CHAPTER – I

INTRODUCTION AND DESIGN OF THE STUDY

1.1 INTRODUCTION

In India, generally, all capital market investment avenues are perceived to be risky by the investors. Properly managed investment in equities will always give higher returns than any other form of investment, though they are volatile in the short run. Ultimately, every investment carries an inherent risk of failure. Stocks as a class have been considered the most risky financial instrument, as there are continuous ups and downs in the market. At present, there is a rigorous transformation in the capital market. The younger generation investors however, are willing to invest in capital market instruments and that too very highly in future and options segment. Even though the knowledge to the investors in the future and options segment is not adequate, they tend to take decisions with the help of the brokers or through their friends and were trying to invest in this market. A future and options value fundamentally depends on the volatility rate of the underlying asset. When the volatility rate is uncertain, the aggregation of volatility assessments across investors determines the market price.

In order to protect investors’ equity against contract default, some future exchanges impose voluntary daily price limits within which trades may occur. Once the future price has increased or decreased to the upper or lower bound, no trading at higher or lower prices is possible until the future price reverses back into
the permissible range, or until the next trading day when new limits are set. Whenever trading is ceased, the future price stops reflecting the market’s assessment of the “true” price of the contract. The future market becomes informationally inefficient because investors are prevented from incorporating publicly available information into prices.

Emerging stock markets operate in very different economic, political, technological and social environments than markets in developed countries like USA and others. Future and options play a very important role in the price discovery process and in completing the market. Their role in risk management for institutional investors and mutual fund managers need hardly be overemphasized. This role as a tool for risk management clearly assumes that future and options trading do not increase market volatility and risk. The results of this research will throw some light on the effects of future and options introduction on the efficiency and volatility of the underlying cash markets.

The present research concentrates on areas such as investment avenue risk and risk diversification, level of satisfaction and investors confidence, problems faced by the investors and important measures need to be undertaken to strengthen the stock market.

1.2 NEED FOR THE STUDY

Number of people wish to have a grand lifestyle which will give them a strong position in the society. They also want to have all the comforts and luxuries
which will make their life simpler, struggle free and allow them to live a luxurious lifestyle. Investing in different shares and derivatives is a good option for people to invest their hard earned money and increase their profits. This profit which one derives from shares and derivatives is highly useful to purchase goods and commodities that enhance their lifestyle. It also becomes an additional source of income to the individual.

A derivative that is inclusive of future and options trading is the most common of all. Future is an agreement of sorts between two individuals or parties to sell and purchase an asset of a standard quantity and quality on a particular date sometime in the future at a rate which the two parties fix and have a consensus with, in today’s date. On the other hand, options gives a right to an individual but he is not bound to buy or sell some future contract at a fixed rate for a particular time period depending on that which has been decided beforehand.

Investment risk has motivated the researcher to take-up the research in this topic of paramount importance, at this point proper investment is uprising time as an evaluation in the midst of the implementation process of a strategy.

1.3 STATEMENT OF THE PROBLEM

Future and options trading in India are seen as a pathway to those who wish to earn quick money. This is a modus operandi which will really benefit people when it is used smartly and wisely after careful analysis and thorough understanding of the volatile position of the companies during various market climates. One has
to understand the relating of high risk factors involved in future and options and there is more chances to lose money and face losses since the market is highly volatile and not in static condition. It is very difficult to find people who make money on a consistent basis in future and options and this phenomenon keeps most people outside this market. It is imperative though not easy to find the reasons for this trend which could invite more people to this segment. The regulators play a vital role in taking measures that could give confidence to common investors to venture into these highly risky but viable instruments.

The only thing that one can do to ensure success is that they need to study the market well. One has to understand the finer nuances of the market, the volatile nature of the same, investing the right amount and trading carefully.

The young investor will have a preference to guess, they do not fully understand the investment process. Guess is often the equivalent of gambling, as the young investor does not necessarily have a reason for a purchase except that there is a chance that it may go up in value. This can be dangerous, as there are many experienced professionals waiting to take advantage of their less-experienced counterparts. Finally they accrue large losses and it affects his future investment.

It is highly ridiculous to note that the Indian Stock Market and SEBI is still offering three months time period for the transactions, which may favors the adverse decision made by the clients. After this period the money investment period is automatically closed. The benefits/ loses are intimated and dispersed.
Where as in USA, they are offering eighteen months as buffer time and the contract which is only after eighteen months. This practice is not followed in derivative markets in India, which is the bottleneck for the clients.

1.4 OBJECTIVE OF THE STUDY

The following are the objectives of the study

1. To trace the origin and growth of future and options in India and analyse risk and risk diversification in future and options market.

2. To understand the profile of traders involved in future and options trading and healthy strategies adopted by traders in future and options segments.

3. To analyse the satisfaction level of future and options investors.

4. To analyse the role of future and options in determining the market direction.

5. To find out the problem faced by the investor while investing in future and options.

1.5 METHODOLOGY

The validity of any research is based on the systematic method of data collection and analysis. Both primary and secondary data were used for the present study. The primary data was collected from 600 respondents in the study area. For collecting the first-hand information, respondents were chosen by stratified random sampling method. The researcher approached the investors residing in Erode, Coimbatore, Karur, Salem, and Tirupur Districts.
1.5.1 DATA COLLECTION

Primary Data

Field survey method was employed to collect the primary data from the selected sample respondents. For this purpose, direct face to face interview method was employed to collect the data from the respondents. Hence, the researcher maintained a good relationship with the respondents. The respondents properly responded to all the questions framed in the questionnaire. The enthusiastic participation of the respondents helped the scholar to complete the task easily. The specimens of the questionnaires given to the selected sample respondents are given in the appendix section of the thesis.

The data thus collected from the primary sources of information were arranged systematically and logically and were tabulated under necessary heads for the study of various aspects and evaluation.

Secondary Data

Secondary data was also collected for this study from leading journals magazines and websites relating to stock market and future and options.

1.5.2 TOOLS FOR DATA COLLECTION

By virtue of the mass data obtained from research survey as well as data from secondary sources, descriptive and analytical research was considered the most appropriate for this study. The research problems and questionnaire were all
framed accordingly. The suggestions offered in the final chapter of the present research report emerged from the inferences drawn from the study of the sample respondent’s information thus analysed. The researcher used close-ended and open-ended questions in the questionnaire to collect the primary data.

Questionnaire was the main tool used to collect the data from the selected sample respondents. For this purpose, a well structured questionnaire was framed with the help of the Research Supervisor. The questionnaire so drafted was circulated among the experts and research scholars for their critical views with regard to its working and its format, sequence and the like. The questionnaire was modified in the light of their comments.

1.5.3 PILOT STUDY

The questionnaire was pre-tested with a set of sample respondents. Taking into consideration, the suggestions of the selected sample respondents, necessary modifications and changes were incorporated after the pilot study as suggested by the Research Supervisor.

1.5.4 FRAME WORK OF ANALYSIS

The core of the study being the risk mitigation through future and options in Indian capital market, it centers around the dependent variable viz., the level of satisfaction perceived by the investors and independent variables chosen for the study are Age, Sex, Marital status, Education, Occupation, Monthly income,
Number of earning members, Residing, Percentage of savings in income, period of
time of investment, Years of experience in future and options investment and Age
of entry in future and options market.

1.5.5 CHI-SQUARE TEST

To find the degree of influence of the independent variables on the level of
satisfaction, a chi-square ($\chi^2$) test was used and the formula is given as follows.

$$\chi^2 = \frac{\sum (O-E)^2}{E}$$

with Degree of Freedom (D.F.) = (c-1) (r-1)

where,

$O$ = Observed frequency,

$E$ = Expected frequency,

$C$ = Number of Columns,

$R$ = Number of Rows.

1.5.6 MULTIPLE REGRESSION ANALYSIS

When there are two or more independent variables, the analysis that describes
such relationship is called the multiple regression. This analysis is adopted where
there is one dependent variable that is presumed to be doing the function of two or
more independent variables. In multiple regressions, a linear composite of
explanatory variables is formed in such a way that it has the maximum correlation
with an active criterion variable. The main objective for using this technique is to
predict the variability of the dependent variable based on its co-variance with all
the independent variables. It is useful to predict the level of dependent phenomenon through multiple regression analysis models, if the level of independent variables were given. The linear multiple regression problem is to estimate the coefficients $\beta_1, \beta_2, \ldots, \beta_j$ and $\beta_0$ such that the expression,

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \ldots + \beta_j X_k$$

provides a good estimate of an individual $Y$ score based on the $X$ scores.

Where,

$Y = \text{Level of satisfaction perceived by the respondents}$

$X_1, X_2, X_3, \ldots$ refers to the independent variables

and $\beta_0 + \beta_1 + \beta_2 X_2 + \ldots + \beta_j$ are the parameters to be estimated.

1.5.7 GARRETT RANKING TECHNIQUE

This technique was used to rank the problems faced by investors selecting suitable companies to invest their capital. In this method the respondents were asked to rank the given problems and factors taking into account the magnitude of the problem or importance of the factor.

The order of merit given by the respondents was converted into ranks by using the following formula.

$$\text{Percentage Position} = \frac{100 (R_{ij} - 0.5)}{N_j}$$
The percentage position of each rank thus obtained was converted into scores by referring to the table given by Henry Garrett. Then for each factor, the scores of individual respondents were added together and divided by the total number of respondents for whom the scores were added. The mean scores for all the factors were arranged in the order of ranks and inferences were drawn on their respective scores.

**1.5.8 FACTOR ANALYSIS**

Factor analysis is a multivariate statistical technique used to condense and simplify the set of large number of variables called factors. This technique is helpful in identifying the underlying factors that determine and provide an empirical classification scheme of clustering of variables into groups called factor.

**1.6 PERIOD OF STUDY**

The study was confined to a period of 3 years i.e., from 2010 to 2012. Reviewing the relevant literature on the topic chosen and conceptual framework took one year. The data collection from the primary sources of information took one year. Preparing the master table, data analysis and interpretation took another six months. Presentation of the data in the form of the report took an additional six months.

**1.7 SCOPE OF THE STUDY**

The study highlights the factors influencing the selection of future and options and their level of satisfaction with regard to the return of their investment. It also covers the problem faced by the investors and throws light on their opinion on the risk mitigation through future and option in Indian capital market.
1.8 LIMITATION OF THE STUDY

Time is the major constraint in collecting the data from the respondents. The respondents at the level of investor were pre-occupied with their busy schedule of work and some of them were reluctant to share their valuable time with the researcher. However, the researcher’s approach and personal rapport made the study possible.

The survey was conducted particularly in Erode, Coimbatore, Tirupur, Karur and Salem Districts of Tamil Nadu. Hence, the results arrived from the study may or may not be applicable to other districts and other states of India. Further, the survey method adopted for collecting the data in this study has its own limitations.

Hence, the generalization of the findings of the study is subject to these limitations.

1.9 CHAPTER SCHEME

This empirical study is organized into seven chapters. The First Chapter deals with the introduction, design and execution of the study.

The Second Chapter gives the Review of the previous research literature.

The Third Chapter presents an overview of future and options in India.

The Fourth Chapter deals with Data analysis and Interpretation.
The Last Chapter recapitulates the key findings and presents the conclusions of the study. Based on these findings, a few suggestions are given for achieving excellence in future and options investment as desired by the investors.