

ARE INVESTORS MAKING INVESTMENTS IN RISKY DERIVATIVES OR ARE THEY BEEN DEPRIVED OF KNOWLEDGE – A STUDY

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ABSTRACT

Present study attempts to provide a deep understanding about the soft infrastructure and how soft infrastructure plays the vital role in the competitive market. We also discuss about the types of Soft-Infrastructure and mainly focus to the social infrastructure. An overview about derivative market is risky investments only for those young and new businesses which don't have a sufficient amount of knowledge in D-Markets scenario in India. This paper emphasis how the investor not getting actual benefits out of the investment done in Derivative Market; this may be due to improper knowledge of soft infrastructure.

Keywords: Derivative Market, Soft Infrastructure.

1. INTRODUCTION

1.1 Meaning of soft-infrastructure

Soft infrastructure includes both physical assets such as highly specialized buildings and equipment, as well as non-physical assets such as the body of rules and regulations governing the various systems, the financing of these systems, as well as the systems and organizations by which highly skilled and specialized professionals are trained, advance in their careers by acquiring experience, and are disciplined if required by professional associations (professional training, accreditation and discipline).

1.2 Meaning of Derivative

A security whose price is dependent upon or derived from one or more underlies assets. The derivative itself is only a contract between two or more parties. Its value is determined by fluctuations in the underlying asset. The most common underlying assets include stocks, bonds, commodities, currencies, interest rates and market indexes.

1.3 Meaning of Derivative Market

The derivative market means the price of particular product in the market is fluctuating time by time. The market of derivative financial instruments plays an important role in the global economy. Futures exchanges where derivatives are traded function as the centres of pricing for

many assets and also as mechanisms that make it possible to re-distribute various financial risks among the participants in this market.

1.4 Investor in Derivative Market

An individual who commits money to investment products with the expectation of financial return. Generally, the primary concern of an investor is to minimize risk while maximizing return, as opposed to a speculator, who is willing to accept a higher level of risk in the hopes of collecting higher-than-average profits.

2. LITERATURE REVIEWS

For this study various papers, articles, and book have been reviewed. Some of the important are as follows:

Hentschel, L (1995) emphasize about the debate over risks and regulation in derivatives markets has failed to provide a clear analysis of what risk are and whether regulation is useful for their control. They analyze the risks associated with derivative transactions, and the impact of regulation in limiting these risks. They provide a simple, parametric framework in which one can analyze price, default and systemic risk. Features of widely used incentive contracts for derivatives trades are induce them to take very risky positions, unless they carefully monitored.

Kim, Y. K. And Mugo-waweru, F. are empirically analyzes the factor behind successful derivative products in the emerging markets of the Asian region, they discuss if the derivatives product was the first derivatives product introduced in the exchange, it is more likely to be successful and also said that the option contracts are relatively more successful than their respective futures contracts due to the costs associated with margin requirement.

Talat Afza (2011) is emphasizes world economy has increased the employment of risk management practices in corporation's financial decisions in order to reduce the variability in firm's future cash flows, due to the highly volatile exchange rates and interest rates.

3. OBJECTIVES AND RESEARCH GAPS OF THE STUDY

1. To study the types of soft Infrastructure.
2. To study the importance of soft infrastructure in competitive market in India.
3. To study the factors effecting derivative market leading to investor disinterest in making investment and what sort of prescribed content to be follow by investor to invest in derivatives in India.
4. To study the level of initiative taken to develop a good social infrastructure for investor in

Derivative Market in India.

4. METHODOLOGY & TECHNIQUES

This research study is totally Exploratory in nature. The methodology used in the study of current scenario on the following points:

- Data and Sample.
- Normality Test of the Data.

5. SCOPE FOR FURTHER RESEARCH/LIMITATION OF THE STUDY

- The study is limited to the secondary data.
- The constraint of available derivatives data from India.
- The only R & D factor represents the soft infrastructure.
- The Scope of this paper could help easy to understand the new generation.

6. ANALYSIS AND FINDINGS

6.1 Types of soft-infrastructure

6.1.1 Governance infrastructure

The system of government and law enforcement, including the political, legislative, law enforcement, justice and penal systems, as well as specialized facilities like government offices, courthouses, prisons and specialized systems for collecting, storing and disseminating data, laws and regulation. Emergency services, such as police, fire protection, and ambulances, including specialized vehicles, buildings, communications and dispatching systems. Military infrastructure, including military bases, arms depots, training facilities, centres, communication, major weapons systems, fortifications, specialised arms manufacturing, strategic reserves.

6.1.2 Economic infrastructure

The financial system, including the banking system, financial institutions, the payment system, exchanges, the money supply, financial regulations, as well as accounting standards and

materials used as inputs in industry, specialized energy, transportation and water infrastructure used by industry, plus the public safety, zoning and environmental laws and regulations that govern and limit industrial activity, and standards organizations.

Agricultural, forestry and fisheries infrastructure, including specialized food and livestock transportation and storage facilities, major feedlots, agricultural price support systems (including agricultural insurance), agricultural health standards, food inspection, experimental farms and agricultural research centres and schools, the system of licensing and quota management, enforcement systems against poaching, forest wardens, and fire fighting.

6.1.3 Social infrastructure

The health care system, including hospitals, the financing of health care, including health insurance, the systems for regulation and testing of medications and medical procedures, the system for training, inspection and professional discipline of doctors and other medical professionals, public health monitoring and regulations, as well as coordination of measures taken during public health emergencies such as epidemic. The educational and research system, including elementary and secondary schools, universities, specialized colleges, research institutions, the systems for financing and accrediting educational institutions. Social welfare systems, including both government support and private charity for the poor, for people in suffering or victims of abuse.

6.1.4 Cultural, sports and recreational infrastructure

Sports and recreational infrastructure, such as parks, sports facilities, the system of sports leagues and associations. Cultural infrastructure, such as concert halls, museums, libraries, theatres, studios, and specialized training facilities. Business travel and tourism infrastructure, including both man-made and natural attractions, convention centers, hotels, restaurants and other services that cater mainly to tourists and business travelers, as well as the systems for informing and attracting tourists, and travel insurance.

6.2 Importance of Soft Infrastructure in India

6.2.1 As per the powerful company they used to expenses in hard infrastructure (Like expenses in building, invest in fixed assets) but nowadays these company has also expenses towards to the soft infrastructure due to the heavy competitions in market. Soft infrastructure like medical insurance of staff, training and development provided to the staff to improve the efficiency, to achieve the organizational goal and survive in the current market. Now research and development expenses directly related to the soft infrastructure so these company has still existence in the current market.

6.2.2 If the research and development expenses of the company are increasing trend then it indicated for surviving in the market and we must to know they are building up their soft infrastructure otherwise they will not existence in the market.

Therefore, to understand how soft infrastructure is playing an essential role in the development of country economy; we have considered that the expenditure incurred on R&D by various is directly proportional to establishing good investment training institutions. In the below mentioned expenditure details of companies we have tried to link that if companies can spend huge amount on R&D expenses then they can also contribute towards setting up new technical training institutes which help the investors to take right decisions which will favor towards the company's growth and development. This is explained with the help of a table and graphs

TABLE-1

R&D Expenses- In view of Setting up Training/Development Institutes

Company Name	Tata Elxsi Ltd Cr.		CMC Limited Cr.		Infosys TechnologiesLtd (Cr.)		InfoTech Enterprises Ltd (Cr.)		Kala Consultants Ltd (Cr.)	
	R&D	Growth	R&D	Growth	R&D	Growth	R&D	Growth	R&D	Growth
2003	3.73	521.67%	7.81	-24.4%	14.44	-2.83%	1.82	71.70%	5.56	10.98%
2004	5.56	49.06%	11.54	47.76%	44.54	208.45%	1.93	6.04%	5.01	-9.89%
2005	7.18	29.14%	10.12	-12.3%	74.00	66.14%	2.20	13.99%	6.62	32.14%
2006	8.41	17.13%	11.81	16.70%	102.16	38.05%	3.17	44.09%	7.20	8.76%
2007	10.91	29.73%	11.66	-1.27%	167.00	63.47%	1.69	-46.69%	6.52	-9.44%

In the above table lets us about the companies' growth which is unpredictable. We can see from the table that Tata Elxsi Ltd in year 2003 attained R&D growth of 521.67% in 2004; but there was unprecedented fall from 521.67% to 49.06% in 2005 this show that may be due to they feel noncompetition in market. It can also be observed that sincere training was not undertaken by the investors which made them not to invest in such companies (the factor of not been trained is mainly emphasised in this research paper)

In the same view (Table-1) to training it can be said that Infosys Technologies Ltd lost its major shares from 2005 to 2006 from 208.45% to 38.05%. The reasons again need to be explored that why there was unprecedented fall in Infosys Technologies Ltd. It can be understood that investors were pretty not aware of how much they can gain by investing in the same company and which made them think and switch to other options available, prior no assessment was done by them it shows the metal block of not accepting the fact that they required trained and skilled people who could guide them better and suggested about the present state of market.

This table-1 has shows the outline of companies' unprecedented growth which indirectly relates to investors who may be making investments in derivatives intentionally and hence are unaware of what need to be done when it comes to taking a decision to make investments in companies.

Below are the graph which shows individual investment made in research and development. The research and development expenditure here related that how much the companies are ready to spend on research training. If these companies are ready to spend on increasing productivity and profitability then they must establish educational institutes where people can be trained about the market intricacies; how to analyze the present market scenarios; how best the risk can be minimized by make use of knowledge provided to these small investors. We think a strong recommendation and instructions must be given by both the governments to have good derivative training institutes. These initiatives must be taken by big companies spending huge amount on research and developments; to open such training institutes which will provide a chance for every individual to learn and assess their investment alternatives in much easy and affordable manner.

From the individual graphs it's observed that every company seems to be making major investments in R&D with an objective of achieving organization goals. It is suggested that after

having seen the trends of such companies; they must give emphasis on contributing in establishing good number of investment training institutes, which will train the investors and building a both the nation to have stable and more secure economy. Lastly, it can be said that still most of companies are unaware of how they can contribute best to the society; but here efforts are made to rethink as to what can be done to improve the level of knowledge of ignorant investor who believes that they agree to make investment and rely on unplanned decisions.

Internationalization of R&D has entered a new phase, with MNCs overseas investments increasing in the Asian region. China and India are emerging as the most preferred destinations for MNCs for setting-up their dedicated R&D centers (Ernst, D (2007)). According to 'The Economists Intelligence Unit survey, 2007', India emerges as the most preferred destination for R&D location, followed by US and then China. Now, the firms from India are also going out to expand their R&D, production and marketing activities.

Main reasons behind this New Trend:

- Escalating Demand on S&T Infrastructure
- Prohibitive Cost of Highly skilled Manpower
- Resource scarcity in Developed Countries.

6.3 Factors effecting derivative market leading to investor disinterest in making investment and what sort of prescribed content to be follow by investor to invest in derivatives in India.

6.3.1 There are several factors effecting to the Indian Derivative Market.

- a) Market sentiments
- b) Political News: Government action on any increase or decrease on tax.
- c) Trends: Positive trend points like inflation, crude oil price hike, RBI policy like CRR, Interest Rate hike does not affect much to market. In down trend the same factors pull down Indian market and heavy selling occurs.
- d) Misconception of Derivatives: There is a wrong feeling that derivatives would bring in financial collapse. There is an enormous negative publicity in the wake of a few incidents of financial misadventure.
- e) Leveraging: another is leveraging. That is, they are 'high risk – high reward vehicles'. There is a prospect of either high return or huge loss in all derivative instruments. So, there is a feeling that only a few can play this game. There is no doubt that derivatives create leverage and leverage creates increased risk or return. At the same time, one should keep in mind that the very same derivatives, if properly handled, could be used as an efficient tool to minimise risk.
- f) Off Balance Sheet Items: A form of financing in which large capital expenditures are kept off of a company's balance sheet through various classification methods.
- g) Absence of Proper Accounting System
- h) Inbuilt Speculative Mechanism
- i) Absence of Proper Infrastructure

6.3.2 These contents follow by investor before investment in derivatives in India.

Basically if the investor would like to invest in derivative market they must have to take

some training course about the derivative before entering. The investor should have to know the available derivative products suite in India, Market Participants list various stakeholders and their roles, economic purpose of derivatives, various risk faced by the participants in derivatives. Know, Significance and economic purpose of Index, Types and attributes of Indices, Index management, Major Indices in India, Understand applications of indices, know about the Forwards, Future, option and swap, Understand concept of convergence of cash and futures prices, Financial Engineering (like Option spreads, Straddle, Strangle, Covered Call, Protective Put, Collar, Butterfly spread), Trading System, Selection criteria of Stock for trading, Adjustments for Corporate Actions, Position Limits, Using daily newspapers to track futures and options, Clearing Members (List different types of clearing members and their roles), Clearing Mechanism, Settlement Mechanism, Risk Management, Legal and Regulatory Environment, Rule and Regulation in Trading, in Clearing & Settlement and Risk Management, the mode of payment of margins, Taxation of Derivative transaction in securities, know how treatment of Profit/ Loss on Derivatives transactions, Investors Grievance Mechanism.

6.4 Level of initiative taken to develop a good social infrastructure for investor in Derivative Market in India.

Nowadays the Derivative Market is very sensitive, if investor would like to invest in derivative market they must have to build up their soft infrastructure, must know about the entire derivative instruments available, they have to analysis the derivative market like fundamental analysis as well as technical analysis also. The fundamental and technical analysis is not easy so the investor should take some training course to build up their soft infrastructure. Few years ago there were only numbered institute but nowadays it has been grown so many institute over here in India. Now the derivative course has also taught in under graduation and post graduation course. In the present scenario there are so many institutes those who provide training course about of derivative.

National stock Exchange (NSE) has also provided the certification programme of derivative in different module.

- a) Derivatives Market Dealers.
- b) Option Trading Strategy Module
- c) Option Trading (Advanced) Module
- d) Commodities Market Module
- e) Currency Derivatives: A Beginner's Module
- f) Equity Derivatives: A Beginner's Module
- g) Interest Rate Derivatives: A Beginner's Module

This module mainly enabling the candidates to better demonstrate their domain knowledge relating to Derivative markets in Indian as well as globally concept. If the investors have build up their soft infrastructure by taking these certification course before entering in this market they will have success and obviously feed good amount benefits

7. CONCLUSIONS

In the concluding part it can be said that soft infrastructure is the most prominent factor in the

Derivative market. In the soft infrastructure there are government, economic, social, culture, sports and recreational infrastructure. It play the vital role in the current competitive market so the company have to make heavy expenses for building the social infrastructure and thus they contribute ample amount of expenses in training and development and up to date of market for achieving the organisational goal, if the company will not make this expenses they will not survive in the market.

Investment in Derivative Market is very sensitive so before entering this market investor should have to take some training course and also aware about the effecting factor of derivative. Without knowing the factor which has influenced to the derivative the investor will never get the benefit. After review of this paper the emerging investor will sure get good amount of benefit and also this paper will aware those investors who were haphazardly investing in derivative market and surely they increase the soft infrastructure.

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