Investors intentions towards various investment options in long term funds market in connection with Derivatives

Jayalakshmi

HoD, Department BBA, Ramaiah Instiutute of Business Studies, Bengalore, Karnataka, India

Abstract

In India, generally all capital market investment avenues are perceived to be risky 5 by the investors. But the younger generation investors are willing to invest in capital market instruments and that too very highly in Derivatives segment. Even though the knowledge to the investors in the Derivatives segment is not adequate. They tend to take decisions with the help of the brokers or through their friends and were trying to invest in this market. This study was undertaken to find out the awareness level of various capital market instruments and also to find out their risk preference of investors on various segment. This study intends 1) to find our the preference level of investors on various capital market instrument 2) to find out the type of risk which are considered by the investors 3) to find out the ways through which the investors on various minimizes their risk 40 to find out the preferences of investors in derivatives. market About 100 samples were collected from Bangalore city from various investors through a structured questionnaire and awareness about derivatives and the investor risk preference in an elaborate

Introduction

In india, generally all capital market investment avenues are perceived to be risky by the investors. But the younger generation investors are willing to invest in capital market instruments and that too very highly in Derivatives segment. Even though the knowledge to the investors in the Derivative segment is not adequate, they tend to take decisions with the help of the brokers or through their friends and were trying to invest in this market. This study was undertaken to find out the awareness level of various capital market instruments and also to find out their risk preference in various segments.

Measure and manages risk. Through derivatives the complex risk that are

Need for the study :

- To educate investors who are risk averse for trade in derivatives.
- Awareness about the various uses of derivatives can help investors to reduce the risk and minimize the losses

Overview of the study:

Derivatives have fundamentally changed financial management by providing new tool to manage risk. What makes derivatives important is not so much the size of the activity, as the role it plays in fostering new ways to understand, bond together in traditional

instruments can be teased apart and managed independently and often more efficiently. A remarkable growth in the derivatives markets has caused many consequences on the players associated with them . some got advantages out of it. Other became victims of the adverse results of investing in it.

Derivatives securities have been recently blamed as culprits for huge financial loses at firms like Gibson, P & G, Barring etc. they are sometimes viewed as bad because, they are complex instruments, highly leveraged and difficult to understand. The development of derivatives has occurred in response to a search for higher yields and lower funding costs and demand for tools to manage risk

DEFINITION

Derivatives may be defined as "A security or contract designed in such a way that its price is derived from the price of an underlying asset".

The price of the derivative security is not arbitrary. It is linked to the price of underlying asset. Changed in the price of derivative security. A true derivative instrument requires no movement of principal funds. It is this characteristic that makes them such useful tool to hedge and to take risk.

Another definition explains derivatives, as "derivatives are financial instruments whose returns are derived from those of other financial instruments"

Their performance depends on how other instruments perform.

Factors Affecting Growth of Derivatives:

Growth of derivatives are affected by a number of factors. Some of the important factors are stated below.

1. Increased volatility in asset prices in financial markets.
2. Increased integration of national financial markets with the international markets.
3. Marked improvement in communication facilities and sharp decline in their costs.
4. Development of more sophisticated risk management tools, providing economic agents, a wider choice of risk management strategies.
5. Innovation in the derivative markets, which optimally combine the risk and returns, reduced risks as well as transactions costs as compared to individual financial assets.

Evolution of derivatives

1. **Forward Trading**

It is not clearly established when and where the first forward market came into existence. There are reports that forward trade existed in India as far back as 2000 B C and in Roman times. Forward trading is believed to have been in existence in the 12th century English and French fairs. There was forward trade in rice in the 17th century in japan. The first organized forward markets came into existence in late.

2. Futures Trading

The Dojima rice market can be considered as the first future market in the sense of an organized exchange. The first futures in the western hemisphere were developed in united states in Chicago. First they were started as spot markets and gradually evolved into futures predetermined price with the intention of actual delivery. Gradually these contracts became transferable and during American civil war, it became common place to sell and resell agreements instead of taking delivery of physical produce. Traders Found that the agreements were easier to but and sell. This is how modern futures contracts came into being.

3. Options Trading

Options trading are of more recent origin. It is estimated that they existed in Greece and Rome as early as 400 BC
Options trading in agriculture products and shares came in US from the 1860s. The first options markets was started by Chicago BOARD of trade (CBOT) in 1973. Standard maturities, standard strike prices, evolved. The risk of default was removed by introducing a clearing house and margin systems. The introduction of traded options opened the way for the evolution of more complex derivatives.

4. SWAP trading

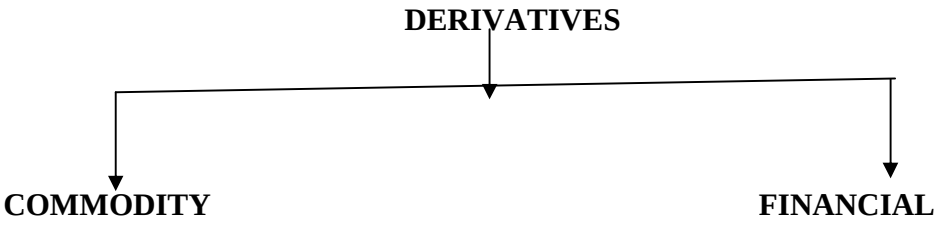
The first SWAP transaction look place between World Bank and IBM(international business machines). They were currency swaps. Interest rates swaps also commenced in 1981.

5. Others Derivatives

Others derivatives like forward rate agreements (FRAs), Ranges Forwards, collars evolved in second half of 1980s.

TYPES OF DERIVATIVES

One way of classifying derivatives is as,



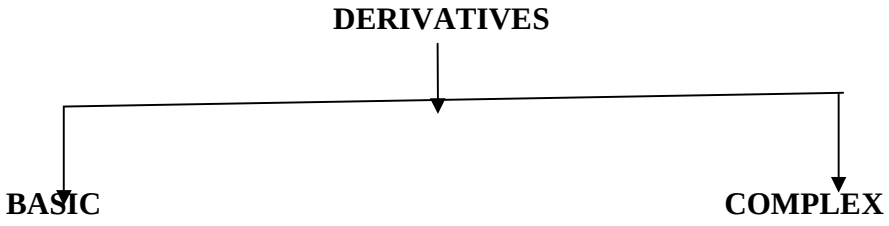
Commodity Derivatives

These deals with commodities like sugar, gold, wheat, pepper, etc, thus , futures or options on gold, sugar, pepper, jute etc are commodity derivatives.

Financial Derivatives

Futures or Options or Swaps on currencies, gilt edged securities, stocks and shares, stock markets indices, cost of living indices etc are financial derivatives.

Another way of classifying Derivative



Basic Derivatives

They are forward/ futures contracts and option contracts.

Complex Derivatives

Others derivatives, such as SWAPS are complex ones because they are built up from either forward/ futures contracts or options contracts or both. Generally derivatives can be classified as follows:

DERIVATIVES

I. **Futures**
II. **Forwards**
III. **Options**
IV. **Complex**

I Futures:

A futures contracts is a contract to "buy or sell a standard amount of or predetermined grades of certain commodity(i.e commodity futures) or financial instruments or currency (that is financial futures) on a predetermined futures day at an agreed prize."

II. Forwards:

Its "an agreement between two parties to buy or sell a commodity or financial instrument at a predetermined futures date at a prize agreed when the contract is made". The forward contracts are normally traded outside the exchanges. Forward contracts are very useful in hedging and speculation

Options

They are the second, most important group of derivative securities. First being futures. It is "a contract between two parties where by one party acquires the right, but not the

obligation to buy or sell a particular commodity or financial instrument at a specified date". Options are of two types

a) Call option b) 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 assets by a certain date for a certain price

Complex Derivatives:

Using futures and options it is possible to build number of complex derivatives. IT is designed to suit the particular needs and circumstance of a client

Example : SWAPS< Credit Derivatives

RISK OF DERIVATIVES: Any comment about derivative would be inadequate without a word of caution. There are 4 inherent risks associated with derivatives. These risk should be clearly understood before establishing position in derivative market.

1) **Credit Risk:** the exposure to the possibility of loss resulting from a counter party's failure to meet its financial obligation.
2) **Market Risk:** adverse movements in the price of financial assets or commodity.
3) **Legal Risk:** an action by a court or by a regulatory body that could invalidate a financial contract.
4) **Operations Risks:** inadequate controls, human error system failure of fraud

REVIEW OF LITERATURE

" Investment property portfolio management and financial derivatives". By Patrick McAllister, john R Mansfield. His study on derivative has been an expanding and controversial features of the financial markets since the late 1980s.the limitations and problems of direct investment in commercial property are briefly discussed and the main principles and types of derivatives are analysed and explained the potential of financial derivatives to mitigate many of the problems.

"Management's discuss of hedging activity An empirical investigation of analysis and investors reactions" byJennifer Reynolds-Moehrle. Participants changed the way they process earnings information after learning of the implementation of hedging activities. Design/methodology/approach –usinga sample of derivatives user and non user firms, this study empirically compares earnings predictability, forecast revision behavior, and the earnings response coefficients before and after the disclosure of hedging activity

Findings – The findings indicate that analysis forecast accuracy increased and that unexpected earning were incorporated into subsequent earnings forecasts to a greater

extent subsequent to disclosure of sustained hedging activity. Additionally, the finding indicate an increase in the earnings- return relation in the hedging activity period.

Research limitations/implications:

This evidence empirically supports the claim that, when a company communicates that hedging activities have been started market participants are betterable to forecast earnings announcement as providing greater information about future earnings**.**

Practical implications – the models used in the tests of forecast revisions and earnings response co efficient could easily be adapted to others settings where the research questions compares different time periods.

Originality:

This study adds to the empirical evidence regarding the effects of hedging activity by providing direct evidence of analysts' use of and investors' reactions to earnings surprises following the disclosure o the implementation of hedging activities.

Objectives of the study

- **primary objective**

1. To study the various Investment analysis and the investor risk performance towards it.

- **secondary objectives**

1) To find out the general demographic factors of the investor dealing in capital market
2) To find out the performance level of investors on various capital market investments
3) To find out the type of risk which are considered by the investor
4) To find out the way to which the investor minimise is there risk
5) To find out the performance of investor in derivative market

Research methodology

Research Design is purely and simply the framework of plan for the study that guides the collection and Analysis of data. The study is intended to find the investor performance towards the cash market and derivatives. The study design is descriptive in nature.

Types of research descriptive research

Descriptive research is a fact- finding investigation with adequate interpretation. It is the simplest type of research and is more specific mainly designed to gather descriptive information and provides information for the formulating more sophisticated studies.

Sampling design

1. Selection of study area: the study area is Bangalore.
2. Selection of sample size: 100

Sampling methods

Convincing method of Sampling is used to collect the data from the respondents. The researcher or the field works how the freedom to choose whomever they find, thus the name "convenience". About 100 samples were collected from Bangalore city and most of the respondents were customer coming into stockbroker's office and certain addresses were collected from reputed brokers.

Formulation of the question is data collection

a) Primary data - collected through structured questionnaire.
b) Secondary date - earlier records from journals, magazines and other source.

Tools used for analysis percentage analysis

1. Chi square test
2. Kendall test
3. ANOVA
4. Correlation analysis
5. Multiple response tables

Limitations of the study

- Understanding the nature of risk is not adequate unless the investor analyst is capable of expressing it in in some quantitative terms expressing the risk of stock in quantitative terms makes it compatible with others stocks.
- The measurement cannot be issued of percent accuracy because the risk is caused by numerous factors such as social, political, and managerial efficiency.
- Time was a limiting factor.
- Only that investor who deals in capital markets is considered.
- The respondents based was another Limited factor

Summary of findings

1) Most of the respondents 44% are of the group age group 31 to 40.
2) The majority of the respondents 65% are male.
3) The most of the respondents 38% are graduates followed by postgraduate.
4) Most of the respondents 29 persons are entrepreneurs and working executives.
5) Most of the respondents 38% are having an income level of 1.25 lacs forest by responding having income level of 5 to 10 laces.
6) Most of the respondents 40 persons are influenced by friends and relatives followed by brokers.
7) Most of them 20% are highly favourable towards the cash market.
8) Most of them 30% highly favored before the future market.
9) Most of them (26%) are highly favorable towards the option market.
10) Majority of the respondents (37%) wanted to invest in short- term funds followed by both short term and long term fund.
11) Majority of the respondents (36%) preferable wealth maximization instruments followed by the steady growth instruments.

12) Most of them(43%) invested about 5- 10% of their income on investment and only 9% invested more than 20% of their income on investments.
13) Respondent perceived that the market risk and the credit risk are the two Major risk observed in capital market.
14) Most of their respondents (82%) wanted to minimize the risk involved in the capital market.
15) Most of the respondents (49%) said that newspaper and financial experts help them to minimize the risk.

Suggestion and Recommendation

A. From the demographic factor is found the most of the English writers are of age 31 to 40 and the most are the most entrepreneurial and working executives so that institution dealing in market capital market can take this factor and develop suitable marketing activity for them and attach them to invest more in capital market
B. Also it is found that the friend and relatives followed by the brokers are the most influential person to build the investors into the capital market so the institutional should develop some referral programs and rewards for reference so that their existing investor can actively bring in more number of investor always brokers should buy idly knowledgeable.
C. Most of their corresponding should positive sign in investing into derivatives market since the most of them performers short term investments and investments leading to health maximization so hi sir the Institutions dealing derivatives market must develop product which suit the average should requirement of the investor.
D. It is also found that investors are investing up to 10% of their income on various investments and also they said that the market risk and the credit risk are the two main parameters they look in into before investing so the institutional should develop the product which are of less market risk and the credibility of the institution should be briefly explain to the investor.
E. Most of them felt that they want to reduce their market risk and they also said that they followed the ideas given by the financial experts and tips given in the newspapers reduce the risk of the institution should keep information about the Institutions developments to the these groups by which it can reach the investors in positive way.
F. Investors false that high margin in derivatives investment was the main barrier of investing so the investor should work on this to reduce the margin.
G. The derivative market most of the investor refer stock index future for the stock index option so the institution should develop more number of the product by which in it Can attach more number of investors.

Conclusion

In the current scenario the investing in stock market is the major challenge ever for professionals derivatives act as a major tool for reducing the risk involved in investing in stock market for getting the best result of the investor should be aware of the where is

designing and speculation strategies which can be used for reducing their risk awareness about out high risk by using derivatives values can be minimized to an extent.

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IMPORTANT TABLEREFERENCES

Influencer

Influencer	No. of Respondents	Percent
Brokers	36	36.0
Friends & relatives	40	40.0
Advertisement	9	9.0
Banks	15	15.0
Total	**100**	**100.0**

Perception towards Capital Market Instruments

Statement	Cash Market	Options Market	Commodities Market	Futures Market
Highly favorable	29	20	27	30
Favorable	28	26	18	24
Neutral	27	26	30	18
Unfavorable	9	18	17	18
Highly favorable	7	10	8	10
Total	100	100	100	100

Basis of overcoming Risk

Basis of overcoming risk	No. of Respondents	Percent
Financial experts	2 4	24.0
Newspaper	4 9	49.0
Friends	1 8	18.0
Others	9	9.0
Total	**100**	**100.0**

Investor Option in Derivatives

Investment options in derivatives	No. of Respondents	Percent
Stock index futures	2 9	29.0
Stock index option	2 7	27.0
Futures on individual stocks	2 6	26.0
Options on individual stocks	1 8	18.0
Total	**100**	**100.0**