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A STUDY ON THE IMPACT OF FINANCIAL LITERACY ON INDIVIDUAL'S DECISION MAKING IN DERIVATIVES MARKET

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Abstract:

Having a fundamental grasp of financial instruments is necessary for making sound financial decisions. In today's complex financial landscape, numerous factors influence individual's decision making in Financial Market. Essentially, possessing financial knowledge empowers individuals to make well-informed decisions regarding their investments. This study aims to analyse how individuals with financial literacy influence the decision-making processes within the complex dynamics of the derivatives market. It also analyses the awareness of derivatives market and risks among the individuals. A well-structured questionnaire was constructed to collect primary data and the survey was conducted among 101 sample respondents in Mumbai.

Key Words: *Financial literacy, Derivative Market, Instruments.*

Introduction:

Financial literacy is a crucial topic for investors and in particular is essential for young people. Financial literacy is the cognitive understanding of financial components and skills on financial matters to confidently take effective action that best fulfils an individual's personal, family and global community goals. The absence of such skills is referred to as being financially illiterate. In a country like India, we have close to 80% literacy, but when it comes to financial literacy, we are not that lucky. National Centre for Financial Education did a survey which says that only 27% of Indians are financially literate. When compared to the wealth of studies on stock market participation there appears to have been considerably less focus placed on the determinants of household participation in complex derivatives markets, which are almost redundant assets for individuals.

In India, Traders want maximum gain with minimum risk or no risk, so is the case with derivatives. Derivatives are among the forefront of the innovations in the financial markets and aim to increase returns and reduce risk.

A derivative is a financial product which has been derived from another financial product or commodity. The derivatives do not have independent existence without underlying product and market. Derivatives are contracts which are written between two parties for easily marketable assets. It is derived by the means of a mutual agreement; the types of derivative products are limited only by imagination and so there is no definitive list of derivative products. Some of the common derivative contracts are:

- Forward Contracts: A forward contract is an agreement between parties to buy/sell a specified

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quantity of an asset at a certain price. It is a simple customised contract between two parties to buy or sell an asset for a certain price at a certain time in future. Forward contracts being bilateral contracts are exposed to counter party risk.

- Future Contracts: A future contract is a standardised contract written by a clearing house that operates an exchange where the underlying can be bought and sold.
- Option Contracts: An Option is an instrument or contract that gives the holder a right, without any obligation, to buy or sell specified quantity of the underlying assets at an agreed price on or before a specified future date.
- Swaps: Swap means barter or exchange. A swap is a derivative contract through which two parties exchange the cash flows or liabilities from two different financial instruments. Most swaps involve cash flows based on a notional principal amount such as a loan or bond, although the instrument can be almost anything.

Derivatives are gaining importance due to increased volatility in capital and foreign currency markets. RBI finds ways for healthy development of market and takes steps to popularise the use of derivative instruments, but still awareness or education about the derivative instruments and its uses are quite low. Hence, it is necessary to find out the level of awareness among investing public and if found low, how to create adequate awareness to encourage the use of derivative products as hedge tools.

The impact of financial literacy in the derivative market is substantial, as individuals with a strong understanding of financial concepts are better equipped to assess and manage risks associated with derivative instruments. Financially literate participants are more likely to make informed decisions, employ risk mitigation strategies, and navigate the complexities of the derivative market, contributing to overall market stability and individual financial well-being.

Significance and Scope of the study:

The global liberalization and integration of financial markets have created new investment opportunities, which in turn require the development of new instruments that are more efficient to deal with increased risk. Trading in derivatives reduce risk by providing additional channels to invest with lower trading cost and it facilitates the investors to extent their settlement through the future contracts. They provide extra liquidity in stock market. The study arises due to, now a days derivative trading has become an important avenue but most of the investors are still unaware about its opportunities and are not financially literate to make decisions in derivative market.

Objectives of the Study:

1. To find out the reasons for preferring Derivative Instrument.
2. To examine the impact of financial literacy on decision’s made in derivative market.
3. To study on the awareness of Derivative market in Mumbai region

Review of Literature:

1) **Ratna Achuta Paluri (2016),** analysed factors influencing financial attitudes of Indian women to classify Indian women based on attitude with 9 variables: anxiety, interest in financial issues intuitive decisions, precautionary savings, free spending, materialistic and fatalistic attitude, propensity to plan for long and short-term financial goals. It was found that only one third of respondents did not buy any financial products as they are financially illiterate.
2) **V. Mathavathani et al. (2014),** focused on financial literacy of rural women in Tamil Nadu based on 3 factors: knowledge, behaviour and attitude. It was found that very low financial literacy was there among rural women.

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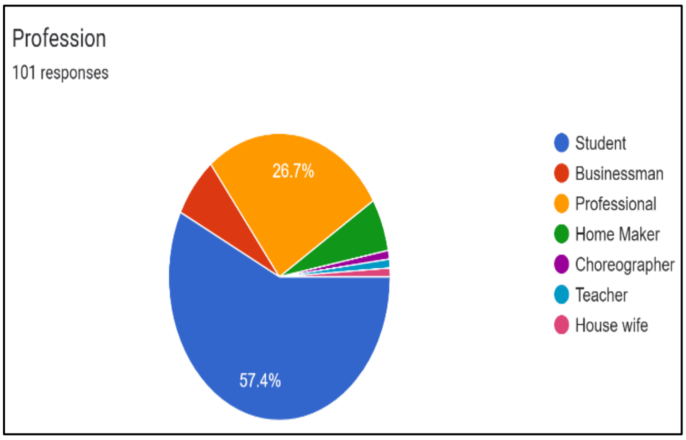
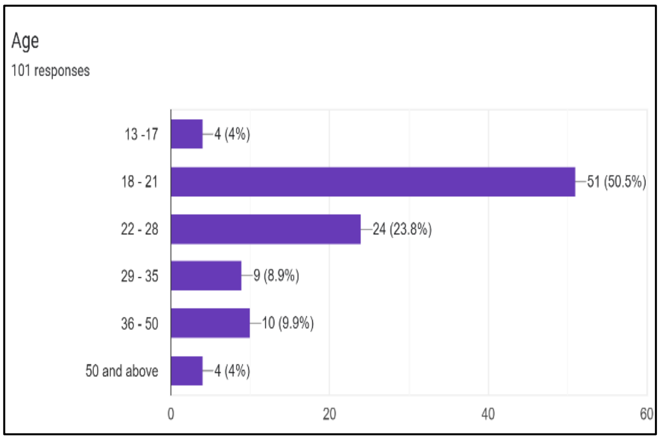
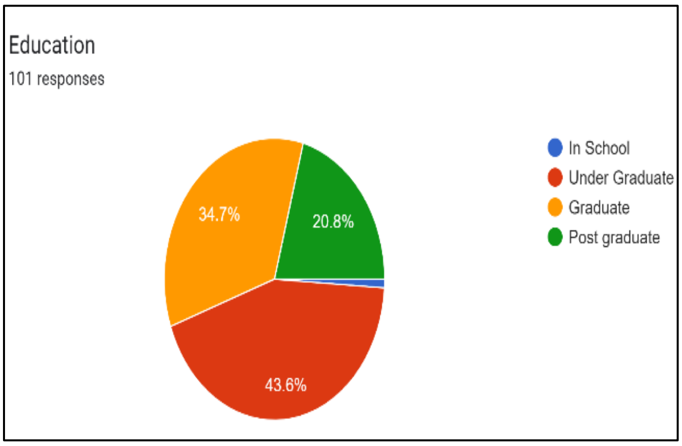
3) **D.V.Gakhar (2016)** studied on Impact on Volatility and Investor Perception explores that the investors awareness and investors investment decisions and risk taking ability on derivative instruments plays an important role in the development of trading activities in derivative market.
4) **Gopal Krishna U M (2019)** study explores that the Investors investment behaviour and risk-taking ability on various investment avenues. The study concludes the ability of risk behind the particular
5) financial instruments in Derivative Market.
6) **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.

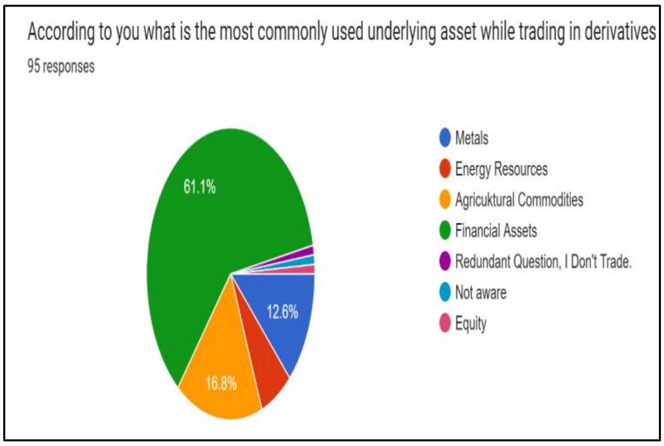
Data Analysis and Interpretation:

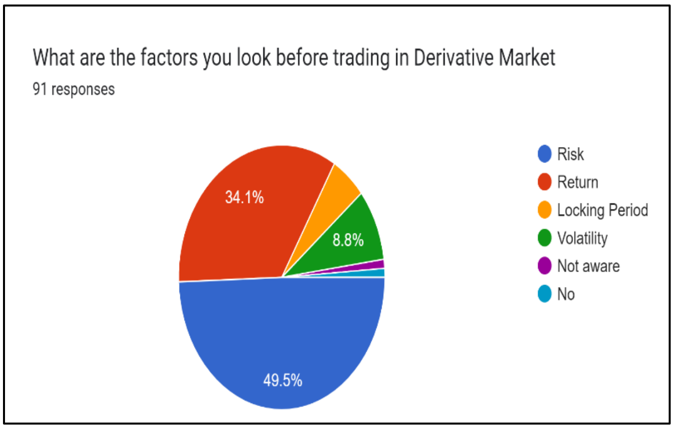
So, for primary data a Google form was circulated with a topic **A Survey on Derivative Market**. 101 people gave their opinion about Derivative Market. The main objective of this survey was to know how many people are aware about the Derivative Market and what are the factors they look upon while trading in the market. The age group targeted for the survey was between 13 to 50 above. The below graph shows the number of people participated in the survey from different age group.

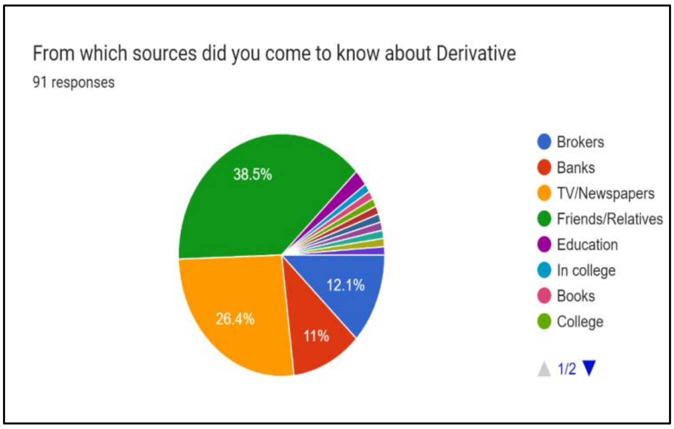


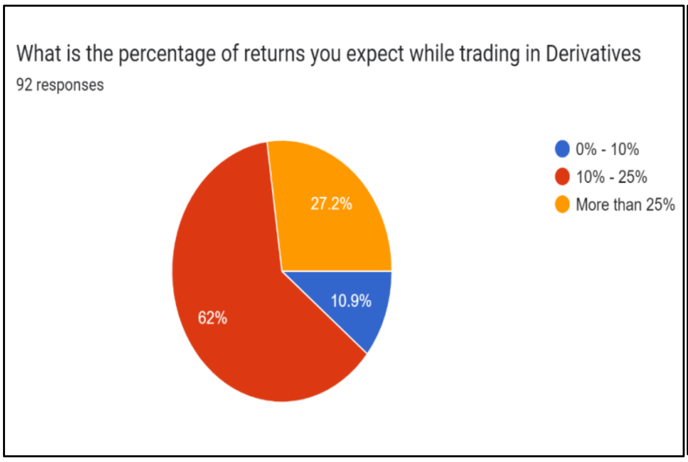


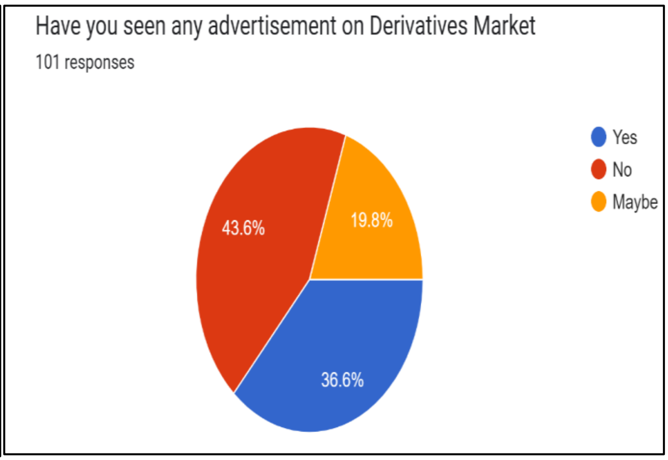


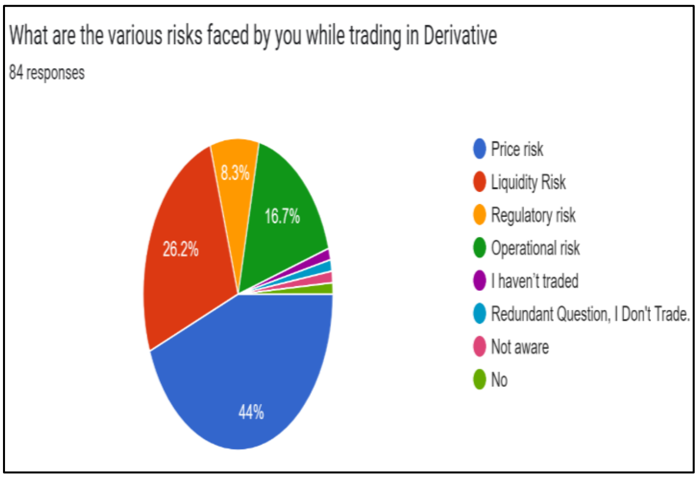


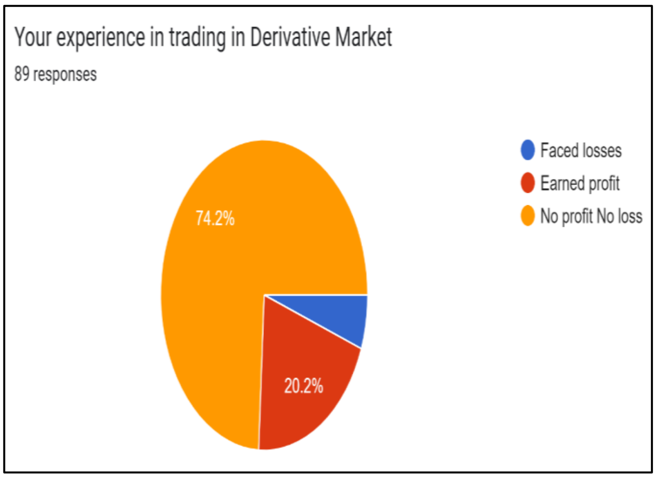












Interpretation:

From the above pie diagram, we can see that 71.3% people do not trade in Derivatives market.

18.8% people do trade in Derivative Market. 9.9% are not aware do they trade or not. Most of the people think that most commonly traded underlying asset is financial assets. 61.1% financial assets are traded in the derivatives market.

According to the people participated in the survey think that 16.8 % agricultural commodities are traded in the market 12.6% metals are the underlying asset traded in the market. Rest all traded underlying asset is Energy Resources, Equity etc.

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Some of the participants in the survey don't trade and are not aware about it. 67% of the people participated from different age group in the survey are aware about the trading in Derivative Market.

33% of the people are not aware about the Derivative Market. Awareness should be created among the people who are not aware about the market.

In 33% school going students are also involved who can be excluded. Rest all people should be aware which will help in the growth of Derivative Market.

13.1% people do trade in Equity Derivative Market.

67% of the people are aware about the market but only 13.1 % of the people trade in Derivative Market

34.1% people think returns is the factor they look before trading in Derivative Market.

8.8% people think volatility is the factor they look before trading in Derivative Market

49.5% people think that it is not necessary to consider any factor before trading in Derivative Market

62% people expect 10% - 25% returns while trading in Derivative Market.

10.9% people expect 0% - 10% returns while trading in Derivative Market.

27.2% people expect more than 25% returns while trading in Derivative Market.

43.6% people have not seen any advertisement on Derivative Market.

36.6% people has seen advertisement and are aware about Derivative Market.

19.8% people are not aware that they have seen any advertisement on Derivative Market or not

38.5% people got to know about Derivative Market from Friends and Relatives.

26.4% people got to know about Derivative Market from TV or Newspapers.

12.1% people got to know about Derivative Market from Banks.

11% people got to know about Derivative Market from Brokers.

Conclusion: As this survey was conducted to know that people are aware about Derivative Market or not. According to the responses I conclude that most of the people participated in the survey are not aware about the market and because of less awareness people do not trade in Derivative Market.

More awareness should be created through advertisements on TV, Newspapers, through banks, brokers etc.

Price risk, Liquidity risk, Operational risk, Regulatory risk should be controlled so that more people would trade in the Derivative Market.

As convenience sampling was undertaken information from this survey is limited to only 101 respondents.

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