques.

According to the resolution passed by the conference, the main aims of rationalization are:

- (1) Securing the maximum efficiency of labour with minimum effort;
- (2) Eliminating waste of power and raw materials;
- (3) Facilitating reduction in the variety of patterns (where such variety offers no obvious advantages) search into the methods of manufacture and use of standardised parts;
- (4) Simplifying distribution of products by eliminating unnecessary transport, burdensome financial charges and useless interposition of middlemen;
- (5) Securing to the community greater stability and a higher standard of living;
- (6) Ensuring to the consumer lower prices of goods;
- (7) Ensuring a higher and steadier remuneration to be equitably and fairly distributed among the various classes of producers,

According to the Bombay Textile Labour Inquiry Committee 1941, rationalisation has three aims:

- (a) "Increase in production per man and machine and its relation to wages;
- (b) Improvement in the efficiency of workers and in the working conditions;
- (c) Financial and Industrial re-organisation.

The objectives of rationalisation may be summed up as follows:

- (1) To eliminate waste and inefficiency of every kind;
- (2) To bring about an adjustment in aggregate production and the aggregate demand by initiating agreements among various firms in the industry;
- (3) To undertake the measures of absorption, amalgamation and reconstruction for the protection of weaker and inefficient units;
- (4) To maintain stable and fair prices in the best interest of the manufacturers and the consumers;
- (5) To ensure maximum allocation and utilisation of available resources;
- (6) To check over-capitalisation and under-capitalisation of financial resources in order to ensure fair return and rational allocation of finances;
- (7) To achieve, the goal of self financing or ploughing back of profits in order to minimise the burden of bank loans, debentures and other long terms loans;
- (8) To introduce the techniques of cost and management accounting, budgetary control and internal audit etc., in order to ensure proper financial control and management.
- (9) To introduce a system of scientific selection, training, promotion and wage payments for workers;
- (10) To provide better working conditions like ventilation, lighting, proper working hours, absence of noise, drinking water, canteen, rest-rooms etc.;
- (11) To institute various schemes like unemployment or sickness accident insurance, housing facilities etc;
- (12) To protect the interests of the consumers by supplying they better quality products to reasonable prices and ensuring their regular and uninterrupted supply.

Automation

Scope of Automation

Automation may be applied to almost all the activities” to manufacturing, insurance, banks, wholesale and retail distribution communications, educational institutions and so-forth. The only exception is a firm which is faced with seasonality” where production consists of short runs of varying items or where operators lead the machines and apply a great deal of skill and judgement Add to this factor, the inability of smaller firms to raise money easily and the lack of specialized staff assistance” then automation recedes still further as a goal.

Proliferation of Automation

The field of automation is mushrooming, particularly the advanced countries .In the US for example, the number of robots increased from 100,000 in 1990 to 19,000 in 1995.The US is far behind Japan in this respect. The Japanese manufacturers of automated production systems are much ahead of their US counterparts.

Automated Machines

The mushrooming of industrial automation has brought a myriad of automation machines with diverse features. Particular emphasis needs to be made about machine attachment numerically controlled (NC) machines, robots, automated quality control ,inspections, automated identification systems (AIS) and automated Process controls.

Methods of Remunerating Labour

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Remuneration may be defined as money received in the performance of work, plus many kinds of benefits and services that organisations provide their employees. Money is a direct compensation, known as wages, gross pay. Benefits are indirect compensation, it includes, life insurance, accident insurance, health insurance, employees contribution to retirement benefits such as gratuity, pension, pay for vacation, pay for illness/ sickness, simply it includes payment for welfare and social security.

It must be in proportion, to what services rendered by him/her to an organisation. Remuneration occupies an important place in the life of an employee. Therefore it must be adequate and fair. His or her all the needs should be satisfied by this remuneration. Employee remuneration is significant because of his contribution only the cost of production would be minimised. Remuneration or compensation is very important function of human resource management.

Remuneration is concerned with needs, motivation and rewards. Managers, therefore, analyse and interpret the needs of their employees so that reward can be individually designed to satisfy these needs. It is very difficult for human resource management to fix wages and wage differentials, salaries acceptable to employees and their leaders.

Wage or salary is very important from employees point of view because it contributes a major share of their income. Pay is a powerful motivational factor. It provides recognition, a sense of accomplishment, social status.

Remuneration Objectives

- (1) To acquire qualified competent personnel
- (2) To retain the present /existing employees
- (3) To secure internal and external equity means similar wages for jobs within an organisation. External equity implies payment of similar wages to similar jobs in comparable organisations.
- (4) To ensure desired / positive behaviour of employees.
- (5) To enhance employee morale and motivation.
- (6) To keep control on labour and administrative cost.
- (7) To protect in public as progressive employers and to comply the wage legislation.
- (8) To satisfy people/employees to reduce the labour turnover, grievances and frictions over pay inequities.

(9) To pay according to the content, challenges, difficulty, risk of the job and according to the effort and merit of the employees.

(10) To facilitate pay roll administration of budgeting and wage and salary control.

(11) To simplify and facilitate collective bargaining procedure and negotiations.

(12) To facilitate growth and survival of the organisation and to promote organisation feasibility.

Remuneration Components:

Basic Wage:

It is a stable wage paid over a period of time; monthly, weekly or daily. It can also be considered as the normal rate for a specified level of output. Thus, for a particular job involving its varied requirements such as skills and training, it commands a price to get it done.

Dearness Allowance (DA):

The system of DA payment was used for the first time after World War I to enable the workers to meet the steep rise in prices of essential commodities such as foodstuffs. Although called by various names, the special allowance thus paid aimed at neutralising the high cost of living and protect the real wages of the wage earners. In other words, the major purpose of DA payment was to provide relief to the workers confronted with inflationary conditions by attempting to offset the cost of living with additional allowance.

Usually, the consumer price index (CPI) is issued to link DA with the cost of living. However, there prevail varying practices with respect to the fixation of DA across industries, regions, sectors and governmental and private undertakings. As National Commission on Labour (NCL) reports, "In some cases it was linked to the Working Class Consumer Price Index in others it was not. It was at flat rate and was applicable in some cases to all employees irrespective of their wages; in others, it varied according to wage or salary slabs. A graded percentage, linked to wages or salaries, was also prevalent."

Overtime:

The overtime meets the exigencies of increased work load. Frequently, on working days, overtime rates are one and a half times the normal wage, while on holidays; these rates are two times the normal wage. However, in many work situations in India, it is used to accomplish vested interest to increase earnings. Indeed, the normal work is not done by workers unless their supervisors sanction the overtime.

Labour Remuneration Methods

There are two basic methods of labour remuneration, i.e., time rate and piece rate system of wage payment. In modern days a number of incentive plans to induce workers to work hard so as to produce more and earn more are being used.

Method 1. Time Rate System:

Under this system of wage payment, workers are paid according to the time for which they work. Payment may be on hourly basis, daily basis, weekly basis, or monthly basis. In this system, no consideration is given to the quantity and quality of work done.

When payment is made on hourly basis, total wages payable are calculated as follows:

Wages = No. of hours worked x Rate per hour

For example – if a worker is paid at the rate of Rs. 7.50 per hour, his wages for a day of 8 hours will be $7.5 \times 8 = \text{Rs. } 60$.

Though this is the oldest system of wage payment, yet it is commonly used these days.

Suitability:

This method of wage payment is suitable under the following type of situations:

1. Where quality of work is more important than quantity of work (i.e., high class tailoring)
2. Where output cannot be measured in quantitative terms, e.g., in the case of indirect workers like watch man, cleaners and sweepers, etc.
3. Where output is beyond the control of the worker, e.g., in process industries, where the work of a worker is dependent on the work of other workers.
4. Where work is being done on a small scale so that close supervision is possible.
5. Where the worker is a learner or an apprentice.

Advantages:

Following are the main advantages of this method:

1. Simplicity:

The system is simple and calculation of wages is easily understood by the workers.

2. Security to Workers:

Under this method, workers are assured of a certain amount of wages payable even if there is stoppage of work due to power failure, machine break-down etc. This gives a sense of security to workers.

3. Quality of Work:

As this method does not give weight to the quantity of work done, workers can concentrate on the quality of goods produced. Thus, the quality of work under this method is better.

4. Economical:

Under this method, no detailed records are required to be maintained regarding the work done by workers. This results in saving of clerical costs. Moreover, workers avoid over-speeding and causeless damage to Plant and Machinery and also materials. This also results in economy.

5. Accepted by Trade Unions:

This method is favoured by trade unions because it treats all workers alike and no distinction is made between efficient and inefficient workers.

6. Unity in Labour:

No hard line of distinction is drawn between an efficient and inefficient worker on the basis of production. This promotes a feeling of unity among the workers.

Disadvantages:

The main disadvantages of this method are:

1. Lack of Incentive:

This method of wage payment offers no positive inducement to workers to improve performance as it does not distinguish between an efficient and inefficient workers.

2. Lower Production:

As workers are paid on time basis, they tend to be slow in work. This results in lower production quantity.

3. More Supervision:

Under this method, more supervision is required, so that workers may not waste time. Appointment of additional supervisors increases supervision costs.

4. Idle Time:

Under this method of wage payment, workers waste a lot of time resulting in increasing in idle time.

5. Costing Difficulties:

From costing point of view, it creates difficulties in the calculation of labour cost per unit because the output is quite fluctuating.

6. It Makes Workers Lazy and Dull:

Due to the adoption of this method, workers become lazy and dull and try to avoid work, and thus production suffers.

Method 2. Piece Wage System:

Under this method, workers are paid in proportion to the work done by them. The rate is fixed per unit of output, per article, per commodity, etc. The worker is paid for the total units manufactured. The system is thus result oriented. For example, if the rate per unit is Rs. 5 and the worker manufactures 100 units in a week, his week's wages shall be Rs. 500 (i.e., 100×5).

It may be expressed in the form of the following formula:

Total earnings = Units Manufactured x Rate per unit

Suitability:

Conditions under which piece rate method of wage payment may be usefully employed are:

1. Where the output of workers can be measured.
2. Where production is standardised and repetitive in nature.
3. When the aim is continuous maximum production.
4. Where workers continue at the same job for a long period.
5. Where the standard time required to complete a job can be measured accurately.

Advantages:

Piece rate system has the following advantages:

1. Incentive to Efficient Workers:

Under this method, as remuneration is paid in proportion to the worker's effort, the method provides a strong incentive to work more.

2. Increase in Production:

Under this method, each worker tries his best to produce more to earn higher wages. This results in increase in production.

3. Decrease in Supervision:

Under this method of wage payment, strict supervision is not required because the workers are themselves interested in maximising their earnings through the maximisation of output.

4. Equitable Wages:

This system is more equitable in comparison to time rate system because wages are paid according to the efficiency of each worker.

5. Simple and Easy:

This method is simple and easily understood by the workers.

6. Simplifies Costing:

As, under this method, wages are paid at a rate per unit, it simplifies cost ascertainment because labour cost per unit is known in advance.

7. Decreased Cost:

On account of increase in production, fixed cost per unit is reduced resulting in higher profit.

Disadvantages:

Piece rate system of wage payment suffers from the following demerits:

1. Lack of Secured Wages:

This system does not guarantee of minimum wage to a worker. If a worker is not able to complete his allotted work in a day, due to any reason, he is paid less amount of wages. Thus, under this method, earnings of workers are uncertain.

2. Inferior Quality of the Product:

Under this method, much emphasis is given on quantity of production and ignores quality of the product. In order to maximise their wages, workers try to produce more and more without caring for the quality of production.

3. Injurious to Health of Workers:

In an effort to earn more wages, workers try to work excessively with greater speed. This proves to injurious to health of workers.

4. Misuse of Equipment and Materials:

In the greed to produce more, workers cause extra wastage of material and damage plant and machinery.

5. Unsuitable in Certain Cases:

This method does not suit where work is of artistic and refined nature.

6. Difficulties in Fixing Piece Rate:

Fixing equitable piece rate is quite a difficult task and may require considerable amount of work in the form of time studies.

7. Opposed by Trade Unions:

Price rate system is generally opposed by trade unions because it creates inequality in the wages of workers. Slow and inefficient workers feel jealous of the higher of their fellow workers.

Incentive Plans:

Both time rate system and piece rate system discussed above have their merits and demerits. Incentive plans attempt to combine the good points of both the systems.

The primary purpose of an incentive plan is to induce a worker to produce more to earn a higher wage. Naturally, producing more in the same period of time should result in higher wages for the workers. Because of greater number of units produced, it should also result in a lower cost per unit for fixed factory cost and also for labour cost.

Objectives of Incentive Plans:

1. To induce the workers to increase their productivity.
2. To provide additional remuneration to the workers to their efforts and efficiency.
3. To have a contented labour force, and to reduce the labour turnover.
4. To keep the morale of the workers high.
5. To have increased production from the improved productivity of the workers.
6. To have reduction in the fixed overhead cost per unit through increased production.

Suitability of the Plan:

Incentive wage plans are suitable in the following cases:

1. Those industries where proper time and motion studies can be undertaken and proper standards of time and output can be fixed.
2. Those industries where overhead charges are considerable and which can be reduced through increased production resulting from incentive schemes.

Essentials of a Good Incentive Plan:

1. For the successful implementation of an incentive plan, proper and accurate time and motion studies should be conducted and proper standards should be fixed.
2. The standard set for production should be such that any worker of normal efficiency can attain them.
3. The standards, on set, should not be changed unless there is a change in the method of production.
4. Job analysis and standardisation must be made on scientific and equitable basis.
5. Tools, equipment and machines must be maintained in efficient working condition.
6. Proper and comfortable working conditions should be provided to workers.

7. Uniform working conditions should be provided to all the workers.
8. Regular flow of materials and other supplies should be ensured.
9. Every worker should be given equal opportunity to earn.
10. The workers should be taught the proper way of doing the work.
11. The workers should not suffer on account of factors beyond their control, such as – break-down of machines, power failure, etc.
12. The incentive plan should be permanent and not temporary.
13. The plant should be flexible enough to permit changes to suit the changes in the method of work.
14. The plan should be easy for the workers to understand.
15. The workers should be properly educated about the scheme and motivated to improve their efficiency and earn more.
16. It should be economical to operate.
17. The plan should be acceptable to both employer and the employees.
18. The incentive provided should be sufficiently attractive.
19. There should be no maximum limit on the amount of earnings of the workers.
20. Indirect workers should also be included under the incentive scheme.
21. The scheme should have the approval of workers and the union.

Advantages of Incentive Plan:

1. The workers are assured of their time rates or day rates of wages, whether they attain the standard or not.
2. In-efficiency is not penalised, as the workers are assured of their day rates of wages, whether they attain the standard or not.
3. Efficiency is rewarded, as the workers of higher efficiency are given bonus in addition to their time wages.
4. Incentive is given to workers to increase their productivity.
5. Opportunity is given to workers to increase their earnings by efficient work.
6. It keeps the labour force contented, and thereby, helps to reduce labour turnover.
7. The increase in production leads to reduction in cost per unit.
8. The gain or losses arising from the efficiency of the workers are shared by both the employer and the employees.

Disadvantages of Incentive Plan:

1. The incentive schemes cannot be gain-fully employed in concerns where the overheads are less.
2. These schemes cannot be adopted in undertakings where proper standards cannot be fixed.
3. It is difficult to calculate indirect labour under the common incentive schemes.
4. These schemes require careful determination of standard time and standard output which involves additional work and expenditure.
5. The bonus paid to workers under these schemes may not be proportionate to the improved efforts or productivity of the workers.

6. The quality of the product may suffer, because of their eagerness to save time and earn more.
7. Once an incentive scheme is introduced, it will be very difficult to withdraw that scheme later, it becomes uneconomical.

Stock Market and Commodity Market

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Stock Exchange (also called Stock Market or Share Market) is one important constituent of capital market. Stock Exchange is an organized market for the purchase and sale of industrial and financial security. It is convenient place where trading in securities is conducted in systematic manner i.e. as per certain rules and regulations.

It performs various functions and offers useful services to investors and borrowing companies. It is an investment intermediary and facilitates economic and industrial development of a country.

Stock exchange is an organized market for buying and selling corporate and other securities. Here, securities are purchased and sold out as per certain well-defined rules and regulations. It provides a convenient and secured mechanism or platform for transactions in different securities. Such securities include shares and debentures issued by public companies which are duly listed at the stock exchange, and bonds and debentures issued by government, public corporations and municipal and port trust bodies.

Stock exchanges are indispensable for the smooth and orderly functioning of corporate sector in a free market economy. A stock exchange need not be treated as a place for speculation or a gambling den. It should act as a place for safe and profitable investment, for this, effective control on the working of stock exchange is necessary. This will avoid misuse of this platform for excessive speculation, scams and other undesirable and anti-social activities.

London stock exchange (LSE) is the oldest stock exchange in the world. While Bombay stock exchange (BSE) is the oldest in India. Similar Stock exchanges exist and operate in large majority of countries of the world.

Characteristics or features of stock exchange are:

1. **Market for securities:** Stock exchange is a market, where securities of corporate bodies, government and semi-government bodies are bought and sold.
2. **Deals in second hand securities:** It deals with shares, debentures bonds and such securities already issued by the companies. In short it deals with existing or second hand securities and hence it is called secondary market.
3. **Regulates trade in securities:** Stock exchange does not buy or sell any securities on its own account. It merely provides the necessary infrastructure and facilities for trade in securities to its members and brokers who trade in securities. It regulates the trade activities so as to ensure free and fair trade
4. **Allows dealings only in listed securities:** In fact, stock exchanges maintain an official list of securities that could be purchased and sold on its floor. Securities which do not figure in the official list of stock exchange are called unlisted securities. Such unlisted securities cannot be traded in the stock exchange.

5. **Transactions effected only through members:** All the transactions in securities at the stock exchange are effected only through its authorised brokers and members. Outsiders or direct investors are not allowed to enter in the trading circles of the stock exchange. Investors have to buy or sell the securities at the stock exchange through the authorised brokers only.
6. **Association of persons:** A stock exchange is an association of persons or body of individuals which may be registered or unregistered.
7. **Recognition from Central Government:** Stock exchange is an organised market. It requires recognition from the Central Government.
8. **Working as per rules:** Buying and selling transactions in securities at the stock exchange are governed by the rules and regulations of stock exchange as well as **SEBI Guidelines**. No deviation from the rules and guidelines is allowed in any case.
9. **Specific location:** Stock exchange is a particular market place where authorised brokers come together daily (i.e. on working days) on the floor of market called trading circles and conduct trading activities. The prices of different securities traded are shown on electronic boards. After the working hours market is closed. All the working of stock exchanges is conducted and controlled through computers and electronic system.
10. **Financial Barometers:** Stock exchanges are the financial barometers and development indicators of national economy of the country. Industrial growth and stability is reflected in the index of stock exchange.

Commodity Market

Commodity market facilitates an exchange of physical goods among residents in a country. Individuals aiming to diversify their portfolio can undertake investments in both perishable and non-perishable products, thereby not only mitigating the risk factor, but also providing a hedge against inflation rates in an economy.

Types of Commodities in the market, available for trading are categorized into the following classes, based on their inherent nature:

Hard commodities:

Precious metals: Gold, platinum, copper, silver, etc.

Energy: Crude oil, Natural gas, gasoline, etc.

Soft commodities:

Agriculture: Soybeans, wheat, rice, coffee, corn, salt, etc.

Livestock and meat: Live cattle, pork, feeder cattle, etc.

As of 2019, some **examples of commodities in the market** that were most commonly traded in major commodity exchanges in India included crude oil and silver. While crude oil acts as one of the most important energy sources required for virtually every industry, silver is one of the most precious metals other than gold with a steady demand.

As crude oil is not domestically available in abundance, almost 82% of it is imported from OPEC and Middle Eastern countries. Similarly, silver is traded in extensive quantities from countries such as Mexico, Peru, etc.

Investing in the Commodity Market

Commodity trading is managed by four major commodity exchanges in India:

1. Multi Commodity Exchange (MCX)
2. Indian Commodity Exchange (ICEX)
3. National Commodity and Derivatives Exchange (NCDEX)
4. National Multi Commodity Exchange (NMCE)

All activities of such nationwide exchanges come under the regulation of Commodity Derivatives Market Regulation (CDMRD) of Securities and Exchange Board of India, which merged with Forward Market Commission in 2015.

Commodity markets facilitate an exchange of both physical goods and derivative contracts while the physical exchange is undertaken by institutional investors and commodity brokers aiming to realise gains through the resale of the products in the retail sector of the country.

Conversely, a derivative contract does not require a physical store of the goods procured, as individuals can trade commodities online through digitised contracts, making the transaction hassle-free and convenient.

Investors can practice **investing in commodity markets** through a futures or options contract. While a futures contract dictates individuals to sign a deed stipulating delivery of a product at a later date with respect to a fixed price, an options contract acts as an agreement but not a liability of the same.

Futures contracts

Future derivative trading is most common in the commodity market, wherein sellers sign a futures agreement with brokers/buyers to purchase a stipulated quantity of products at a given price. While a downtrend in the market prices can help sellers realise margin profits, a rising price can help buyers or brokers profit from the transactions.

If such trade is supervised by commodity exchange, it is known as a future derivative contract. Any settlement between two parties without any overseeing exchange is known as over the counter exchange trading.

Both exchange-traded and derivative future contracts are undertaken by two primary classes of investors producers aiming to reduce fluctuations in final good price, and speculators aiming to profit from the volatility of a futures contract.

Options contracts

As of 2017 SEBI regulations, options trading can be practised while investing in top commodities wherein traders enjoy a right but not obligation to purchase/ sell a commodity derivative at a fixed price. Partaking in commodity investment through such agreements help individuals profit from any market fluctuations, as no obligation regarding the purchase or sale of products is imposed on either of the parties, depending upon the type of options contract.

Relationship of the Commodity Market and Stock/Bond Market

One of the **features of a commodity market** is that its performance demonstrates an inverse relation with both stock and bond markets, as the bond and stock prices fall when the average price level of goods rise in the economy.

During times of rising aggregate price level or inflation, the prices of commodities traded on respective exchange rises significantly. As extreme inflation has a negative impact on consumers, the government often tries to tackle the situation by increasing the domestic lending rates through a repo rate hike. As the cost of borrowing rises, investors often reduce their speculative demand for stock market investments, making the prices of capital sector plummet.

The bond market is also affected as a result of such a hike in the lending rates levied by scheduled commercial banks, as interests on respective savings tools rise. Consequently, fixed coupon bonds indicate a relatively less profitable investment venture, thereby creating a surplus amount of bonds with reduced demand, causing bond prices to fall.

While bond and stock prices move in the opposite direction as compared to commodity prices, investment in commodities, especially in precious metals and energy sources, tend to generate significant returns for investors.

Traders in a Commodity Market

The **commodity markets holds importance** for two kinds of individuals based on the commodity market operations they partake in:

Hedgers

Such investors aim to reduce exposure to market volatility by entering into a futures contract with traders. Any change in the price level does not affect the rate at which respective commodities are traded in the market. Most hedgers trade physical goods in the commodities market, as they require the stipulated goods or production or resale purposes.

Speculators

Investors aiming to generate substantial profits from trade in the commodity market are termed as speculators. A prediction regarding the direction of movement of market prices are assumed by such individuals before signing a futures contract, and depending upon accuracy of market forecast, positive or negative returns can be realised, subject to spot prices.

Speculators don't desire physical possession of the goods traded, and hence, opt for a cash settlement to reduce the hassles of physical trading.

Price Determination

The prices of commodity markets are heavily dependent on the market demand and supply of commodities, both domestically and from foreign sources. Speculative news also affects the commodity prices heavily, as socio-economic conditions deeply influence the productive capacity of respective companies.

The factors affecting commodity prices in an economy are discussed below –

Market demand and supply

Market demand and consequent supply of goods traded on a commodity exchange heavily influence the market price. A rising demand (for any reason) can cause prices to rise in the short run, as supply cannot be increased immediately to compensate for the higher demand in the market. Generally, such a rise in demand can be attributed to a pessimistic performance outlook towards the stock market, thereby causing investors to shift towards relatively safer investment avenues.

Global scenario

Global indicators play a crucial role in determining the prices of commodities available internally in a country. For example, any turmoil in the Middle Eastern countries can affect the prices at which crude oil is exported, thereby affecting the prices at which it is traded domestically.

A significant example can be cited in this respect when a supply shock was experienced by all major countries in the world triggered by Iraq-Kuwait tensions in the 1990s.

External factors

Any condition affecting the total production of stipulated goods traded in an exchange can cause price changes accordingly. For example, a rise in the cost of production can drive up the prices at which a product is sold in the market, consequently affecting the equilibrium rate.

Also, the performance of the stock and bond market has an effect on the prices of commodities, as a negative viewpoint regarding their performances tends to divert investors towards commodity market securities. Individuals often trade in commodity derivatives to compensate for stock market risks, or to safeguard their portfolio from stock market downturns.

Speculative demand

Demand for derivative investing in commodities online can arise from speculative investors, who aim to realise profits through market price fluctuations. Speculators often make predictions regarding the direction of movement of prices and aim to close the contract before the expiration date to realise capital gains on total gains.

Individuals unwilling to take physical delivery of the goods can opt for cash settlement contracts, whereby upon completion of the tenure of the futures contract, the difference between the price in spot trading and price stated in the futures contract has to be paid.

Depending upon the market assumptions, individuals can assume either a short or a long position in a futures contract. Investors expecting the price to drop in the future can undertake a short position (sell the security at a fixed price on a stipulated date) to realise profits through a fall in the market price. On the other hand, if individuals expect the price of a commodity future contract to rise in the future, they can opt to go long (buy the security at a fixed price on a stipulated date) so as to sell the same at higher prices in the future.

Nonetheless, a futures contract tends to merge with the spot price at which a commodity is trading at a future date, as prices adjust automatically at the expected level.

Market outlook

Any unforeseen fluctuations in the stock market can cause investors to shift towards commodity trade, as chances of severe fluctuations in prices of certain commodities such as precious metals are low. Hence, commodity market investments are secure in nature and act as a hedge against inflation for risk-averse individuals.

Limitations

High risk

The commodity market is volatile, as any fluctuations in the productive capacity, demand, or changing social circumstances readily affect the prices. Due to such high volatility, predicting the movement of commodity prices might be challenging, causing investors to lose out substantial returns due to unforeseen market events.

Hence, individuals need to be well-equipped with both the internal working of an economy as well as external factors such as international trade before choosing to trade in commodities. Additionally, the demand and supply patterns should be kept in mind to mitigate the risk further.

Limited returns:

While stock and bond markets have periodic pay-outs such as dividend yields, coupon payments, etc. commodity investment can only generate capital gains.

While commodity market investments can reap significant returns, substantial expertise is required for the same. Nonetheless, individuals can trade in goods through any established commodity exchange by registering with a commodities broker.