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Investors perception towards investment in financial derivatives in Vizag city

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Abstract

Innovation of derivatives have redefined and revolutionized the landscape of financial industry across the world and derivatives have earned a well-deserved and extremely significant place among all the financial products. Derivatives are risk management tool that help in effective management of risk by various stakeholders. The emergence of the market for derivative product, most notably Forwards, futures and options, can be traced back to the willingness of risk-averse economic agents to guard themselves against uncertainties arising out of Fluctuations in asset prices. By their very nature, the financial markets are marked by a very high degree of volatility. Through the use of derivative products, it is possible to partially or fully transfer price risks by locking – in asset prices, As Instruments of risk Management; these generally do not influence the fluctuations in the underlying asset prices. However, by locking in asset prices, derivative products minimize the impact of fluctuations in asset prices on the profitability and cash flow situation of risk – averse investors. A sound risk management system is integral to an efficient clearing and settlement system. NSE introduced for the first time in India, risk containment measures that were common internationally but were absent from the Indian securities markets. This paper deals with investor perception in derivatives investment in Vizag city and concern issue and challenges.

Keywords: Risk factors, stock market, derivatives, stock exchange

Introduction

Trading in Derivatives of Securities commenced in June 2000 with the enactment of enabling legislation in early 2000. Derivatives are formally defined to include: (a) a Security derived from a debt instrument, share, loan whether secured or unsecured, risk instrument or contract for differences or any others from of Security, and (b) a contract Which derives its value from the price, or index of prices, or underlying Securities. Derivatives Trading in India are Legal and valid only if such contracts are traded on a recognized Stock exchange, thus precluding OTC derivatives.

Derivatives trading commenced in India in June 2000 after SEBI granted the approval to this effect in May 2000. SEBI permitted the derivative segment of two Stock exchanges, i.e. NSE and BSE, and their clearing house/ corporation to commerce trading and settlement in approved derivative contracts.

Derivatives are a very important financial instrument of the financial derivatives market as they help investors to hedge their risks, enable price discovery, and improve the liquidity of the underlying asset. There are different types of the derivatives market for derivative trading, namely; Options Derivatives, Future Derivatives, Index Derivatives. These financial derivatives are the financial contracts whose value is derived from their respective underlying asset. Further, there are various types of individuals with various investment goals to trade in the market, called Market Participants.

Each type of individual will have an objective to participate in the derivative market. Derivatives market participants can be divided into the following categories based on their trading motives:

Hedgers

These are risk-averse traders in stock markets. Hedgers use derivatives, especially during market volatility.

They aim at derivative markets to secure their investment portfolio against the market risk and price movements. They do this by assuming an opposite position in the derivatives market. In this way, they transfer the risk of loss to those others who are ready to take it (speculators). In return for the hedging available, they need to pay a premium to the risk-taker. This works in a way that - If you hold 100 shares of a company which is currently trading at a price of Rs.120. Your aim is to sell these shares after three months. However, you don't want to make losses due to a fall in market price. At the same time, you don't want to lose an opportunity to earn profits by selling them at a higher price in the future. In this situation, you can buy a put option by paying a nominal premium that will take care of both the above requirements.

Speculators

Speculators are the exact opposite of hedgers. These are the risk-takers of the market. Rather than protecting their portfolio, they aim at making higher gains in a shorter amount of time by taking risks in the derivatives market. Speculators take positions in the derivatives market without having a position in the underlying cash market. These positions are based upon their expectations of the price movement of the underlying assets. When they expect the market to go up, they may take a long position in these futures and when they expect the market to go down, they may take a short position in single stock futures.

This difference of perception and thought process helps them to make huge profits if the bets turn correct. In the above example, you bought a put option to secure yourself from a fall in stock prices. So on the other hand i.e. the speculator will bet that the stock price won't fall. If the stock prices don't fall, then you won't exercise your put option. Hence, the speculator keeps the premium and makes a profit

Arbitrageurs

Arbitrageurs utilize low-risk market imperfections to make profits. They buy low-priced securities in one market and sell them at a higher price in another market at the same time. This is only possible when the same security is quoted at different prices in different markets. If an equity share is trading at Rs. 1000 in the stock market and at Rs.1050 in the futures market. An arbitrageur would buy the stock at Rs 1000 in the stock market and sell it at Rs 1050 in the futures market. In this process, he/she earns a low-risk profit of Rs 50.

Literature

Nilam Panchal (2022) [6]. "Due to some adverse changes in this, which threatened the survival of business world. Therefore, in order to manage such risk, the new instruments have been developed in the financial markets, which are popularly known as financial derivatives at national and international financial market. Now there is a faster development in derivatives products as well as trading as they are very significant for every corporate and investor. The derivatives segment is to be handled by the SEBI. Derivatives segment is normal use by the trading purpose and other hand hedging purpose. In this research paper we have try to find the investors perception towards the derivatives market. Here we have found the popular strategy along with the all strategies also try to find the relation

between the income and spent in the derivatives market. We have found out the psychology towards the derivatives instrument and then which problem facing the derivatives market by the investors.

Haritha (2021) [5] 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 Return, Future Contract investments Is Risk and Safety, Option Contract Investment is Future Needs and Investments in Swaps is Future Needs. Gopal Krishna U M (2019) [4] 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.

D.V.Gakhar (2016) [2] 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.

Y. Nagaraju (2014) [3] 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.

Babraj (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.

Methodology

Objectives

1. To analyse the socio-economic profile of the investors and their investment characteristics.
2. To find out the level of awareness of the investors towards financial derivatives.
3. To analyse the investors' perceptions regarding Equity derivatives.

Hypothesis

H₀₁: There is no significant relationship between age group of investor and level of awareness about derivative market.

H₀₂: There is no significant relationship between Educational Qualification of investor and level of awareness about derivative market.

H₀₃: There is no significant relationship between Marital Status of investor and level of awareness about derivative market.

Data Collection

The primary data is obtained by administering a structured questionnaire/ schedule to investors & stock broking companies in Vishakhapatnam.

Sample Size

A sample of 100 above profile responded opinion was collected with the help of a short questionnaire.

Influencing factor attracts to invest in equity derivative market

Table 1: KMO and Bartlett's test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy		.657
Bartlett's Test of Sphericity	Approx. Chi-Square	2291.559
	DF	21
	Sig.	.000

The KMO value is 0.65 >0.6. Bartlett's Test of Sphericity indicates a measure of the multivariate normality of set of

variables (Sig. value is less than 0.00 indicates multivariate normal and acceptable for factor analysis).

Table 2: Communalities

	Initial	Extraction
Low Risk	1.000	.490
Low Investment	1.000	.962
High Return	1.000	.962
High Liquidity	1.000	1.000
Price discovery	1.000	1.000
Less brokerage	1.000	.953
Sufficient time to square off	1.000	.953

Extraction Method: Principal Component Analysis.

The above table shows communalities which indicate how much of the variance in the variables has been accounted for by the extracted factors. The item named "Low Risk factor"

is removed further steps of factor analysis as its extraction value is less than 0.5 and rest of items has been accounted for further analysis.

Table 3: Total variance explained

Component	Initial Eigen values			Extraction Sums of Squared Loadings			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	2.872	41.023	41.023	2.872	41.023	41.023	2.163	30.899	30.899
2	2.111	30.159	71.182	2.111	30.159	71.182	2.145	30.637	61.537
3	1.337	19.103	90.285	1.337	19.103	90.285	2.012	28.748	90.285
4	.680	9.715	100.000						
5	7.547 17	1.078 15	100.000						
6	-1.920 16	-2.742 15	100.000						

Extraction Method: Principal component analysis

From the above table it is observed that 3 components or factors are having Eigen value more than 1, so only these 3 factors (value of component 1 = 2.872, component 2 = 2.111, and component 3 = 1.337) are considered for further analysis. Further, the extracted sum of squared holding % of variance depicts that the first factor accounts for 41.023% of the variance features from the stated observations, the second 30.15%, and the third 19.1%. Thus, 3 components are effective enough in representing all the characteristics or components highlighted by the stated 7 variables.

6 items are divided into 3 variables according to the most important items which are similar responses in component 1 and simultaneously in components 2, and 3. The gap (empty spaces) on the table represents loadings that are less than 0.5, this makes reading the table easier. We suppressed all loadings less than 0.5.

H₀₁: There is no significant relationship between age group of investor and level of awareness about derivative market.

Table 4: Component Matrix^a

	Component		
	1	2	3
Low Investment		.910	
High Return		.910	
High Liquidity	.743		.590
Price discovery	.743		.590
Less brokerage	.840		
Sufficient time to square off	.840		

Extraction Method: Principal Component Analysis.
a. 3 components extracted.

The Table below shows the loadings (extracted values of each item under 3 variables) of the 7 variables on the 3 factors extracted. We have extracted 3 variables wherein the

Table 2: Chi-Square Tests

	Value	DF	Asymp. Sig. (2-sided)
Pearson Chi-Square	119.557 ^a	6	.000
Likelihood Ratio	157.589	6	.000
Linear-by-Linear Association	1.727	1	.189
N of Valid Cases	500		

a. 0 cells (.0%) have expected count less than 5. The minimum expected count is 11.20.

From the above table it is observed that Chi Squared test value is 119.55, p = 0.00 (<0.05), so null hypothesis shall be rejected. We can conclude that there is statistically significant relationship among age group of investor and level of awareness about derivative market.

H₀₂: There is no significant relationship between Educational Qualification of investor and level of awareness about derivative market.

Table 3: Chi-Square Tests

	Value	DF	Asymp. Sig. (2-sided)
Pearson Chi-Square	366.799 ^a	15	.000
Likelihood Ratio	442.087	15	.000
Linear-by-Linear Association	8.456	1	.004
N of Valid Cases	500		

a. 2 cells (8.3%) have expected count less than 5. The minimum expected count is 3.00.

From the above table it is observed that Chi Squared test value is 366.79, $p = 0.00$ (<0.05), so null hypothesis shall be rejected. We can conclude that there is statistically significant relationship among Educational Qualification of investor and level of awareness about derivative market.

H₀₃: There is no significant relationship between Marital Status of investor and level of awareness about derivative market.

Table 4: Chi-Square Tests

	Value	DF	Asymp. Sig. (2-sided)
Pearson Chi-Square	7.3998	2	.116
Likelihood Ratio	8.002	2	.000
Linear-by-Linear Association	10.238	1	.000
N of Valid Cases	500		

a. 1 cell (16.7%) has expected count less than 5. The minimum expected count is 4.00.

From the above table it is observed that Chi Squared test value is 7.399, $p = 0.116$ (>0.05), so null hypothesis shall be accepted. We can conclude that there is no statistically significant relationship among Marital Status of investor and level of awareness about derivative market.

Discussion of Results

According to the results of this study, investor view of financial derivatives in India has changed in recent years, with investment in financial derivatives growing year after year. Investors' socioeconomic profiles (such as age, gender, income, and education, among other things) and investing patterns vary. Most investors believe that investing in derivatives is riskier than other avenues of investment. The majority of investors have discovered that liquidity and transparency are quite high in financial derivatives. The main disadvantages in derivatives market include volatility, large contract sizes, and a lack of flexibility; small investors are suffering a lot for investment in financial derivatives. Investing in financial derivatives entails both high risk and good return. As the derivative market provides a higher return by hedging interest rate and currency rate risk with maximum revenue. For their investments in financial derivatives, the majority of investors depend on third parties like brokers and social media. This is made possible by the market's significantly increased number of trading agents. Most of the investors are not aware about the derivatives trading mechanisms. The investors mostly depend on professionals or experts and stock broker for trading in derivatives. There on the light of the above concerned authorities must take efforts to educate the investors. The main reason for the problems in the Futures and Options trading in the study is that lack of right information at the right time. This can be rectified by the authorities by

providing necessary information through their online websites, Social media, National Seminars and so on. The Stock Broking firms should provide mock trades, handouts and advices to create optimism among the investors. It is advisable to minimize the contract size because small investors cannot afford this much of huge premium. Investors felt that margin trading in derivative segment was the main barrier for investing, so the Institutions should work on this to reduce the margin.

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