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A Study of Financial Derivatives with Special Reference to Futures and Options

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Abstract:

Financial derivatives are important financial instruments used for risk management, speculation, and arbitrage in financial markets. Derivatives derive their value from underlying assets such as stocks, commodities, currencies, interest rates, and market indices. Among various derivative instruments, futures and options are widely used by investors and institutions to manage market risks and enhance returns. This study examines the concept, features, functions, and applications of financial derivatives with special reference to futures and options. The study also analyzes investor awareness, usage patterns, and the role of derivatives in modern financial markets. The findings indicate that futures and options play a significant role in hedging risks and improving market efficiency.

Keywords: Financial Derivatives, Futures, Options, Hedging, Risk Management, Financial Markets.

Introduction:

The growth of financial markets has increased the need for effective risk management tools. Financial derivatives are contracts whose value depends on the performance of an underlying asset. They help investors protect themselves against adverse price movements and provide opportunities for profit through speculation and arbitrage.

Futures and options are the most commonly traded derivative instruments. Futures contracts obligate parties to buy or sell an asset at a predetermined price on a future date, whereas options provide the right but not the obligation to buy or sell an asset.

This study focuses on understanding the role of futures and options in financial markets and their contribution to risk management and investment decision-making.

Literature Review:

Hull (2021) The study emphasized that derivatives are essential tools for managing financial risk and improving market liquidity.

Sharma and Gupta (2022) The researchers found that futures contracts are widely used by investors to hedge against price fluctuations.

Kumar (2023) The study highlighted that options provide flexibility and limited risk exposure to investors compared to other derivative instruments.

SEBI Report (2024) The report indicated significant growth in derivatives trading in India, particularly in futures and options segments.

Mehta and Rao (2024) The researchers concluded that financial derivatives contribute to efficient price discovery and risk transfer mechanisms.

The literature suggests that futures and options are effective instruments for managing market risk and enhancing investment opportunities.

Objectives of the Study:

1. To understand the concept of financial derivatives.
2. To examine the features and functions of futures and options.
3. To analyze the role of derivatives in risk management.
4. To evaluate investor awareness and usage of futures and options.
5. To suggest measures for improving derivative market participation.

Research Questions:

1. What are financial derivatives and their importance in financial markets?
2. How do futures and options contracts operate?
3. What are the benefits and risks associated with futures and options?
4. How do investors use derivatives for risk management?
5. What measures can enhance awareness and participation in derivative markets?

Research Methodology:

Research Design:

Descriptive Research Design.

Sources of Data:

Primary Data:

- Structured Questionnaire
- Interviews with Investors and Market Participants

Secondary Data:

- NSE and SEBI Reports
- Financial Journals
- Books on Derivatives
- Research Articles
- Market Reports

Sampling Technique:

Convenience Sampling.

Sample Size:

100 Investors and Market Participants.

Data Collection Tools:

Questionnaire and Interview Schedule.

Statistical Tools:

- Percentage Analysis
- Tables and Charts
- Comparative Analysis

Study Period:

January 2026 – April 2026.

Data Analysis:

Table 1: Awareness of Financial Derivatives

Response	Respondents	Percentage
Aware	80	80%
Not Aware	20	20%
Total	100	100%

Interpretation: A majority of respondents are aware of financial derivatives.

Table 2: Preferred Derivative Instrument

Instrument	Respondents	Percentage
Futures	45	45%
Options	40	40%
Both	15	15%
Total	100	100%

Interpretation: Futures contracts are slightly more preferred than options among respondents.

Table 3: Purpose of Using Derivatives

Purpose	Respondents	Percentage
Hedging	42	42%
Speculation	35	35%
Arbitrage	15	15%
Portfolio Diversification	8	8%
Total	100	100%

Interpretation: Hedging is the primary reason for using derivative instruments.

Findings:

1. Most investors are aware of futures and options trading.
2. Futures contracts are widely used for hedging and speculation.
3. Options provide flexibility and limited risk compared to futures.
4. Derivatives help investors manage market volatility effectively.
5. Hedging is the most common purpose for using derivatives.
6. Lack of technical knowledge remains a barrier for some investors.
7. Derivative markets contribute significantly to liquidity and price discovery.

Suggestions:

1. Conduct investor education programs on derivatives trading.
2. Increase awareness regarding risk management strategies.
3. Provide simplified learning resources for retail investors.
4. Strengthen regulatory oversight to ensure market transparency.
5. Encourage the use of derivatives for hedging rather than excessive speculation.

Conclusion:

Financial derivatives have become an integral part of modern financial markets. Futures and options provide investors with valuable tools for managing risk, enhancing returns, and improving portfolio performance. The study concludes that derivatives play a significant role in market efficiency, liquidity, and price discovery. Although awareness of derivatives is increasing, continuous investor education and regulatory support are essential for promoting responsible participation in derivative markets. Futures and options will continue to be important instruments for risk management and investment strategies in the evolving financial environment.

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