PHOTO: RASHED SHUMON

Secrets of an informal commodity exchange

Millers and wholesalers established a trading system, known as supply orders (SOs), to speculate on the local prices of goods to make a windfall profit. If their prediction goes wrong, they suffer losses

AHSAN HABIB *and* SUKANTA HALDER

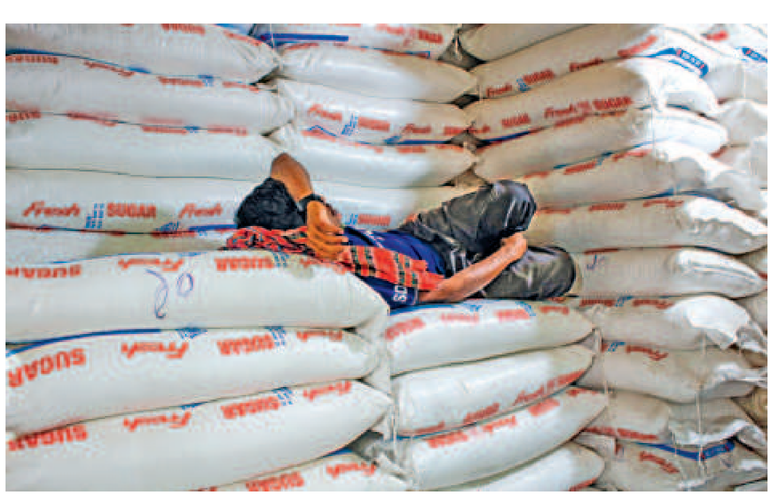
"We follow the international market to gauge the future movements of prices. Sometimes, our forecasts work and we make a profit, said Iqbal Hossain, who has been in the business for around 20 years

The narrow streets of Old Dhaka's Moulvibazar hum with activity: commodity trading. On mobile phones, wholesalers fervently follow prices on trading floors in Chicago and London to bet on the local prices of sugar and edible oil. In and around tea stalls in this gloomy corner of Dhaka, even idle chats are centred around the price movement on the London Commodity Exchange, the Chicago Board of Trade, and the Bursa Malaysia.

Discussions become animated over the going rates of sugar and edible oil in the global commodity markets, production and weather forecasts. The reason for their enthusiasm is that these individuals are businessmen looking to invest in supply orders (SOs), a price-sensitive commodity trading system operated by a network of refiners and wholesalers.

Wholesalers decide to buy or sell SOs of goods like sugar or edible oil, speculating on future prices to make a windfall profit. If a prediction goes awry, they incur huge losses. For example, wholesalers may pay an oil refiner in advance at a fixed rate for an SO, which can be used for the delivery of products at a future date. In the meantime, wholesalers buy and sell the SOs among each other at a margin when prices change, said Abul Hashem, president of the Bangladesh Sugar Traders' Association.

PHOTO: RAJIB RAIHAN



Individuals buy an SO if they believe the price will rise on the international market as a spike usually sends the price of the item upward in the local market as well.

At present, there are around 3,500 wholesalers who deal in SOs in Bangladesh. Each SO entitles the bearer to 16 tonnes of sugar priced at Tk 22 lakh or 6 tonnes of edible oil at Tk 7.5 lakh.

An SO is usually valid for up to 15 days after being issued. However, in reality, the contracts are honoured by refiners even if the SO-holders show up two months after the deadline, according to Hashem, also the general secretary of the Bangladesh Edible Oil Wholesalers Association.

"We follow the international market to gauge the future movements of prices. Sometimes, our forecasts work and we make a profit," said Iqbal Hossain, who has been in the business for around 20 years.

"However, sometimes they don't work, prices fall on the international market, and we incur losses."

Recently, many wholesalers suffered losses because they could not predict the depreciation of the local currency against the US dollar, which has appreciated by about 30 percent against the taka in the past two years.

In 2011, the SO system replaced its predecessor – delivery order (DO), an old system used by millers. The DO business began in the middle of the 1980s when refineries were set up and they started importing large quantities of edible oil and sugar. The DOs became invalid after the government enacted the Essential Commodities Distribution and Distributor Recruitment Order 2011 as the previous system was said to be offering the scope for manipulation.

Since the facilities needed working capital, they sold DOs to wholesalers, who invested funds seeking future returns. Afsar Uddin, a trader in Moulvibazar, launched his business in Khatunganj of Chattogram when Bangladeshi firms began to import palm oil in the late 1970s. At the time, the business relied on cash memos. Wholesalers bought the paper receipts when imported products were in transit on the seas. Before the ship docked in Bangladesh, the memos changed hands several times. When the ship reached the port, the person who held the memos collected the goods. After that, they were free to sell it to retailers.

Md Shafiul Ather Taslim, director for finance and operation at TK Group, one of the leading importers and processors of commodities in Bangladesh, said the DO system had no specific timeline for dealers to supply products.

However, under the SO system, they are obliged to deliver products within 15 days. "The rule to deliver within a specific time has brought a major change to the supply chain," Taslim added.

He claims that there is no scope for price hikes at the consumer level due to the SO business. "At the end of the day, the business through the SO system benefits consumers."

Prof MA Taslim, a former chairman of the economics department of the University of Dhaka, says the SO-based market is functioning well.

"This is why we don't hear complaints from anybody even if they incur losses due to the international price fluctuation. They know that there is a risk of racking up losses."

SO-holders are also honoured even if they demand products from refiners after a long time. "You can say that it is a formal market in their view. It has been running for many decades and no manipulation about this system has been reported yet," Prof Taslim said.

The economist urged the government to formalise the system instead of introducing commodity exchanges overlooking established businesses.

Does SO system impact prices of essentials?

AHSAN HABIB *and* SUKANTA HALDER

Some think that the existing supply order (SO) system is one of the reasons for the spike in the prices of essential goods such as sugar and edible oil simply because prices increase each time the document changes hands.

Others allege that big corporations sell SOs to favoured wholesalers, giving them the scope to drive up prices artificially.

However, wholesalers beg to differ, pointing to the fact that their profit margins are minimal. Since the number of SO-holders is high, it also reduces the scope for syndication, they say.

Ghulam Rahman, president of the Consumers Association of Bangladesh, told The Daily Star that prices of goods rose at least to some extent each time an SO changes hands.

He added that SO traders rarely incur losses, explaining that they only sell an order at a lower price than they had paid if they fear that the rate would fall in the international market.

In either case, the possibility that the price remains unchanged during the trade of an SO is very low.

Abul Hashem, president of the Bangladesh Sugar Traders' Association, denied that the informal trade had anything to do with price hikes and said a very limited number of SOs change hands. He added that their profit margins were minimal.

"How will consumers get the supply of products if wholesalers don't divvy up the trade?" he questioned, adding that refiners don't sell in meagre quantities.

Hashem further explained that costs would be much higher if all wholesalers were required to collect goods from millers and store them in their warehouses.

To save on rent for storage, they trade SOs while goods remain at local refineries.

Prof MA Taslim, a former chairman of the department of economics at the University of Dhaka, said wholesalers of SOs invest huge funds and take massive risks.

Usually, the prices of products are lower when acquired through the SO system compared to purchasing them at the mill gate. This is because products are traded in bulk amounts under the SO system, he added.

On the other hand, trading is centred around select goods such as sugar and edible oil. However, syndicates usually form in the cases of products such as rice, chicken, vegetables, or eggs, which are all produced locally.

"The problem is not related to the SO system; it lies elsewhere. The government should work on identifying that area," the economist added.

On the condition of anonymity, a wholesaler in Khatunganj, one of Bangladesh's largest wholesale hubs for essentials, said if SO documents of a certain product were confined to a few traders, they could form a syndicate and increase prices.

In the past, the document was traded only among wholesalers. Now an SO passes through many hands. Hence, there is a low chance of manipulation, he added.

Khondaker Golam Moazzem, research director of the Centre for Policy Dialogue, said when a single businessman is in control of a supply chain, it is natural that he or she dominate the market.

"The government should pay attention to the commodity market so that it can't be controlled by a handful of businessmen."

A top official of an oil refinery said the SO system helps overall business since wholesalers pour in funds in advance, extending financial support to refineries.

Traders are investing funds to make a profit, so SO trading is not inherently wrong. Moreover, the nature of the SO business is different from the delivery order (DO) system.

"Now, they are not making huge profits from the trading of SOs. So, its impact on price hikes is minimal," he said.

Prof Helal Uddin, a professor of economics at the University of Dhaka, said a common perception that prevailed among people was that price hikes are caused by SO trading.

"If a large group dominates prices, the government should definitely detect it. However, prices rise and fall in the market mainly owing to speculation."

He said if a foreign government takes a step that can impact the prices of goods, it can lead to rampant speculation.

"Under such a scenario, goods that may be affected are hoarded for several days. On the other hand, consumers are desperate to buy the goods as they speculate about further price increases. Ultimately, it creates a crisis in the market and raises prices. So, the problem does not lie with the SO business."

Helal recommended ensuring adequate imports of goods when prices are low on the international market so that the supply is abundant in Bangladesh.

"It will reduce abnormal price hikes. Moreover, the government should reduce duties on some essential goods to curb speculation."