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Growth of Futures & Options (F&O) Markets in India

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Abstract:

Indian derivatives markets witnessed a considerable growth during last decade. The growth derivatives contributed a significant role in overall growth of the GDP of the country. Derivatives are the financial instruments which are traded in future market segments. The risk factor in derivatives products is higher comparing with other financial instruments which are available in financial markets.

The present paper studied and analyses the growth of the derivatives and its impact on economy. This paper also focused the factors which are influencing the fluctuations in futures and options markets.

Keywords: derivatives, markets, growth, financial instruments, and economy.

1. Introduction:

In Futures Market, a futures contract is a commitment to buy or sell a specific commodity, financial instrument or index, of designated quality at a specified price at a specified date in the future. The futures market consists of contracts to make or take delivery in commodities, financial instruments or indexes. This market is to take one of three possible positions.

- Speculate on anticipated price movements
- Hedge an existing or anticipated position that they may have in the cash (spot) market
- Arbitrage inconsistent prices among financial securities

A future is an exchange-traded derivative which is similar to a forward. Both futures and forwards represent agreements to buy/sell some underlying asset in the future for a specified price. The fundamental difference between futures and forwards is the fact that futures are traded on exchanges, like a stock. Instead of buying and selling a forward contract, outside stock exchanges, futures can be bought and sold on a regulated, transparent market which is provided by a stock exchange. Futures were created to solve the problems which existed with the forward contracts, namely counter party risk and liquidity. If one of the parties default or declares bankruptcy, the other party suffers exposing the contract to a risk of settlement. There is too much generality and flexibility in designing forward contracts which make them convenient in a specific situation but makes them non-tradable and illiquid. To make futures tradable and liquid, the Exchange specifies certain standard features of the contract. It is a standardized contract with a standardized underlying, a standardized contract size and a standardized settlement.

Features of Futures & Options (F&O) Market

Organized: Commodity Futures contracts always traded in an organized exchange, e.g. NCDEX, MCX, etc. in India and NYMEX, LME, COMEX etc. internationally.

Standardized: Commodity Futures contracts are highly standardized with the quality, quantity, and delivery date, which are predetermined.

Eliminates Counterparty Risk: Futures exchanges use clearing houses to guarantee that the terms of the futures contract are fulfilled. The Clearing House guarantees that the contract will be fulfilled, eliminating the risk of any default by the other party.

Facilitates Margin Trading: Futures traders do not have to put up the entire value of a contract. Rather, they are required to post a margin that is roughly up to 8% of the total value of the contract (this margin varies across exchanges and commodities). This facilitates taking of leveraged positions.

Closing a Position: Futures markets are closely regulated by government agencies, e.g. SEBI in India, Commodity Futures Trading Commission in (CFTC) USA, etc. This ensures fair practices in these markets.

Regulated Markets Environment: Commodity Futures contracts are highly standardized with the quality, quantity, and delivery date, being predetermined by the recognized exchange.

2. History of Futures Trading:

A future trading has a long history. Though the modern trade in future contracts could trace its origins back to the 17th century in Osaka, Japan, there is evidence to suggest that a form of futures trading in commodities existed in China 6000 years earlier. Organized trading On an exchange started in the year 1848 with the establishment of the Chicago Board of Trade (CBOT).

Future trading in India is started in late 19th Century in the Marwari business community. The first organized futures market was established in the year 1875 by the Bombay cotton trade association and later future trading in Raw Jute and Jute goods began in Calcutta with the establishment of the Calcutta Hessian Exchange Ltd., in 1919.

2.1 Recent Developments in Futures & Options Markets:

Last three decades witnessed a significant growth in Futures and Options markets development.

The trading volume of the futures contracts in Chicago Mercantile Exchange trading is more than 70 percent on its overall segments this shown the growth of the futures contracts in global markets. In the year 2010 the exchange unveils a novel system of electronic trading, known as After®. After® extends the potential volume of processing of information and allows the Exchange to increase its overall volume of trading activities.

3. Objectives of Study:

1. To study the growth of the Futures and Options (F&O) Markets in India
2. To analyses the performance of the Derivatives markets
3. To study the factors influencing the performance of markets
4. To analyses the fluctuations in Futures and Options markets
5. To suggest necessary recommendations to investors for better returns

4. Literature Review:

There has been a different path of studies concerning financial sector reforms in general and capital market reforms in particular, since new industrial policy implemented in India. This part highlights important studies that are context relevant.

In India derivatives trading was introduced Index Futures Contracts from June 2000 and stock option trading in July 2001 grown very fast to reach an average daily turnover of derivatives at NSE, at Rs. 33,745 crores during May 2006 as against cash markets turnover of about Rs. 9202.15 crores (as on May 2006), which indicates the importance of the derivatives. Normally the derivative turnover is three to four times the cash market turnover in India.

Shah and Thomas (2003) review the changes which took place on India's equity and debt markets in the decade of the 1990s. This has focused on the importance of crises as a mechanism for obtaining reforms.

Gurumurthy (2006) arrives at the conclusion that the achievements in the financial sector indicate that the financial sector could become competitive without involving unhealthy competition, within the constraints imposed by the macroeconomic policy stance. Mohan (2007) reviews India's approach to financial sector reforms that set in process since early 1990s.

Shenbagraman (2004) reviewed the role of some non-price variables such as open interests, trading volume and other factors, in the stock option market for determining the price of underlying shares in cash market. The study covered stock option contracts for four months from Nov. 2002 to Feb. 2003 consisting 77 trading 49 days. The study concluded that net open interest of stock option is one of the significant variables in determining future spot price of underlying share. The results clearly indicated that open interest based predictors are statistically more significant than volume based predictors in Indian context.

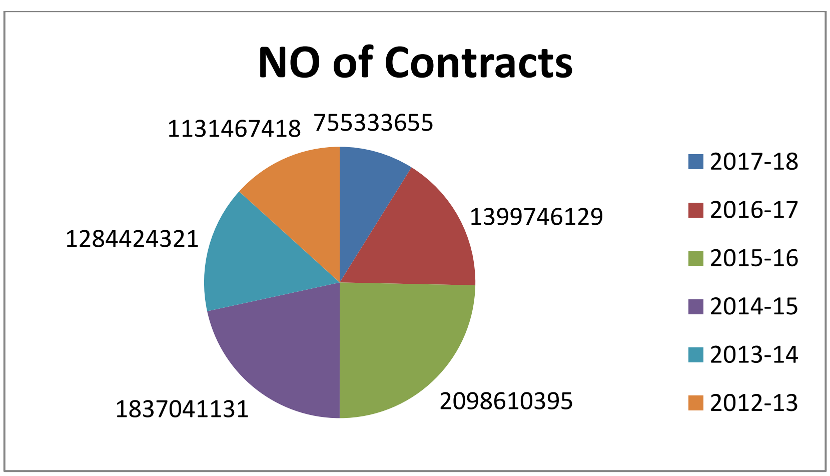
While examining the volatility spillover, Abhyankar (1995), Tse (1999) and Min (1999) have documented that unlike a lead-lag relation, there is a bi-directional or contemporaneous relationship among the spot and the derivative markets, with bad news having a greater impact on volatility, and the relationship is entirely sample period dependent.

5. Analysis of study: The following table is considering for the analyzing the performance of the Futures and options markets for the proposed research study during the study period FY 2012-13 to 2017-18.

Year	**NO of Contracts**	**Turnover (₹ Cr)**
2017-18	755333655	62599465.7
2016-17	1399746129	94370301.61
2015-16	2098610395	64825834.3
2014-15	1837041131	55606453.39
2013-14	1284424321	38211408.05
2012-13	1131467418	31533003.96

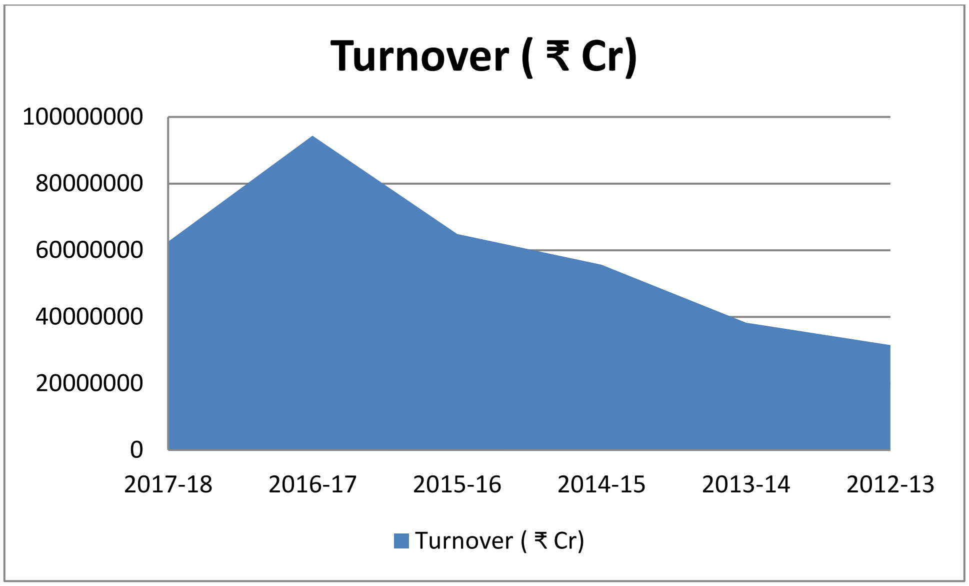
INTERPREATION: From the above table it clearly shown us there is market fluctuations in terms of no of contracts and overall turnover of the market. The market is witnessed ups and downs during last five years. Various factors are around globally influencing the fluctuations in derivatives market.

5.1 Analysis on No of contracts



The figure shown us there is significant growth in the size of contracts during the last five years and also noted that there is a decrease in size of contracts especially during the year 2016-17 due market slow down and also other reasons like drought and fall down in GDP etc.

5.2 Analysis on Turnover of the Futures and options market



INTERPREATION: There a continuous growth in futures and options markets in terms of the overall turnover at the same time we can clearly identified there is down fall in the year 2017-18 the current year this has occurred due to the financial reforms taken by the government during last year and other factors like slowdown in agriculture sector.

6. **Conclusion:** From the above study it clearly identified there is volatility in market that resulted in overall returns of the investors in futures and options market. This segment in India much influenced by the political and fiscal reforms taken by the government. The market is heavily influenced by the agriculture sector growth especially in commodity segment. The investors who want to invest in futures and options market consider the risk factors and follow the short hedges to avoid the heavy losses in futures markets.

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