A BASIS FOR THE DEVELOPMENT OF COMMODITY EXCHANGE IN NIGERIA

Francis Kehinde Emeni

Abstract
This paper presents a basis for the development of a commodity exchange in Nigeria. It is therefore proposed that the development of a commodity exchange is positively related to availability of market information, existence of a legal framework for commodity exchange and the existing policy framework in support of commodity exchange in Nigeria. The cross-sectional survey research design was used as the blueprint for data collection; while the t-statistic was used to analyse the data collected. It was found that, the development of a commodity exchange is positively associated with availability of market information and not with existing legal and policy framework in support of commodity exchange in Nigeria. Following from the result of this study, it was recommended that, adequate market information should be made available in the commodity market by embracing modern communication system, e.g. World Wide Web and Wide Area Networks which applies national and international communications.

Introduction
The economic growth and development of any nation depends on its investment potentials, while investment potentials of any nation depend on its natural resources endowment (Oluwatoyin and Sekuru, 2007). Economic development can be attained with the availability of a commodity exchange. This paper presents a basis for the development of a commodity exchange in Nigeria, given commodity markets. A commodity market is where raw or primary products (cereals, food items and so on) are sold without any form of official regulation. On the other hand, a commodity exchange is where raw or primary products are traded on regulated market, in which they are bought and sold in standardized contracts (Wikipedia, 2009).

According to Akinyosoye (1989), commodity exchanges are the closest to the theoretical perfectly competitive market. Futures market daily price quotations are available in the print media and up-to-the-minute reports on exchange prices are available in the offices of most commodity brokers. At any point in time there are thousands of buyers and sellers of futures contracts participating in the market, and there are an even greater number of potential participants. Prices are established through open trading on the floor of the exchange, where all buyers and sellers are represented either personally or via electronic communication through their brokers. The mechanism of the market is not, however, as simple as presented here and before establishing one, it is pertinent to understand the theoretical underpinning of what a commodity market
and commodity exchange is and also existing legal base and general policy environment for commodity trade. This is the focus of the next section of this paper.

As earlier stated, a commodity market is where raw or primary products are sold without any form of official regulation. Two types of commodity markets have been considered in Nigeria, namely; a market trading in both Security and Commodities as now planned by Abuja Securities and Commodity Exchange (ASCE); and a market dealing only in commodity trade – multi-commodities or single commodity. In respect of the former, the basic organizational framework recommended by Interministerial Technical Committee (ITC) with particular reference to integrate commodity market operation within ASCE has been accepted (Makinde, 1989).

ASCE is expected to carry-on business in stock, financial futures, and commodity trade. However, because of the peculiar nature of commodity trade, it is proposed that the commodity market operation of ASCE be carried out by a semi-autonomous department with operational independence. The Commodity market Department (CMD) is expected to operate under the policy and legal framework of ASCE through the ASCE Board of Directors. This institutional framework can be adopted by existing Exchanges and future promoters wishing to set-up a multi-purpose Exchange including trade on Securities Financial Futures and Commodities (SEC, 2004).

Following from the above, it could be submitted that the existing government policies, and legal framework – including the Companies and Allied Matters Act (2004), and Investment and Securities Act of 1999 are adjudged by the Nigerian Securities and Exchange Commission (SEC) to be sufficient for the development and operation of a multi-purpose Exchange such as ASCE, as a pure commodity exchange (SEC, 2004). However, the design of the market in particular the estimation of trade volumes and the related financial projections, have been hampered by a lack of reliable market information. Following from this submission, it is hereby hypothesized that:

\[ H_1: \text{The development of a commodity exchange is positively related to availability of market information.} \]

According to Idris (1989) there are some constraints for a viable commodity exchange in Nigeria. These include legal and regulatory frameworks, low trade volumes and lack of reliable production and market information amongst others. In addressing some of these constraints, there would be a need to effect some modifications in the SEC Act, to enable it accommodate the added role of commodities exchange. Likewise, the Banking Act makes it mandatory for any deposit – taker to be licensed as such with the Central Bank of Nigeria (CBN). By the very nature of commodity exchange transactions, the clearing houses of the Exchange as well as dealers do take and collect margins, premiums
and deposits. It may, therefore, be necessary to seek exemptions from these aspects of the Act for such bodies or organizations who are duly registered as dealers and clearing houses of the Exchange.

It should be noted that, commodity exchanges, otherwise known as, Futures Market Exchange (FME) are market places designed to facilitate trading in futures contracts. Futures contracts that are traded on commodity exchanges are promises to deliver or accept delivery of a specific commodity in the future (Akinyosoye, 1989). With the nature of the market arrangement, no physical commodities changes hands when the contract is traded and priced. Deliveries are made against the contract when it matures (or become due) in the month for which it is named (Shahabudin, 1989).

Akinyosoye (1989) further opines that, there is a trading floor, where buyers and sellers meet; a governing board or council, which sets and enforces the rules for orderly trading and a clearing house, which facilitates trading and delivery of commodities. The most viable aspect of the exchanges are the exchange floor and the trading “pits” where actual trades are made.

Legal and Regulatory Base for Commodity Trade

What is basically required is the establishment of a comprehensive system of regulation within a statutory framework based so far as possible on self-regulation of the Exchange subject to government surveillance (Idris, 1989). The ASCE can be said to be the most suitable and convenient organ to referee the commodity exchange as at today; given its closeness to commodities usually produced in the northern part of Nigeria and coupled with experience in the Securities Exchange.

The existing laws include the Banking and Other Financial Institutions Act (BOFIA, 1999), Investment and Securities Act (ISA, 1999), and the Companies and Allied Matters Act (CAMA, 2004). The BOFIA (1999) makes it mandatory for any deposit-taker to be licensed as such with the Central Bank of Nigeria. By the very nature of commodity exchange transactions, the clearing houses of the Exchange as well as dealers do take and collect margins, premiums and deposits. It may, therefore, be necessary to seek exemptions from these aspects of the Act for such bodies or organizations who are duly registered as dealers and clearing houses of the Exchange (Idris, 1989).

These laws (BOFIA, ISA, and CAMA) refer to the Nigeria Central Marketing Board, the Regional Marketing Boards, the Nigeria Produce Marketing Company, and the Produce Inspection Board none of which is currently functioning (Udoh, 1989). The functions of the Marketing Board and the Marketing Company have been taken over by the private companies following market liberalization. Although the Inspection Board is not currently functioning, there is the need to re-establish this Board in support of regulatory functions of the government (SEC, 2004). The Board constitution and functions
may be reviewed in the light of new government policies; as discussed in the next section of this paper. Following from this submission, it is hypothesized that:

\( H_2: \) The development of a commodity exchange is positively related to the existing legal framework for commodity exchange in Nigeria.

The General Policy Environment

An exchange will not operate in a vacuum. It will operate within a given socio-political and policy environment which, it may under normal situation also influence the macro-economic environment of a nation. According to Gold (1971), social environment is important for an effective development of an exchange as public opinion may influence government reaction to real or perceived problems caused by an exchange. For example, the public may be unaware that an exchange merely reflects market prices, and can blame the exchange for being responsible for price development that may be unfavourable to one group or the other. Producers may protest and castigate the exchange if prices fall, causing government to unnecessarily interfere in the exchange operations. An exchange should be aware of these real problems and counter their potentiality through public awareness and education programme. To this end, it is hypothesized that:

\( H_3: \) The development of a commodity exchange is positively related to the existing policy frameworks in support of commodity exchange in Nigeria.

Government policies particularly with respect to regulation of an exchange should be directed at ensuring exchange integrity and protection of users and not at influencing prices formed on the exchange. Government should not use the exchange to implement its pricing policies. Government should not interrupt trade arbitrarily, and physical market should not be disrupted by government policies as this will influence the process of price formation on the exchange and make it difficult for market participants to manage their operation and risk exposure. Any interventionist policies may reduce interest in using organized commodity markets, and should therefore be avoided (SEC, 2004).

According to Powers (1973) fiscal and monetary policies that lead to high inflation environment may erode the function of an exchange as a commodity hedge and heighten its use as an inflation hedge. Taxation policies can be used to provide incentives to use the exchange – for example, tax rebates may be granted farmers who sell their produce through the exchange; taxes and import duties collection may be delayed until the buyers take actual delivery of the commodity for importers who sell their imported goods through the exchange. This merely means that exchange is permitted to operate to operate bonded warehouses.
The government export liberalization policy augurs well for a commodity exchange. Nevertheless, relevant legislations and regulations need be visited and addressed towards identifying systematic bottlenecks which might affect the outward shipment of commodities bought on the Exchange for export purposes (Idris, 1989). Idris (1989) further opines that, it is necessary for government to put forward clearly discernible legal provisions for imports as are to be traded on the Exchange. It should be taken into consideration that prompt delivery obligations have to be met, and that the slightest variations in pre-accepted tariffs and other costs of shipment would have an adverse effect on pre-bargained prices. It certainly would be frustrating to allow laxities to impinge on the credibility of the Exchange.

Materials and Method
The commodities of interest in this paper are wood and cassava. The cross-sectional survey research design was adopted in this study given that data were collected at a given point in time. The market sampled by way of judgemental sampling techniques is the New Benin Market in Benin City. The Binis are blessed with rich forest that produce wood in abundance, which to a large extent informed the Benin wood carving and furniture making culture. Also, the climatic condition of Benin and it’s environ favours the production of cassava. However, one issue that presents major difficulty for the sellers of wood in Benin is the liability accruing to the purchaser: unless the wood can be guaranteed or insured to be free of liability based on where it came from and how it got to the market; such that the wood is free from claims that it comes from protected forests.

It should be noted that, the wood and cassava market in Benin is a ‘spot market’ and not a ‘forward market’. However, this spot market has not been sufficiently developed to provide the basis for developing a commodity exchange in Benin City. To be able to provide guidelines on how to transmit from a commodity market to a commodity exchange, the researcher administered questionnaires on staff of ICMG securities (stock brokers) and unions in charge of wood and cassava market in Benin City.

Results and Discussions
The t-statistic was used to test the assumptions made in this study. The result of the t-test is as shown below:

1. $H_{01}$: The development of a commodity exchange is not positively related to availability of market information.

   $H_{A1}$: The development of a commodity exchange is positively related to availability of market information.
Francis Kehinde Emeni

t-test: Paired Two Sample for Means

<table>
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<tr>
<th>Variable 1</th>
<th>Variable 2</th>
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<td>Mean</td>
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</tbody>
</table>

Source: research result compiled from the third t-statistic and Pearson correlation via excel computer package.

t test = 0.002, df = 4
\[ t^* = t \text{ critical two tailed} = 2.7765 \]
\[ t = t \text{ calculated} = 4.4163, \quad t > t^* \]

Decision rule: Since \( t > t^* \), accept \( H_{A1} \) and reject \( H_{01} \)

Following from the above, the first t-test result reveals that calculated t-value of 4.4163 is greater than the table t-value of 2.7765. Also, the Pearson correlation of -1 shows a strong association between the development of a commodity exchange and availability of market information in Nigeria. Therefore, it can be concluded that, the development of a commodity exchange is positively related to availability of market information. This result tends to agree with the submission of Idris (1989) in literature, that one of the constraints for a viable commodity exchange in Nigeria is lack of market information.

2. \( H_{O2} \): The development of a commodity exchange is not positively related to the existing legal framework for commodity exchange in Nigeria.

\( H_{A2} \): The development of a commodity exchange is positively related to the existing legal framework for commodity exchange in Nigeria.
t-test: Paired Two Sample for Means

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Source: research result compiled from the third t-statistic and Pearson correlation via excel computer package.

\[ t = \frac{0.002}{4} \]
\[ t^* = t \text{ critical two tailed} = 2.7765 \]
\[ t < t^* \]

Decision rule: Since \( t < t^* \), reject \( H_{A2} \) and accept \( H_{02} \)

The second t-test result reveals that, the calculated \( t \)-value of 0.5345 is less than the table \( t \)-value of 2.7765. However, the Pearson correlation of \(-1\) shows a strong association (opposite direction) between the development of commodity exchange and existing legal framework for commodity exchange in Nigeria. It can therefore be concluded that, the development of exchange is not positively related to the existing legal framework for commodity exchange in Nigeria. This result tends to disagree with the submission of Idris (1989) in literature, that one of the constraints for a viable commodity exchange in Nigeria is the existing legal and regulatory framework for commodity exchange. The implication of this is that, the existing legal framework for commodity marketing in Nigeria should be sustained, though with some refinement to reposition it for the current globalization of the financial system.

3. \( H_{03} \): The development of a commodity exchange is not positively related to the existing policy frameworks in support of commodity exchange in Nigeria.

\( H_{A3} \): The development of a commodity exchange is positively related to the existing policy frameworks in support of commodity exchange in Nigeria.
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t-test: Paired Two Sample for Means

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</tbody>
</table>

Source: research result compiled from the third t-statistic and Pearson correlation via excel computer package.

\[
t - test = 0.002, \quad df = 4
\]
\[
t* = t \text{ critical two tailed} = 2.7765
\]
\[
t = t \text{ calculated} = 0.1557, \quad t < t^*
\]

**Decision rule:** Since \( t < t^* \), reject \( H_{A3} \) and accept \( H_{03} \)

The third \( t \) – test result reveals that, the calculated \( t \) – value of 0.1557 is less than the table \( t \) – value of 2.7765. However, the Pearson correlation of -0.9 shows a strong association (opposite direction) between the development of commodity exchange and existing policy framework in support of commodity exchange in Nigeria. It can therefore be concluded that, the development of a commodity exchange is not positively related to the existing policy framework in support of commodity exchange in Nigeria. Likewise as in the case of the legal framework, the implication of this result is that, the existing policy framework for commodity marketing which was found not to be too relevant in a generalized and deregulated marketing system should be sustained.

**Conclusion**

In this paper, I have examined factors necessary for the development of a commodity exchange in Nigeria. Beginning with a general discussion of the subject matter I moved to the theoretical underpinnings and reviews of extant literature towards development of a commodity exchange in Nigeria. The claim in extant literature that the development of a commodity exchange is positively related to availability of market information was found to be true. However, the theoretical claims that the development of a commodity exchange is positively related to the existing legal framework for commodity exchange in Nigeria and...
the existing policy framework in support of commodity exchange in Nigeria is not true.

**Recommendations**

Thus in this direction, it is recommended that:

1. The communication system in place in Nigeria should be improved upon. Access to Global Service Mobile (GSM) as it were in Nigeria today is encouraging, but there is need to introduce easier access by the populace to e-service via the internet. This will make for easier communication and service delivery which is a panacea for a successful commodity exchange; for example, see Fama (1970) influential survey article, “Efficient capital market” - It was generally believed that for securities markets to be efficient it must reflect information about individual stocks and about the stock market as a whole.

2. On the other hand, even though the current policy and legal framework for commodity marketing in Nigeria is sustainable, they will need refining and expansion to support market risks management and cater for the different interests of diverse market players. The refinement and expansion required need not delay the establishment and operation of a commodity exchange market as the existing legal and policy framework is adequate to commence operation.

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