

A STUDY ON RETAIL INVESTORS PREFERENCE TOWARDS EQUITY DERIVATIVE INSTRUMENTS

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Abstract

The equity derivatives market of India has witnessed significant growth over the past decades. A large number of retail investors are investing in equity derivatives due to increased technological advancements, market accessibility and possibility of higher returns. This study examines the preferences of retail investors towards equity derivative instruments in the National Capital Territory of Delhi. Primary data was collected through a self-structured questionnaire from retail investors across the National Capital Territory (NCT). Descriptive Statistics has been used to study the preference of retail investors towards various equity derivatives instruments such as index futures, index options, stock futures and stock options. The findings indicate that retail investors prefer to trade in options as compared to futures. Moreover, most of the respondents prefer to trade in index options followed by stock options, stock futures, and index futures. The results provide useful insights for policymakers, financial educators, and market intermediaries to enhance retail participation in a more informed and sustainable manner.

Key Words: Retail Investors; Derivative Instruments; Futures; Options.

Introduction

The capital market of India has experienced remarkable growth and transformation over the past decades, which is supported by financial sector reforms and technological advancements. The equity derivatives market has emerged a crucial segment of the financial system (Hull, 2023). Stock market is one of the financial markets in which buying and selling of equities are done by traders/investors. Stock market participants consist of small individual investors (retail investors) to large institutional investors. Stock market is a key indicator of a country's economic growth and development. Stock market participants play a prominent role in increasing the prices of assets from their true value (Kumawat, 2014).

The derivatives market is that place where contracts according to the value of underlying assets namely commodities, equities, interest rates or currencies are bought and sold. It enables participants to manage risk and speculate on price movements (Mishkin and Eakins, 2012). Derivatives use varies from institution to institution. Thus, interest rate derivatives or currency derivatives are used to minimize credit risk. There is a different mechanism to regulate the institutions which are non-financial as compared to financial institutions. This will affect their profits to use derivatives. IRDA issues guidelines for insurance companies regarding derivatives uses. Financial institutions are not the major users of ETDs and their participation to total NSE value trades was under 8% in 2005 in India. Market Insider thinks that scenario is changing which is shown by increasing share of index derivatives (institution invests more than retail investors). On contrary to ETD markets, OTC instruments having fixed income are preferred by mutual funds and indigenous financial institutions. Whereas, companies prefer currency forwards and these instruments are purchased from banks.

Index futures have been started in June, 2000 and index options in June, 2001. The futures and options on underlying assets in July 2001 and November 2001. NSE has been trading in derivatives viz. futures and options on 118 distinct stocks and market indices since 2005. These contracts of derivatives do not deliver the underlying assets but transfer the net cash position (SEBI, 2003). Rapid expansion can be seen in derivatives which were based on individual stock and stock indexes since its origin. SSFs have become highly popular. Indeed, the NSE ranks first globally in terms of volume of SSFs contracts traded. Futures were more widely used as compare to single stock options (Chellasamy and Anu, 2015).

Review of Literature

Prasad (2016) studied the investors' perception towards equity derivatives in Anantapuram District and found that index options preference does not differ with investor's income, age and gender. Investors' first preference in derivative was index options followed by stock futures, stock options and index futures. Majority of investors were investing in equity derivatives were speculators. **Sivasankar and Anantha (2016)** examined the perception of the investors with regard to derivatives market and found that 29.24% of the investors invested their funds for a period of more than 5 years. 28.7% of the investors invested their funds for 3-5 years, 26% of the investors invested for 1-3 years and 16% invested their funds for a period of less than 1 year. The results also revealed that 57.14% investors preferred futures on individual stocks, 23.81% investors preferred options on individual stocks, 11.9% of the investors invested in stock index futures and 7.14% of the investors invested in stock index options. 40.62% of the investors preferred to enter in 1-3 contracts, 12.86% of the investors preferred to enter in 3-6 contracts and rest opted for more than 6 contracts. **Dhanaiah and Prasad (2017)** studied the growth potential of equity derivatives market in India and showed drastic shift in share of different derivative products of equity derivatives market. Major share contributed in derivatives turnover in 2014-15 was by index options. SSF product trade decreased. Single stock options share increased from 2% in 2008-09 to 5.9% in 2014-15. NSE ranked at No.1 in stock index options, at No.2 in single stock futures and at No.6 in single stock options and stock index futures in 2014-15. **Venkatesha et al. (2018)** studied investors' perception in equity derivatives and found that their first preference in derivative instruments were index options than stock futures, stock options and index futures. The results also revealed that equity derivative was considered as risk hedging tool and the trading of equity derivative has been affected by spot market. Few respondents save their major part of income for investment. Investors invested in equity derivative market very often i.e. more than 30 times a year. Market and credit risk were identified as two major factors in capital market. **Kaur and Setia (2022)** conducted a study on equity derivative market in India. It was found that there had been a positive relationship between NSE cash turnover and derivatives turnover from 2016 to 2021. Correlation method was applied to identify the relation between derivatives market and cash market turnover. There was 5% participation of cash market in total turnover of NSE while there was 95 % participation of derivatives market in total turnover of NSE in 2016-2017. From 2016-2017 onwards, participation of cash market was decreased 1% to 3% in total turnover of NSE as compared to derivatives turnover. There was strong positive relationship between derivatives turnover and total turnover. In futures and options segment, index options had maximum volume of percentage as compared to index futures, option futures and stock options. **Belim et al. (2023)** studied the challenges faced by new traders in equity derivatives and found that conditional volatility was significant across all the sample stocks. Retail investors' trade had significant impact on price volatility of stock futures. It was also observed that trading at NSE equity and equity derivatives by all investors jointly affected trade volume at equity market. Moreover, trade through stock and index futures had significant impact on trade volume in equity market.

Objectives of the Study

- i. To study the concept of equity derivatives.
- ii. To study retail investors preference towards equity derivative instruments.

Research Methodology

Data has been collected from National Capital Territory of Delhi, which is the universe of the study. Delhi is divided into four Zone. From these zones, eleven administrative districts were selected by using purposive sampling technique. Data was collected from 500 respondents of National Capital Territory. Demographics pertaining to age, gender, educational qualification, marital status, occupation and income were considered while collecting the data.

Analysis and Interpretation

This section describes the retail investors' preference for various derivative instruments. Descriptives Statistics has been used to study the preference of retail investors.

Table 4.1: Frequency Distribution of Preference for Equity Derivatives

Statements	Frequency	Percentage
Index Derivatives	98	19.6
Stock Derivatives	77	15.4
Both	325	65.0

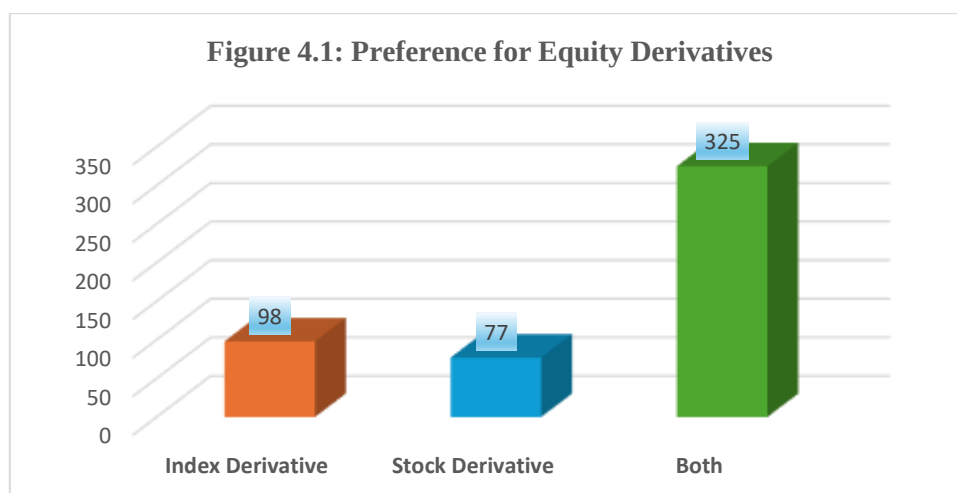


Table 4.1 and figure 4.1 depict the frequency distribution of preference of the retail investors for equity derivatives. The result shows that 325 respondents i.e. 65 percent prefer the both segments of equity derivatives such as index derivatives and stock derivatives. 98 respondents i.e. 19.6 percent prefer to trade in index derivatives while 77 respondents i.e. 15.4 percent respondents prefer to trade in stock derivatives.

Table 4.2: Frequency Distribution of Preferred Trading Segment of Equity Derivatives

Statements	Frequency	Percentage
Futures	39	7.8
Options	153	30.6
Both	308	61.6

Figure 4.2: Preferred Trading Segment of Equity Derivative

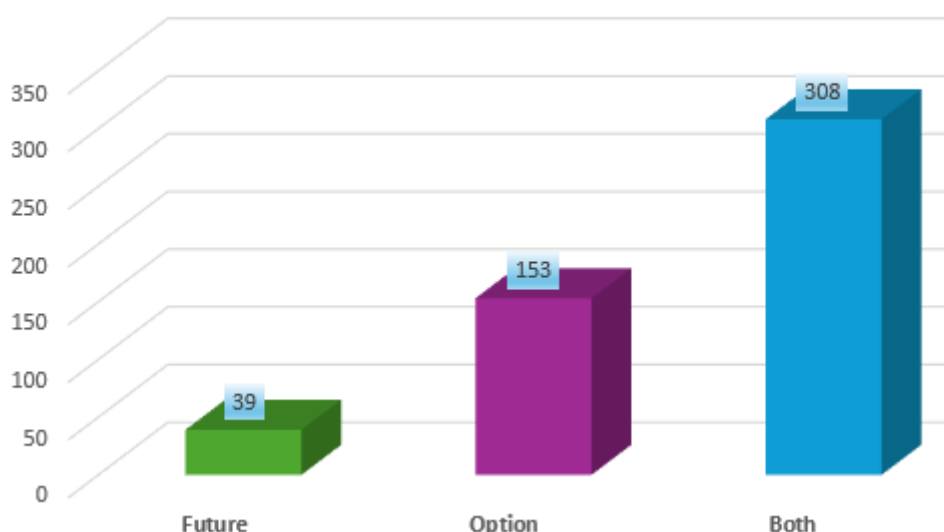


Figure and table 4.2 show the frequency distribution of preference of the retail investors regarding trading segments of equity derivatives. The result indicates that 308 respondents i.e. 61.6 percent prefer to trade in both segments such as futures and options. 153 respondents i.e. 30.6 percent prefer to trade in options while 39 respondents i.e. 7.8 percent prefer to trade in futures.

Table 4.3: Frequency Distribution of Preferred Securities for Trading in Equity Derivatives

Statements	Frequency	Percentage
Index Futures	15	3.0
Index Options	105	21.0
Stock Futures	49	9.8
Stock Options	55	11.0
All of the above	276	55.2

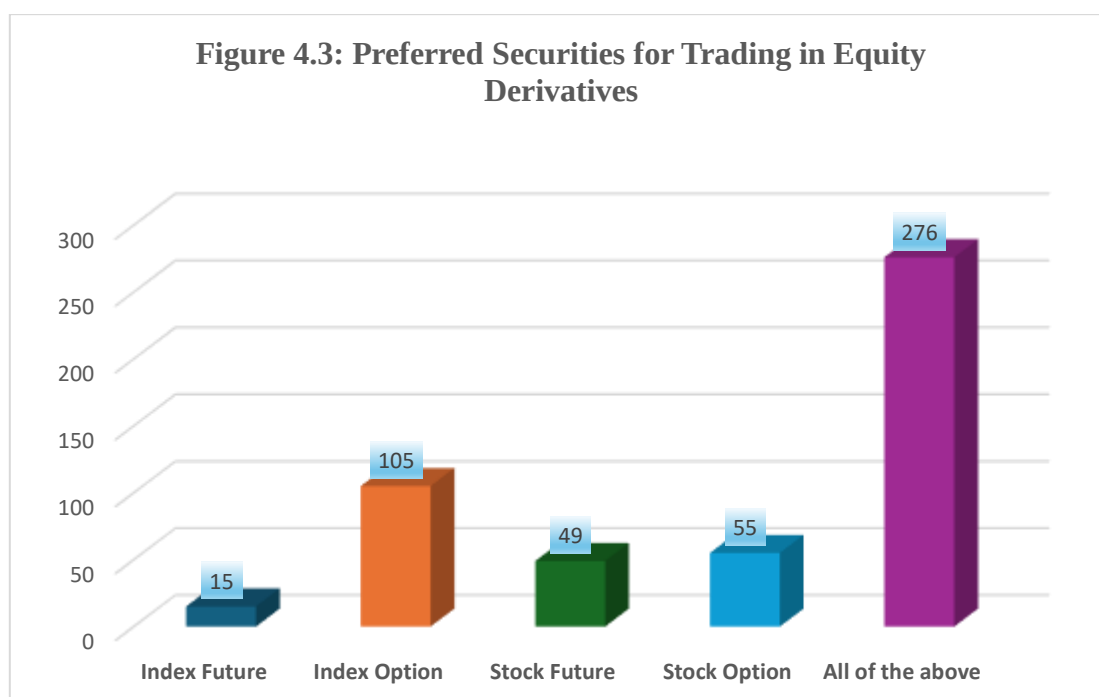


Table and figure 4.3 show the frequency distribution of securities in which retail investors' trade. The result highlighted that 276 respondents i.e. (55.2%) prefer to trade in all the categories of equity derivatives. 105 respondents i.e. (21%) prefer to trade in index options followed by 55 respondents (11%) in stock options, 49 respondents (9.8%) in stock futures, and 15 respondents (3%) in index futures.

Table 4.4: Frequency Distribution of Preference for Option Trading

Statements	Frequency	Percentage
Buy an option	150	30.0
Sell an option	47	9.4
Both	303	60.6

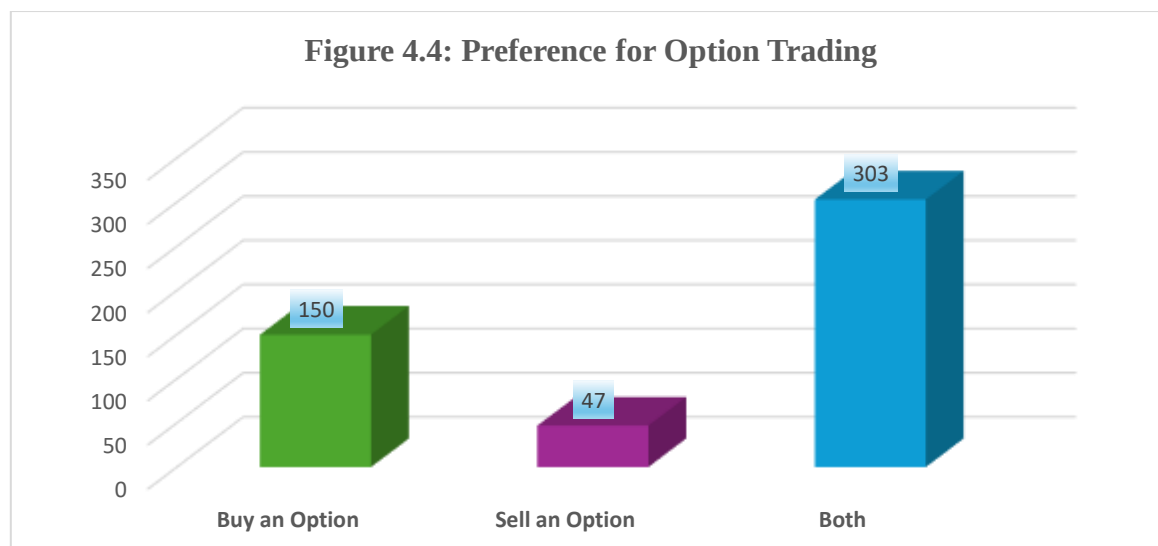


Table and figure 4.4 depict the frequency distribution of option trading choices. The results indicate that 60.6 percent i.e. 303 respondents preferred both the options available like buy an option and sell an option. Whereas, 30 percent i.e. 150 respondents opted to buy an option and 9.4 percent i.e. 47 respondents opted to sell an option.

Table 4.5: Frequency Distribution of Preference for Benefits of Securities

Statements	Frequency	Percentage
Liquidity	133	26.6
Profitability	279	55.8
Safety	88	17.6

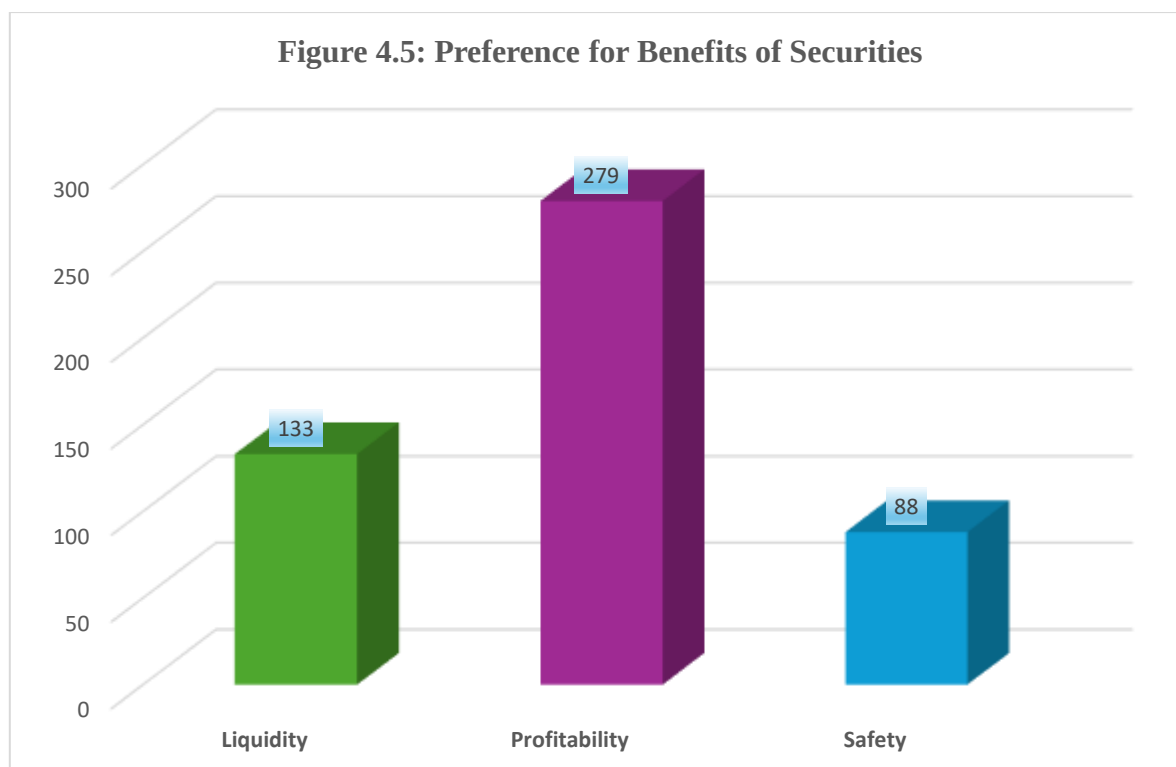


Table and figure 4.5 depict the preference of retail investors' regarding benefits derived from securities in which they trade. The result depicts that 55.8 percent i.e. 279 respondents trade in equity derivative segment because of high profitability. High profitability attracts the investors to invest in equity derivatives. 26.6 percent i.e. 133 respondents consider liquidity as a benefit for trading in equity

derivatives. 17.6 percent i.e. 88 respondents consider safety as a measure for trading in equity derivatives.

Table 4.6: Frequency Distribution of How Often Retail Investors Do Trading in Equity Derivatives

Statements	Frequency	Percentage
Regularly	199	39.8
Few times in a week	178	35.6
Few times in a month	123	24.6

Table 4.6 depicts the frequency distribution of how often retail investors trade in equity derivatives. It is clear from the above table that 39.8 percent i.e. 199 respondents prefer to trade regularly in equity derivatives market. 35.6 percent i.e. 178 respondents prefer to trade few times in a week and remaining 24.6 percent i.e. 123 respondents prefer to trade few times in a month in equity derivatives market.

Table 4.7: Frequency Distribution of the Statements that Shift the Retail Investors from Cash Segment to Derivative Segment

Statements	Frequency	Percentage
More profit	131	26.2
Lesser funds required	146	29.2
Low brokerage	31	6.2
Higher lot size	17	3.4
More volatility	51	10.2
Hedging	124	24.8

Table 4.7 reveals the frequency distribution of why do retail investors shift from cash segment to derivatives segment. The result indicates that 29.2 percent i.e. 146 respondents prefer to trade in derivatives market because lesser funds are required to trade in equity derivatives. Lesser fund requirement is motivational factor for them to trade in equity derivatives. 26.2 percent i.e. 131 respondents shifted from cash segment to derivatives segment because there is high possibility of profit in equity derivatives market. Generally, it is seen that derivatives market offers high profit to investors as compare traditional platforms of investment. 24.8 percent i.e. 124 respondents prefer to trade in equity derivative as it is a hedging tool. It helps the investors in minimizing the risk. Because of volatility, 10.2 percent i.e. 51 respondents shifted towards equity derivatives. 6.2 percent i.e. 31 respondents shifted towards equity derivative because of low brokerage charged by brokers and 3.4 percent i.e. 17 respondents preferred to trade in equity derivatives because of higher lot size.

Table 4.8: Frequency Distribution of Awareness of Retail Investors towards Risks Involved in Derivatives Trading

Statements	Frequency	Percentage
Credit risk	63	12.6
Market risk	373	74.6
Legal risk	26	5.2
Operation risk	38	7.6

Table 4.8 demonstrates the frequency distribution of awareness level of retail investors towards risks involved in equity derivatives. It is clear from the above table that 74.6 percent i.e. 373 respondents are of the opinion that market risk is high in equity derivatives market followed by credit risk (12.6%), operational risk (7.6%) and legal risk (5.2%).

Table 4.9: Frequency Distribution of do Investors Wait till Settlement Day of the Contract or Square off Before the Settlement Day

Statements	Frequency	Percentage
Wait till settlement day	72	14.4
Square off before settlement	166	33.2
Both	262	52.4

Table 4.9 shows the frequency distribution of do retail investors wait till settlement day of the contract or square of the contract before settlement. The results indicated that 33.2 percent i.e. 166 respondents square off the contract before settlement while 14.4 percent i.e. 72 respondents wait till the settlement day of the contract. 52.4 percent i.e. 262 respondents wait till settlement day and square off the contract before settlement day.

Table 4.10: Frequency Distribution of do Retail Investors Carry Forward their Position to the Next Settlement

Statements	Frequency	Percentage
Yes	70	14.0
No	152	30.4
Sometimes	278	55.6

Table 4.10 shows the frequency distribution of do retail investors carry forward their position to the next settlement. The result depicted that 30.4 percent i.e. 152 respondents do not carry forward their position to the next settlement. 14 percent i.e. 70 respondents regularly carry forward their position to the next settlement. 55.6 percent i.e. 278 respondents sometimes carry forward their position to the next settlement.

Discussion

Equity derivatives refer to financial contracts whose value is inferred from the price of an underlying stock. Options and futures are common types of equity derivatives. Descriptive Statistics was used to find out preference of retail investors towards equity derivatives. The results of Descriptive Statistics reveal that 65 percent respondents prefer the both segments of equity derivatives such as index derivatives and stock derivatives. 19.6 percent respondents prefer to trade in index derivatives while 15.4 percent respondents prefer to trade in stock derivatives. Further, retail investors prefer to trade in options as compared to futures. Moreover, most of the respondents prefer to trade in index options followed by stock options, stock futures, and index futures. The results of the present study are supported by Prasad (2016) studied investors' perception towards equity derivatives in Anantapuram District. The results showed that Investor's first preference in derivatives was index options followed by stock futures, stock options and index futures. Most of the investors investing in equity derivatives were speculators. Dhanaiah and Prasad (2017) studied the growth of equity derivatives market in India and showed drastic shift in share of different derivative products of equity derivative market. Major share contributed in derivatives turnover in 2014-15 by index options. Single stock futures product trade decreased. Single stock options share increased from 2% in 2008-09 to 5.9% in 2014-15. NSE ranked at No.1 in stock index options, at No.2 in single stock futures and at No.6 in single stock options and stock index futures in 2014-15. Venkatesha et al. (2018) studied investors perception in equity derivatives and found that investors first preference in derivative instruments were index options than stock futures, stock options and index futures. Kaur and Setia (2022) conducted a study on equity derivatives market in India and found that in futures and options segment, index options had maximum volume of percentage than index futures, option futures and stock options.

Conclusion

The study reveals that retail investors exhibit a clear preference hierarchy when it comes to derivative instruments. Among the various options available, index options emerge as the most favoured instrument, reflecting a tendency among investors to seek exposure to broader market

movements with limited risk and defined costs. Stock options rank next, appealing to investors who seek strategic flexibility and controlled downside. This is followed by a preference for stock futures, which offer opportunities for leveraged positions on individual stocks. Index futures, however, are the least preferred, possibly due to their complexity and higher capital requirements. This pattern of preference suggests that retail investors are inclined towards instruments that combine affordability, strategic utility, and risk-limiting features. These insights are critical for financial intermediaries, policymakers, and market regulators to better understand retail investor behaviour and to design appropriate educational and risk-mitigation initiatives to promote informed participation in derivative markets.

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