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Investors Preference For Financial And Commodity Derivatives – With Special Reference To South Goa

Savina Annie Rebello

Assistant Professor, M.E.S College of Arts & Commerce

Abstract: ***Derivatives have fundamentally changed financial management by providing new tools o manage risk. What makes derivatives important is the role it plays in fostering new ways to manage risks that are involved in traditional instruments which can be managed more efficiently with help of derivatives. In India most of the investors are risk averse. If you invest in traditional instruments you have to face risk but if the investors use derivatives they can reduce or mitigate their risk. This paper tries to know about their risk preference, the awareness of derivatives, and also the investor's preference for commodity or financial derivatives.***

I. INTRODUCTION

The concept derivatives originate in mathematics and refer to a variable which has been derived from another variable. A derivative is a financial product which has been derived from another financial product or commodity. Derivatives do not have an independent existence without an underlying product or asset. The underlying asset may be financial or non-financial. Derivatives provide an effective solution to the problem of risk caused by uncertainty and volatility in underlying asset. Traders can assume highly leveraged positions at low transaction costs using these extremely flexible instruments. Derivative products like index futures, stock futures, index options and stock options have become important instruments of price discovery, portfolio diversification and risk hedging in stock markets all over the world in recent times. With the introduction of all the above-mentioned derivative products in the Indian markets a wider range of instruments are now available to investors. The emergence of derivatives market is an ingenious feat of financial engineering that provides an effective and less costly solution to the problem of risk that is embedded in the price unpredictability of the underlying asset.

II. LITERATURE REVIEW

Ashutosh Vashishtha and Satish Kumar (2010) studied the development of financial markets in India. The paper studies how risk management is possible in an uncertain business scenario with the introduction of derivatives trading in India in June 2000. SEBI permitted the derivatives segments of NSE and BSE and their clearing houses to commence trading and settlement of derivatives contracts. Since then derivatives market has witnessed a tremendous growth in India in terms of number of traded contracts.

Nagaraju (2014) the study was conducted on "A study on Investors' Perceptions towards Derivative Instruments and Markets". This paper mainly focused investor's perception towards different types of derivative instruments that is Index Futures, Stock Futures, Index Options, Stock Options, Interest Rate Futures, and Currency Options. The study aimed to know about the investors preferences to derivative instruments.

Midhula Mohan K and A V Hemalatha (2016) the study was conducted to find out the awareness about investments in derivatives market among government employees in Calicut district of Kerala. The paper aimed at studying the level of awareness of government and aided employees on derivative trading. And to assess whether any difference exist in the level of awareness among the employees based on gender, locale and type of management. The sample size for the study was 100 based on convenience sampling. Based hypothesis testing it was found that there is a significant difference in the level of

awareness among investors based on gender, locale and type of management.

Dr. SP. Dhandhayuthapani and K. Sarathkumar (2016): The paper studies the investor's attitude towards derivatives market and awareness about derivative market. The sample size for the study was 200 respondents based on convenience sampling. From the study it was found that male respondents as compared to females invest in derivatives. It was also found that higher education plays an role in derivatives trading. And after derivatives investments the next preferred choice for investments was stocks.

DEFINITION OF DERIVATIVES

Section 2(ac) of Securities Contract Regulation Act (SCRA) 1956 defines Derivative as:

- ✓ "A security derived from a debt instrument, share, loan whether secured or unsecured, risk instrument or contract for differences or any other form of security;
- ✓ "A contract which derives its value from the prices, or index of prices, of underlying securities".

UNDERLYING ASSET IN A DERIVATIVES CONTRACT

As defined above, the value of a derivative instrument depends upon the underlying asset. The underlying asset can be securities, commodities, bullion, currency, livestock or anything else. In other way the underlying asset may assume many forms:

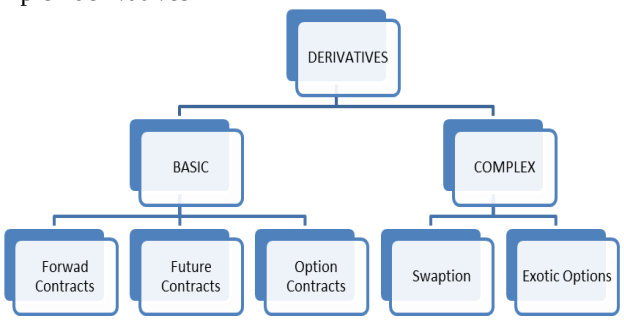
- ✓ Commodities including grain, coffee beans, orange juice;
- ✓ Precious metals like gold and silver;
- ✓ Foreign exchange rates or currencies;
- ✓ Bonds of different types, including medium to long term negotiable debt securities issued by governments, companies, etc.
- ✓ Shares and share warrants of companies traded on recognized stock exchanges and Stock Index
- ✓ Short term securities such as T-bills; and
- ✓ Over- the Counter (OTC) money market products such as loans or deposits.

PARTICIPANTS IN DERIVATIVES MARKET

- ✓ *HEDGERS:* They use derivatives markets to reduce or eliminate the risk associated with price of an asset. Majority of the participants in derivatives market belongs to this category.
- ✓ *SPECULATORS:* They transact futures and options contracts to get extra leverage in betting on future movements in the price of an asset. They can increase both the potential gains and potential losses by usage of derivatives in a speculative venture.
- ✓ *ARBITRAGEURS:* Their behavior is guided by the desire to take advantage of a discrepancy between prices of more or less the same assets or competing assets in different markets. If, for example, they see the futures price of an asset getting out of line with the cash price, they will take offsetting positions in the two markets to lock in a profit.

III. CLASSIFICATION OF DERIVATIVES

Derivatives can be classified as basic derivatives and complex derivatives



FORWARD CONTRACT

A forward contract is a customized contract between the buyer and the seller where settlement takes place on a specific date in future at a price agreed today. In case of a forward contract the price which is paid / received by the parties is decided at the time of entering into contract. It is simplest form of derivative contract mostly entered by individual in day to day life. It is contract for delivering the goods. These transactions are spot transactions. It is also known as "specific delivery contract".

FUTURE CONTRACTS

A futures contract is an agreement between two parties to buy or sell a specified quantity of an asset at a specified price and at a specified time and place. Future contracts are normally traded on an exchange which sets the certain standardized norms for trading in futures contracts.

OPTION CONTRACTS

Options are derivative contract that give the right, but not the obligation to either buy or sell a specific underlying security for a specified price on or before a specific date.

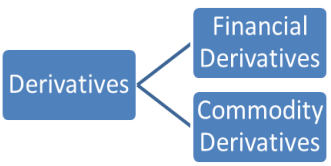
Options are of two types

- ✓ Call option
- ✓ Put option

CALL OPTION: Call option gives the holder the right but not the obligation to buy an asset by a certain date for a certain price.

PUT OPTION: Put option gives the holder the right but not the obligation to sell an asset by a certain date for a certain price.

Derivatives can also be classified based upon the underlying asset



In case of commodity derivatives, underlying asset can be commodities like wheat, gold, silver etc., whereas in case of financial derivatives underlying assets are stocks, currencies, bonds and other interest rates bearing securities etc.

IV. HISTORY

Derivatives markets in India have been in existence in one form or the other for a long time. In the area of commodities, the Bombay Cotton Trade Association started futures trading way back in 1875. In 1952, the Government of India banned cash settlement and options trading. Derivatives trading shifted to informal forwards markets. In recent years, government policy has shifted in favour of an increased role of market-based pricing and less suspicious derivatives trading. The first step towards introduction of financial derivatives trading in India was the promulgation of the Securities Laws (Amendment) Ordinance, 1995. It provided for withdrawal of prohibition on options in securities. The last decade, beginning the year 2000, saw lifting of ban on futures trading in many commodities. Around the same period, national electronic commodity exchanges were also set up.

Derivatives trading commenced in India in June 2000 after SEBI granted the final approval to this effect in May 2001 on the recommendation of L. C Gupta committee. Securities and Exchange Board of India (SEBI) permitted the derivative segments of two stock exchanges, NSE3 and BSE4, and their clearing house/corporation to commence trading and settlement in approved derivatives contracts. Initially, SEBI approved trading in index futures contracts based on various stock market indices such as, S&P CNX, Nifty and Sensex. Subsequently, index-based trading was permitted in options as well as individual securities. The trading in BSE Sensex options commenced on June 4, 2001 and the trading in options on individual securities commenced in July 2001. Futures contracts on individual stocks were launched in November 2001. The derivatives trading on NSE commenced with S&P CNX Nifty Index futures on June 12, 2000. The trading in index options commenced on June 4, 2001 and trading in options on individual securities commenced on July 2, 2001.

November 9, 2001	Single stock futures were launched
June 2003	NSE introduced Interest Rate Futures.
September 13, 2004	Weekly Options at BSE
January 1, 2008	Trading of Chhota(Mini) Sensex at BSE
January 1, 2008	Trading of Mini Index Futures & Options at NSE
August 29, 2008	Trading of Currency Futures at NSE
October 2, 2008	Trading of Currency Futures at BSE
Aug. 2009	Launch of interest rate futures at NSE
7th Aug. 2009	BSE-USE form alliance to develop currency & interest rate derivative markets
18th Dec. 2009	BSE's new derivatives rate to lower transaction costs for all
Feb. 2010	Launch of currency future on additional currency pairs at NSE
Apr. 2010	Financial derivatives exchange award of the year by Asian Banker to NSE
July 2010	Commencement trading of S&P CNX Nifty futures on CME at NSE
Oct. 2010	Introduction of European style stock option at NSE and Currency options on USD INR by NSE
July 2011	Commencement of 91 day GOI trading Bill futures by NSE
Aug. 2011	Launch of derivative on Global Indices at NSE
Sep. 2011	Launch of derivative on CNX PSE & CNX infrastructure Indices at NSE
30th March 2012	BSE launched trading in BRICSMART indices derivatives.

Data compiled from BSE and NSE website

OBJECTIVES OF THE STUDY

- ✓ To find out the investors risk preference.
- ✓ To study the investors awareness about derivatives markets.
- ✓ To understand the preference of the investors relating to financial or commodity derivatives.
- ✓ To understand the relationship between the age and portion of savings kept aside for the purpose of investments in various investment avenues.
- ✓ To study the relationship between the educational qualification and investment avenues.

V. RESEARCH METHODOLOGY

A Research design is purely and simply the framework of plan for a study that guides the collection and analysis of data. The study is intended to find the investors preference towards cash market and derivatives. The study design is descriptive in nature.

SAMPLING DESIGN

- ✓ Selection of study area: The study area is in South Goa.
- ✓ Selection of the sample size: 100

SAMPLING METHODS

Convenience method of sampling is used to collect the data from the respondents. Researchers or field workers have the freedom to choose whomever they find, thus the name "convenience". About 100 samples were collected from South Goa and most of the respondents were customers coming in to stock broker's office and certain addresses were collected from reputed brokers.

FORMULATION OF THE QUESTIONNAIRE

DATA COLLECTION

- ✓ Primary data: collected through Structured Questionnaire.
- ✓ Secondary data: Earlier records from journals, magazines and other sources

Tools used for data analysis

- ✓ Coefficient of Correlation
- ✓ Mode
- ✓ Simple percentage method

Limitations of the study

- ✓ Time was a limiting factor.
- ✓ Only those investors who deal in capital markets are considered.
- ✓ Respondent's bias was another limiting factor

VI. DATA ANALYSIS AND INTERPRETATION

A. THE CORRELATION BETWEEN AGE GROUP AND PORTION OF SAVINGS KEPT ASIDE FOR INVESTMENT PURPOSE

Age group (x)	No. of respondents	Investment portion (y)	No. of respondents
✓ 18-25 years	15	✓ Below 25%	20
✓ 26-35 years	40	✓ 25-50%	35
✓ 36-45 years	25	✓ 50 -75 %	20
✓ 46 years and above	20	✓ Above 75 %	25

Source: primary data

Table 1

Therefore, there is a positive correlation between the age and portion of savings kept aside for investment purpose.

r=0.873

B. THE TIME PERIOD OF INVOLVEMENT IN TRADING IN THE DERIVATIVES MARKET

Involved in derivatives market	No. of respondents
✓ Below 1 year	10
✓ 1-3 years	15
✓ Above 3 years	35

Source: primary data

Table 2

Therefore the number of respondents involved in derivatives market is above 3 years.

Mode = 35

C. INVESTORS PREFERENCE FOR DERIVATIVE CONTRACTS IN SOUTH GOA

Preference of derivatives	No. of respondents
✓ Commodity derivatives	15
✓ Financial derivatives	35
✓ Both	10

Source: primary data

Table 3

Therefore the preference for financial derivatives is the highest.

Mode = 35

D. THE CORRELATION BETWEEN EDUCATION QUALIFICATION AND INVESTMENT AVENUES

Education Qualification (x)	No. of respondents	Investment Avenues (y)	No. of Respondents
✓ SSC	10	✓ Shares	10
✓ HSSC	15	✓ Mutual Funds	7
✓ Graduate	25	✓ Derivatives	60
✓ Post Graduate	35	✓ Bank Deposits	20
✓ Others	15	✓ Others	3

Source: primary data

Table 4

Therefore there is a positive correlation between education qualification and investment avenues.

r=0.48

E. THE UNDERLYING ASSET WHICH IS PREFERRED IN CASE OF COMMODITY DERIVATIVES

Underlying asset for commodity derivatives	No. of Respondents
✓ Bullion	7
✓ Agriculture	2
✓ Metal	10
✓ Energy	1

Source: primary data

Table 5

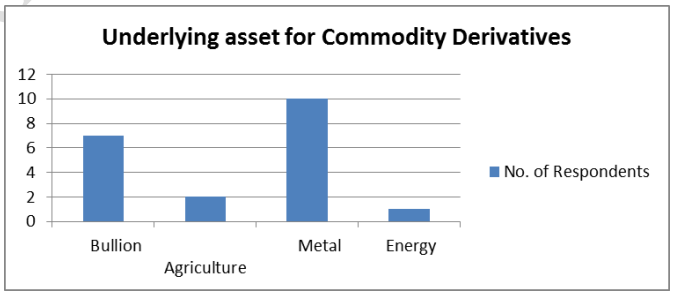


Figure 1: Underlying Asset for Commodity Derivatives

Therefore metal as an underlying asset for commodity derivatives is highly preferred, followed by bullion, agriculture and energy.

F. THE UNDERLYING ASSET WHICH IS PREFERRED IN CASE OF FINANCIAL DERIVATIVES

Underlying asset for commodity derivatives	No. of Respondents
✓ Bullion	7
✓ Agriculture	2
✓ Metal	10
✓ Energy	1

Source: primary data

Table 6

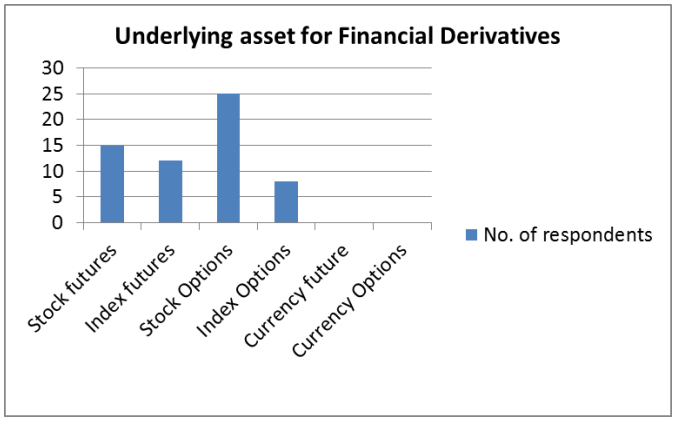


Figure 2: Underlying assets for Financial derivatives

Therefore stock options are highly preferred followed by stock futures, index futures and index options. They do not prefer currency futures and currency options.

G. THE PERIOD OF THE CONTRACT PREFERRED BY INVESTORS IN THE DERIVATIVES MARKET

Time period of the contract	No. of respondents	Percentage
✓ 1 month	30	50%
✓ 2 months	20	33.33%
✓ 3 months	10	16.67%

Source: primary data

Table 7

Nearly 50% of the respondents prefer a one month derivative contract, 33.33% of the respondents prefer a two months derivative contract and the remaining 16.67% prefer a three months derivative contract.

VII. CONCLUSION

From the study which has been conducted with reference to investors preference relating to Financial or Commodity Derivatives in South Goa the following conclusions are drawn:

- ✓ By using coefficient correlation we have found a positive correlation between the age group and the savings portions in different investment avenues. It has been observed that people between the age group of 26-35 years are investing a higher portion of their savings as compared to other age groups. As they grow older the portion of savings reduces since it is the time where they start withdrawing their investments.
- ✓ Most of the traders in the derivatives market is involved in trading for a period above 3 years while few are involved in less than 1 year
- ✓ Out of the survey most of the respondents prefer derivatives which is then followed by bank deposits which implies that more qualified an investor is, much more knowledge he has about the market so he prefers derivatives.
- ✓ In case of investors of commodity markets they highly prefer metal has the underlying asset and the second most preferred underlying asset is bullions.
- ✓ In case of financial derivatives investors highly prefer stock options which are followed by stock futures, index futures and index options. While the investors in our study do not trade in currency futures and currency options.
- ✓ 50% of the investors interviewed by us enter into a derivatives contract for a time period of 1 month, 33.33% investors derivatives contract is for 2 months while the remaining 16.67% derivatives contract is for 3 months.
- ✓ From this study we can thus conclude that the investors in South Goa prefer to invest in derivatives market and they are aware of derivatives but still there is a need to spread more awareness of derivatives in Goa since they second most preferred investment avenue is still bank avenues which means that people still stuck on the traditional methods of investments.
- ✓ An in South Goa most of the investors prefer more of financial derivatives as compared to commodity derivatives.
- ✓ Most of the investors restrict themselves from trading in derivatives market because the margin money is higher as compared to equity markets, and also those who are not highly qualified feel that dealing in derivatives is difficult and complex.

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