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A STUDY ON INVESTMENT STYLE OF CAPITAL MARKET INVESTORS ON FINANCIAL DERIVATIVES

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Abstract
The process of liberalization and deregulation of the financial market led to the integration of the world financial markets. The arrival of information technology facilitated the process of integration on an unprecedented scale. With the integration of financial markets and free mobility of capital, risks also multiplied and risk diversification came to occupy the center stage. This led to the evolution of risk hedging mechanisms, which are generally known as derivatives. Derivative is a product whose value is derived from the value of one or more basic variables called bases in a contractual manner. That is, the price of a derivative instrument is contingent on the value of its underlying asset. Underlying asset can be foreign exchange, equity shares, interest bearing financial assets, commodities or any other asset. Derivatives are very important financial instruments for risk management as they allow risks to be separated and more effectively managed. The primary objective of the study is to evaluate the investment style of the stock market investors on derivatives.

Key Words: Derivatives, Option, Futures.

Introduction
The use of derivative instruments in corporate risk management has grown rapidly in recent years, caused partly by financial deregulation and partly by the success of the financial industry in designing a great variety of OTC and exchange-traded contracts. Derivatives enable their users to separate, value and transfer market risks. The use of derivatives, therefore, enhances the possibilities for active corporate risk management, which is likely to have an impact on macroeconomic and monetary policy issues. Derivatives provide investors with a tool to hedge their naked positions in the cash market. They also enable the unexpected movement in the market. Derivatives help you in managing your cash flows in a better fashion. Derivative trading by individuals is generally considered as speculative business. But derivatives, apart from speculation, provide investors with a multitude of uses namely hedging and speculation.

Scope and Significance of the Study
The rapid globalization of the business environment during the last decade has exposed many firms to exchange rate fluctuation. The increased exposure is forcing many corporations to manage effectively financial risks like foreign exchange risk, interest rate risk and other financial risks. The growing significance of corporate hedging has had its demand for innovative risk management mechanisms and revolutionary developments in the field of financial engineering. The support offered by financial derivatives in this respect is highly acknowledged by the firms.

The gradual liberalization of Indian economy has resulted in substantial inflow of foreign capital into India. Simultaneously dismantling of trade barriers has also facilitated the integration of domestic economy with world economy. With the globalization of trade and relatively free movement of financial assets, risk management through derivatives product has become a necessity in India also, like in other developed and developing countries. Tremendous growth in derivative market can be attributed to a number of factors. They reallocate risk among financial market participants, help to make financial markets more complete, and provide valuable information to investors about economic fundamentals. Derivatives also provide an important function of efficient price discovery and make unbundling of risk easier.

Objectives
1. To understand the degree of knowledge and popularity of derivatives among capital market investors.
2. To evaluate the perception of investors about the liquidity, return and risk of different types of derivatives.
3. To identify the role-played by the investment advisors/employees of securities trading firms in motivating or de motivating investors from dealing in derivatives instruments.

Hypothesis
- There is no association between the preference towards derivatives and experience in capital markets.

Methodology
Capital market investors dealing with Geogit securities ,JRG security Ltd and Hedge Equities are selected for conducting this study. 200 sample investors from Kottayam District who are regularly dealing with Geogit or JRG or Hedge Equities are selected for data collections through structural questionnaire. Secondary data are collected from the websites of NSE, OTCEI etc. Primary data collected is analyzed by using statistical tools like chi-square analysis, percentages, likert scaling

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techniques, composite index etc. Secondary data related to derivative transactions are analyzed by using ratios, percentages, correlation and Analysis of variance.

Analysis of Data

Table 1: Educational Back Ground of Respondents

S. No	Particulars	No.	%
1	SSLC	36	18
2	Pre Degree	24	12
3	Graduate	80	40
4	Post graduate	28	14
5	Professional degree	32	16
Total		**200**	**100**

Source: Primary data

The above table shows the education profile of the investors selected for the study. 40% of the investor selected for the study are graduates 14% are post graduates and another 16% have professional qualification. Hence 70% of the selected investors have bachelors' degree or post graduate degree.

Table 2: Occupational Classification of Respondents

S. No	Particulars	No.	%
1	Business	52	26
2	Employee	44	22
3	Professional	32	16
4	Agriculturist	20	10
5	Others	52	26
Total		**200**	**100**

Source: Primary data

The above table shows the occupational profile of the investors selected for the study. Out of the 200 respondents 26% are engaged in business and 22% are employees. Professionals constitute 16% and balance includes agriculturists and others. It can be seen that there is a dominance of businessmen and others in this field.

Table 3: Monthly Income Classification

S. No	Particulars	No.	%
1	Below 10,000	128	64
2	10,000 – 20,000	40	20
3	20,000 – 30,000	24	12
4	Above 30,000	8	4
Total		**200**	**100**

Source: Primary data

The survey results show that 64% of the traders have a monthly income of below 10,000. 20% traders belong to Rs.10, 000 to Rs.20, 000 category and 12% traders monthly income is between Rs.20, 000 – 30,000. Rest 4% people belong to high income group. It is interesting to note that majority of the traders belong to average income group.

Table 4: Investment Avenues of Respondents

S. No	Particulars	No.	%
1	Bank	116	58
2	Real estate	16	8
3	National saving scheme	64	32
4	Insurance	100	50
5	Stock market	200	100
6	Others	-	-

Source: Primary data

The above table shows various investment avenues of the investors selected for study. Most of the respondents have more than 2 avenues. 200 respondents having investment in capital market are selected for the study. 58% of the respondents have

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deposits with banks, 50% have investments with insurance companies and 32% have investments with National Savings Schemes.

Table 6: Type of Derivatives Dealt in by the Respondents

S. No	Particulars	No.	%
1	Stock options	112	75.68
2	Stock futures	96	64.86
3	Index options	92	62.16
4	Index futures	96	64.86

Source: Primary data

Table 3.10 shows the types of derivative instruments dealt in by the respondents. As the table indicates 75.68% of investors in derivatives deals in stock options, 64.86% deal in stock futures. 62.16% deals in index options and 64.86% investors deals in index futures. Thus it can be concluded that stock option is the most popular derivative instrument. Most of the investors are dealing in both options and futures.

Table 7: Duration of Derivative Contracts

S. No	Particulars	No.	%
1	1 month	100	67.57
2	2 months	16	10.81
3	3 months	16	10.81
4	Multiple	16	10.81
Total		**148**	**100**

Source: Primary data

Out of the 148 derivative traders 67.57% traders chose 1month contract for dealing in derivatives and 10.81% selected 2 months contract 10.81% of traders are dealing 3 month's contract and balance 10.81% of traders are dealing multiple of above months. Hence it can be concluded that large majority of derivative investors prefer the shortest duration investment.

Table 8: Frequency in Derivative Deals

S. No.	Particulars	No.	%
1	Daily	56	37.84
2	Weekly	52	35.14
3	Fortnightly	16	10.82
4	Monthly	24	16.20
Total		**148**	**100**

Source: Primary data

The above table shows details about the frequency of dealings in derivative instruments. Out of the 148 derivative investors 37.84% deal on daily basis, 35.14% of the investors deal on weekly basis.27.02% of the investors deal in fortnightly or monthly basis. Hence it is evident that majority of the investors are very active in the market.

Table 9

S. No	Particulars	Strongly agree	Agree	Agree to certain extent	Disagree	Strongly disagree	No opinion
a)	Dealings in derivatives helps to hedge risk	56	8	100	12	8	16
b)	Lack of knowledge may result in loss	132	16	28	12	12	-
c)	Majority of the investors dealing in derivatives know everything about it	24	12	52	52	36	24
d)	All employees of stock broking firms know everything about derivatives	32	12	60	64	24	8
e)	Majority of the investors in derivatives act in accordance with the advice of employees of firms	24	16	64	40	24	32

Source: Primary data

Table 9a: Value as per Likert's Scaling

Weight		5	4	3	2	1	
S. No	**Particulars**	**Strongly agree**	**Agree**	**Agree to certain extent**	**Disagree**	**Strongly disagree**	**Total**
a)	Dealings in derivatives helps to hedge risk	280	32	300	24	8	664
b)	Lack of knowledge may result in loss	660	64	84	24	12	844
c)	Majority of the investors dealing in derivatives know everything about it	120	48	156	104	36	464
d)	All employees of stock broking firms know everything about derivatives	160	48	180	128	24	540
e)	Majority of the investors in derivatives act in accordance with the advice of employees of firms	120	64	192	80	24	480

Tables 9 and 9a shows the degree of agreement by the respondents about the statements related to derivative trading. Likerts scaling technique is used to quantify the degree of agreement. All the 200 respondents have expressed their opinion about the statements.

a) Dealings in derivatives helps to hedge risk: 50% of the respondents agree to a certain extent but 56 out of 200 respondents have strong agreement to this statement. The computed value as per the Likert's Scaling technique is 644 and score in the 5 point scale is 3.22. Since the score is just above 3 (value assigned to agree to a certain extent) it can be concluded that the capital market investors are not fully accepting derivatives as a risk hedging mechanism.
b) Lack of Knowledge may result in loss: 132 out of 200 respondents strongly agree to the statement. It is areality that knowledge is the most powerful factor that determines the gain or loss in derivatives market. Hence it is fact that the investors have very good knowledge about the basic aspects about derivatives. The quantified value of the opinion about this statement is 844. The value asper the 5 point scale is 4.2 (844/200), which is a very high value.
c) Majority of the investors dealing in derivatives know every thing about it: Only 24 out of 200 respondants strongly agree with this statement but 52 out of 200 respondents disagree with this statement. The calculated value as per the Likert's Scaling technique is 464 and score in the 5 point scale is 3.34. Since the score is just above 3. It can be concluded that the capital market investors are agree to a certain extent that majority of the investors dealing in derivatives know everything about it.
d) All employees of stock broking firms know everything about derivatives. The quantified value as per the Likert's scaling technique is 540. Hence the score in a five point scale is just 2.7. Hence it is very clear that investors believe that the level of knowledge of employees of stock market about derivative is low.
e) Majority of the investors in derivatives act in accordance with the advice of employee of firms. The quantified value as per the Likert's scaling technique is 480. Hence the score in a five point scale is just 2.4. Hence it is very clear that investor agrees that investors in derivatives act in accordance with the advice of employee of firms.

Hypothesis
Experience in Capital Market

Level of Experience in Capital Market	Invest in Derivative	Not Invest in Derivative	Total
1 yr – 5 yrs	92	24	116
Above 5 yrs	56	28	84
Total	148	52	200

Ho: There is no association between the preference towards derivatives and experience in capital market.

Level of significance	:	5%
Degree of freedom	:	1
Calculated value	:	1.174
Table value	:	3.841

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Since the computed value of χ^2 is less than critical value of χ^2 Accept **Ho:** It is therefore conclude that preference towards derivatives and experience in capital market are not related.

Findings of the Study

Financial derivatives are the most popular mode of investment in capital market. Commodities market is also gaining popularity world over. The present study is undertaken among small investors actively engaged in capital market. Following are the major findings of the study

- It is found that most of the respondents have more than 2 investment avenues. Investors prefer to invest their funds in stock market, bank and insurance.
- It is found that 76% of the respondents have investment in equity shares and 74% of the respondents invested their funds in derivatives. Only 4% of the traders have invested in debentures.
- It was found that 82% of the respondents have more than 5 years.
- 67.57% of investors enter into one-month contract.
- 72.98% investors either deal daily or weekly.
- Investors strongly agrees that lack of knowledge about derivative trading will result in loss. Awareness about this fact is very high.
- Investors dealing in derivatives believer that they know everything about derivative trading. It shows either ignorance about the derivatives/they pretend that they know everything about it.
- Investors disagree that all employees of stock broking firms know everything about derivative.
- Respondents agree that investors in derivatives act in accordance with the advice of employees of stock trading firms.
- Majority of the respondents agreed that services of stock broking firms play a pivotal role in the selection of securities.
- It was found out that employees play a critical role in popularsing derivative transactions.
- Respondents agree that management of security trading firms are scientific, systematic and highly helpful to the investors.
- It was found that number of investors dealing in derivative instruments is showing an increasing trend.
- The preference towards derivative and experience in capital market are not related.

Conclusion and Suggestions

The result of the study reveals that small investors are not considering derivatives as a tool for hedging risk. This shows the level of ignorance of the small investors about financial derivatives. The authorities of capital market, stock exchange and firms dealing in derivatives must try their level best to improve the level of knowledge of investors about derivative**.** Derivatives enable their users to separate, value and transfer market risks. Risks are securitised and thus gain fungibility, which, in turn, allows the unbundling and repackaging of market risks embodied in underlying assets. The use of derivatives, therefore, enhances the possibilities for active corporate risk management, which is likely to have an impact on macroeconomic and monetary policy issues.

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