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By:

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Message from the Principal

"Knowledge is always the light of happiness"

Dr. Jayan Erancheri Ilam

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Foreword

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Education aims to empower the mankind through knowledge acquisition and sharing. Due to rapid technological advancement the world is getting changed within no time. The fruits and benefits of these changes make life more easy, happy and comfortable. The Covid pandemic situation paved easy for the widespread use of technology among the people of different walks of life across the world. Innovations are taking place in production, financing, marketing, human resources, operations, logistics, warehousing, tourism etc. The knowledge, hypotheses and theories have to be shared and made available to the stakeholders of the society through different platforms. Research enriches the teaching and learning process while contributing to the body of knowledge. Organising seminars, conferences, workshops, panel discussions etc. are some of the initiatives in this direction. Publishing research articles through journals and magazines you have online and offline create platforms for the stakeholders of education like students, teachers, researchers and other academicians to understand, discuss, share, internalize and implement innovations taking place in the field of education.

The journal entitled **"Academy of Commerce Review"** is a noble attempt in this direction by the V.T. Bhattathiripad College, Sreekrishnapuram under the initiative of the P.G. Department of Commerce and Management Studies. It contains reviews and research papers related to different areas of Commerce and Management. The original articles and review papers contained therein are sure to take the readers forward in their quest for excellence in the field of academic research. I wish the College in general and the Department of Commerce and Management in particular and all success in this endeavour and hope they will continue the journey further on the path to create a benchmark for the coming generations as it will be highly useful to create, develop and sharpen the research mindset of the readers.

Sd

Prof. B. Johnson

Preface

Research is the important part for the academic development of faculty members and students of the college. We are publishing this journal from June 2015. Our research journal has separate expert committee and advisory committee which look after the plagiarism of papers. The selected papers are published in the research journal. We also promote other institutions' faculty to publish the papers in our research journal "Academy of Commerce Review". Our teachers are encouraging the students to take up research projects and involve students too.

The objective of the journal is to provide a platform to faculty, research scholars and practitioners of management discipline to highlight new knowledge, innovation, and technology usage in the commerce and management field. These papers are not meant to be the final word but rather a step towards classification and to stimulate the debate and helps you to do your further researches and thinking on the subject.

We would like to convey our appreciation to all the contributors including the authors of the chapters in this book. We would like to express special thanks to our HOD, Ms. Bindu T. for her continuous support and great effort to bringing the book into fruition. We also express our sincere gratitude to Dr. E.Jayan–our Principal, Dr. Saritha Namboodiri—IQAC Coordinator, all colleagues and staff of our college.

Dr. Vinitha A.S.

Ms. Vidya K.

Ms. Anu A.N.

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Dr. Vinitha A.S. is working as Assistant Professor, PG Department of Commerce and Management Studies, Sreekrishnapuram V.T. Bhattathiripad College, Mannampatta, Palakkad, affiliated to University of Calicut. She has 14 years of teaching experience in the field of commerce education. She had acted as resource person in national level seminar. She had presented several research papers in national and international seminar in the field of commerce. She had published several research articles in national and international journals. Her area of interest includes Research Methodology, Human Resource Management and Investment Management.

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A Study on Derivative Markets in India

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ABSTRACT

Derivative market has a significant role in country's economic development. Currently, financial derivatives have become increasingly popular and utmost frequently used in the world of finance. In India, the emergence and growth of the derivatives market is relatively more. The main objective of this study is to understand about derivatives and also to minimize the risks associated with such trades by analyzing the factors contributing towards the growth of derivatives.

Keywords: *Financial market, Derivatives.*

Introduction

A derivative is a complex type of financial security that is set between two or more parties. Traders use derivatives to access specific market and trade different assets. Derivatives are important breed of financial instrument which are central to today's financial markets. In India, the derivative market segment is very popular and quit active. It is very clear that in currency markets, commodity markets and stock markets involving all the market participants face considerable risk on account of price fluctuations regarding assets traded in these markets. In financial market system, derivatives can improve a market's efficiency by price discovery, liquidity and transfer of risk. Moreover investors and business houses use derivatives to hedge or manage their risk.

A derivative instrument helps to hedge the risk involved in the trading of an underlying asset. In short derivatives are those financial instruments which derive value from an underlying asset or index. The underlying assets are of two types, namely commodities like gold, cotton, pepper etc. and financial assets like shares, currencies, bonds etc. the basic purpose of these instruments is to provide commitments to prices for future dates for giving protection against adverse movements in future price, in order to reduce the extent of financial risk. Not only this, it also provides opportunities to earn profit for those persons who are ready to go for higher risks. In other words, these instruments, indeed, facilitate to transfer the risk from those who wish to avoid it to those who are willing to accept the same.

Objectives and Research Methodology

Objectives of the study

- To analyze the role of derivatives in Indian stock market
- To analyze the factors contributing towards the growth of derivative market

Research methodology

The study mainly focuses on secondary data. The information about the problem is collected from several secondary sources such as the research journals, trade magazines and the internet.

Results and Discussion

Indian Derivative Market

As the initial a step towards the introduction of derivatives trading in India SEBI set up a 24 member committee under the chairmanship of Dr. Lc Guptha on November 18, 1996 to develop an appropriate regulatory framework for derivatives trading in India. The committee submitted the report on March 17th, 1998 recommending that derivatives should be declared as securities so that regulatory framework applicable to the trading of securities could also governen the trading of derivatives. Subsequently SEBI set up a group in June 1998 under the chairmanship of prof. JR Verma, to recommend submitted its reports in October 1998. It worked out the operational details of the margining system, a methodology for charging the initial margins, membership details and netwoth criterions, deposit requirements and real time monitoring of positions requirements. The Exchange Traded Derivatives started in India in June 2000 with SEBI permitting BSE and NSE to introduce the equity derivative segment. To begin with SEBI approved trading in Index Futures contracts based on NIFTY and SENSEX, which commenced trading in June 2000. Later trading in Index Options commenced in June 2001 and trading in Options on Individual stocks commenced in July 2001. Future contracts on Individual stocks started in November 2001. Metropolitan stock exchange of India ltd (MESI) started trading in derivative products in February 2013. Derivatives market in India has a history dating back in 1875. The Bombay Cotton Trading Association started Future trading this year. History suggests that by 1900 India became one of the world's largest Future trading industry. However after Independence in 1952, the Government of India officially put a ban on cash settlement and option trading. The ban on commodities Future trading was uplift in the year 2000. The creation of national electronics commodity exchange made it possible. In 1993, the National Stock Exchange, an electronics based trading exchange came in to existence. The Bombay Stock Exchange was already fully functional for over hundred years then. Over the BSE, Forward trading was there in the form of Badala trading, but formally derivatives trading kicked started in its presence from after 2001 only. The NSE started trading in CNX NIFTY Index Futures on June 12, 2000, based on CNX NIFTY50 Index.

Categorization of Derivatives

Commodity derivative

Commodity derivatives are the investment tools that allow investors to profit from certain commodities without possessing them. The buyer of the derivative contract buys the right to exchange a commodity for a certain price at a future date. The buyer may be buying or selling the commodity.

Financial derivative

A financial derivative is a contract between two or more parties whose value is based on an agreed-upon underlying financial asset (like security) or set of assets (like an index). Common underlying instruments includes bonds, commodities, currencies, interest rates, market index, and stocks.

Forwards

Forwards are over the counter (OTC) derivative that enable buying or selling an underlying on a future date, at an agreed upon price. The terms of a forward contract are as agreed between counterparties.

Futures

Futures are exchange traded forwards. A future is a contract for buying and selling a specific underlying, on a future date, at a price specified today, and entered through a formal mechanism on an exchange. The terms of the contract are specified by the exchange.

Options

An option is a contract that gives right, but not an obligation, to buy or sell the underlying on or before a stated date and at a stated price. While buyer of an option pays the premium and buys the right, writer/seller of an option receives the premium with obligation to buy/ sell the underlying asset, if the buyer exercises his right.

Swaps

A swap is an agreement made between two parties to exchange cash flow in the future according to a prearranged formula. Swaps are a series of forward contracts. Swaps helps market participants manage risk associated with volatile interest rates, currency exchange rates and commodity prices.

Factors Contributing to the Growth of Derivatives

Factors contributing to the growth of derivatives are price volatility, globalization of markets, technological developments and advances in the financial theories.

Price volatility

A price what one pays to acquire or use of something of value. The objects having value may be commodities, local currency or foreign currencies. The concept of price is clear to almost everybody when we discuss commodities. There is a price to be paid for the purchase of food grain, oil, petrol, metal etc. the price one pays for use of a unit of another person's money is called interest rate. And the price one pays in one's own currency for a unit of another currency is called exchange rate.

The changes in demand and supply influencing factors culminate in market adjustments through price changes. These price changes expose individuals, producing firms and governments to significant risks.

Globalization of markets

Earlier, managers had to deal with domestic economic concerns; what happened in other part of the world was mostly irrelevant. Now globalization has increased the size of markets and has increased the size of markets and has greatly enhanced competition. It has benefited consumers who cannot obtain better quality goods at lower cost. It has also exposed the modern business to significant risks and, in many cases, led to cut profit margins in Indian context. Thus, it is evident that globalization of industrial and financial activities necessitates use of derivatives to guard against future losses.

Technological Advances

A significant growth of derivative instruments has been driven by technological breakthrough. Advances in this area include the development of high speed processors, network system and enhanced method of data entry. Closely related to advances in computer technology are advances in telecommunications. Improvement in communications allow for instantaneous worldwide conferencing. Data transmission by satellite. At the same time there were significant advances in software programed without which computer and tele-communication advances would be meaningless. These facilitated the more rapid movement of information and consequently its instantaneous impact on market price.

Advances in financial theories

Advance in financial theories gave birth to derivatives. Initially forward contracts in its traditional form, was the only hedging tool available. Option pricing models developed by Black and Scholes in 1973 were used to determine prices of all call and put options. The work of economic theorists gave rise to new products for risk management which led to the growth of derivatives.

Conclusion

The study provides an overview of derivatives markets, products and the factors which affect the growth of derivatives. Derivatives invented to response to some fundamental changes in global financial system. They, if properly handled, should help improve the resilience of the system and bring economic benefits to the users. In this context, they are expected to grow further with financial globalization. However, past credit events exposed many weaknesses in the organization of derivative trading. The main aim is to minimize the risk associated with such trades while enjoying the benefits they bring to the financial system.

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