A Study on Investors perception towards derivative trading

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***Abstract*—Investments are motivated by the prospect for returns, which carry with it the stigma of risk. Investors are often faced with choices about investment alternatives, allocation, and risk management. Knowledge of finance is essential in making these choices. In the range of financial instruments, derivatives that include forward contracts, futures, and options provide a valuable tool for managing risk exposures. Derivatives get their value from underlying assets and are important elements of capital markets.**

Investor attitudes towards trading derivatives are tested in this research based on risk-return evaluations and investment patterns. Derivatives are useful vehicles for hedging against risks as well as obtaining financial goals but have the attribute of being difficult to understand. This research questions how investors hedge risks and capture returns, subject to market sentiments, regulations, stability, and liquidity. Furthermore, it asserts that investors should have adequate awareness about market drivers, regulatory policy, and incoming trends to avoid hasty investments.

The study seeks to gain insights into investor attitudes, issues, and motivations for derivative investments. Results will add to a wider understanding of how risk perception affects market participation and the role of financial literacy in promoting well-informed investment choices.

***Index Terms*—Derivatives, Risk, Return, Investor Perception, Financial Literacy.**

I. INTRODUCTION

Background

Investment choices are driven by a variety of factors, ranging from financial acumen to risk appetite and market conditions. Investors make investment choices based on fundamental and technical analysis, trying to gauge the return possibilities and make sound investment choices. The derivatives market has become an indispensable component of financial markets, offering instruments to hedge risks, speculate, and diversify portfolios.

Investor decisions in financial markets are usually influenced by psychological considerations, economic environments, and regulatory policies. Although derivatives provide much room for exploration, most investors are averse to investing due to their complexity and accompanying risks. Financial literacy and knowledge are therefore needed, as derivatives demand a critical understanding of market movements, pricing mechanisms, and risk management tactics.

Behavioral finance also significantly contributes to understanding investor decision-making because emotions and cognitive biases affect their perception of risk and return. Investors vary in how they perceive derivatives, with some perceiving derivatives as high-risk products while others see them as necessary to offset uncertainties in the financial markets.

This research aims to know how investors think about trading derivatives and what drives them to trade. Through an examination of investor demographics, their level of knowledge, and trading activities, the study wants to identify areas of concern regarding financial literacy and propose steps to increase investor confidence in derivatives. Policymakers, financial institutions, and educators can make informed strategies to encourage prudent derivative trading and enhance market participation if these factors are understood.

Keywords: Derivative Trading, Investor Perception, Risk Management, Behavioral Finance, Financial Literacy.

Problem Statement

investors are constrained by diverse degrees of financial knowledge, perception of risk, and market fluctuations to choose proper avenues of investment.

Derivatives trading, even though it is an important financial instrument for speculation and hedging, is convoluted and not optimally utilized by the majority of investors. Derivatives markets' underdevelopment results from insufficient exposure, reluctance in undertaking high risk, and in comprehending the products involved.

This research endeavours to examine investor sentiment towards derivatives and establish critical determinants that shape their decisions. It aims to provide answers to some of the following questions:

1. What motivates investors to engage in trading derivatives?
2. What determines their decision to purchase or shun derivatives?
3. How does financial knowledge affect their attitude towards derivative trading?
4. What are the challenges faced by investors in derivative markets?

Objectives

1. To study the investor perception of derivative trading and the risks involved.
2. To evaluate investors' level of financial literacy with respect to derivatives.
3. To determine influential factors on investment choices in the derivative market.
4. To study difficulties faced by investors when trading in derivatives.
5. To determine the contribution of derivatives to portfolio diversification and risk management.
6. To provide recommendations for increasing investor awareness and engagement in derivative trading.

Hypothesis

H_0 (Null Hypothesis): Investor demographics (e.g., age, education, and income) have no significant relationship with their perception of derivative trading.

H_1 (Alternative Hypothesis): There is a significant relationship between investor demographics (e.g., age, education, and income) and their perception of derivative trading.

H_0: Financial literacy has no significant impact on investor involvement in the derivative market.

H_1: Investor involvement in the derivative market is highly affected by financial literacy.

H_0: Risk perception does not significantly affect an investor's decision to trade in derivatives.

H_1: An investor's choice of trading derivatives is greatly affected by risk perception.

Literature Review

Investor Behavior and Risk Perception

N. Arunsankar (2020) discovered that investors opt for security rather than high-risk investments, resulting in low derivatives participation. Likewise, Meenakshi Bindal (2018) noted that high margins in derivatives discourage investors, even though they have the potential to yield high returns.

Financial Literacy and Market Awareness

Gautami & Nalla Bala Kalyan (2018) reiterated the significance of financial literacy where investor awareness becomes a key driving force in participation in the markets. Dr. Y. Nagaraju (2014) noted that most investors lack an understanding of derivatives and thus fear or hesitate to deal in them.

Growth and Evolution of Derivative Markets

Mamtha & Srinivasan (2017) identified that the Indian derivatives market has expanded considerably, providing varied financial products. Nevertheless, Dr. Shree Bhagwat & Angad Singh Maravi (2016) indicated that commodity derivatives, as important as price risk management, are still underutilized in India.

Behavioral Finance and Decision Making

K Sarathkumar & SP Dhandhayuthapani (2016) investigated behavioural finance and found that risk-averse investors shun derivatives, while risk-takers look for high returns. Likewise, Tripathi (2014) discovered that there is no meaningful gender-based divergence in derivative investment behavior.

Regulatory and Market Issues

Bose Suchismita (2006) talked about derivatives as risk-reducing instruments but cautioned against their misuse in destabilizing financial markets. Ravichandran (2008) emphasized the importance of investor education and regulatory reforms in building confidence in derivative trading.

II. RESEARCH METHODOLOGY

Study Design

The research has a descriptive and exploratory study design with an objective of examining investor perception towards derivative trading. A mixed-method study design is used by combining both qualitative and quantitative data to derive overall insights. The research is centred around understanding investors' knowledge, risk perception, market participation, and the determinants of their decision-making in the derivative market.

The study analyses the extent of financial literacy among investors and analyses their knowledge towards derivatives as a risk management tool. It also analyzes how age, education level, and income affect their investment decisions.

Data Collection

The investigation is based on both primary and secondary data sources:

1. Primary Data:

First-hand data is gathered from respondents using a structured questionnaire.

The questionnaire includes multiple-choice items and Likert scale responses to measure investor sentiments towards derivatives.

The questionnaire is framed to address issues like risk perception, investment motive, financial knowledge, and difficulties in trading derivatives.

2. Secondary Data:

Data are collected from books, research articles, financial statements, journals, and internet sources.

Existing literature on derivatives, behavioral finance, and investor psychology is studied to validate the findings.

Sampling Techniques

To provide a relevant and varied sample, the study employs non-probability convenience sampling. This technique provides the opportunity to select respondents on the basis of their availability and willingness to respond. Due to the nature of derivative trading, selecting individuals with some degree of financial awareness ensures more accurate findings.

Sampling Unit

The research targets individuals who are potential or existing investors in the financial market. The targeted respondents are:

- MBA students (as prospective investors and finance professionals)
- Working professionals (who might have investable income)
- Retail investors (people already involved in trading and investment operations)

Sample Size

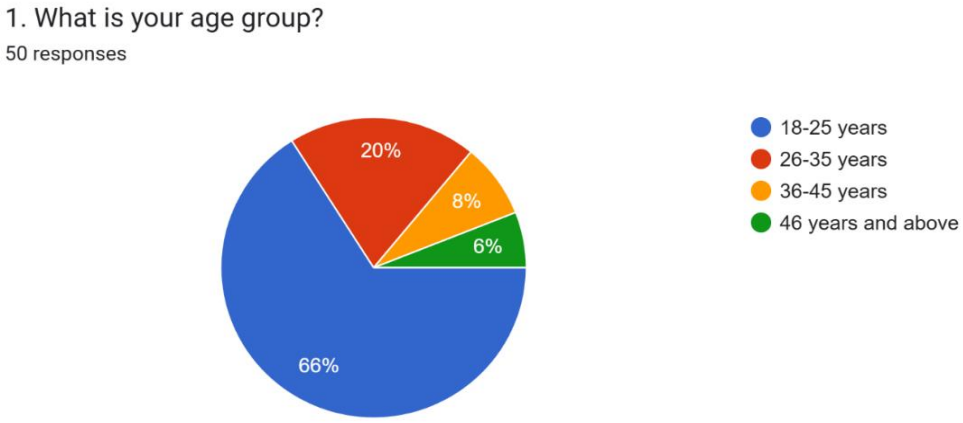
50 respondents are surveyed in total. The sample is chosen to cover various age groups, professional backgrounds, and investment experience levels to provide varied perspectives.

Sampling Methods

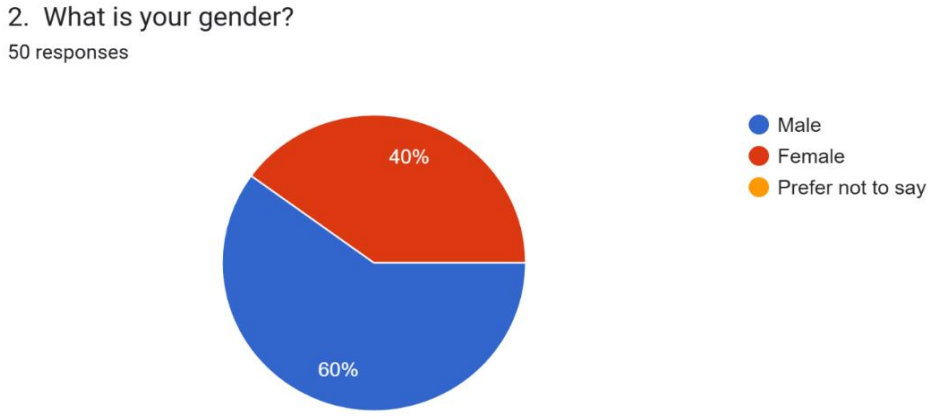
Convenience Sampling: Participants are chosen based on ease of access and willingness to take part in the survey.

Judgmental Sampling: Certain respondents are selected based on their financial history and previous exposure to derivative markets to make data collection relevant.

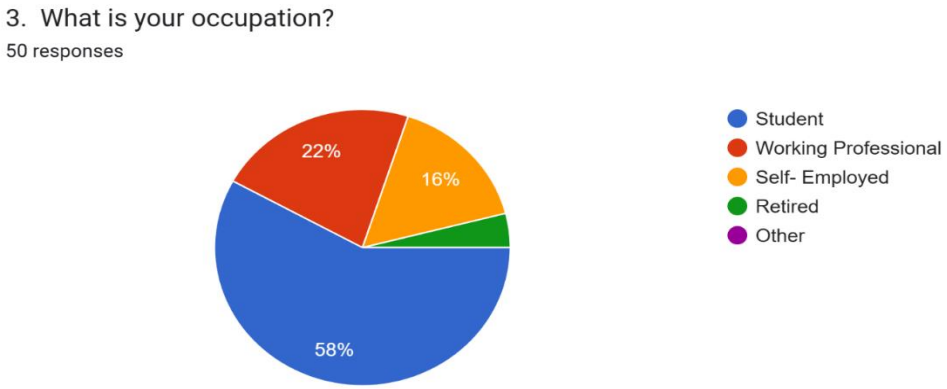
III. DATA ANALYSIS AND INTERPRETATION



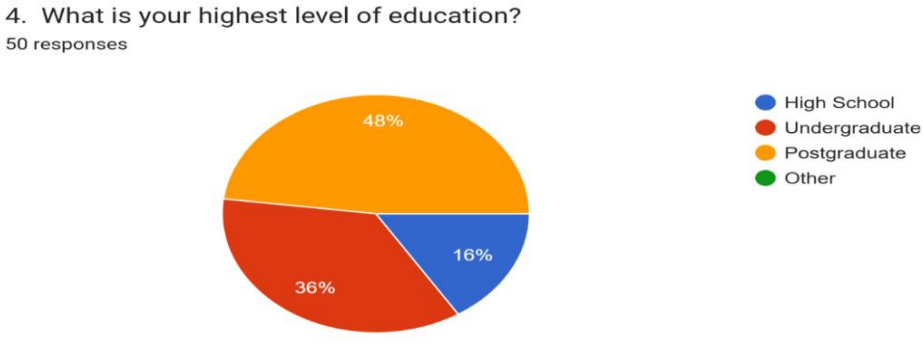
The data was collected from various age group from above table it is concluded that among all the respondents the level of awareness about Derivative market is 66% are 18-25 years of age group, 20% respondents belong to 26 - 35 years of age group, 8% are from age group of 36-45 and rest 6% above 45 age group.



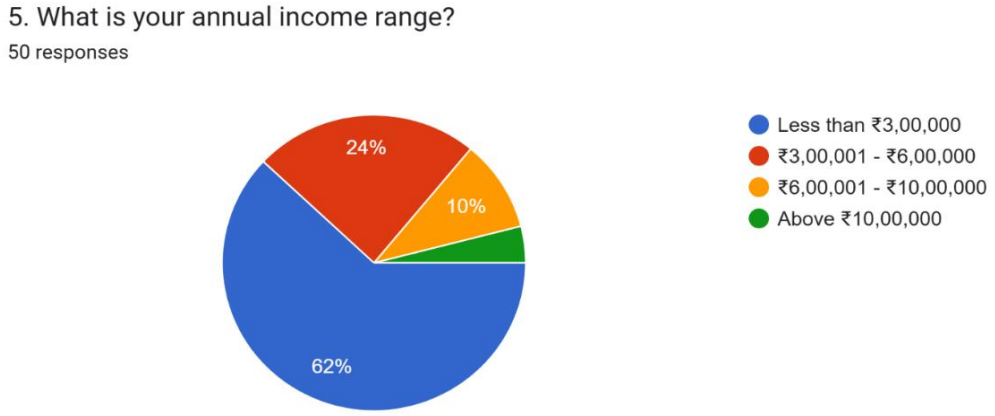
As per the above figure, it can be observed that, among all the respondents the level of awareness and perception towards Derivative market is 60% respondents are male and 40% respondents are female.



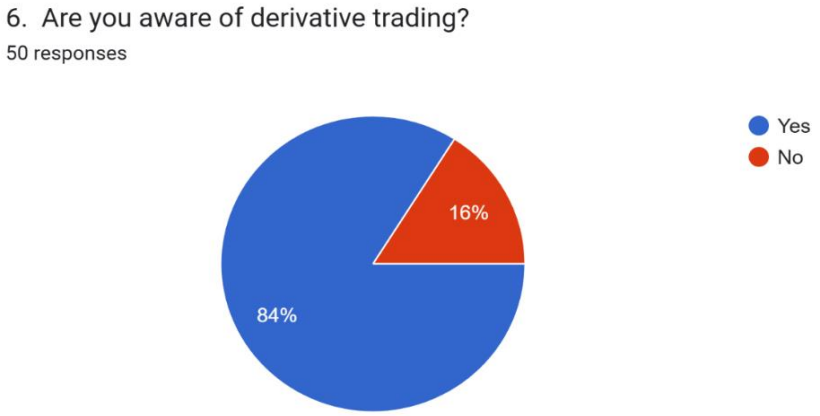
As per the data it shows that 56% are students.22% are working professionals.16% are self-employed and 6% belong to other categories.Majority are students it shows that the young generation are mosrt involved in the derivative trading



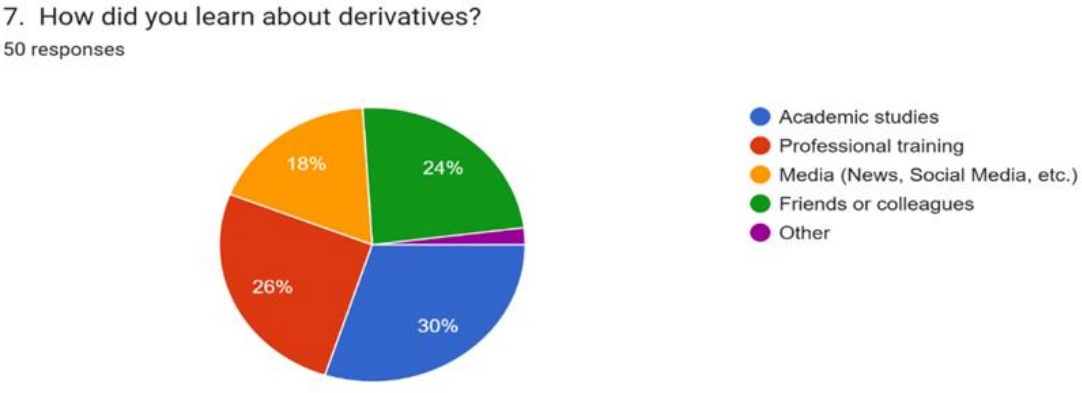
By taking response about educational background it state that 48% have a postgraduate degree 36% hold an undergraduate degree 16% have other qualifications.



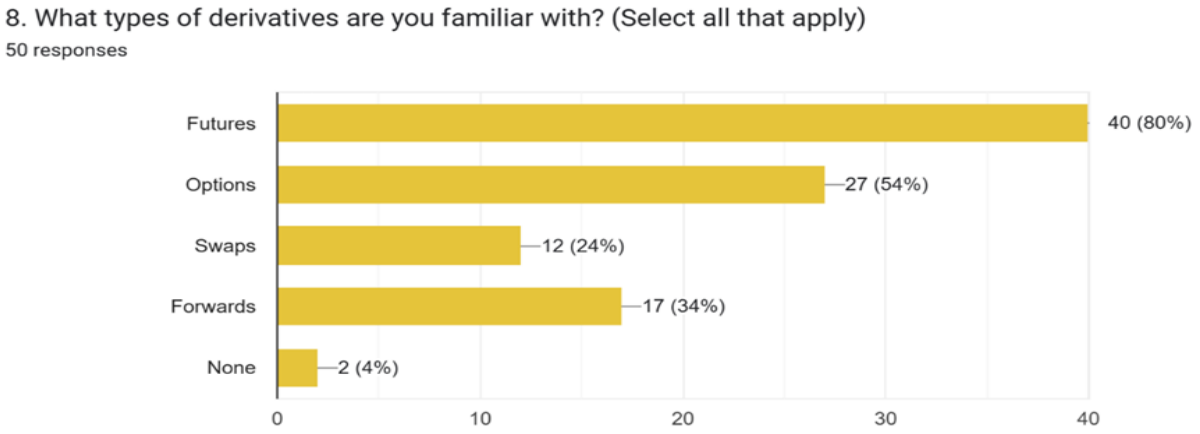
The annual income range shows about the pepole 62% earn less than ₹3,00,000 per year.24% fall in the ₹3,00,001 - ₹6,00,000 range, 10% earn ₹6,00,001 - ₹10,00,000, 4% have incomes above ₹10,00,000.



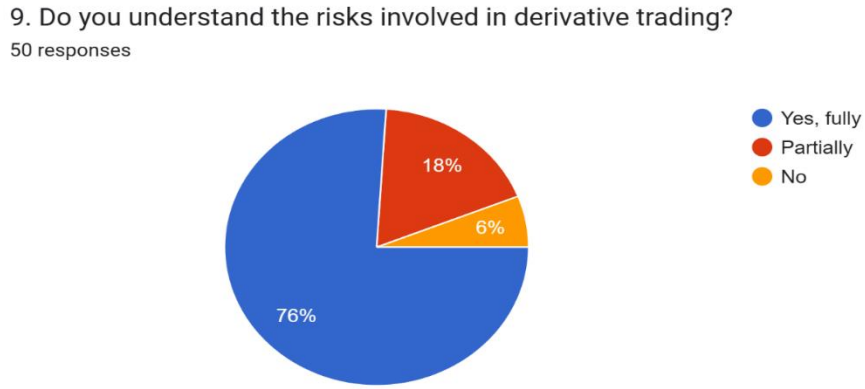
By collecting data about awareness, it shows that 84% people have knowledge about derivative trading while 16% people have no any knowledge.



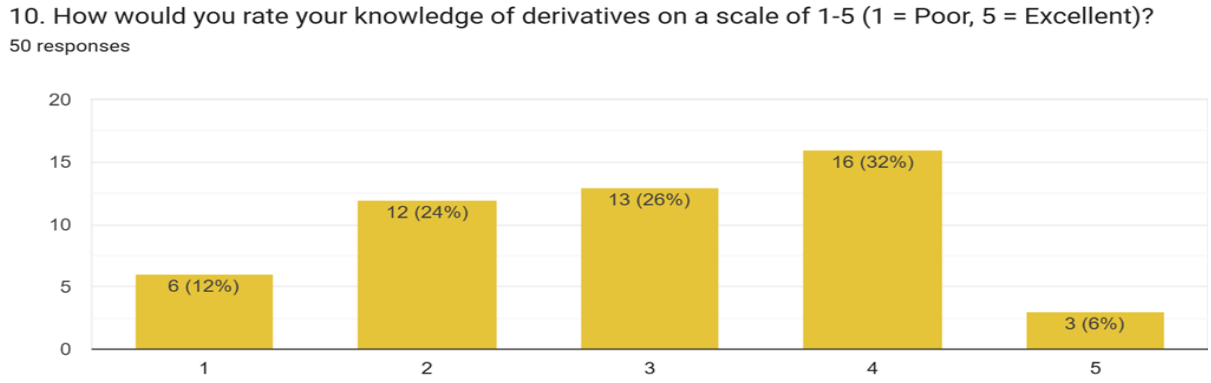
As per the data collection it shows that 30% people learn from Academic studies, 26% from professional training , 18% from Media, 24% from friends or colleagues while only 2% people have learned from other sources.



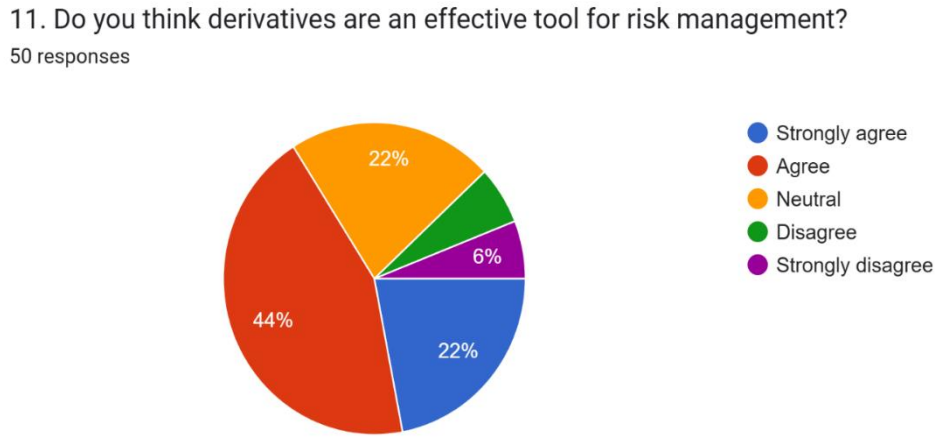
By analyizing this table, we can conclude that out of 50 people 40 are familiar with futures, 27 with options,12 with swaps, 17 with forwards and 2 people are not familiar with any one of them.



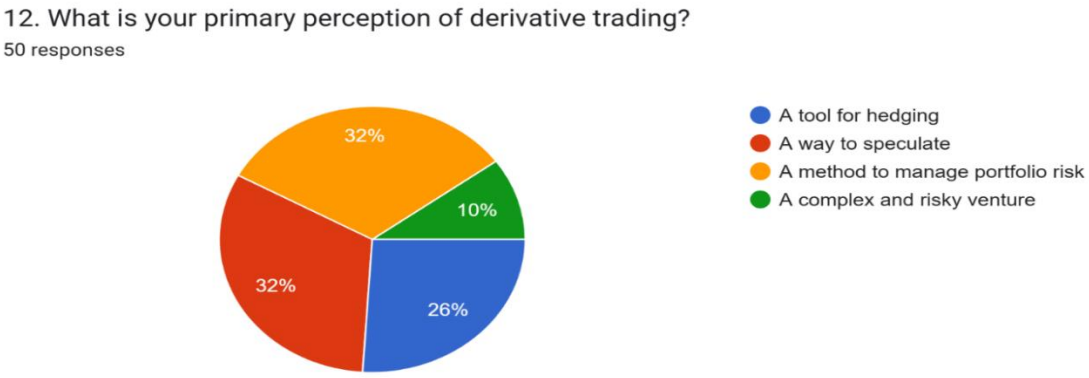
Risk is always a vital part in any derivative trading. By analyzing this data we came to know that 76% people have knowledge that it envolve Risk, 18 % mentioned that there is partial risk while 6% saying that there is no risk.



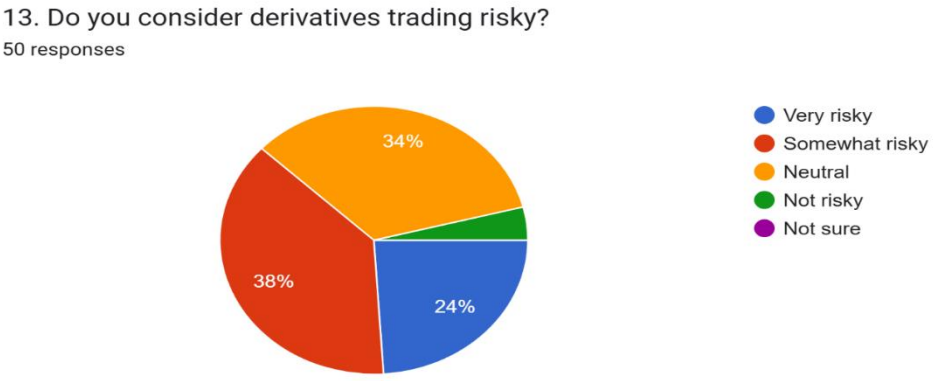
As per the data 12% people rated for 1, 24% rated for 2, 26% rated for 3, 32% rated for 4 and 6% rated for 5.This shows that on an average people have mild knowledge about derivative.



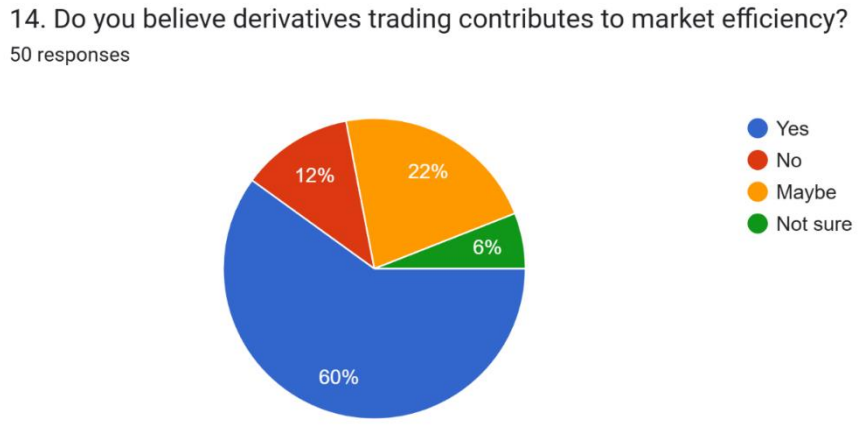
As per the risk managemnet tool, the following observation state that 44% people are agreed with it, 22% percent are strongly agreed, 22% are neutral on this, 6% are disagree and also 6 % is strongly disagreed with it.



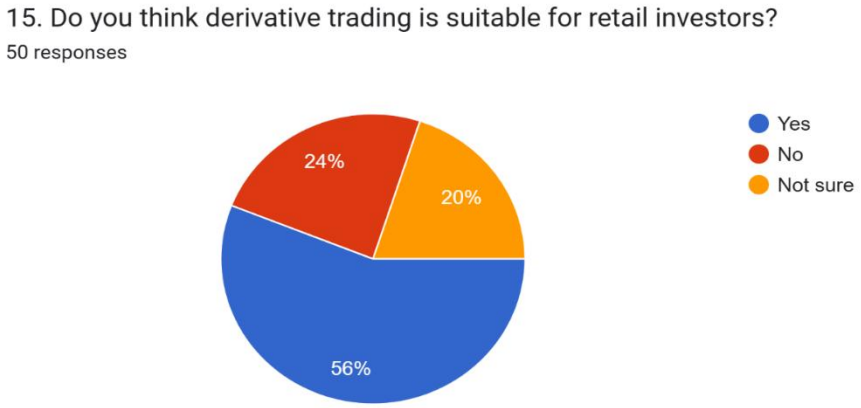
By adding this question about people perception we came to know that equally 32% people says that a way to speculate and A method to manage portfolio risk, 26% people have perception A tool for hedging and 10% people says that it is A complex and risky venture



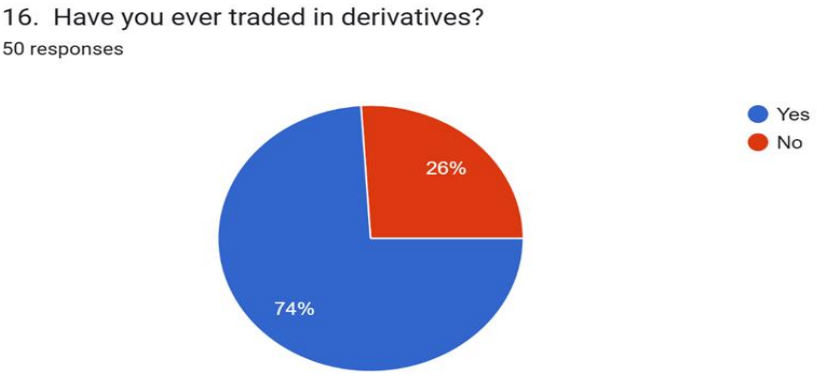
In measuring risk 24% people said that derivative trading is very risky, 38% are saying somewhat risky, 34% are neutral with it and only 4% are saying it is not risky at all.



As per the data collected for role of derivative trading in market efficiency 60%, people said Yes, 12 % says No, 22 % said maybe and 6% said not sure.

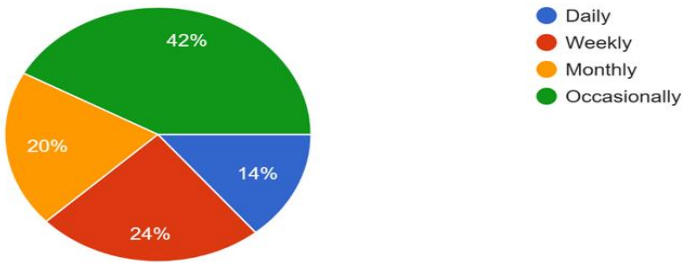


This chart shows that people observation for derivative trading for retail investor os somewhat positive. 56% are saying Yes , 24% are saying No and 20% are not sure about it.



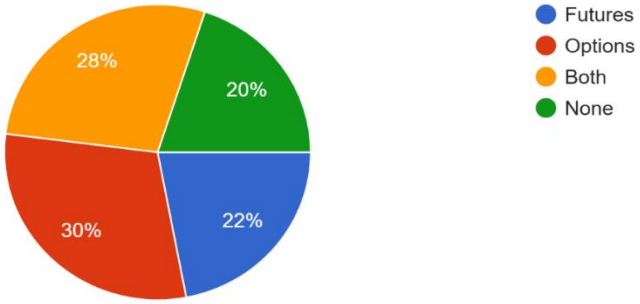
By analysing this chart we came to know that 74% percent are once traded in derivative whilw 26% people never traded at all.

17. If yes, how frequently do you trade in derivatives?
50 responses



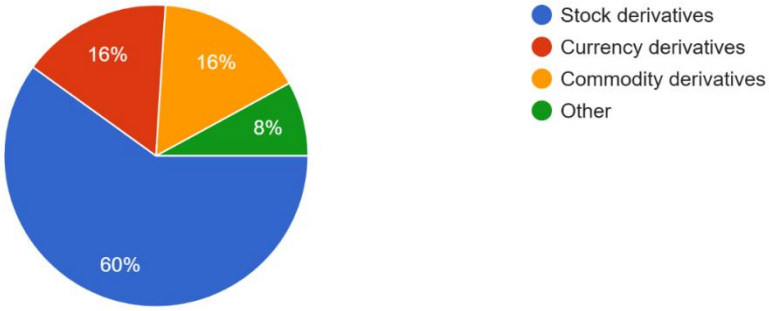
By interpreting this chart we come to know that out of 37 people who at least once traded in derivative trading are trade how frequent. 14% are saying daily, 24% are saying weekly, 20% are saying monthly, and majority i.e 42% are trading occasionally.

18. What type of derivative contracts do you trade most?
50 responses

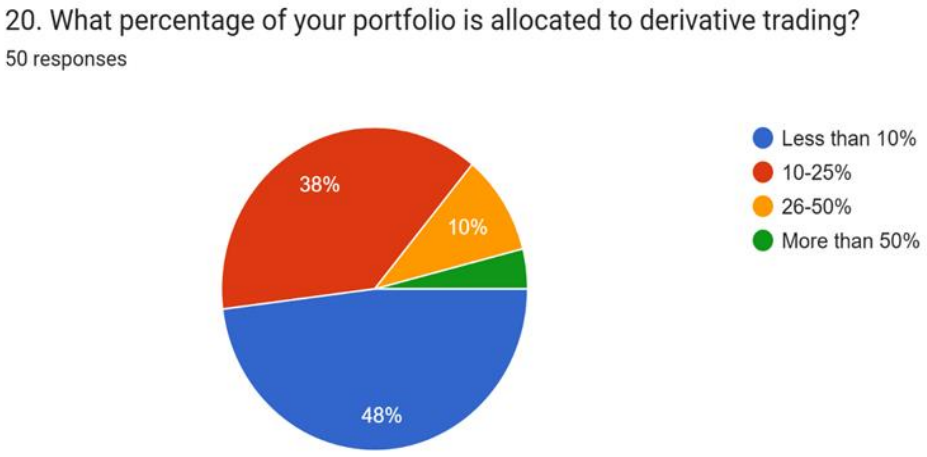


This chart show that 22% trading in future 30% on options, 28% on both while 20% are in no any of them.

19. What is your preferred market for derivative trading?
50 responses



Market is type in which Derivative Trading Is done. Here the data shows that majority of people i.e almost 60 % people are trading in stock market, 16% people trading in currency Derivative, 16% people in commodity Derivative, and minor 8 % in other Derivative



As the data shows people are somehow Afraid of Risk involved in Derivative Trading then only Majority 48% people having portfolio of derivative less than 10%, 38% have 10-25%, 10% have 26-50% and only 4% have more than 50% coverage of portfolio which are in derivative market

IV. FINDINGS

1. Investor Awareness: Approximately 84% of the respondents are aware of derivative trading, but a lesser number actively engage in it.
2. Risk Perception: 76% of the investors are aware of the risk in derivatives, where 38% view them as highly risky.
3. Investment Motivation: The main reason for investing in derivatives is high potential for returns (56%), followed by diversification of the portfolio (48%) and risk management (36%).
4. Obstacles Encountered: The most significant obstacles to derivative trading are high risk (52%), market volatility (48%), and insufficient knowledge (40%).
5. Investor Activity: 74% of respondents have traded derivatives at least once, but only 42% trade from time to time, and 14% trade every day.
6. Technology Application: 46% feel that technology greatly helps derivative trading, increasing ease of access and risk management.
7. Expert Guidance: 70% of the participants believe that trading in derivatives requires professional guidance.
8. Market Choice: 60% of investors trade stock market derivatives, whereas fewer do so in currency (16%) and commodity derivatives (16%).

V. CONCLUSIONS

The research on investor attitude towards derivative trading emphasizes the need for financial literacy, risk consciousness, and market involvement. Although derivatives provide scope for high returns and risk management, their sophistication discourages most investors from actively participating in the market. The research shows that most investors are familiar with derivatives, but their involvement is still low due to reasons like high-risk perception, market volatility, and ignorance.

Risk management is a crucial aspect of derivative trading, yet many investors struggle to fully understand hedging strategies and market trends. Although derivatives can help mitigate risk and enhance portfolio diversification, many traders view them as speculative tools rather than instruments for financial stability. The fear of losing capital discourages potential investors, leading to low participation rates despite growing awareness.

The study also indicates that investors like stock market derivatives more than other forms such as commodity and currency derivatives. Furthermore, professional help and technological improvements in trading systems are crucial to enhancing investor confidence. Nevertheless, issues such as high margin levels, complicated regulatory systems, and the

requirement for specialist knowledge remain to restrict market accessibility.

In order to fill this gap between the awareness and the active involvement, investor education, easy trading mechanism, and regulation enhancement are called for. The enhancement of financial literacy will allow investors to take well-informed decisions, optimize risk management, and use derivatives as a tactical investment vehicle, not as a speculative tool.

VI. SUGGESTIONS

1. Financial Literacy Improvement:
- Organize training programs and workshops to provide investors with education on derivatives, their advantages, and risk control methods.
- Integrate modules of derivative trading in business and finance education to raise students' and prospective investors' awareness.

2. Risk Management Strategies: Improving
- Encourage investors to use hedging strategies to reduce losses and portfolio risk management effectively.
- Make stop-loss orders and risk protection tools available and encourage their usage to protect investments.

3. Making Market Access & Trading Platforms Easy:
- Design easy-to-use trading platforms with simple access to derivative contracts, easy-to-understand explanations, and risk analyses.
- Use AI-based risk analysis tools to enable investors to make evidence-based decisions.

4. Regulation Enhancement:
- Enforce transparency in the derivative market by implementing strict regulations to safeguard retail investors.
- Lower margin requirements for retail investors to induce participation while retaining risk mitigation measures.

5. Promoting Professional Advice:
- Encourage financial advisory services to new investors to educate them on market trends and enable informed decision-making.
- Offer certification programs for derivative specialists in advisory services to instill confidence in advisory services.

6. Diversified Investment Strategies:
- Encourage investors to employ derivatives for portfolio diversification and risk management as well as speculation.
- Promote education about the use of derivatives along with conventional investments for diversified investment strategies.

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