



## INTERNATIONAL JOURNAL OF RESEARCH IN COMMERCE AND MANAGEMENT

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## A STUDY ON BENEFITS AND RISK ANALYSIS OF FUTURES AND OPTIONS IN MADURAI

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### ABSTRACT

*The economic system depends on an adequate supply of capital from private investors. The savings of individual investors is the main source of capital investment for business expansion. With increasingly complicated financial products available to investors and electronic financial transactions becoming the norm, people need to learn how to make wise financial decisions. The investors should be able to identify industries that are growing at a faster rate. This requires constant analysis and expertise to analyze the financial indicators. Hence, derivatives help in the process of shifting risk, earn high return in accordance to the risk taken (High risk-High return), and earn profit from price difference in two markets. Such instruments have to be analyzed in terms of its risks and benefits to help different traders to take right decision before trading in derivatives according to their attitude towards risk. Derivatives include forward contracts, futures contracts, options and swaps. A trader needs to understand the concept of derivatives and its applications and the risk associated with it and risk management strategies to play safe and successful in the market. Therefore the study aims at analyzing the benefits and risks in trading futures and options market. The research is focused on survey method to collect participants' responses to identify the level of awareness on futures and options market and analyze the risks and benefits associated with it. The responses are concluded with suggestions and recommendations managerial and research implications.*

### KEYWORDS

Arbitrators, Futures and Options, Hedgers, Stock Brokers, Speculators.

### INTRODUCTION

Derivatives have changed the world of finance as pervasively as the internet has changed communications. Well they are everywhere nowadays. New ideas and innovations have always been the hallmark of progress made by mankind. At every stage of development, two core factors drive man to ideas and innovations. These are increasing returns and reducing risk, in all facets of life. One such innovation in the financial market is Derivatives, which are contracts that originated from the need to minimize risk and maximize return to the investors. Hence it is introduced with the main purposes of enabling individual or corporate investors to either increase their exposure to certain specified risks in the hope that they will earn returns more than adequate to compensate them for bearing these added risks, known as speculation. On the other hand, reduce their exposure to specific financial risks by transferring these risks to other parties who are willing to bear them at lower cost, known as hedging. In addition, there is an important activity carried out known as Arbitration, which helps in earning profit from price differential existing in two markets by simultaneously operating in two different markets. Cash market participants negotiate the buying and selling (the transfer of title) of a specific product; futures market participants focus on the buying and selling of a contract on the underlying product. With the contract standardized in terms of delivery months and locations, quantity and grade of the commodity, the only element left to negotiate in the exchange market is the price. Since price and not the commodity is the focus of the futures and options market, delivery of the actual commodity is a function that generally is assigned to the cash market. The market makes it easy to enter and exit the market before delivery becomes even a possibility. All the mechanisms of the futures marketplace focus on the taking of a "price" position and then closing it out at a profit or loss.

### FUTURES

Futures contract means a legally binding agreement to buy or sell the underlying security on a future date. Future contracts are the organized contracts in terms of quantity, quality, delivery time and place for settlement on any date in future. The contract expires on a pre-specified date called expiry date of the contract. All the financial futures contracts are cash settled. There is no physical transfer of securities. Future contracts traded in India are based on commodities, indices, individual stocks, interest rate and currency.

### OPTIONS

Options contract is a type of derivatives contract that gives the buyer/holder of the contract the right but not the obligation to buy / sell the underlying asset at a predetermined price within or at the end of specific period. The buyer/holder of the option, purchases the right from the seller/writer for a consideration which is called the premium. The seller/writer of an option is obligated to settle the option as per the terms of the contract when the buyer/holder exercises his right. Option contracts traded in India are based on commodities, indices, individual stocks, interest rate and currency. Option contracts may be

- Call Option where the buyer has the right but not the obligation to purchase a given volume of the underlying asset at a given price on or before a given future date.
- Put Option where the buyer has the right, but not the obligation to sell a given volume of the underlying asset at a given price on or before a given future date.

An investor needs to understand the concept of derivatives and its applications and the risk associated with it and risk management strategies to play safe and successful in the market. Therefore the study aims at analyzing the benefits and risks in trading futures and options market

### OBJECTIVES

- ✓ To study the concepts, technicalities and mechanics of trading in futures and options.
- ✓ To examine the benefits of Futures and options.
- ✓ To analyze the risks of Futures and Options.
- ✓ To analyze the level of awareness among traders in Futures and Options.

### RESEARCH DESIGN AND METHODOLOGY



The following research methodology and design has been used for the study.

- (1) **RESEARCH DESIGN:** Survey method was used with a structured type questionnaire as the data-collecting instrument.  
 (2) **PRE- TESTING:** Pre – testing was done for clarity and reliability of the tool.  
 (3) **SAMPLE SIZE:** A total of 50 respondents were taken for the study.  
 (4) **SAMPLING PROCEDURE:** The sample for the study was selected from Madurai district of Tamilnadu. Convenient sampling was chosen after critical review of literature. Respondents were males and females who are interested in trading in futures and options.  
 (5) **DATA COLLECTION:** In total 70 questionnaires were distributed out of which 50 sample was finally selected.  
 (6) **ANALYSIS OF DATA:** The statements on traders were framed after critical review of literature and discussions with experts in the field. The answer to these statements was sought in terms of 'Yes or No' and percentage analysis and chi square analysis.

## ANALYSIS AND INTERPRETATION

### AGE

**TABLE 1: AGE OF THE RESPONDENTS TRADING IN FUTURES AND OPTIONS**

Age Group	No. of Respondents	Percentage %
21 – 35	28	56.0
36 – 50	12	24.0
Above 50	10	20.0
Total	50	100.0

Source : Primary Data

The table1 shows that the young aged people between 21 and 35 have High risk taking attitude of 56% and the around 24% of the respondents trading belongs to the age group of 36 – 50 .The study shows that the trading level decreases as the age increases.

### EDUCATIONAL QUALIFICATION

**TABLE 2: EDUCATIONAL QUALIFICATION OF THE RESPONDENTS TRADING IN FUTURES AND OPTIONS**

Educational Qualification	No. of Respondents	Percentage %
Upto XII Standard	5	10.0
Degree Holder	45	90.0
Total	50	100.0

Source : Primary Data

Table 2 shows that majority of the respondents are degree holders who have greater exposure to the futures and options market as the exposure, understanding ability and practical analysis is more in college education compared to school.

### OCCUPATION

**TABLE 3: OCCUPATION OF THE RESPONDENTS IN FUTURES AND OPTIONS**

Occupation	No. of Respondents	Percentage %
Retired	7	14.0
Professional	4	8.0
Government Employee	2	4.0
Private Employee	12	24.0
Business	20	40.0
Service	3	6.0
Agriculture	0	0.0
Home maker	2	4.0
Total	50	100.0

Source : Primary Data

Table 3 portrays that the majority (40%) of the respondents are Business people who are very interested in making money and risk taking. Around 24 % are private employees who are next to business people in risk taking.

### MONTHLY INCOME

**TABLE 4: MONTHLY INCOME OF THE RESPONDENTS TRADING IN FUTURES AND OPTIONS**

Monthly Income	No.of Respondents	Percentage %
Less than 10000	7	14.0
10000 – 20000	18	36.0
20000 – 30000	12	24.0
30000 – 40000	4	8.0
40000 – 50000	2	4.0
Above 50000	7	14.0
Total	50	100.0

Source: Primary Data

Table 4 shows that the majority of the respondents who are trading in futures and options belong to the income group of 10000 – 20000 which depicts that the middle income people are more interested in trading in derivatives to maximize their earnings.

#### MARITAL STATUS

**TABLE 5: MARITAL STATUS OF THE RESPONDENTS TRADING IN FUTURES AND OPTIONS**

Marital Status	No.of Respondents	Percentage %
Married	37	74.0
Unmarried	13	26.0
Total	50	100.0

Source: Primary Data

Table 5 explains that the majority of the respondents (74%) are married as they have more responsibilities to take care of their family when compared to the unmarried traders.

#### SOURCE OF KNOWLEDGE ABOUT FUTURES AND OPTIONS

**TABLE 6 :SOURCE OF KNOWLEDGE OF THE RESPONDENTS TRADING IN FUTURES AND OPTIONS**

Source of Knowledge	No.of Respondents	Percentage %
Broker	35	70.0
Advertisement	5	10.0
Studied in course of my Education	10	20.0
Total	50	100.0

Source: Primary Data

Table 6 shows that majority of the respondents knew about futures and options through the awareness created by brokers, who market these products for earning revenue. Advertisements play only a trivial role in creating awareness about futures and options.

#### MODE OF CONTACT OF STOCK BROKERS

**TABLE 7: MODE OF CONTACT OF STOCK BROKERS BY THE RESPONDENTS TRADING IN FUTURES AND OPTIONS**

Mode of Contact	No. of Respondents	Percentage %
Telephone	13	26.0
Direct Personal Contact	17	34.0
Online trading	5	10.0
Telephone & Direct Personal Contact	8	16.0
Telephone & Online trading	4	8.0
Direct and Online Contact	0	0.0
Telephone, Direct Personal Contact and Online trading	3	6.0
Total	50	100.0

Source : Primary Data

Table 7 shows that the majority of the respondents have chosen direct personal contact to trade as the trader may feel comfortable to be with broker and other traders to get sufficient details about the market. The next mode was the telephone as they have direct conversation with the brokers.

#### TYPES OF TRADERS IN FUTURES AND OPTIONS

**TABLE 8 : TYPES OF TRADERS IN FUTURES AND OPTIONS**

Type of Traders	No.of Traders	Percentage %
Hedgers	12	24.0
Speculators	31	62.0
Arbitraders	0	0.0
Hedgers and Speculators	7	14.0
Total	50	100.0

Source: Primary Data

Table 8 shows that the majority of the traders play the role of speculators due to the natural human attitude of earning huge at a short span of time and addiction to gambling and people are not aware of Arbitraders in Madurai as they show nil percentage.



**INFLUENCE OF OCCUPATION ON THE ROLE PLAYED IN THE FUTURES AND OPTIONS MARKET**

**TABLE 9: INFLUENCE OF OCCUPATION ON THE ROLE PLAYED IN THE FUTURES AND OPTIONS MARKET.**

Occupation	Role played in the Futures and options Market			Total
	Hedger	Speculator	Hedger & Speculator	
Retired	2 (40.0)	3 (60.0)	0 (0.0)	5 (100)
Professional	1 (25.0)	3 (75.0)	0 (0.0)	4 (100)
Government Employee	0 (0.0)	1 (100.0)	0 (0.0)	1 (100)
Private Employee	3 (21.5)	9 (64.3)	2 (14.2)	14 (100)
Business	5 (23.8)	15 (71.4)	1 (4.8)	21 (100)
Service	0 (0.0)	1 (100.0)	0 (0.0)	1 (100)
Agriculture	0 (0.0)	0 (0.0)	1 (100.0)	1 (100)
Home maker	2 (66.7)	1 (33.3)	0 (0.0)	3 (100)
Total	13 (26.0)	33 (66.0)	4 (8.0)	50 (100)

Source: Primary Data, Figures in Parentheses represents percentage

From the table 9 it is clear that based on the occupation the role played by the traders varies. The government employees and service sector people have widely chosen the role of speculators followed by professionals and business people.

The calculated Chi square value is 28.071 and the p value is .014 (p< 0.05). Hence there is significant influence of occupation on the role played by the traders.

**RANK GIVEN BY THE TRADERS ACCORDING TO THE SUITABILITY OF THE INSTRUMENT**

**TABLE10: RANK GIVEN BY THE TRADERS ACCORDING TO THE SUITABILITY OF THE INSTRUMENT**

Product	Total Score	Mean Score	Rank
Index Futures	5666.5	59.02	I
Stock Futures	4133	49.2	II
Index Options	3988	48.05	III
Stock Options	3152.5	41.48	IV

Source: Primary Data

Table 10 shows that index futures are most suitable to trade because of its diverse nature and high volume even during economic recession, which makes traders to enter easily, earn high return and exit.

**PRIORITY GIVEN BY THE STOCKBROKERS ACCORDING TO THE BENEFITS AND RISKS OF THE INSTRUMENT**

**TABLE 11: PRIORITY GIVEN BY THE STOCKBROKERS ACCORDING TO THE BENEFITS AND RISKS OF THE INSTRUMENT**

Product	Total Score	Mean Score	Rank
Index Futures	1127	66.29	I
Stock Futures	853.5	56.9	II
Index Options	725	45.31	III
Stock Options	547	36.47	IV

Source: Primary Data

Table 11 shows that the members' opinion goes with the traders except in the shift in position between index option and stock futures. Index option gets second rank because of the diverse nature of index. Stock futures ranks third because of the high risk factor in it.

**INFLUENCE OF EXPERIENCE OF THE TRADER ON THE RISK EXPOSURE IN FUTURES AND OPTIONS MARKET**

**TABLE 12: INFLUENCE OF EXPERIENCE OF THE TRADER ON THE RISK EXPOSURE IN FUTURES AND OPTIONS MARKET**

Experience(in months)	Risk exposure in the futures and options		Total
	Yes	No	
1 – 24	18 (75.0)	6 (25.0)	24 (100)
25 – 48	10 (66.7)	5 (33.3)	15 (100)
Above 48	8 (72.7)	3 (27.3)	11 (100)
Total	36 (72.0)	14 (28.0)	50 (100)

Source: Primary Data

Note: Figures in Parentheses represents percentage

Table 12 shows that there is very mere difference in risk exposure between the trade having experience below two years and the traders of experience above 4 years. The calculated Chi square value is 0.496 and p value is 0.780(p>.05). Hence there is no significant relationship between experience and the risk met by the traders in futures and options.

## INVESTMENT PATTERN OF THE RESPONDENTS IN EQUITY AND DERIVATIVES MARKET

TABLE 13: INVESTMENT PATTERN OF THE RESPONDENTS IN EQUITY AND DERIVATIVES MARKET

Investment pattern	No.of traders	Percentage %
Equity	25	50.0
Futures	18	36.0
Options	7	14.0
Total	50	100.0

Source: Primary Data

Table 13 shows that majority of the traders of around 50% follow the investment pattern of equity shares than futures and options.

## FINDINGS

- ✓ The analysis portrays that the majority of the respondents who involved in trading futures and options were youngsters under the age group of 21 – 35.
- ✓ The study reveals that business and privately employed people are interested in trading especially married degree holders.
- ✓ It is apparent from the study that the brokers were the main source of contact and created awareness to the traders.
- ✓ The study reveals that the majority of the traders preferred direct personal contact with the broker in trading.
- ✓ Majority (64%) of the traders plays the role of speculators and none of the traders were Arbitrators.
- ✓ The study reveals that the experience in the field of futures and options has no significant relationship with the rate of hedging and speculation
- ✓ Majority of the traders are exposed to high risk ,but even then they have not stopped trading .Instead they are trying to identify the better solution to reduce the risk.
- ✓ The study reveals that the majority of the traders invest in the cash market rather than in futures market and equity market.
- ✓ The analysis portrays that the hedgers has comparatively lower risk exposure than the speculators.
- ✓ The traders have given first rank to index futures, then to stock futures, index options and stock options respectively.
- ✓ The brokers have given first rank to index futures, then to index options, stock futures and stock options respectively.
- ✓ The analysis shows that majority of the traders follow the investment pattern of equity shares than futures and options.

## SUGGESTIONS

- The traders should have proper knowledge about the instrument, its risk, benefits and strategies before entering the market to play safe and successful in the market.
- Read and properly understand the risks associated with investing in securities/derivatives before undertaking transactions.
- The traders must be aware of the risks and benefits in trading through various sources like media, news papers, magazines, websites etc.
- The trader must consider his/her financial strength and obligations before starting to trade in the derivatives market.
- The economic variables affecting the stock market are to be considered before placing the orders.
- The traders need to get the expert's opinion and advice before trading rather than merely relying on broker.
- The traders need to have detailed information about the broker with whom they are in contact for trading.
- The trends in futures and options market need to be analyzed to play safe and successful in the market.
- Investors who trade in derivatives at the exchange should carefully read the Model Risk Disclosure Document and the details contained therein before entering into the markets.
- Traders must not blindly imitate investment decisions of others who may have profited from their investment decisions.
- Be aware of your rights and responsibilities
- In case of complaints approach the right authorities for redressal in a timely manner.

## CONCLUSION

Futures and Options market provides the benefits of playing different roles in the market according to the objective of the trader. It offers different instruments to trader to choose suitable instrument. It provides contracts of different duration to avail it according to the forecasting ability of the trader and objective in trading. In addition, the trader gets the benefits of high leverage, price discovery, lower transaction cost, cash settlement and initial payment in the form of collateral. Investors must understand that investment in derivatives has an element of risk. In addition , it is generally not an appropriate avenue for someone of limited resources/ limited investment, limited knowledge and low risk tolerance. An investor should therefore carefully consider whether such trading is suitable for them in lights of their financial condition. An investor must accept that there can be no guarantee of profits or no exception from losses while executing orders for purchase and / or sale of derivative contracts, Investors who trade in derivatives at the exchange should carefully read the Model Risk Disclosure Document and the details contained therein before entering into the markets. An efficient trader should know the benefits and risks involved in trading and try to manage the risks using the risk management strategies so as to efficiently trade in futures and options market.

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