THE STUDY OF INVESTOR'S PERCEPTION TOWARDS DERIVATIVES

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ABSTRACT

Derivatives, have an revolutionary impact on the global financial industry, are now held in the highest regard among all other financial products. The use of derivatives in multi-party risk management is becoming increasingly common. Through the use of derivatives, risk can be shifted from those who are unwilling to bear it to those who are prepared to do so. India's new equity derivatives market has been met with an outpouring of support and enthusiasm. The derivatives market on the NSE now handles more volume than the equity market. Investors' views on derivatives are investigated in the present research. The study relies heavily on survey responses from individual investors as its primary data source. The current study demonstrates that when deciding whether or not to invest in derivatives, investors consider various factors, including the recommendations of financial advisors and brokers, risk management, product familiarity, and stock market volatility.

Keywords: Financial Wall Street, Stock Exchange, Derivatives, Forwards, Investor Discretion.

INTRODUCTION

For India's economy, the introduction of derivative products and the subsequent growth of derivative markets was a turning point. Even though derivatives have many advantages, their proponents concede that the term "derivatives" itself raises many questions and that the public tends to view them skeptically. But derivatives are a cutting-edge tool for hedging against losses, allocating scarce resources, and dividing up the risk inherent in productive investment projects. The study aimed to debunk myths and unearth more proof of the positive role derivatives play in the economy. This research aims to shed light on how Indian investors think and behave in the derivatives market.

OUT-OF-RANGE DATA INTERPRETATION

A derivative's worth is tied to the worth of some underlying asset. One common form that these arrangements take is an agreement to make payments to one another at a future date based on the value of some underlying asset or other data. Futures, forwards, options, and swaps make up the vast majority of the derivatives market.

It's possible for one party to use a derivative to protect themselves from financial loss, while the other uses it to profitably increase their exposure to risk in exchange for a higher rate of return. There is a huge market for derivatives contracts due to the wide variety of underlying assets and settlement methods.

Derivatives can be based on a wide variety of assets, including commodities, stocks, bonds, interest rates, exchange rates, and indices (such as a stock market index, consumer price index (CPI) — inflation derivatives — or even a weather index). The size and timing of their reward will depend on how well they perform.

As the name "Derivative" implies, the instrument's worth is "derived" from that of the underlying asset. A security, commodity, bullion, currency, livestock, or any other valuable item could serve as the underlying asset. A "derivative" is a contract whose value is derived from the value of another asset, such as a fixed-term contract, forward contract, future contract, option, or hybrid contract.

The Securities Laws (Second Amendment) Act of 1999 reclassified derivatives as securities. Under the Securities Contracts (Regulations) Act, a derivative is any debt instrument, share, loan (secured or unsecured), risk instrument, or contract for differences whose value is derived from the price or index of prices of underlying securities.

HYPOTHESES AND THEIR DEVELOPMENT

Established in 1848, the Chicago Board of Trade (CBOT) had standardised forward contracts for a wide range of commodities by 1865. Futures contracts haven't changed much since then. The derivatives market in India has been around for a long time. The Cotton Trade Association standardised cotton trading in India in 1875, ushering in the country's first commodity derivatives market. Since then, numerous novel varieties of commodity contracts have emerged.

The first Indian stock exchanges to provide access to exchange-traded financial derivatives were the National Stock Exchange (NSE) and the Bombay Stock Exchange (BSE) in June of 2000. The Bombay Stock Exchange (BSE) Sensex is India's primary stock market index, and on June 9, 2000, futures trading based on the index made headlines. Prof. J.R. Varma, a member of SEBI and chairman of the committee tasked with creating protections for the Derivatives market, opened the trading floor. On June 9, 2000, at 9:55:03 am, M/s Kaji and Maulik Securities Pvt. Ltd. and M/s Emkay Share and Stock Brokers Ltd. conducted the first trade in the June series contract at the rate of Rs. 4755. Traders in these markets can choose from a wide range of contracts. NCDEX has been operating as a marketplace for commodities and derivatives trading since its inception in December 2003. The NSE has been instrumental in India's derivatives market's recent meteoric rise. On April 13, 2005, approximately 55% of the total turnover of derivatives on NSE was in stock futures.

DIFFERENT TYPES

A financial instrument that is not traded on a centralized exchange but rather between two parties directly is known as an over-the-counter derivative. This is the typical procedure for the exchange of exotic options, FRAs, and swaps. The market for OTC derivatives is enormous.

Derivatives products that trade on a regulated exchange, like the Derivatives Exchange, are known as exchange-traded derivatives (ETDs). A derivatives exchange acts as an unbiased third party in transactions involving its underlying assets and collects the initial margin as collateral. The CME Group, formed in 2007 by the merger of the Chicago Mercantile Exchange and the Chicago Board of Trade, is the world's largest derivatives exchange. The KOSPI Index Futures and Options are listed on the Korea Exchange, the world's second-largest derivatives exchange. It is estimated that USD 344 trillion was traded on derivatives exchanges around the world in the fourth quarter of 2005.

LITERATURE REVIEW

India has been implementing financial market reforms, such as the introduction of new instruments and the reengineering of existing ones, since 1991 (GAUTAMI AND NALLA BALA KALYAN, 2018). Derivatives are an area that could use more development and innovation. India's derivatives market has flourished only in recent years. Since its inception in June of 2000, the derivatives market has grown enormously in terms of both size and volume of contracts traded. Futures and options contracts are the two most common types of derivatives, which are a class of financial instruments. These instruments are valued in relation to the underlying asset and its current market price. While tokens have no intrinsic value, the rights they grant their holders over another asset or security do.

The importance of the derivative market to national economic growth is highlighted by research conducted by MEENAKSHI BINDAL (2018). Uncertainty has been introduced into the bottom lines of businesses around the world due to the volatility of interest rates, stock prices, and exchange rates across global financial markets. Negative shifts in macroeconomic factors threaten the very existence of businesses. Derivatives, a new type of financial instrument, are necessary in the Indian financial markets to reduce this threat. These instruments are created to guard against potential future price declines and can help reduce financial risks.

KUKREJA, G. (2012) polled NCR investors to determine their outlook on the Indian stock market. The study included data from 120 people who were selected at random. Two of the most significant findings of the study are the link between age and investment behaviour and the link between education and tax benefits. Investors' optimism was evaluated in terms of 119 distinct operational variables.

Pasha (2013) surveyed small-scale Indian investors to determine their opinions on financial derivatives. Five-hundred-fifty per cent of those who call themselves small investors agree that derivatives are cutting-edge because of their novelty, complexity, and sophistication. Derivatives are seen as less novel, complex, and high-tech by those who are already familiar with them (38%). Seven per cent of the investors who read the question still had follow-up questions. This led many to conclude that their education in derivatives was inadequate. A large majority of retail investors (62%) agreed that derivatives are risky due to their speculative and leveraged nature.

(Goodell, 2020) and others have provided compelling explanations for the COVID-19 paradox, demonstrating the importance of exploring the implications of the paradox for economic policy. Conlon & McGee (2020), Conlon, Corbet, & McGee (2020), and Goodell (2020) have all examined the far-reaching effects of the COVID-19 pandemic, as well as the ways in which previously observed associations shift in the wake of the disaster. Sharif, Aloui, & Yarovaya (2020); Yarovaya, Matkovskyy, & Jalan (2020) are just a few of the researchers looking into the connections between the housing market, the economy, and monetary policy volatility. The findings of Yarovaya, Brzeszczynski, Goodell, Lucey, and Lau in 2020 about the potential impact of COVID-19 on future exploration efforts are significant. The global travel, tourism, and hospitality industries are extremely vulnerable to catastrophic shocks like COVID-19, according to research by Chang, McAleer, and Ramos (2020). We need to plan for the long-term viability of these essential industries after COVID-19. Since the share, oil, capital, and bond markets have recently collapsed, the COVID-19 has serious implications for the global financial markets, as stated by Baret, Celner, O'Reilly, and Shilling (2020). Since most infectious diseases have a positive track record, Chang and McAleer of the year 2020 wondered if the rapid spread of the COVID-19 pandemic could have been predicted. In an article published in Impact (2020), the author states, "it is now obvious that the hit to global economic recreation from the standards to hamper the extension of the coronavirus pandemic will be massive." Jim's (2020) economic analysis of the current COVID-19 pandemic is detailed and informative. According to Larry (2020), one country's decision to increase its Chinese imports explains the sudden shift in export economies. Segal and Gerstel (2020) looked into the fears of a larger explosion and found that the monetary effects stretched financial markets heavily the month before, proving that the fears were unfounded.

Sarathkumar, K., and Dhandhayuthapani, S. P. published in 2016 research showing that investors' views of India's derivatives market shifted as behavioural finance became more mainstream. The expanding study of behavioural finance has consequences for the entire financial services industry.

This study's findings differ substantially from those of similar studies. Some researchers believe that a person's age and income level play a role in their ability to purchase a derivative instrument. It was determined how much weight various factors played in the final decision. Both an analysis and a thorough justification of the report's findings are provided.

Tripathi (2014) investigated how traders' minds work in relation to derivatives. The study found that Indian investors lean towards the insurance and real estate sectors due to the reliability of their returns. It was found that over 75% of investors were familiar with derivatives in some capacity and that over 25% actually held derivative positions. Most users put no more than 10%-15% of their portfolio into derivatives, with a sizable minority putting in 20%-35%. Options were the most widely held derivative, held by 76% of all traders. This high percentage can be attributed to the many benefits associated with options, such as the potential for high returns on low investments and the ability to protect capital. The derivatives market is dominated by men (72%), with only 28% being female.

In September 2008, SANDEEP SRIVASTAVA, SURENDRA S YADAV, and P K JAIN polled brokers in India's newly established derivatives markets to evaluate the market activity and discuss the benefits and drawbacks of derivative trading.

RAKESH, H.M. (2015) conducted this research to gain a better understanding of the risk preferences, risk considerations, and risk mitigation strategies of investors in the derivatives market.

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Research

DUBIOUS GOAL OF LEARNING Although derivatives can reduce some investment risks, they are not risk-free in and of themselves. Market risk, liquidity risk, credit risk, hedging risk, and other risks associated with derivatives have already been discussed in this analysis. Given the current economic climate and the inherent uncertainty of derivatives, it is crucial to gain insight from those with direct experience in the field.

Understanding the properties and risks associated with derivative products will be made clearer by the findings of this study.

The study's overarching objectives are (1) to learn how investors think about derivatives, and (2) to learn how they weigh different factors when deciding whether or not to invest in derivatives.

SCIENTIFIC THEORY:

The research strategy utilised in this study was descriptive. The goal of descriptive research is to offer explanations for the phenomena being studied. In terms of time and effort, there is no better way to learn. While gathering descriptive information is its primary purpose, it does aid in the creation of in-depth studies as well. The data herein was gathered from a variety of primary and secondary resources. A well-structured questionnaire is the primary data collection tool. Books, articles, websites, etc., written by other people are all acceptable secondary sources for use in a literature review.

A survey's respondents can be chosen with the help of CONVENIENCE SAMPLING.

The SAMPLE UNIT is comprised of traders based in the Delhi-National Capital Region and Uttar Pradesh.

The Sample Had Fifty Members.

The most common method of data collection is the use of questionnaires.

Data and evaluations: Bar charts, pie charts, and statistical tests like the Pearson correlation and the Friedman rank test are just some of the visual and statistical tools used to examine the data.

CAUSES FOR EXCLUSION Only about half (40) of the 60 investors who were approached for the survey actually filled it out. Therefore, it cannot be used across the board in the derivatives market.

To see if they are in line with the goals of the study, the following hypotheses have been formulated and will be tested.

According to the null hypothesis (H0), respondents' age does not play a significant role in their choice to invest in derivatives.

H0, the null hypothesis, states that respondents' incomes do not influence their decisions to purchase derivatives.

A Third (H0) Hypothesis Investing in a Derivative can be done for any number of reasons, including hedging, risk management, cash flow, and so on.

There is no statistically significant difference in how male or female users interact with the service (H0).

Fifth, H0: There is no correlation between exposure to and enthusiasm for the derivatives market.

Investors come from all walks of life and of all ages (6.H0).

7.H0: There is no difference in derivatives market knowledge between sexes.

A User's Income Has No Relation to Their Involvement in Derivative Markets (H8)

H0 is true because investors don't care whether or not a catastrophic event occurs.

The choice of industry is of little importance to investors (H10).

The derivatives market is not a place where investors should avoid participating.

FINDING

These can be calculated using either underlying asset prices or reference rates. Wheat farmers, for example, might wait for the price to stabilise before selling their crop. The transaction itself would be derivative, with the spot price of wheat serving as the underlying asset.

 In order to lessen this threat, derivatives were developed. Derivatives are monetary instruments whose values are based on those of another asset or assets.

Risks associated with the market, interest rates, liquidity, and credit are all very similar. Due to the volatility and unpredictability of cash flows, derivatives carry a risk similar to that of other financial instruments.

 They have not yet made any investments in the derivatives market, but they are keeping a close eye on it. Providing risk-mitigating mechanisms, strategic guidance, and additional support can help ease investors' concerns about losing money. If given the chance and guidance, more than half of respondents said they would put money into this market. For businesses that want to educate the public about personal finance through a series of seminars, this is an invaluable tool.

The findings of this study provide evidence for several links. This information can be used to better understand the target market. The company should reassure retail investors that entering the derivatives market presents few difficulties, despite the fact that many institutional investors, mutual fund managers, and corporations believe the market is better suited to their needs. Even though most investors have traditionally been men, the company may find success by focusing on women, especially stay-at-home mothers, as potential investors.

Market risk can be mitigated and a separate market for borrowing and lending money and securities can be established thanks to the derivatives market.

The cash market can be strengthened and new financial products can thrive.

Forwards: The forward contract is an example of a financial instrument in which two parties agree to exchange assets at a future date and the current market price.

Contracts for the future purchase or sale of an asset. Due to the standardised nature of the exchange market on which futures contracts are traded, they constitute a subset of forward contracts.

Both "calls" and "puts" are options, so keep that in mind. A call option gives the buyer the right, but not the obligation, to purchase the underlying asset at a future date and price. In exchange for payment, the buyer of a put option agrees, but is not obligated, to sell the underlying security on or before the expiration date and at the strike price.

Options on options exchanges typically have a maximum maturity of nine months, though options with a one-year maturity are possible. Warrants are an off-exchange option with a long time horizon.

Long-Term Equity Anticipation Securities (LEAPS) is the shortened version of this term. To make this decision, you have until March 2019, plus three years.

Options on groups of underlying assets are often referred to as "basket options." Moving averages and asset baskets are common choices for underlying assets. Basket options include stock index options.

Swaps are agreements between two parties to exchange future cash flows in a private and mutually beneficial manner. Portfolios of forward contracts are like this. One can categorise interactions as either

In an interest rate swap, two parties exchange constant-currency cash flows that are solely attributable to movements in interest rates.

When two parties engage in a currency swap, one will receive payments in one currency and the other will make payments in the other currency.

When an option to buy or sell a swap expires, the corresponding transaction takes place. Swaptions are options on forward swaps. You can think of calls and puts in the swaptions market as receiver swaptions and payer swaptions, respectively. By exchanging fixed payments for variable ones, swaptions allow you to hedge your financial risk. When one party would rather receive fixed payments and the other would rather receive floating payments, they enter into what is known as a "payer swaption."

CONCLUSION

The results show that the highest private sector earners are educated experts who have the kind of liquid capital that can be put to use in derivatives like futures and options. The survey found that men made up the vast majority of investors. There are more men than women working in derivatives investing. The majority of the derivatives trading community is comprised of individuals between the ages of 25 and 40.

Those with an annual disposable income between 2 and 5 million rupees often choose to invest in derivatives contracts.

Many participants in the derivatives market rely on their brokers for guidance, but others also make use of the wealth of information available online to learn the ropes on their own.

Brokers have more influence than anyone else over investors.

Our survey respondents skew heavily towards professional futures and options traders. Potential benefits of options contracts may outweigh those of futures contracts.

Investors prefer index funds over buying individual stocks.

More than half of those who invest do not think derivatives are only suitable for institutional investors, which means that retail investors can participate.

Investor interest in derivatives is strongly correlated with respondent age.

A person's annual income is inversely related to the probability that they will purchase a derivative.

The Friedman test shows which characteristics of derivatives are most highly valued by investors. Consider the following in light of the uncertainty of the stock market: the knowledge of investors, the knowledge of hedging funds, the knowledge of investors regarding products, and the knowledge of products themselves.

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