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A SURVEY ON DERIVATIVE AWARENESS AND USAGE BY MSMEs IN LUCKNOW CHIKAN CLUSTER

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ABSTRACT

Currency fluctuations always presents a great deal of risk for businesses dealing in international export and imports. During the year 2007-08, when rupee was appreciating against US dollar and was even expected to touch Rs 35 against a dollar, many MSME (Micro Small and Medium Enterprises) exporters (and others) entered into forex derivative contracts with banks to hedge against the currency fluctuations, which ultimately turn out to be sour and in the process, SME (small and medium enterprises) lost thousands of crores in the process and many cases were filed in Indian courts in this regard. This paper ventures to find out about the derivative awareness and uses in one of India's largest artisan based cluster namely Lucknow Chikan Cluster.

KEYWORDS

MSMEs/SMEs, Financial Derivatives, Chikan.

INTRODUCTION

Micro Small and Medium Enterprises (MSMEs) constitute over 90% of total enterprises in most of the developed and developing economies and are credited with generating the highest rates of employment growth and account for a major share of industrial production and exports. In India too, the MSMEs play a pivotal role in the overall industrial economy of the country. Micro Small and Medium Enterprises in India accounts for 35-45% (at present it stood at 36%) of total goods and services exports. According to the 4th all India census of MSMEs, this sector provide employment for more than 5.0 crores of working force. These factors signify the undisputed role of MSMEs in Indian economy.

When derivatives are becoming a standardized tool to unbundling and managing risk in almost every market around the world, it is inevitable that they would also find their way to Indian financial market. In a globalizing world there is no other choice.

These products or contracts are like double edged sword, which if not used wisely and competitively can seriously hamper the user itself as happened in the case of MSMEs during the regime of appreciating rupee versus dollar(2007-2008) where MSMEs (especially the exporters) suffered huge losses in their currency derivative contracts . The MSME export sector which has limited knowledge of forex derivatives suffered huge losses due to volatile fluctuations in the value of currencies. With the rupee breaching the barrier of 46 to a dollar, quite a few exporters had booked their export receivables in the forward market for 42/43 to a dollar. While some exporters would gain in terms of profitability, the depreciation of the rupee vis-à-vis dollar definitely impacted the overall competitiveness of the MSME export sector.

According to the various news reports, published by reputed agencies, losses incurred by Indian exporters runs in thousands of crores resulting from the sale of derivative products by 19 bank (foreign+public+private) to the exporters, by violating RBI and FEMA regulations, while according to the Tahelka report, it amounts to a scandle much bigger than the scale of 2G, which may have caused the loss of staggering Rs 25 lakh crores to the various parties.

These loses are reported to be incurred by MSMEs in various parts of country, most notably in Tamilnadu and Panjab. Current study tries to find out whether there are similar experience felt by MSMEs of Uttar Pradesh and for its study it has picked Lucknow Chikan cluster to find out the derivatives awareness and uses in the said cluster.

ABOUT LUCKNOW CHIKAN CLUSTER

Lucknow Chikan embroidery cluster is the biggest artisan cluster of India. There are approximately 3.0 lacs artisans of hand embroidery associated with this cluster situated in Lucknow and nearby districts. Apart from this, the artisans from other fields such as Cutting, Stitching, Hand Block Textile Printing, Jali work and Washer men are also a part of this cluster. According to the estimates there are thousands of artisans associated with Chikan Embroidery Cluster, other than chikankari artisans.

The artisans of Chikan Embroidery are scattered in and around Lucknow. The districts covered are Unnao, Barabanki, Lakhimpur, Hardoi and to some aspect are in Raibareilly, Sultanpur and Faizabad.

This Chikan Embroidery is not only providing employment to lacs of artisans of different related crafts but people from non-craft base are also earning their livelihood by associating themselves with this craft in various ways. Expected number of non-artisan persons earning their bread and butter from this craft is more than million which includes contractors, manufacturers, retailers, raw material providers or employee with manufacturers.

Despite its established uniqueness, dominance and huge export potential to generate revenue for the country and state, government support for the growth of the cluster is not optimum. Around one fourth of exports are made from outside of the state, where the exporters after purchasing finished products from state rout the exports through bigger cities like Delhi, Mumbai and Chennai.

OBJECTIVES OF THE STUDY

Present paper studies the about the state of derivative awareness and their uses by MSMEs in Lucknow Chikan cluster putting special attention on the Chikan exporters in the region. Main objectives of the study are-

- To find out awareness level about derivatives among entrepreneurs and exporters in the region.
- To find out the use of derivatives in the cluster.
- To identify the factors affecting the awareness and the use of financial derivatives in the cluster.

RESEARCH METHODOLOGY

The study is mainly based on primary data collected with the help of structured questionnaire contacting directly with the respondents and with the help of personal, through internet and telephonic responses. There are around 10-12 big (approximate turnover more than 500 lakhs yearly) and 40-50 medium size

exporters (approximate turnover more than 51-500 lakhs yearly) and hundreds of domestic suppliers in the cluster. At first list of exporters were procured through various online sources like tradeindia.com and in subsequent process with the help of respondent's references. Out of 210 entrepreneurs contacted through various means, statistical analysis was carried out based on 102 respondents. Secondary data was collected through various online and offline sources for related study.

REVIEW OF RELATED LITERATURE

There are plenty of literatures available on the various aspects of derivatives and their uses by financial institution and by the corporates, but MSME sector till now is to some extent neglected. There are no specific and concrete studies on the use of derivatives by the Micro Small and Medium Enterprises in India. Some selected useful literature/studies are discussed here-

Marston, Richard C., discusses in their paper, *1995 Wharton survey of derivatives usage by US non-financial firms* discusses the use of derivatives by US non-financial firms in which one of the primary objectives of the survey is the development of a database on risk management practices suitable for academic research. Study touches various aspects of derivative uses which includes subjects like *Derivatives Usage by Size and Industry, Use of Derivatives in Risk Management, Objectives of Derivatives Use in Risk Management, Concerns about Derivatives Usage, Foreign Exchange Exposure Management, Impact of a Market View on Foreign Currency Derivatives Use, Market Risk Assessment, Impact of Accounting Issues on Derivatives Use, Non-Use of Derivatives* among others.

Henk Berkman, Michael E. Bradbury, 1996 in his paper *Empirical evidence on the corporate use of derivatives* studies the derivatives uses by corporates in New Zealand. According to the author, theory indicates that hedging can increase firm value by reducing expected taxes, expected costs of financial distress, and other agency costs. Prior research, based on survey data, has found only weak evidence consistent with theory. This study provides evidence on the corporate use of derivative instruments from the 1994 audited financial statements of 116 firms.

Asani Sarkar, 2006 in *Indian Derivative Markets*, talks about the rise of derivatives, definition and uses of derivatives, development of derivative markets in India, derivatives instruments traded in India and derivative users.

4th All India Census of MSMEs (2006-07) - According to the Quick results of "4th All India Census of MSMEs (2006-07)", there are a total number of 2.61 crore MSMEs in 2006-07 (as against the current projected figure of 1.3 crore). This includes 0.15 crore registered units and 2.46 crore un-registered units. Of the total, 28% are in manufacturing and 72% in services. These units are largely in Apparel (14.03 %) followed by Food Products and Beverages (13.53%) and Maintenance of Personal and Household goods (9.25%). The MSME sector accounts for employment of 5.97 crore persons, of which, 0.95 crore are in registered units and 5.03 crore in the un-registered units.

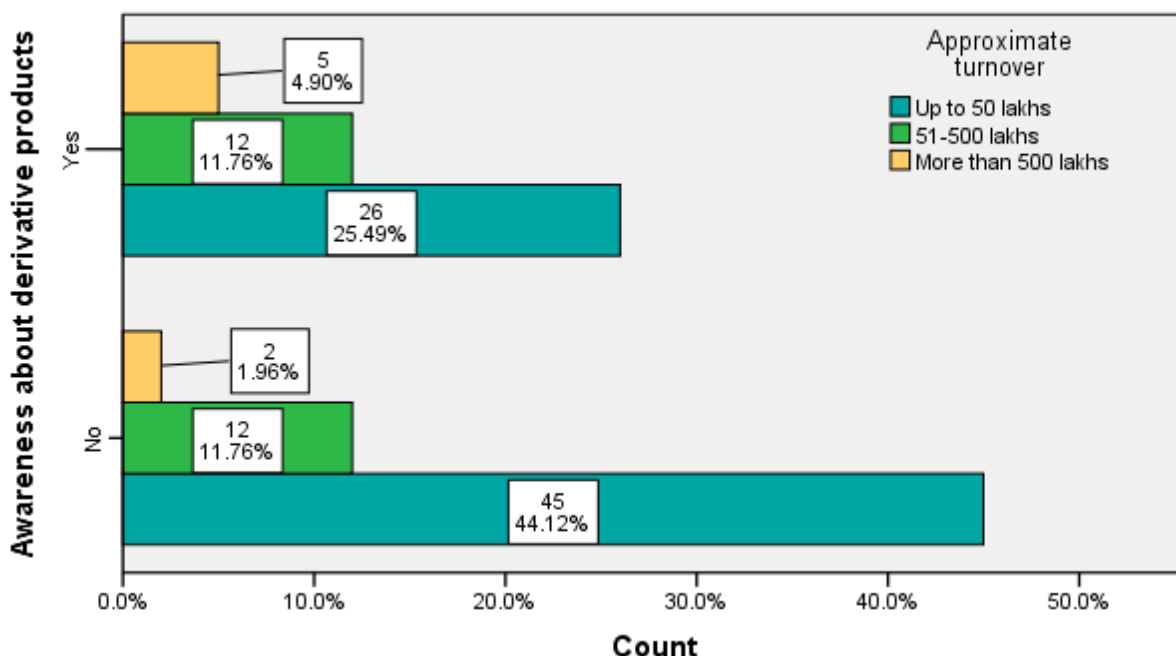
ANALYSIS AND FINDINGS

1: AWARENESS ABOUT DERIVATIVE PRODUCTS: This variable in the form of a nominal dichotomous (yes/no) variable asks about the awareness about the derivatives in any form among its respondents. Being asked about having awareness about derivatives in any form, in total, around 42.2% respondents in Lucknow accepted to have some kind of idea about these products. Explanation for the comparatively good percentage of awareness about derivative products can be attributed to the high coverage of American financial crisis in print and electronic media in India.

The graph given below is bifurcated based on the approximate turnover of the firm. It is clear from the graph that out of total seven respondents of having approximate turnover more than 500 lakhs a year, five are having some kind of knowledge about the derivative products, which is around five percent of the total respondents.

Around twelve firms, which are having the turnover in the range of 51-500 lakhs/year are having the knowledge about the derivative products, which is around 11.76% of the total firms.

Around forty four percent of the firms in the range of up to fifty lakh turnover are having some kind of knowledge about the derivative products.



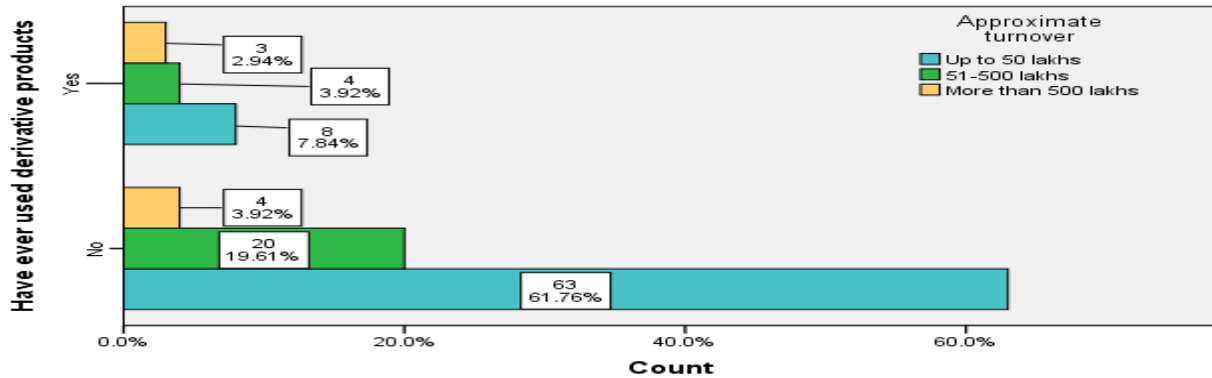
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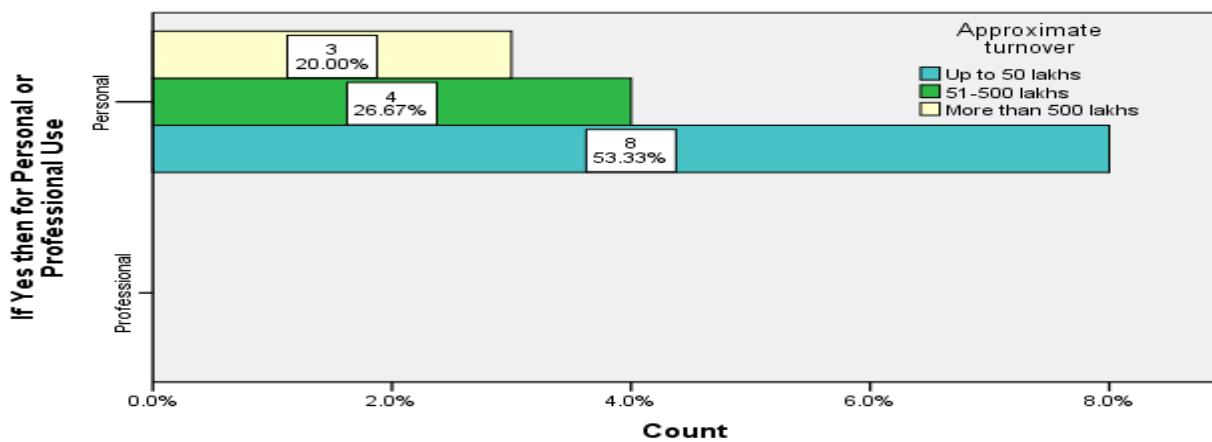
Around forty four percent of the firms in the range of up to fifty lakh turnover are having some kind of knowledge about the derivative products.

2: USE OF DERIVATIVE PRODUCT: Being asked about whether the respondents have ever used the derivative product, fifteen respondents (14.71%) responded in affirmation. Bifurcating the responses in terms of the turnover of the firms, three firms (2.94%) having the turnover of more than 500 lakhs have used the

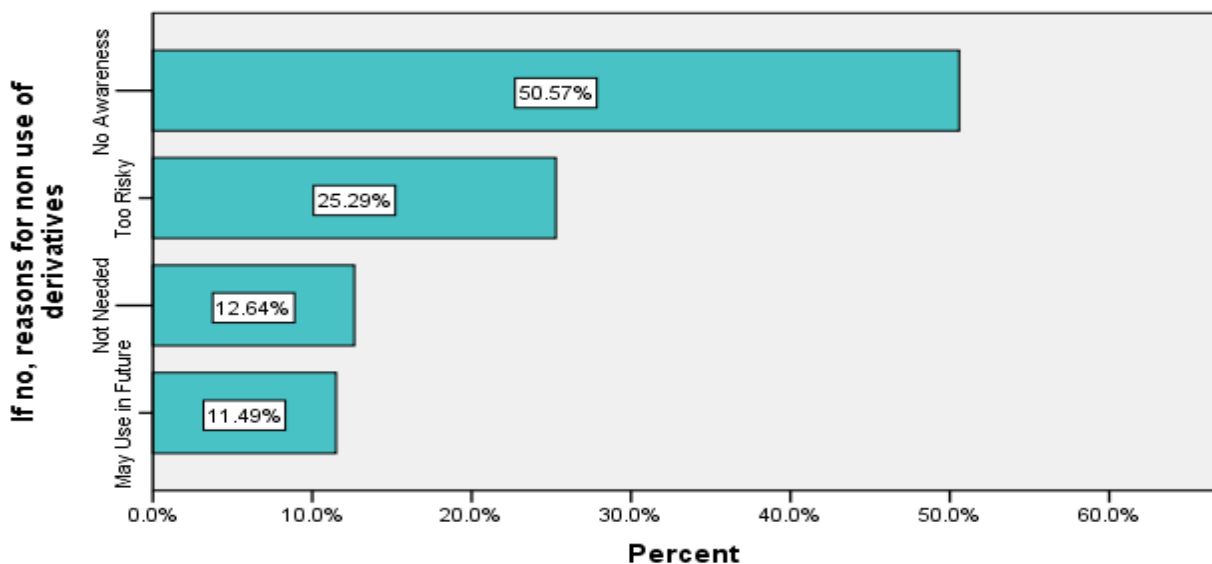
derivative products, while in the range of the firms having turnover between 51-500 lakhs, four firms (3.92%) have used the derivative products, while just eight firms (7.84% of total) have used any kind of derivative products.



3: FOR PERSONAL OR PROFESSIONAL USE: It is clear from the given self-explanatory graph that almost all the respondents who have used any kind of derivative products have used these products for personal use say for example as investment or speculation. None of the respondents in Lucknow Chikan Cluster have used these products for professional use.



4: REASONS FOR NON-USE OF THE PRODUCTS: Given around 85.29% of the respondents have never used any kind of derivative products, when asked about the reason behind the non-use of derivatives, more than fifty percent of the respondents said it is due to the lack of awareness about the derivative product, while more than twenty five percent of the respondents consider these products too risky to use. Around eleven percent of the respondents who have the knowledge about the derivative products still have not used these products, because they do not find these products worthy to invest



5: FACTORS AFFECTING THE AWARENESS AND THE USE OF DERIVATIVE PRODUCTS

Being the part of wider study, to identify the factors affecting the awareness and the use of derivatives in Lucknow Chikan Cluster, eight variables were identified namely- age of the firm, number of workers, approximate turnover, firm type, educational level of the entrepreneur, professional course undertaken and self-assessed financial literacy of the entrepreneur and paired t-test was used to assess the effect of independent variables on the dependent variable. It is clear from table-1 and table-2 that out of seven variables affecting the awareness about the derivative products in cluster, the most statistically significant are- age of the firm, number of workers/craftsmen employed, approximate turnover, educational level of the entrepreneur and self-assessed financial literacy of the entrepreneur.

Similarly from table-2 and table-3 based on the significance level of paired t-test (table-3) all the seven variables have their statistically significant role regarding the outcome about derivative uses by firms.

CONCLUSION

Derivatives are increasingly becoming unavoidable tools for risk mitigation especially for the firms dealing with foreign currencies and firms have burned their fingers in their uses due to their high risk association. Even the larger firms having access to the trained manpower in finances and risk calculating tools have faced the havoc of their improper use where the risk mitigation tools have turned into the big risk in itself.

Even the Indian firms including the MSMEs have lost thousands of crores of money in recent years. This aspect needs proper study and consideration in this regard.

Current study is just a small contribution in this regard which needs to be carried forward in future.

LIMITATIONS OF THE STUDY

- 1: Study was conducted based on the snowball and convenience sampling which is not always best or optimal surveying method.
- 2: Representation of grouping variables like type of firms based on export (exporter, domestic supplier, and domestic supplier+ exporter) or based on turnover is not proportionate.
- 3: There might be the general human response errors or hesitation in the response of financial aspects like not correctly showing turnover range or other financial aspects.
- 4: Lack of sufficient literature regarding the uses of derivative products by MSMEs in India and elsewhere despite their growing exposure towards these products.

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TABLES

TABLE-1: PAIRED SAMPLES CORRELATIONS

| | | N | Correlation | Sig. |
|--------|-----------------------------------------------------------------------------------|-----|-------------|------|
| Pair 1 | Awareness about derivative products & Age of the firm | 102 | .096 | .336 |
| Pair 2 | Awareness about derivative products & No. of workers/craftmen employed | 102 | -.151 | .131 |
| Pair 3 | Awareness about derivative products & Approximate turnover | 102 | -.195 | .050 |
| Pair 4 | Awareness about derivative products & Type of the firm | 102 | -.269 | .006 |
| Pair 5 | Awareness about derivative products & Educational Level of Entrepreneur | 102 | -.071 | .477 |
| Pair 6 | Awareness about derivative products & Professional Course Undertaken | 102 | .154 | .121 |
| Pair 7 | Awareness about derivative products & Fin. Literacy of entrepreneur on 1-10 scale | 102 | -.056 | .577 |

TABLE-2: PAIRED SAMPLES TEST-2

| | t | df | Sig. (2-tailed) |
|-----------------------------------------------------------------------------------|---------|-----|-----------------|
| Awareness about derivative products - Age of the firm | -10.263 | 101 | .000 |
| Awareness about derivative products - No. of workers/craftmen employed | -10.554 | 101 | .000 |
| Awareness about derivative products - Approximate turnover | 2.418 | 101 | .017 |
| Awareness about derivative products - Type of the firm | -.342 | 101 | .733 |
| Awareness about derivative products - Educational Level of Entrepreneur | -8.116 | 101 | .000 |
| Awareness about derivative products - Professional Course Undertaken | -1.412 | 101 | .161 |
| Awareness about derivative products - Fin. Literacy of entrepreneur on 1-10 scale | -39.542 | 101 | .000 |

TABLE-3: PAIRED SAMPLES CORRELATIONS-2

| | | N | Correlation | Sig. |
|--------|----------------------------------------------------------------------------------|-----|-------------|------|
| Pair 1 | Have ever used derivative products & Age of the firm | 102 | -.003 | .978 |
| Pair 2 | Have ever used derivative products & No. of workers/craftmen employed | 102 | -.054 | .587 |
| Pair 3 | Have ever used derivative products & Approximate turnover | 102 | -.200 | .043 |
| Pair 4 | Have ever used derivative products & Type of the firm | 102 | -.113 | .260 |
| Pair 5 | Have ever used derivative products & Educational Level of Entrepreneur | 102 | .081 | .421 |
| Pair 6 | Have ever used derivative products & Professional Course Undertaken | 102 | .235 | .017 |
| Pair 7 | Have ever used derivative products & Fin. Literacy of entrepreneur on 1-10 scale | 102 | -.240 | .015 |

TABLE-4: PAIRED SAMPLES TEST-2

| | t | Sig. (2-tailed) |
|----------------------------------------------------------------------------------|---------|-----------------|
| Have ever used derivative products - Age of the firm | -10.126 | .000 |
| Have ever used derivative products - No. of workers/craftmen employed | -9.195 | .000 |
| Have ever used derivative products - Approximate turnover | 6.323 | .000 |
| Have ever used derivative products - Type of the firm | 2.316 | .023 |
| Have ever used derivative products - Educational Level of Entrepreneur | -6.002 | .000 |
| Have ever used derivative products - Professional Course Undertaken | 3.608 | .000 |
| Have ever used derivative products - Fin. Literacy of entrepreneur on 1-10 scale | -37.398 | .000 |

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