Chapter -6
Suggestions and Conclusions

6.1 Suggestions

6.2 Conclusions

6.3 Future Scope for Research

6.1 Suggestions

1) There was a point of deliberation in the L C Gupta committee report on the introduction of a separate derivative exchange. It has been analysed that the market (52%) does not find it relevant in today’s circumstances for introducing a separate derivative exchange. They find the present arrangement and structure enable them to carry out their trades efficiently. Hence there is no need to introduce a separate derivative exchange presently.

2) It is recommended that a strong single clearing corporation to clear all trades under exchanges be set up. This would help control settlements of trades in an effective and transparent manner leading to lower defaults in delivery and payments in multiple markets.

3) It is recommended that a strong audit body with regular audits should be active throughout the year to detect any upcoming signs of manipulation etc. Although audits are conducted periodically by the regulatory bodies, its felt that a stronger initiative towards this direction is needed. The same should be not be a burden on the traders for compliance but should be facilitated as a normal routine activity with less paper work and more automation.

4) It’s recommended that rigorous and continuous training should be the norm for as an eligibility to remain as members in the market. The initiative should not be considered as a cost centre but should be considered as an investment for future returns.

5) An awareness drive amongst investors should be a continuous initiative so that investors park their money in the markets with full knowledge of risks involved in the business. This would help build an efficient and strong market with a symmetric and homogeneous group participating in the market.
6) It is recommended that efforts towards developing a matured market should be taken by the regulatory bodies like NSE, BSE and MCX etc. Maturity could be described leading towards an efficient market with an appropriate and transparent regulatory structure, adequate number of players, and availability of symmetric information. Maturity could be also described as building of strong processes and procedures immune to kneejerk reactions and immature shocks and vibrations, responses to the timeframe in responding to failures, complaints and feedbacks. It also includes developing an idea or a policy as and when the need arises. As per the Indian Express report on 10th July 2012, the Indian Stock Market activities have very low penetration of less than 2% of its population of over 1.2 billion, which takes part in exchange traded activities. In most mature markets penetration is 30% - 50%. In USA out of total population of 300 million over 50% participates in exchange traded activities. In India only top 5 cities contribute towards ¾th of total market turnover. Top 25 brokers account for 45% of equity volumes in the country. The equity segments accounts for over 75% of all market activities. Hence we see that there is a large scope to build the financial markets.

7) It’s been recommended that we move towards a t+1 settlement system for small tickets as recommended by players in the market.

8) It’s recommended that steps should be taken to generate liquidity in interest rate futures. The prime deterrent seems to be the mandatory physical delivery in the interest rate futures market.

9) An effort towards building risk management models with respect to Indian conditions should be encouraged. Presently we find that all these models although may be workable are built on conditions of foreign markets, which if applied to Indian market conditions may or may not give the desired results.

10) It is recommended that a strict compliance of separation of front and back operations should be mandated. Every financial decision should be transparently shared with in the organisational setup. These may avoid unnecessary repercussions which might lead to harm the organisations and market sentiments.
11) Human Greed overtakes balanced sensibilities. Although this tendency may not be controlled, all efforts and developing foolproof systems to recognize the signs of it in time and taking pro-active action, before it does collateral damage to the financial system should be done.

12) It is recommended that strong, responsive investor protection mechanism be set up, although the present system and infrastructure is just proving to be adequate.

13) Need for a single regulator is being felt for a long time by the markets for their efficient and effective functioning. It is suggested that steps towards forming such a body by amending appropriate laws be done with an emergent mindset.

14) A long term plan (10 years) could be made to develop the derivative market segment to give it a larger scope in the future.

6.2 Conclusions

There is a vast scope for our markets to develop vis-a-vis the growth and development around the world. Currently, Indian derivative market is passing through teething problems and testing waters. Maturity in this segment would come over the years with passage of time. Our regulators approach towards developing this segment seems to be positive but conservative. This of course is to protect the investor's interest and setbacks to our financial systems. There is a wide scope to study the functioning of derivative markets and models in Indian conditions to determine the market’s functionality and effectiveness. A number of researchers have thrown light on the efficacy of the functioning of the derivative market, thus giving insights into designing future strategies by the stake holders. Conclusions could be drawn through following points:

1) Trading in derivatives is a riskier option than cash market due to high leveraged positions taken by counter parties but it is also a tool to hedge risk associated with price volatility and delivering underlying assets.

2) In developed countries regulators are well aware of the risks involved and take measures from time to time to control the risk factors. But since they work on the capitalist model the regulators allow the markets to determine their profit and loss positions.
3) Experts have developed models over the years to gauge risks involved in transactions, predict probable gains/losses. The models may not necessarily hold well against the unpredictable forces of markets. Hence continued efforts are made by market participants to refine and develop to come as close as possible to predict market gains and losses. A revision for stress testing of VaR limits adapted by equity houses may be considered due to fast and dynamically changing domestic and world market conditions. The confidence level used for computing VaR may also need some stress tests.

4) Indian equity derivative markets are small compared to the turnovers of developed countries. Our regulators have studied problems as faced by developed markets and have designed our regulations and risk models to adapt to Indian conditions. They have tried to peg the loop holes through strict market playing conditions. This has helped our Indian markets to develop in a structured manner without any major financial collapses. Operational problems are taken care by exchanges routinely and effectively.

5) An awareness generation though is needed to make this market segment more popular. But the same cannot be done without introducing products which gives opportunities for the market players to make gains. But the same could be risky at this stage. So a future scope could be developed by taking into consideration the micro and macro economic factors of our financial markets.

6) A very strict control and vigil over trades which trigger red flags help in controlling malpractices.

7) High end technology has to back the growth and development of the segment. Since technology plays a vital role in price discovery process, delivery and exchange of underlying assets and cash, their effective and efficient functioning without glitches becomes paramount. Technology also connects different markets around the world which help market gain real time data, information without delay. Therefore an efficient technology becomes the focal point in development of the markets.
8) Derivatives help in lowering the volatility in the cash market which has been validated by secondary data study. The standard deviation was 201.78 before introduction of derivatives trading at NSE and after the introduction it was posted at 1.73. The result validates the hypothesis that the functioning of derivatives is effective.

9) We find that there is a strong correlation between the derivative market and NSE cash market which stood at 0.999974. It signifies that the price movements in the derivative segment affect the cash market strongly and that the cash market follows the derivative market for price determination. The price discovery happens in the derivative segment which is one of the functions of derivative market. The result validates the hypothesis that the functioning of derivatives is effective.

10) ‘Risk awareness’ practice before selling products to clients is being observed by 88% (trading members) of respondents, which is a mandatory requirement for selling derivative products. This validates hypothesis that the functioning of derivatives is effective as majority of the respondents follow the mandatory requirement.

11) A separation in the operation of front, middle and back offices is being done by 100% (trading members) respondents, which is a very positive sign in the back drop of misuse of the office authority by the operators leading to many major financial scams. This again validates hypothesis that derivative markets are effective.

12) 94% (trading members) respondents feel that they do not face any operational difficulties by executing derivative transactions. This is a positive sign which validates hypothesis that derivative markets are effective. An overwhelming 70% finance professionals also feel that derivative trades under exchanges are well regulated with a Chi-square value of 22.800, this validates our hypothesis. Around 68% finance professionals feel that Indian derivative markets are efficient with a Chi-square of 12.766, which validates our hypothesis.

13) 82% finance professionals feel that derivative trading is better than badla trading with a Chi-square value of 82.36 thus validating our hypothesis that functioning of derivative markets is effective.
14) 72% finance professionals feel that inefficient derivative market would highly impact the Indian financial system with a Chi-square value of 31.213 thus validating that constant overhauling of the derivative segment is imperative to realize its full potentiality.

15) 62% finance professionals feel that innovation in derivative products lead to an efficient market with a Chi-square of 26.49. But we find that only basic derivative products are traded at our exchanges. This leads to validation of hypothesis that an overhauling is imperative to realise the derivative markets full potentiality.

16) Our derivative markets are not adequately integrated with international derivative markets. 94% trading members do not interact with international brokers which reflect that they have limited exposure to international markets. This validates our hypothesis that an overhauling towards development and integrating our markets to world markets is needed to realise its full potentiality.

6.3 Future Scope for Research

1) The J R Verma Committee Report could be studied in detail and validated for its efficacy in today’s time.

2) My study was limited to Mumbai as it being the financial hub of India. The study could cover metropolitan cities to identify the penetration of financial literacy and functioning of the derivative markets.

3) A detailed study could be undertaken to determine the role of a lead financial regulator which has been discussed in the financial fraternity for some time.

4) Since the introduction of equity and equity derivatives at MCX- SX it would be interesting to do study its growth and response in the exchange.

5) The value at risk models adopted by mutual funds, investment banks and other financial institutions like insurance companies etc. could be studied for their efficacy.

6) The study of price volatility and price- discovery process could be studied in detail with daily or minute-to- minute price changes in cash and derivative segment.
7) Financial Sector Legislative Reforms Commission (FSLRC) was constituted by the Ministry of Finance, Department of Economic Affairs, Government of India on 24th March 2011 with a view to review and rewrite the financial sector laws to bring them at par with the current requirements. It would be interesting to study its findings on its publication. It would review SC(R) A, SEBI Act, depositaries legislation, RBI Amendment Act of 2006, FC (R) A etc. for organized financial trading.