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RESEARCH ARTICLE

A STUDY ON TRADING AND DEVELOPMENT OF FINANCIAL DERIVATIVES: ANECDOTES FROM INDIAN STOCK MARKET

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ABSTRACT

The innovative practices always persuade concerned people whereas ideas and innovation become the hall mark of progress. Stock market is also not exempted from this; since financial derivatives have given drastic change in the growth of Indian stock market. The product of derivatives existence in Indian stock market is for minimizing price risk. The derivative Product in Indian Stock market has become multi trillion dollars over the years

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INTRODUCTION

In Indian stock market, the derivative trading has shown a tremendous growth in the recent years and has become multi trillion dollar market. Derivatives are gaining popularity among the investors due to marked with the ability to partially and fully transfer the risk by locking in assets prices. Derivatives are traded in organized stock exchanges or over the counter by derivatives dealers. The issue of the impact of derivatives trading on stock market volatility has received considerable attention in present scenario in India.

Statement of the problem

New ideas and innovations have always been the hallmark of progress made by mankind. At every stage of development there have been two core factors that drive man to ideas and innovation. Those factors are increasing return and reducing risk in all facets of life. Similarly a lot of innovation has taken place in developing the financial products like derivative existence in the Indian Stock Market. The derivatives trading in Indian Stock Market as innovative financial tool has spawned whole new areas as financial engineering derivative instruments are used for variety of purposes, but, perhaps, involves transfer of market risk. To facilitate the development of the derivatives market, It is necessary to create awareness among the market participants and investors to know about the derivatives trading is for reducing risk and increasing return but it is not used as gambling in Indian Stock Market.

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Reviews

- Arawalla and Tuteja (2007), provided a statement that a stable long run equillibrium relationship between stock market development and economic growth in India due to the existence of derivatives in Stock Market.
- Hemavathi (2013), in her study expressed that to look over the beginning of derivatives trading in India and its regulation for prolonging the sustainability of derivatives trading in relation to Indian Capital Market.

Objectives of the study

- To study the business growth of derivatives in Indian Stock Market.
- To view the Products, Applications and Classifications of Financial Derivatives.

Significance of the study

In India, the emergence and growth of derivatives market is relatively a recent phenomenon, since its inception in June 2000. Drivatives trading in the Indian Stock Market has exhibited an exponential growth both in terms of volume and number of traded contracts. The most derived instruments that allow market participants to manage risk in derivatives in Indian Stock Market.

Concept of derivatives

The general definition of derivative means to derive something from something else which means with a simple example of the price of butter depends upon price of milk which in turn depends upon the demand and supply of milk.

Definition of financial derivatives

As Per Section 2 (ac) of Securities Contract Regulation Act (SCRA) 1956 defined Derivatives as

- "A Security derived from a debt instrument, Share, Loan, whether secured or unsecured, risk instrument or contract for differences or any other form of security."
- " A Contract which derives its value from the prices or index of prices of underlying securities"

Application of financial derivatives

Management of Risk: This is the major tool of trading derivatives in Indian Stock Market financial derivatives provide a powerful aid for limiting or reducing risk for the market participants or investors.

Efficiency in Trading: Financial derivatives allow for free trading of improve market efficiency. This is mainly because of the greater amount of liquidity in the market offered by derivatives. Financial derivative transaction cost is lower than when compared to the transaction cost of underlying instrument in cash market.

Speculation: Speculation is not only the use and probably not the most important us of financial derivatives .It is risky but if it is not properly used then it cause financial obstruction.

Price Discover: It is the important application of derivatives in the price discovery which means revealing information about future cash market price through the futures market.

Price Stabilization Function: Derivative market helps to keep a stabilizing influence on spot prices by reducing the short – term fluctuations. Derivative reduces both the peak and depths and leads to price stabilizing effect for underlying assets in the cash market.

A snapshot on currency derivative segment of national stock exchange

Table 1. Trading of currency futures

Year	Currency futures	
	No. of Contracts	Turnover Rs.cr)
2017-2018	6,32,99,971	4,17,169.57
2016-2017	36,26,15,931	24,89,778.94
2015-2016	40,97,59,364	27,49,332.96
2014-2015	35,55,88.963	22,47,992.34
2013-2014	47,83,01,579	29,40,885.92
2012-2013	68,41,59,263	37,65,105.33
2011-2012	70,13,71,974	33,78,488.92
2010-2011	71,21,81,928	32,79,002.13
2009-2010	37,86,06,983	17,82,608.04
2008-2009	3,26,72,768	16,22,272.43

Note: Daily Turnover Data is presented after rounding off.
Source: Data Compiled From www.nseindia.com

Table 2. Trading of currency options

Year	Currency options		
	No.of contracts	Notional turnover (Rs.cr)	Premium turnover (Rs.cr)
2017-2018	7,28,57,595	4,74,062.73	1,586.74
2016-2017	34,98,35,508	23,67,296.92	7,153.09
2015-2016	26,38,23,800	17,52,552.62	6,059.00
2014-2015	12,50,75,731	77,5,915.32	3,164.45
2013-2014	18,18,90,951	10,716,27.54	7,297.15
2012-2013	27,50,84,185	15,09,359.32	10,109.99
2011-2012	27,19,72,158	12,96,500.98	7,100.69
2010-2011	37,42,20,147	1,70,785.59	946.70
2009-2010	-	-	-
2008-2009	-	-	-

Note: In case of Option contracts "Turnover" represents "Notional Turnover"
Source: Data Compiled From www.nseindia.com

Table 3. Business growth of futures and options in currency derivatives

Year	Total no.of contracts	Turnover (RS.CR)	Average daily turnover (rs.cr)
2017-2018	13,61,57,566	8,91,232.30	18,962.39
2016-2017	71,24,51,439	48,57,075.85	20,070.56
2015-2016	67,35,83,164	45,01,885.58	18,602.83
2014-2015	48,06,64,694	30,23,907.67	12,705.49
2013-2014	66,01,92,530	40,12,513.45	16,444.73
2012-2013	95,92,43,448	52,74,464.65	21,705.62
2011-2012	97,33,44,132	46,74,989.91	19,479.12
2010-2011	74,96,02,075	34,49,787.72	13,854.57
2009-2010	37,86,06,983	17,82,608.04	7,427.53
2008-2009	3,26,72,768	1,62,272.43	1,167.43

Note: Average Daily Turnover (ADT) is computed at segment level based on total trading days in the respective year across products
Source: Data Compiled From www.nseindia.com

Classification of derivatives: Derivatives are broadly classified into two types. They are Commodity derivatives and financial derivatives. In case of commodity derivative, Underlying assets are Wheat, Gold, Silver etc. and in case financial derivatives are underlying assets are stocks, currencies, bonds and risk bearing securities.

Forward Contracts: Forward Contract is a cash market transaction in which delivery of the instrument is differed until the contracts has been made, although the delivery is made in future. The price is determined on the initial trade date. The contract terms like delivery price and quantity are mutually agreed upon by the parties to the contract; Forward contracts are traded over the counter and are not dealt with on exchange.

Futures Contract: Futures is a standardized forward contract to buy (long) or sell (short) of the underlying assets at a specific future date at a specified price through a specified exchange. Exchange sets the standardized terms in term of quality, quantity, price quotation, date and delivery place of a commodity. Future contracts being traded on organized exchanges impart liquidity to the transaction. The clearing house is the counter party to both sides of transaction.

Options Contract: Option Contract as the name suggest is in sense as an optional contract. The option is the right but not the obligation to buy or sell something at a stated price and a stated date. Option contract are of two types and they are call option and put option."Call Option" gives one the right to buy whereas "put Option" gives one the right to sell a pacified asset at a set pric on or before a specified date trough exchanges.

Swaps Contract: A Swap can be defined as a barter exchange. It is a contract whereby the parties agree to exchange underlying assets to each of them. The two commonly used swaps are Interest rate swaps and Currency Swaps. Interest rate swaps which enable swapping only the interest related cash flows between the parties in same currency whereas the currency swaps entail both principal and interest swapping of different currencies between the parties.

Participants in derivatives market

Hedgers: They use derivative instruments so as to reduce risk. Most of the Participants are hedgers only in Indian Stock market by trading in derivatives of financial instruments.

Speculators: They will transact with futures and options contract to get extra leverage through betting on future movements in the price of underlying asset.

Arbitrageurs: Arbitrageurs are desired to take a benefit of discrepancy between price of more or less on the same assets or competing assets in different markets.

Summary and conclusion

Innovation of derivatives have redefined and revolutionized the landscape of financial sector across the world. The world financial markets have undergone qualitative changes in the last three decades due to the phenomenal growth of derivatives. Hence there is an increasing sense that the derivatives market is playing a major role in shaping growth of Indian Stock Market.

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