REVIEW OF LITERATURE

**Barents Group LLC (1997)** studied that India’s household savings and foreign investors are key sources of this capital and can and will be increasingly attracted to more efficient, safe and transparent market. Retail investors in India are mostly short-term traders, and day trading is not uncommon. To the extent that buying publicly traded equities is perceived as a risky and speculative short-term activity, many potential investors will simply avoid capital market instruments altogether in deciding to allocate savings.

**R. Dixon and R.K. Bhandari (1997)** said in their study that consequently derivative instruments can have a significant impact on financial institutions, individual investors and even national economies. Using derivatives to hedge against risk carries in itself a new risk was brought sharply into focus by the collapse of Barings Bank. There is a clear call for international harmonization and its recognition by both traders and regulators. There are calls also for a new international body to be set up to ensure that derivatives, while remaining an effective tool of risk management, carry a minimum risk to investors, institutions and national/global economies. Considers the expanding role of banks and securities houses in the light of their sharp reactions to increases in interest rates and the effect their presence in the derivatives market may have on market volatility.

**Patrick McAllister and John R. Mansfield (1998)** stated that derivatives have been an expanding and controversial feature of the financial markets since the late 1980s. They are used by a wide range of manufacturers and investors to manage risk. This paper analyses the role and potential of financial derivatives investment property portfolio management. The limitations and problems of direct investment in commercial property are briefly discussed and the main principles and types of derivatives are analyzed and explained. The potential of financial derivatives to mitigate many of the problems associated with direct property investment is examined.

**Yoon Je Cho (1998)** showed in his study that increasing turnover figures in the Indian stock exchanges from 1994-95 to 1996-97, implying that they are dominated by speculative investments, which is not unusual in emerging markets. However, trading volumes in the Indian capital market are fairly large compared to those in other emerging markets. The substantial increase in turnover may be attributed primarily to the expansion of the NSE’s
trading network. But this also reflects the fact that the Indian stock market is dominated by speculative investments for short-term capital gains, rather than long-term investment.

**Abdulla Yameen (2001)** delivered massage, investors will need to be alert to any new development in capital market and take advantage of the Investor Education and Awareness Campaign program which to be undertaken by the Capital Market Section to acquaint of the risks and rewards of investing on the Capital market. Speech was also focused on to create a new breed of financial intermediaries, which will deal on the market for their clients. These intermediaries have to be professionals with quite advanced knowledge on stock exchange operations, techniques, law and companies valuation. Investors depend to a large extent on their professional advice when investing on the market. Furthermore, these intermediaries must be men of integrity and honesty as they would deal with clients’ money. Confidence of investors in these professionals is a key to the success of the capital market.

**Makbul Rahim (2001)** argued in his speech that the regulatory framework must provide the right environment for the development and the growth of the market. High standards of probity and professional conduct have to be maintained and reach world class standards. Integrity is very important as well confidence. The development of a proper free flow of information and disclosure helps investors to make informed investment decisions.

**P. M. Deleep Kumar and G. Raju (2001)** showed that the capital market is becoming more and more risky and complex in nature so that ordinary investors are unable to keep track of its movement and direction. The study revealed that the Indian market is probably more volatile than developed country markets, which is probably why a much higher proportion of savings in developed countries go into equities. More than half of individual shareowners in India belonged to just five cities. The distribution of share ownership by States and Union Territories show that just five States accounted for 74.7 per cent of the country’s share ownership population and 71.7 per cent of the aggregate value of the shareholdings of individuals in India. Among the five States Maharashtra tops the list with Gujarat as a distant second followed by West Bengal, Delhi and Tamil Nadu. In the midpoint of the study also argued that introduction of derivatives is the first step to hedge the risk of unfavourable movement in the market. This will also lower transaction cost and provides depth and liquidity to the market.
Peter Carr and Dilip Madan (2001) disclosed that generally does not formally consider derivatives securities as a potential investment vehicles. Derivatives are considered at all, they are only viewed as tactical vehicles for efficiently re-allocating funds across broad asset classes, such as cash, fixed income, equity and alternative investments. They studied that under reasonable market conditions, derivatives comprise an important, interesting and separate asset class, imperfectly correlated with other broad asset classes. If derivatives are not held in our economy then the investor confines his holdings to the bond and the stock and the optimal derivatives position is zero.

Prof. Peter McKenzie (2001) in his speech at seminar investors have a choice instead of placing their money in only one company they can pick areas of growth and move their money, buying and selling and placing it where it is going to be most profitable. The individual investor does not have to make an individual decision where to place his savings. These decisions are made by an expert fund manager, which would spread the risk by spreading the investments across different sectors of the economy.

Hong Kong Exchanges and Clearing Ltd. (2002) surveyed on derivatives retail investors, and argued first based on empirical evidence that years of trading experience and usual deal size have a positive correlation. Second, Male investors traded to trade more frequently than female investors. Third, the usual deal size of investor with higher personal income traded to be larger. Fourth majority of respondents are motivated by their stock trading experience to start derivatives trading. Fifth, trading for profit is the key reason for derivatives trading other than high rate of return, hedging, etc. Sixth, the most significant motivating factors are more liquid market and more transparent market. Seventh, majority of traders are infrequent in trade- 3 times or less in a month and Index futures is the most popular product to trade most frequently. Ninth, a large proportion of the investors invest in exchange cash products than derivatives or investment avenues.

Through empirical evidence form investor’s opinion, study argued that the liquidity of derivatives products other than futures is low. High transaction costs or margin requirement is the barrier for active participation in derivatives market. But also shows that more active traders do not have much complaint towards transaction costs and margin requirement.

S. M. Imamual Haque and Khan Ashfaq Ahmad (2002) argued that the sluggish trends in primary equity markets need to be reverse by restoring investors’ confidence in market.
Savings for retirement essential seek long term growth and for that investment in equity is desirable. It is a well established fact that investments in equities give higher returns than debt and it would, therefore, be in the interest of the banks to invest in equities.

Warren Buffet (2002) argued that derivatives as time bombs, both for the parties that deal in them and the economic system. He also argued that those who trade derivatives are usually paid, in whole or part, on “earnings” calculated by mark-to-market accounting. But often there is no real market, and “mark-to-model” is utilized. This substitution can bring on large-scale mischief. In extreme cases, mark-to-model degenerates into mark-to-myth. Many people argue that derivatives reduce systemic problems, in that participant who can’t bear certain risks are able to transfer them to stronger hands. He said that the derivatives genie is now well out of the bottle, and these instruments will almost certainly multiply in variety and number until some event makes their toxicity clear.

Swarup K. S. (2003) empirically found that equity investors first enter capital market though investment in primary market. The main reason for slump in equity offering is lack of investor confidence in the primary market. It appeared from the analysis that the investors give importance to own analysis as compared to brokers’ advice. They also consider market price as a better indicator than analyst recommendations. Accordingly number of suggestive measures in terms of regulatory, policy level and market oriented were suggested to improve the investor confidence in equity primary markets.

Leyla Şenturk Ozer, Azize Ergeneli and Mehmet Baha Karan (2004) studied that the risk factor is one of the main determinants of investment decisions. Market participants that are rational investors ultimately should receive greater returns from more risky investments. They also concluded that the crisis and resulting deep recession in 2002 changed many things, including market confidence of investors and financial analysts. In addition to decreasing trading volume of Istanbul Stock Exchange (ISE), the number of individual investors reduced and investment horizon of investors shortened and liquid instruments.

Jennifer Reynolds-Moehrle (2005) used a sample of derivative user and non-user firms; they came to know that analysts’ forecast accuracy increased and that unexpected earnings are incorporated into subsequent earnings forecasts to a greater extent subsequent to disclosure of sustained hedging activity. Additionally, the findings indicated an increase in the earnings-return relation in the hedging activity period.
Rajeswari, T. R. and Moorthy, V. E. R. (2005) said that expectations of the investors influenced by their perception and human generally relate perception to action. The study revealed that the most preferred vehicle is bank deposit with mutual funds and equity on fourth and sixth respectively. The survey also revealed that the investment decision is made by investors on their own, and other sources influencing their selection decision are newspaper, magazine, brokers, television and friends or relatives.

Chris Veld and Yulia V. Veld-Merkoulova (2006) found that investors consider the original investment returns to be the most important benchmark, followed by the risk-free rate of return and the market return. Study found that investors with longer time horizon would generally be better off investing in stocks compared to investors with shorter time horizon. They knew through the question on risk perceptions that investors who are more risk tolerant would benefit from relatively larger investment in stocks. Their study showed the investors optimize their utility by choosing the alternative with the lowest perceived risk.

G.N. Bajpai (2006) showed that continuously monitors performance through movements of share prices in the market and the threats of takeover improves efficiency of resource utilisation and thereby significantly increases returns on investment. As a result, savers and investors are not constrained by their individual abilities, but facilitated by the economy’s capability to invest and save, which inevitably enhances savings and investment in the economy. Thus, the capital market converts a given stock of investible resources into a larger flow of goods and services and augments economic growth. The study concluded the investors and issuers can take comfort and undertake transactions with confidence if the intermediaries as well as their employees (i.) follow a code of conduct and deal with probity and (ii) are capable of providing professional services.

J. K. Nayak (2006) interpreted the preferred mode of investment is first equity, banks, mutual fund and then any other in a descending order. It means Investor's faith has increased and their risk taking ability has also increased. One thing that could be drawn from this study is that problems are mostly broker related and therefore that is one area where reforms are required. The investors feel that the amount of knowledge available on the equity market is not satisfactory. Investors, it appears, need to be educated more. Investors still considered the capital market as highly risky. But from the investment pattern from the descriptive statistics it seems that the number of people willing to invest in capital market has increased.
Narender L. Ahuja (2006) expressed Futures and options trading helps in hedging the price risk and also provides investment opportunity to speculators who are willing to assume risk for a possible return. They can also help in building a competitive edge and enable businesses to smoothen their earnings because non-hedging of the risk would increase the volatility of their quarterly earnings. At the same time, it is true that too much speculative activity in essential commodities would destabilize the markets and therefore, these markets are normally regulated as per the laws of the country.

Randall Dodd and Stephany Griffith-Jones (2006) studied that derivatives markets serve two important economic purposes: risk shifting and price discovery. Derivatives markets can serve to determine not just spot prices but also future prices (and in the options the price of the risk is determined). In the research, interviews with representatives from several major corporations revealed that they sometimes prefer to use options as a means to hedge. They also argued derivatives have a potential to encourage international capital inflows.

K. Ravichandran (2007) argued the younger generation investors are willing to invest in capital market instruments and that too very highly in Derivatives segment. Even though the knowledge to the investors in the Derivative segment is not adequate, they tend to take decisions with the help of the brokers or through their friends and were trying to invest in this market. He also argued majority the investors want to invest in short-term funds instead of long-term funds that prefer wealth maximization instruments followed by steady growth instruments. Empirical study also shows that market risk and credit risk are the two major risks perceived by the investors, and for minimizing that risk they take the help of newspaper and financial experts. Derivatives acts as a major tool for reducing the risk involved in investing in stock markets for getting the best results out of it. The investors should be aware of the various hedging and speculation strategies, which can be used for reducing their risk. Awareness about the various uses of derivatives can help investors to reduce risk and increase profits. Though the stock market is subjected to high risk, by using derivatives the loss can be minimized to an extent.

Nicole Branger and Beate Breuer (2007) showed that investors can benefit from including derivatives into their portfolios. For retail investors, however, a direct investment in derivatives is often too complicated. They argued if the investor can trade only in the stock and money market account, the exposure of his portfolio to volatility risk will be zero, and the relation between the exposure to stock diffusion risk and jump risk will be fixed. They
proved through documentation both theoretically and empirically that investors can increase their utility significantly by trading plain vanilla options. And also told that in a complete market and with continuous trading, it does not matter which derivatives an investor uses to realize his optimal asset allocation. But with incomplete markets, and in particular, discrete trading, on the other hand, the choice of derivatives may actually matter a lot. This problem particularly sever for retail investor, who are hindered from implementing their optimal payoff profile by too high minimum investment amounts, high transaction costs or margin requirements, short-selling restrictions and may be also lack of knowledge.

Philipp Schmitz and Martin Weber (2007) exposed that the trading behavior is also influenced if the underlying reaches some exceptional prices. The probability to buy calls is positively related to the holding of the underlying in the portfolio, meaning that investors tend to leverage their stock positions, while the relation between put purchases and portfolio holdings of the underlying is negative. They also showed higher option market trading activity is positively correlated with past returns and volatility, and negatively correlated with book-to-market ratios. In addition they report that investors open and close long and short call positions if past week's return is positive and write puts as well as close bought and written put positions if the past returns are negative.

B. Das, Ms. S. Mohanty and N. Chandra Shil (2008) studied the behavior of the investors in the selection of investment vehicles. Retail investors face a lot of problem in the stock market. Empirically they found and concluded which are valuable for both the investors and the companies having such investment opportunities. First, different investment avenues do not provide the same level of satisfaction. And majority of investors are from younger group.

Gupta and Naveen Jain (2008) found that majority of the investors are from younger group and as per occupation, salaried persons are more inclined towards investment. Study also argued education qualification is the major influenced factor in investment. Their most preferred investment is found to be shares followed by mutual funds. Empirically they found and argued the Indian stock market is considerably dominated by the speculating crowd, the large scale of day trading and also fact the futures trading in individual stocks is several times the value of trading in cash segment. They also found the largest proportions of the investors are worried about too much volatility of the market. For trader and speculators, price volatility is an opportunity to make quick profits. In the study, high proportions of investors have a very favorable opinion about the capital market regulation.
Prasanna P. K. (2008) empirically found that foreign investors invested more in companies with a higher volume of shares owned by general public. Foreign investors choose the companies where family shareholding of promoters is not essential. The study concluded that corporate performance is the major influencing factor for investment decision for any investor. As far as financial performance is concerned, the share return and earnings per share are significant factors influencing investment decision. The study concluded that it is required to understand when FII withdraw their funds and when they pump in more money.

Deleep Kumar P M and Deyanandan M N (2009) analyzed the opinion of retail investors on the major market reforms as well as their investment performance. The study revealed introduction of derivatives trading and internet trading are found useful by only a marginal group of investors. The empirical results of the study concluded that even though SEBI claims itself to be the champion of investor protection, it has not been successful in instilling a sense of confidence in the minds of majority of investors.

G. Ramakrishna Reddy and Ch. Krishnudu (2009) summarized that a majority of the investors are quite unaware of corporate investment avenues like equity, mutual funds, debt securities and deposits. They are highly aware of traditional investment avenues like real estate, bullion, bank deposits, life insurance schemes and small saving schemes. Study argued the primary motive of investment among the small and individual investors is to earn a regular income either in form of interest or dividend on the investment made. The other motives like capital gains, tax benefits, and speculative profits are stated to be the secondary motives of investment. From empirical research they argued to motivate the people to invest their savings in the stock market to be achieved only if the regulatory authorities succeed in providing a manipulation free stock market.

K. Logeshwari and V. Ramadevi (2009) advocated that a commodities market provides a platform for the investors as well as hedgers to protect their economic interests as well as increase their investible wealth. Commodity prices are generally less volatile than the stocks. Therefore it’s relatively safer to trade in commodities. But the volume being traded in commodities is much less than the stock market. This is because of the two reasons that the investors are less aware about the commodities market and their risk perception.

Nidhi Walia and Ravi Kiran (2009) studied that to satisfy the needs of investors’ mutual funds are designing more lucrative and innovative tools considering the appetite for risk
taking of individual investors. A successful investor is one who strives to achieve not less than rate of return consistent with risk assumed. They also argued as per observation by survey responses of the individual investor’s fact is clear that overall among other investment avenues capital market instruments are at the priority of investors but level of preference varies with different category/ level of income, and an association exists between income status of investors and their preference for capital market instrument with return as objective.

**Vinay Mishra and Harshita Bhatnagar (2009)** documented that Derivatives are considered to be extremely versatile financial instruments, as they help to manage risks, lower funding costs, enhance yields and diversify portfolios. The contributions made by derivatives have been so great that they have been credited with having ‘changed the face of finance’ in the world. Derivatives markets are an integral part of capital markets in developed as well as in emerging market economies. These instruments assist business growth by disseminating effective price signals concerning exchange rates, indices and reference rates or other assets, thereby, rendering both cash and derivatives markets more efficient.

**Ashutosh Vashishtha and Satish Kumar (2010)** studied encompasses scope an analysis of historical roots of derivative market of India. The emergence of derivatives market is an ingenious feat of financial engineering that provides an effective and less costly solution to the problem of risk that is embedded in the price unpredictability of the underlying asset. In India, since its inception derivatives market has exhibited exponential growth both in terms of volume and number of traded contracts. They argued that NSE and BSE has added more products in their derivatives segment but still it is far less than the depth and variety of products prevailing across many developed capital markets.

**Daniel Dorn (2010)** concluded market for OTC derivatives have grown rapidly during the last decade in many Asian and European countries. Investors often face a choice between dozens of OTC options that differ only slightly in their attributes. He argued that professional advice can help uninformed investor better navigate the menu of choices, unless issuers raise complexity or offer advisors incentives to share in industry profit.

**David Nicolaus (2010)** studied that retail derivatives allow retail investors to pursue sophisticated trading, investment strategies and hedging financial instruments. Retail investors’ motivation for improving the after tax return of their household portfolio represents a major driver of the derivatives choice of the products and that provide only little equity exposure for the investor. The derivatives reveal the divergent belief of retail investors about
the future price level of the underlying as these can be tailored to specific demand of the investor. He argued the potential role of search costs and financial advice on the portfolio decisions of retail investors, the flexibility of retail derivatives and low issuance costs are likely to emphasize the existing frictions in financial retail markets such as an increase of strategies and heuristics used by retail investors to cope with the complex decision situation or an inadequate disclosure of conflicts of interest in financial retail markets.

Gaurav Kabra, Prashant Mishra and Manoj Dash (2010) studied key factors influencing investment behaviour and ways these factors impacts investment risk tolerance and decision making process among men and women and those different age groups. They said that not all investments will be profitable, as investor will not always make the correct investment decisions over the period of years. Through evidence they proved that security as the most important criterion; there is no significant difference of security, opinion, hedging in all age group. But there is significant difference of awareness, benefits and duration in all age group. From the empirical results they concluded the modern investor is a mature and adequately groomed person.

Rajiv Gupta (2010) argued in Capital Market 2009-10 IPO-QIP Report there have been several noticeable trends over the past five years. First, the size of offerings by Indian issuers has been growing and there are more and larger size global offerings reflecting the maturing and increasing depth of the Indian capital markets. Second, India has become a destination and region in its own right for 13 raising capital - previously companies could not raise more than a few hundred million, but now have capital issues like Reliance Power, in excess of Rs. 13,200 crore ($ 3 billion). While the ADR/GDR markets remain attractive, fewer companies are using that route as Indian markets have become strong and have the appetite for large transactions. Third, Indian capital markets now attract companies across sectors, rather than in any single sector.

R R Rajamohan (2010) analyzed the role of the financial knowledge is important in decision making in information intensive assets like stocks and other risky securities. Hence, reading habit, as a proxy for financial knowledge. Younger people have greater labor flexibility than older people; if the returns on their investments turn out to be low, they could work more or retire later. Hence age an important factor to be considered in household portfolio analysis.
Sheng-Hung Chen and Chun-Hung Tsai (2010) wanted to identifying key factors influencing individual investor’s decision to make portfolio choices is of importance to understand their heterogeneous investment behavior. Through conjoint analysis examine how individual investors derive their preferences for financial assets. Study stated female investors tend to be more detail oriented; elder is more likely to have low level of risk tolerance; the level of education is thought to impact on a person’s ability to accept risk; increasing income level of individual investor is associated with increased levels of risk tolerance. At last they argued single investors are more risk tolerance than married investors.

Shyan-Rong Chou, Gow-Liang Huang and Hui-Lin Hsu (2010) expressed that faced with the series of financial events leading to the current turmoil, unpleasant investor experience has become common and personal experiences and reports of such are demonstrated in risk and attitudes to risk. The paper showed that investors are able to choose an investment with potential risk and returns to suit their own preferences. Products of lower potential profit are tolerated when the risk associated with those products is similarly low. In their study they found that attitude to risk is very similar for both the genders. The study shows most stock trading is transacted by individual rather than institutional investors, therefore the capital gains and losses from stock price fluctuations are felt first-hand by individual investors.

Yu-Jane Liu, Ming-Chun Wang and Longkai Zhao (2010) found options are important investment financial instruments as their flexibility makes financial market complete. Accordingly, options are complicated for those who do not educate themselves on the subject. Study found a trader who is more professional, sophisticated, and experienced is less susceptible to isolate his decision-making sets and simplify complicated investment strategies to form his portfolios. The study revealed that traders in option markets don’t trade call/put contracts to such a great degree. In general, most investors prefer to trade front-month or near-the-money. Trading in a futures market for option traders, this suggests that almost half of the investors are trading in both options and futures market.

Gopikrishna Suvanam & Amit Trivedi (2011) studied derivative trading is essential tool for the health of markets as they enhance price discovery and supplement liquidity. In a span of a year and a half after that index options, stock options and lastly stock futures were introduced, derivatives volumes have grown to multiples of cash market volumes and have been a mode of speculation and hedging for market participants, not possible otherwise through cash markets. The investor invests for a certain period, the issuer of the product
constantly uses derivatives segment to hedge his positions to create the desired payoff for its clients.

**M. Sathish, K. J. Naveen and V. Jeevanantham (2011)** studied in the options available to investors are different and the factors motivating the investors to invest are governed by their socio-economic. They argued that instead of investing directly, the investors particularly, small investors may go for indirect investment because they may not be in a position to undertake fundamental and technical analysis before they decide about their investment options. Their empirical study showed that majority of the investors of mutual funds is also belongs to equities who give the first preference to that avenue which gives good return. From the study, concluded that lack of knowledge as the primary reason for not investing in investment vehicle.

**S. Gupta, P. Chawla and S. Harkant (2011)** stated financial markets are constantly becoming more efficient providing more promising solutions to the investors. Study also proved that occupation of the investor is not affected in investment decision. The most preferred investment avenue is insurance with least equity market. The study also argued that return on investment and safety are the most preferred attributes for the investment decision instead of liquidity.

**S. Saravanakumar, S. Gunasekaran and R. Aarthy (2011)** showed the upswing in capital market allows the investors to harvest handsome return in their investments, but day-trader in stock market hard to take advantage in bullish and bearish market conditions by holding long or short positions. Now the derivative instruments offer them to hedge against the adverse conditions in the stock market. They argued that secondary market is the most preferred than primary market and cash market is the most preferred market than derivatives market because of high risk when derivatives market is preferred than cash market for higher return.