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A Study on Risk Management- Futures and Options at Indiainfoline Ltd Bangalore

KEYWORDS: Risk, financial market, Futures and Options

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ABSTRACT *A market is a place or mechanism which facilitates the transfer of resources from one entity to another. A financial market is an institution or arrangement that facilitates the exchange of financial instruments, like shares, debentures, loan etc. A market wherein financial instruments such as financial claims, assets and securities are traded is known as a 'financial market'. Financial market transactions may take place either at a specific place or location, e.g. bank, stock exchange, or through other mechanisms such as telephone, telex, or other electronic media*

INTRODUCTION

In the 17th century, in Japan, the rice was been grown abundantly, later the trade in rice grew and evolved to the stage where receipts for future delivery. Were traded with a high degree of standardization. This led to forward Trading. The trade known as "cho-ai-mai a kinai" (rice - trade - on - book), centered around Dojima, a district of Osaka. In 1730, the market received official recognition from the "Tokugawa Shogunate" (the ruling clan of shoguns or feudal lords). The Dojima rice market can thus be regarded as the first futures market in the sense of an organized exchange with standardized trading terms. The first futures markets in the Western hemisphere were developed in the United States in Chicago. These markets (in grain) had started as spot markets and gradually evolved into futures trading. This evolution occurred in stages. The first stage was the starting of agreements to buy grain in the future at 'e- determined price with the intension of actual delivery. Gradually these, contracts became transferable and over a period of time, particularly delivery of "physical produce. Traders found that the agreements themselves, instead of taking delivery of the physical produce. Traders found that the agreements were easier to buy and sell if they were standardized in terms of quality of grain, market lot and place of delivery. This is how modern futures contracts first came, into being. The Chicago Board of Trade (CBOT), which opened in 1848, is, to this day, the largest futures market in the world.

The primary objectives of any investor are to maximize returns and minimize risks. Derivatives are contracts that originated from the need to minimize risk. The word 'derivative' originates from mathematics and refers to a variable, which has been derived from another variable. Derivatives are so called because they have no value of their own. They derive their value from the value of some other asset, which is known as the underlying.

STATEMENT OF THE PROBLEM

Stock broking firms will be under pressure many a time due to market risk problems. The nonpayment of dues by clients on time and insufficient fund to have particular futures or options always create lot of problem in these broking house. The study is conducted to understand the system followed by India Infoline to handle these crucial situations and techniques used by customer to overcome problems.

OBJECTIVES OF THE STUDY

- To study the various types of risk associated with futures and options.
- To know the reasons for trading in futures and options.
- To offer constructive suggestions to the clients and brokers.

SCOPE OF THE STUDY

The scope of the study is limited to the back office support system followed by IndiaInfoline ltd. Primary data collected from the customers of IndiaInfoline to know their objective in investment as well as, how they are managing the risk pertaining to futures and options. Other potential investors & existing investor's opinion is beyond the scope of study.

RESEARCH METHODOLOGY

To fulfill the set of objectives of the study of Risk Management with reference to futures and options by following methods:

Primary data:

- By conducting interview with brokers and officials.
- Using questionnaire method, opinion of investors is collected.

Secondary data

Websites & Reports

Limitations of the Study

- The data collected are based on quota sampling and sample size is limited to 100, which may lead to sampling error. As time is one of the constraints I could not go beyond sample size 100 to avoid sampling error.
- The respondents might not have given genuine feedback for various reasons.
- The study cannot be generalized.

Sample Size

The sample size includes 100, questionnaires filled with investor who deal in futures and options.

ANALYSIS & INTERPRETATION

The following table shows the response of respondents about the reason for trading in futures and options

SL No.	Category	Hedging	Arbitrage	Speculative Profit	Trend based	Holding position
1	Office Goers	6	0	9	1	9
2	Business Man	4	0	14	4	3
3	Professional	6	0	13	1	5
4	Others	9	9	5	1	1
	Total	25	9	41	7	18

Analysis From the above table, different category of people has different priority.25% of them trade for hedging against risk, 9% for arbitrage, 41% for speculative Profit, 7% for trend based trading, and 18% for holding position.

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Interpretation
From the above table and analysis it can be inferred that many of the investors who trade in futures and options has the main motto of speculative profit.

The following table shows the future trading preferences

SL. No.	Category	Index Future	Stock Future	None
1	Office Goers	12	11	2
2	Business Man	19	4	2
3	Professional	14	10	1
4	Others	13	4	8

Analysis From the above table, different category of people has different priority.58% of them prefer trading in index future, 29% of them prefer trading in stock future, and 13% do not trade in either of these.

Interpretation From the above table and analysis it can be inferred that more than 50% of the investors prefer trading in index futures than that of stock future, because index futures provides greater opportunity than stock futures.

Findings:
- It was found that there are two types of risk namely, systematic and unsystematic risk associated with futures and options.
- The Future and Option market is experiencing tremendous growth in the recent past. This can be emphasized by the fact that the trading volume in futures and option is increasing and are widely used derivative instruments.
- Most of the investors prefer trading in cash market, than derivative market, because it is less risky when compared to derivatives.
- It was found that majority of the respondents' motto and the reason behind trading in future and option is speculative profits.
- It was found that different category of investors have different reasons for trading in futures and options i.e. office goers prefer speculative profit and holding position, majority of business man and professionals give reasons for trading is speculative profit and other investors give preference to hedging and arbitrage.
- Investors use various tactics such as stop loss order, rolling over, etc to manage the risk of trading in future and option.
- From the survey it was found that, majority of the investors manage the loss by taking position whenever they suffer a loss in future and option.

Suggestions
- Broker should provide the research report and all the necessary information through written and published articles to avoid the ignorance about company performance, market performance etc.
- Proper coordination between operator and investor (client) should be maintained for the smooth functioning.
- Make investor aware about the advantages and disadvantages, various risks involved and importance of margin money while trading in future and option.
- The stock exchange has to take initiation of conducting seminars, presentations etc at college level and university levels so as to create awareness about stock market.
- Investors should be alert and know the market fluctuations and updates.

Conclusion
To conclude, I could say that the derivative market (Futures and options) holds a great promise for Indian capital markets, which could be seen from tremendous growth in the trading taking place in recent past. The market provides hedgers with the tools to manage their exposure to risk. The use of derivatives by risk managers is increasing dramatically. Financial derivatives are central to both portfolio optimization and risk management. As risk management teams and their functions have become more prominent, the language of derivatives has become more familiar at the highest levels of business. This has assured the development of a risk management culture throughout all levels of trading companies, and continued growth of the market for financial derivatives. Such risk management guidelines and limits provide an important framework within which transactions may be executed and business opportunities considered, and also the knowledge of risk, the ability to assess the risk, helps an individual as well as the broker to trade carefully and to avoid loss. Therefore by using these strategies appropriate decisions could be taken to maximize gains and minimize losses.

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