

A Study On The Awareness Level Among The Retail Investors About Futures Market As Investors Risk Reducer

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INTRODUCTION

A futures contract is a type of derivative instrument, or financial contract, in which two parties agree to transact a set of financial instruments or physical commodities for future delivery at a particular price. If you buy a futures contract, you are basically agreeing to buy something that a seller has not yet produced for a set price. But participating in the futures market does not necessarily mean that you will be dependable for receiving or delivering large inventories of physical commodities - remember, buyers and sellers in the futures market primarily enter into futures contracts to hedge risk or speculate rather than to exchange physical goods (which is the primary activity of the cash/spot market). That is why futures are used as financial instruments by not only producers and consumers but also speculators.

The harmony in the investment world is that the futures market is a major financial hub, providing an outlet for forceful competition among buyers and sellers and, more importantly, providing a center to manage price risks. The futures market is extremely liquid, risky and complex by nature, but it can be understood if we break down how it functions.

LITERATURE REVIEW

1. **Steven R. Grenadier Allen M. Weis Investment in technological innovations: An option pricing approach, 1998.** This paper develops a model of the optimal investment strategy for a firm confronted with a sequence of technological innovations. We incorporate many of the most important characteristics of real-world technology markets. For example, we permit innovations to be stochastic in their arrival times and their profitability. We also incorporate learning so that firms adopting current innovations become better able to benefit from future innovations. The model yields four distinct investment strategies. The model is then used to predict actual firm policy. These implications are discussed and compared with observed firm behaviour.
2. **Gerald D. Gay, The quality option implicit in futures contract Available online, 2002.** The quality option implicit in futures contracts allows the short position to satisfy the contract by delivering one of a variety of specified assets. If, at the time the contract is purchased, knowledge of which of the allowed assets will be cheapest at maturity is uncertain, then the quality option will have value. The greater the value of this option, the lower will be the futures price. This paper presents, and tests, a futures pricing model that incorporates the quality option aspect of commodity futures contracts. Our research shows that the quality option has a significant impact on futures prices.
3. **Theodore E. Day, Stock market volatility and the information content of stock index options, 2002.** Previous studies of the information content of the implied volatilities from the prices of call options have used a cross-sectional regression approach. This paper compares the information content of the implied volatilities from call options on the S&P 100 index to GARCH (Generalized Autoregressive Conditional Heteroscedasticity) and Exponential GARCH models of conditional volatility. By adding the implied volatility to GARCH and EGARCH models as an exogenous variable, the within-sample incremental information content of implied volatilities can be examined using a likelihood ratio test of several nested models for

conditional volatility. The out-of-sample predictive content of these models is also examined by regressing *ex post* volatility on the implied volatilities and the forecasts from GARCH and EGARCH models.

4. **Rama, Marc potters Scaling in Stock Market Data: Stable Laws and Beyond 1997** The concepts of scale invariance and scaling behaviour are now increasingly applied outside their traditional domains of application, the physical sciences. Their application to financial markets, initiated by Mandelbrot in the 1960s, has experienced a regain of interest in the recent years, partly due to the abundance of high-frequency data sets and availability of computers for analyzing their statistical properties. This lecture was intended as an introduction and a brief review of current research in a field which is increasingly applied in the study of time aggregation properties of financial data. They tried to show how the concepts of scale invariance and scaling behaviour may be usefully applied in the framework of a statistical approach to the study of financial data, pointing out at the same time the limits of such an approach.
5. **David Aboody, Market valuation of employee stock options 1999.** This study investigates whether investors incorporate the value of a firm's outstanding employee stock options into its stock price. They estimate the outstanding options' value for a sample of firms for which outstanding fixed options exceed 5% of outstanding common shares in 1988. They find a negative correlation between the value of outstanding options and a firm's share price. The correlation is stronger (i) for the option's intrinsic value than for the option's time value, (ii) for options that are later in their vesting stage than earlier in their vesting stage, and (iii) for large firms than for small firms. In addition, the FASB's method for calculating compensation expense has no explanatory power in the presence of this paper's calculation of the options' value.
6. **Andreas Grünbichler, Francis A. Longstaff, Valuing futures and options on volatility 1999.** This paper presents simple closed-form expressions for volatility futures and option prices and examines their implications for the characteristics of these securities. They show that the properties of these volatility derivatives are fundamentally different from those of conventional option and futures contracts. This analysis also provides insights into the role that volatility derivatives may play in managing and hedging volatility risk in financial markets.
7. **Philip G. Berger, Eli Ofek, Itzhak Swary Investor valuation of the abandonment option 1999.** They investigate whether investors price the option to abandon a firm at its exit value. Theory prices this real option as an American put with both a stochastic strike price (exit value) and a stochastic value of the underlying security (the value of cash flows). The empirical implications are that firm value increases in exit value, after controlling for expected going-concern cash flows, and that more generalizable assets produce more abandonment option value. Using discounted earnings forecasts to proxy for expected cash flows and prior literature to categorize asset generalizability, we find strong support for the predictions of abandonment option theory.

OBJECTIVES OF THE STUDY

- The prime objective of this research study is to know the awareness among the retail investors about futures and options.
- To find out the satisfaction level of investors by investing through such derivatives
- How well investors utilized derivatives in minimizing their investment risk.
- Criteria for investment in the present scenario
- How the unknown segment of futures and options want to know more about this tool.
- To identify the potential of futures and options in the future.

RESEARCH METHODOLOGY

It is a freelance type study. Along with the study about the investors of different security dealers it has a field study with general investor analysis. A structured questionnaire is used for data collection from

100 respondents, which includes clients of various broking houses and investing public. The random sampling technique is used for the study.

ANALYSIS AND INTERPRETATION

AWARENESS TO FUTURES AND OPTIONS

Table No. 1

AWARENESS OF DERIVATIVES	RESPONDENTS	PERCENTAGE
YES	42	42
NO	58	58

Only 42% of the respondents are aware of futures and options or partially know about them. The remaining 58% do not know about futures and options. This indicates that still futures and options are not known to a large segment of investors. This shows that media and market experts have not been so effective in educating the investors about futures and options.

INVESTMENT OF THE RESPONDENTS

Table No. 2

INVEST	FREQUENCY	PERCENTAGE
EQUITIES	16	16
DERIVATIVES	22	22
COMMODITIES	21	21
FOREX	12	12
REAL ESTATE	7	7
POST OFFICE	3	3
BANKS	12	12
MUTUAL FUNDS	7	7
TOTAL	100	100

INTERPRETATION

The above table infers that 16 %of respondents invested in equities, 22% of the respondents invested in derivatives,21 %of the respondents invested in commodities, 12% of respondents invested in FOREX, 7% of the respondents invested in real estate,3 %of the respondents invested in post office, 12% of the respondents invested in banks, 7 %of the respondents invested in mutual funds.

RESPONDENTS WHO THINK RISK CAN BE MINIMIZED

Table No. 3

RISK CAN BE MINIMIZED	RESPONDENTS	PERCENTAGE
YES	93	93
NO	7	7

As the saying goes “higher the risk higher the return”, 7% of the respondents are of the opinion that risk cannot be minimized and the remaining 93% says that risk can be minimized. Risk is involved in every investment, in some investments it may be less and in some investments it may be high. The respondents are of the opinion that the risk involved in investments can be minimized.

RISK MINIMIZING INSTRUMENTS

Table No. 4

INSTRUMENTS	RESPONDENTS	PERCENTAGE
INSURANCE	56	56
POST OFFICE	10	10
GOVERNMENT BONDS	6	6
FUTURES & OPTIONS	26	26
OTHERS	2	2

As an instrument of minimizing risk the respondents are aware of insurance than derivatives. Insurance constitute 56%, followed by futures and options 26%, post office 10%, government bonds 6% and others 2%. As compared to futures and options, insurance is very easy to understand and to deal with. So the respondents opt for insurance as a risk minimizing instrument rather than complicated futures and options.

RESPONDENTS WHO LIKE TO KNOW MORE ABOUT THEM

Table No. 5

LIKE TO KNOW MORE	RESPONDENTS	PERCENTAGE
YES	85	85
NO	15	15

The above table shows that about 85% of the respondents want to know more about futures and options, this also include people with partial knowledge and the remaining 15% say no. This can be either they know about them or do not want to know about it. Majority of the respondents want to know more about futures and options. As the futures and options are little complex to understand, respondents would like to know more about them.

TABLE SHOWING CHI SQUARE

Table No. 6

Null Hypothesis: There is no significant association between qualification and investment preference.

Alternative Hypothesis: There is significant association between qualification and investment preference.

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	12.413 ^a	8	0.134
Likelihood Ratio	12.814	8	0.118
Linear-by-Linear Association	0.298	1	0.585
N of Valid Cases	100		

a. 6 cells (40.0%) have expected count less than 5. The minimum expected count is .20.

INTERPRETATION:

The chi square (1, N=100) =12.413, p=0.134 which is greater than .05, the null hypothesis is accepted hence we say that there is no association between qualification and investment preference.

TABLE SHOWING CHI SQUARE

Table No. 7

Null Hypothesis: There is no significant association between instruments to invest and investment preference.

Alternative Hypothesis: There is significant association between instruments to invest and investment preference.

Chi-Square Tests			
	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	10.743 ^a	14	0.706
Likelihood Ratio	10.717	14	0.708
Linear-by-Linear Association	1.393	1	0.238
N of Valid Cases	100		

a. 16 cells (66.7%) have expected count less than 5. The minimum expected count is .60.

INTERPRETATION:

The chi square (1, N=100) =10.743, p=0.706 which is greater than .05, the null hypothesis is accepted hence we say that there is no significant association between instruments to invest and investment preference.

TABLE SHOWING ONE WAY ANOVA

Table No. 8

Null Hypothesis: There is no significant association between investment in futures and options

Alternative Hypothesis: There is significant association between investment in futures and options

How Long You Have Investing in Future and Options					
	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	3.661	4	0.915	1.076	0.373
Within Groups	80.779	95	0.85		
Total	84.44	99			

Inference:

The calculated significance value (0.373) is higher than the level of significance (0.05) so the null hypothesis is rejected and alternative hypothesis is accepted. Hence there is significant difference between reducing risk through future and options & experience in the share market

FINDINGS

Major parts of the respondents are employees and regular investors to stock markets.

- The respondents consider safety and liquidity to be the prime importance and therefore want to invest their savings in banks rather than in the stock market and other investment avenues.
- Major portions of investors consider insurance, as the best hedging tool and the exposure to futures and options is also quite well.
- Respondents believe that futures and options are very technical and difficult to understand.

CONCLUSION

Though the derivatives market has overtaken the cash market in daily turnover and volumes we can see that the awareness among the investing public about futures and options as a tool of hedging is not much and respondents think that this topic is highly technical and complicated to understand. And a few respondents know about derivatives and are reluctant in keeping heavy sums and margins with brokers. As the study shows that most of the respondents do not want to take risk in their investment, the futures and options can be an ideal tool for minimizing their investment risk. But the problem is, they are not aware of futures and options fully. There is a necessity on the part of the media and market experts to make futures and options more familiar among the investing public.

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