Introduction

1.1 INTRODUCTION TO INDIAN ECONOMY

India is one of the largest fast growing economies of the world. Since the last two decades Indian economy is on a rise and has proved its mettle to the Indian. India is one of the fastest growing economies and is often considered as one of the major super powers. India is an Asian nation with seventh largest land base and second largest in term of population. The economy of India is the largest economy in the Indian by nominal GDP and the fourth largest by purchasing power parity (PPP).

Indian economy stands today as one of the influential and attractive economy. The liberalization move by the Indian Government in 1990s has given a boost to the Indian economy and put her into a fast track economic growth route. With the beginning of the new millennium, India was considered as an emerging super power. The reform process in India was initiated with the aim of accelerating the pace of economic growth and eradication of poverty. The process of economic liberalization in India can be traced back to the late 1970s. However, the reform process began in earnest only in July 1991. It was only in 1991 that the Government signaled a systemic shift to a more open economy with greater reliance upon market forces, a larger role for the financial system.

The economic reforms initiated in 1991 introduced far-reaching measures, which changed the working and machinery of the economy. These changes were pertinent to the following:

- Dominance of the public sector in the industrial activity
- Discretionary controls on industrial investment and capacity expansion
- Trade and exchange controls
- Limited access to foreign investment
- Public ownership and regulation of the financial sector

The reforms have unlocked India's enormous growth potential and unleashed powerful entrepreneurial forces. Since 1991, successive governments, across political parties, have successfully carried forward the country's economic reform agenda.
1.1.1 Financial sector reforms

Financial sector reforms have long been regarded as an integral part of the overall policy reforms in India. India has recognized that these reforms are imperative for increasing the efficiency of resource mobilization and allocation in the real economy and for the overall macroeconomic stability. The reforms have been driven by a thrust towards liberalization and several initiatives such as liberalization in the interest rate and reserve requirements have been taken on this front. At the same time, the government has emphasized on stronger regulation aimed at strengthening prudential norms, transparency and supervision to mitigate the prospects of systemic risks. Today the Indian financial structure is inherently strong, functionally diverse, efficient and globally competitive. During the last fifteen years, the Indian financial system has been incrementally deregulated and exposed to international financial markets along with the introduction of new instruments and products.

1.2 IMPORTANCE OF INVESTMENT

Investment culture among the people of a country is an essential prerequisite for capital formation and the faster growth of an economy. Investment culture refers to the attitudes, perceptions, and willingness of the individuals and institutions in placing their savings in various financial assets, more popularly known as securities. A study of the investors’ perceptions and preferences, thus, assumes a greater significance in the formulation of policies for the development and regulation of security markets in general and protection and promotion of small and household investors in particular.

Capital is a crucial factor in the development of an economy. The pace of economic development is conditioned, among other things, by the rate of capital formation. And capital formation is conditioned by the mobilisation and channelisation of investible funds. The role of the financial system is to channel funds from surplus sectors to deficit sectors. Facilitating such flows on a national level increases the level of investment and effective demand and thus accelerates economic development.

1.3 THE INDIAN FINANCIAL SYSTEM

The financial system consists of many institutions, instruments, and markets. Financial institutions range from pawnshops and moneylenders to banks, pension funds, insurance companies, brokerage houses, investments trusts and stock
Financial instruments range from the common – coins, currency notes, and cheques; mortgages, corporate bills, bonds, and stocks – to the more exotic – futures and swaps of high finance. Markets for these instruments may be organized formally (as in stock or bond exchanges with centralized trading floors) or informally (as in over-the-counter or curb markets). The financial system provides services that are essential in a modern economy. It is a core factor of development and growth. The primary role of any financial system is to act as a conduit for the transfer of financial resources from net savers to borrowers, i.e., from those who spend less than they earn to those who earn less than what they spend.

Financial system is a mirror reflection of an economy. The economic development of a country depends, inter alia, on its financial structure. In the long run the larger the proportion of financial assets to real assets, the greater the scope for economic growth. Investment is a pre-condition of economic growth. This apart, to sustain growth, continued investment in the growth process is essential.

**Figure 1.1: The Structure of the Financial System in India**

![Diagram of the Financial System in India](image)

1.3.1 Financial Markets

Financial Markets are the centers or arrangements that provide facilities for buying and selling of financial claims and services. Financial markets can be classified into primary, secondary, capital and money markets as shown in the above figure.

- **Organized markets**

These markets comprise of corporations, financial institutions, individuals and governments who trade in these markets either directly or indirectly through brokers on organized exchanges or offices.

- **Unorganized markets**

The financial transactions, which take place outside the well-established exchanges or without systematic and orderly structure or arrangements constitutes the unorganized markets. They generally refer to the markets in the villages.

The financial markets today encompass not only traditional banking institutions, but also many other financial entities such as insurance companies, pension, mutual and venture capital funds and stock and commodity exchanges that perform the function of financial intermediation. This development has been accompanied by the advent of market-based instruments of the stock and bond markets, financial products such as asset-backed securities, financial futures and derivative instruments. While reducing the dependence of investors on bank credit to fund their investments, these have also contributed to reallocation of risks and putting of capital to more efficient use.

Trading in money and monetary assets constitute the activity in the financial markets. These are markets in which marketable securities are traded. Marketable securities are divided into money market securities and capital market securities, on the basis of their maturity. And this research is limited to only individual investors’ preference to some specific capital market investment avenues with special focus on equity derivatives within Gujarat region.

1.4 THE INDIAN CAPITAL MARKET

The capital market in India has a long history, during the most part; it remained on the periphery of the financial system. Various reforms undertaken since the early 1990s
by the Securities and Exchange Board of India (SEBI) and the Government have brought about a significant structural transformation in the Indian capital market. As a result, the Indian equity market has become a transparent.

### 1.4.1 Post-reforms Capital Market in India

The Indian securities market has a history of more than one and half century. There are three stock exchanges are the oldest stock exchanges of India - Bombay Stock Exchange, Ahmedabad Stock Exchange and Calcutta Stock Exchange. However, the modern era in the Indian securities market and its transformation began with the economic reforms in the early 1990s when the government initiated a systemic shift to a more open economy with greater reliance on market forces in which the private sector plays an important role. The Indian securities market gained greater importance and the SEBI Act, 1992 established the Securities and Exchange Board of India (SEBI) as a statutory authority to oversee the securities market in India. The development of capital market in India during last decade can be narrated as below:

- To reduce transaction time and liquidity, various reforms were undertaken, such as automated trading system, reduction in the settlement cycle, dematerialization etc.
- Various new products were introduced in different market segments of the securities markets.
- India began trading derivatives with underlying such as indices and individual stocks and later extended to other asset classes like interest rate and currency.
- To strengthen financial structure the amendments has been made in Securities Contracts (regulation) Act 1956 in the year 2004.

### 1.4.2 Trends in Indian Stock Market Indices

The stock market has shown number of times ups and downs during 2000-10, and during the concerned period the market has felt remarkable changes in total market capitalisation, turnover and trading activities, which is shown in following figure 1.2. This figure reflects the trends of major two indices of Indian stock market – BSE Sensex and NSE Nifty from 1st January 2000 to 1st July 2010.
1.5 DERIVATIVES MARKET

Derivatives are an important class of financial instruments that are central to today’s financial and trade markets. They offer various types of risk protection and allow innovative investment strategies. Around 25 years ago, the derivatives market was small and domestic. Since then it has grown impressively – around 24 percent per year in the last decade.

No other class of financial instruments has experienced as much innovation. Product and technology innovation together with competition have fuelled the impressive growth that has created many new jobs both at exchanges and intermediaries as well as at related service providers. Given the derivatives market’s global nature, users can trade around the clock and make use of derivatives that offer exposure to almost any “underlying” across all markets and asset classes. The derivatives market is predominantly a professional wholesale market with banks, investment firms, insurance companies and corporates as its main participants.

There are two competing segments in the derivatives market: the off-exchange or over-the-counter (OTC) segment and the on-exchange segment.
By and large, the derivatives market is safe and efficient. Risks are particularly well controlled in the exchange segment, where central counterparties (CCPs) operate very efficiently and mitigate the risks for all market participants. In this respect, derivatives have to be distinguished from e.g. structured credit linked security such as collateralized debt obligations that triggered the financial crisis in 2007. The derivatives market has successfully developed under an effective regulatory regime. All three prerequisites for a well-functioning market – safety, efficiency and innovation – are fulfilled.

Many associate the financial market mostly with the equity market. The financial market is, of course, far broader, encompassing bonds, foreign exchange, real estate, commodities, and numerous other asset classes and financial instruments. A segment of the market has fast become its most important one: derivatives. The derivatives market has seen the highest growth of all financial market segments in recent years. It has become a central contributor to the stability of the financial system and an important factor in the functioning of the real economy.

1.5.1 Derivatives Market in India

Derivatives trading commenced in India in June 2000 after SEBI granted the final approval to this effect in May 2001 on the recommendation of L. C Gupta committee. Securities and Exchange Board of India (SEBI) permitted the derivative segments of two stock exchanges, NSE and BSE, and their clearing house/corporation to commence trading and settlement in approved derivatives contracts. Initially, SEBI approved trading in index futures contracts based on various stock market indices such as, S&P CNX, Nifty and Sensex. Subsequently, index-based trading was permitted in options as well as individual securities.

India is one of the most successful developing countries in terms of a vibrant market for derivatives. NSE is now one of the prominent exchanges amongst all emerging markets, in terms of equity derivatives turnover. This reiterates the strengths of the modern development of India’s securities markets, which are based on nationwide market access, anonymous electronic trading, and a predominantly retail market. There is an increasing sense that the equity derivatives market is playing a major role in shaping price discovery.
1.6 CHAPTERIZATION

The Chapterization the research work is the most important part of the research, because this part includes the planning and strategy of the research work. This research work divided into eight chapters. The chapter planning of this research is as below:

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- 3.8.2 Foundation of Ahmedabad Stock Exchange
- 3.8.3 Capital Market and Swadeshi Movement
- 3.8.4 Establishment of Calcutta Stock Exchange
- 3.8.5 The Madras Stock Exchange Ltd

### 3.9 INDIA’S CAPITAL MARKET- PRE-REFORM
- 3.9.1 Stock Exchange Environment
- 3.9.2 Settlement of Securities Transactions
- 3.9.3 Institutional Investors
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- 3.9.5 Market Manipulation and Collapse

### 3.10 MODERN AND DYNAMIC CAPITAL MARKET
- 3.10.1 Issues and Developments in the past decade (2000-2010)
- 3.10.2 The Quantitative Aspects of Market Transformation during 2000-2010
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  - 3.10.2.7 Trend of Secondary Market

### 3.11 ROLE OF SEBI
- 3.11.1 Receipt and Redressal of Investors Grievances
- 3.11.2 Investigations against Unfair means by SEBI
- 3.11.3 Nature of Investigations Taken up by SEBI
- 3.11.4 Nature of Investigations Completed by SEBI
- 3.11.5 Action Taken by SEBI

| 4 | Derivatives Market of India: |
|   | The detail information about the derivative market of India has been given in this chapter. This chapter explains how the derivative market works and the performance of derivative market during last decade in India. It also includes the problems of derivatives market. |
| 4.1 | INTRODUCTION TO DERIVATIVES |
| 4.2 | WHAT ARE DERIVATIVES AND WHAT DO THEY DO? |
| 4.3 | ECONOMIC FUNCTIONS PERFORMS BY DERIVATIVES |
| 4.4 | APPLICATION OF FINANCIAL DERIVATIVES |
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4.6 DERIVATIVES INSTRUMENTS AVAILABLE IN INDIA

4.7 TRADERS IN DERIVATIVES MARKET

4.8 HISTORY OF DERIVATIVES MARKETS IN INDIA

4.9 EVOLUTION OF DERIVATIVES MARKET IN INDIA
4.9.1 Main Recommendations of L.C. Gupta Committee
4.9.2 SEBI Measures to Protect the Rights of Investors in the Derivatives Market

4.10 CLEARING AND SETTLEMENT SYSTEM FOR FINANCIAL DERIVATIVES
4.10.1 National Securities Clearing Corporation Limited
4.10.2 Settlement Mechanism
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4.11 TRENDS OF DERIVATIVES MARKET IN INDIA
4.11.1 Journey of Equity Derivatives Market at NSE
4.11.2 Journey of Equity Derivatives Market at BSE

4.12 COMPARATIVE GROWTH BETWEEN CASH AND DERIVATIVES SEGMENT

4.13 RISKS IN DERIVATIVES TRADING
4.13.1 Risk in Options Trading
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4.14 DERIVATIVE DISASTERS
4.14.1 Disasters caused by Rogue Trader
4.14.2 Defective of Inappropriately Implemented Strategies
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4.14.4 Lessons learnt from derivatives disasters

5 Research Methodology:
Which methods and methodology has been used for the research work are narrated in this chapter. The objective and hypothesis are also mentioned in this chapter.

5.1 INTRODUCTION
5.2 RESEARCH STATEMENT
5.3 RESEARCH DESIGN
5.3.1 Objectives of study
5.3.2 Hypothesis of the study
5.3.3 Nature of Data and Sources of Data
5.3.4 Tools for data collection
5.3.5 Sample design
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5.3.7 Data Scaling and Measurement
### 5.4 TOOLS AND METHODS OF DATA ANALYSIS

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### 5.5 SCOPE OF THE STUDY

### 5.6 ANTICIPATED BENEFITS OF THE STUDY

### 5.7 LIMITATIONS OF THE STUDY

### 6 Analysis of Investors’ Preferences

This chapter is an analytical chapter. In this chapter the analysis of derivatives investors’ preferences in respect of age, gender, income, education, and occupation. For this analysis various statistical techniques have been used like frequency distribution, cross tabulation, coefficient of correlation, chi-square and z statistics, etc.

### 6.1 FREQUENCY (PERCENTAGE) ANALYSIS

### 6.2 CROSS-TABULATION ANALYSIS

### 6.3 HYPOTHESIS TESTING

### 7 Findings, Suggestions and Conclusion

This chapter includes findings from the analysis.

### 7.1 FINDINGS

### 7.2 SUGGESTIONS

7.2.1 Suggestions for investors

7.2.2 Suggestions for institutions

### 7.3 CONCLUSION

#### References

(i) Journals, Books, Articles, Govt. Publications,

(ii) Webliography

#### Appendix

(i) Questionnaire

(ii) Conferences/Seminars/Workshops/FDP Attended

(iii) Paper presented/published/Books published/chapter in book during research work