A Study on Investors Perception towards Derivatives Market with special reference to Pathanamthitta District

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Abstract

Financial sector reforms in the decade of 1990‟s have transformed the Indian capital markets into a dynamic and extensive market among the world financial markets. The internalization of economic activity and the unparalleled currency and interest rate volatility, risk hedging techniques have grown at a rapid speed which open up the financial market to wide range of potential investors. The derivative instruments emerged as a tool of risk avoiding economic agents in order to protect themselves against worries arising out of fluctuations in asset prices. Derivatives have shifted the speculative trading to a more controlled environment. This paper analyses the perception of investors towards derivative trading. The study was conducted in Pathanamthitta district,Kerala, to get an insight into the minds of investors to analyse their awareness and perception on investment in derivative instruments. Percentage analysis, weighted average method and chi square test are used for analyzing the data.

Keywords: Investors Perception, Derivative Instruments, Risk, Investors.

Introduction

A derivative is a financial tool which derives its importance from the value of underlying assets such as equities, debt, currencies, index or interest rate. Derivative securities provide them a valuable set of tools for managing the risk. Risk management, the managerial process that is used to control price volatility, has consequently risen to the top level of financial agendas. SEBI appointed the L C Gupta committee to envelop appropriate regulatory framework for derivatives trading and to recommend suggestive bylaws for Regulation and Control of Trading and Settlement of Derivative Contract. A series of modifications in the financial markets paved the way for the improvement of exchange traded derivatives. It is here that derivative instruments are of utmost utility. Derivative products minimize the impact of fluctuations in asset prices on the profitability and cash flow situations of risk averse investor. A variety of derivative contracts are introduced. Such as Forward Contracts, Future Contracts, Options, Swaps etc. Each financial derivative has its own unique features.

- **Forward Contracts:** A forward contract is an agreement between parties to buy/sell a specified quantity of an asset at a certain price. In simple words, itis a simple customized contract between two parties to buy or sell an asset for a certain price at a certain time in future. A forward contract is custom designed, and hence, it is unique in terms of contract size, maturity date, quality and quantity of asset, etc. The contract is settled by the delivery of asset on the expiration date. Forward contracts being bilateral contracts are exposed to counter party risk.

- **Future Contracts**: A future contract is a standardize contract written by a clearing house that operates an exchange where the underlying can be bought and sold. In a simple language, a futures contract is transacted through in exchange.
- **Option Contracts:** An Option is an instrument or contract that gives the holder a right, without any obligation, to buy or sell specified quantity of the underlying assets at an agreed price on or before a specified future date.
- **Swaps:** Swap or Swop means barter or exchange. A swap is a derivative contract through which two parties exchange the cash flows or liabilities from two different financial instruments. Most swaps involve cash flows based on a notional principal amount such as a loan or bond, although the instrument can be almost anything.

Significance and scope of the study

The global liberalization and integration of financial markets have created new investment opportunities, which in turn require the development of new instruments that are more efficient to deal with increased risk. Trading in derivatives reduce risk by providing additional channels to invest with lower trading cost and it facilitates the investors to extent their settlement through the future contracts. They provide extra liquidity in stock market. The study arises due to, now a days derivative trading has become an important avenue but most of the investors are still unaware about its opportunities and limits. The study was conducted in Pathanamthitta district to analyse the investors perception towards derivative market.

Objectives of the study

- To find out the reasons for preferring derivative instrument.
- To evaluate the risk factors associated with derivative market instrument.
- To examine the problems faced by investors of derivatives market.
- To analyze the overall satisfaction from derivative instruments.

Hypothesis of the study

Ho1: There is no significant difference between the income level of investors and percentage of investment

Ho2: There is no significant difference between the gender and percentage of investment

Research Methodology

The study was conducted among 100 respondents in Pathanamthitta district. Both descriptive and analytical study was conducted. Convenience sampling technique was used for the selection of samples. Questionnaire survey was applied in this study to collect primary data from the consumers. Information collected through consumer survey is utilized for further analysis and verification of hypotheses. The analysis of the data was conducted using the statistical tools which includes percentage analysis, weighted average method and chi square test. The secondary data for the study was obtained from newspapers, magazines and internet.

Limitations of the study

- The survey was carried through questionnaire and the questions where based on perception.
- The respondents may not open with their responses.
- Reliability of the opinion is based on the responses of the customer.

Review of Literature

Dr. Babraju (2014) analysed the perception of investor towards derivatives as an investment avenue. He found that the derivatives are risk management tool that support in effective management of risk by various stockholders. Derivatives provide a chance to transfer risk from the one who wish to avoid it, to one who wish to agree it. India's experience with the introduction of the equity derivatives market has been really encouraging and successful.

Y. Nagaraju (2014) conducted study on investors' perception towards derivative instruments and markets. The study concludes that before making of investment the investor should take effective measurements and determining the factors of risk for investment decision on particular financial instruments.

D.V.Gakhar (2016) study on Impact on Volatility and Investor Perception explores that the investors awareness and investors investment decisions and risk taking ability on derivative instruments plays an important role in the development of trading activities in derivative market.

Gopal Krishna U M (2019) study explores that the Investors investment behavior and risk taking ability on various investment avenues. The study concludes the ability of risk behind the particular financial instruments in capital market.

Analysis Of Data

Table 1
Age wise classification of the respondents

Age	No. of respondents	Percentage
20 - 30	8	8%
30 - 40	35	35%
40 - 50	33	33%
Above 50	24	24%
Total	100	100%

Source: primary data

Interpretation: The above table shows the age wise classification of the respondents.35% of respondents are in between the age group of 30 – 40. 33% of respondents are belonging to 40 – 50 age class. There are 24% of respondents are in above 50 age group. There is only 8% of respondents are between the age group of 20 – 30. Majority of the respondents belongs to 30-40 age group.

Table 2

Ranking of reasons for preferring derivative instrument

Reasons	Score 4	Score 3	Score 2	Score 1	Total
Transferability of risk	11	31	36	22	100
High return	18	45	34	3	100
Low investment	67	22	9	2	100
High liquidity	5	1	19	75	100

Source: primary data

Weighted average score

Reasons	Weight	Rank
Low investment	**3.54**	**I**
High return	2.78	II
Transferability of risk	2.31	III
High liquidity	1.36	IV

Interpretation: Table 2 analyse the various reasons for the preference of derivative instrument. The factors considered are transferability of risk, high return, low investment and high liquidity. From the analysis it is understand that the most reason for preferring derivative instrument is of low investment. It is ranked as 1 with 3.54 weight. The Liquidity factor is not much attractive reason for investors preferring derivative investment.

Table 3

Ranking of risk factors of derivatives market

Risk	Score 4	Score 3	Score 2	Score 1	Total
Price volatility	29	60	7	4	100
Finite contract period	1	9	68	22	100
Margin pressure	58	24	8	10	100
Time value	3	8	19	70	100

Source: primary data

Weighted average score

Risk	Weight	Rank
Margin pressure	**3.30**	**I**
Price volatility	3.14	II
Finite contract period	1.89	III
Time value	1.44	VI

Interpretation: The table analyze the risk factors associated with derivative financial instruments. Marginal pressure, price volatility, finite contract period and time value are the factors considered. The study reveals that the most risk factor involved in the derivatives market is margin pressure.

Table 4

Ranking on overall performance of Derivative instruments

Instrument	Excellent	Good	Average	Poor	Very poor	Total
Forward	1	3	6	36	54	100
Future	73	22	5	0	0	100
Options	33	49	15	3	0	100
Swaps	1	0	11	9	79	100

Source: primary data

Weighted average score

Instrument	Weight	Rank
Future	**4.68**	**I**
Options	4.12	II
Forwards	1.61	III
Swaps	1.35	IV

Interpretation: The table evaluates the overall performance of the derivative financial instruments. Among the derivative financial instrument, futures, forwards, options and swaps, the performance and level of satisfaction from future contract are ranked 1. The respondents are least satisfied with the performance of the swaps.

Hypothesis Testing

$H_0$1: There is no significance difference between the gender and percentage of their investment.

Table 5

Chi-square test

Investment	Gender		
	Male	Female	Total
Less than 5%	55	6	61
5%-10%	24	1	25
10%-15%	11	0	11
More than 15%	3	0	3
Total	93	7	100

Observed frequency	Expected frequency	$(O-E)^2$	$\frac{(O-E)^2}{E}$
55	56.73	2.9929	.052
24	23.25	.5625	.024
14	13.02	.9604	.073
7	7	0	0

$$X^2 = \frac{(O-E)^2}{E}$$

=.149

Degrees of freedom = (C-1) (R-1)

=3

Table value at 5% level of significance =7.815

The calculated value (.149) is less than table value (7.815). So we accept null hypothesis. The analysis reveals that there is no significance difference between the gender and percentage of investment.

H02 : There is no significance difference between income level and percentage of investment

Table 6

Chi-square test

Investment	**Annual income**				
	Below 100000	100000 - 200000	200000 - 300000	Above 300000	Total
Less than5%	2	12	40	7	61
5%-10%	2	3	8	12	25
10%-15%	0	0	6	5	11
More than 15%	0	0	0	3	3
Total	4	15	54	27	100

Observed frequency	Expected frequency	$(O-E)^2$	$\frac{(O-E)^2}{E}$
16	13.15	8.1225	.6176
43	38.79	17.7241	.456
8	13.5	30.25	2.240
6	7.56	2.4336	.321
7	16.47	89.6809	5.44
12	6.75	27.5625	4.083
8	3.78	17.8084	4.711

$$X^2 = \frac{(O-E)^2}{E}$$

$=18.4862$

Degrees of freedom = (C-1) (R-1)

=9

Table value at 5% level of significance =16.919

So the calculated value (18.4862)is greater than table value(16.919), reject the null hypothesis. The study reveals that is there is significance difference between the income level and percentage of investment.

Findings

- Majority of the respondents prefer to invest in derivative instrument due to low investment and high return.
- The investors expect that the most risk factor involved in the derivatives market is margin pressure.
- The most important problem of derivative market is that the returns are not assure which feels the investors insecure
- Majority of the investors rated the futures as an excellent derivative instrument.
- There is no significant difference between the gender and percentage of investment.
- There is significant difference between the income level of investors and percentage of investment.

Suggestions

- The investors can make sensible investment decision at the right time by having right perception and awareness about the government policies and market regulation, market trend and market reforms
- The regulating bodies have to take suitable measures to propagate the information regarding derivative products and its features, operations, merits and demerits of derivative investment in India and thereby level of awareness on derivative instrument can be increased.
- It is advisable to minimize the contract size because small investors cannot afford this much of huge premium.
- Efforts should be made to educate prospective and potential individual investors through different seminars or training programs regarding the advantages and risk factors associated with derivative instruments.

CONCLUSION

The study shows that an average Indian investor has fair level of understanding of derivatives market and its concepts. Risk averse investors always tries to play safe by investing in mutual funds, insurance, government bonds and securities whereas risk takers want to earn more returns and in lieu of that they prefer to invest in derivative market. As derivative market offers more return, with the hedging of interest rate risk and exchange rate risk with maximum profits and minimum loss. The literature review reveals that though developing countries have realized the importance of derivative market, still in depth studies in this field are few, which leads to lack of knowledge on part of retail investors because of its complexities and relatively high initial investment. The study determines that the investors preference reasons in the derivative investment is different in different investment avenues. The investors preference reason in derivative investments is depends upon the investment objective such as Risk, Return, Safety and liquidity of the investment. Most of the investors enter into the Forward Contract investments is due to the Return factor.

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