

Derivative markets in India

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ABSTRACT

Trading in derivatives is dominated by NSE with a market share of 99 per cent in the total equity derivatives turnover. In terms of product-wise share in equity derivatives segment, index options have been holding top position for last three years. During 2010-11, the largest share in the total equity derivatives turnover has been contributed by index options with 62.8 per cent. The second largest share was held by single stock futures (18.8 per cent) which was followed by index futures (14.9 per cent) and single stock options (3.5 per cent). In India, the exchange traded currency derivatives were introduced at different points of time through four exchanges, namely NSE, BSE, MCX-SX and USE starting from August 2008 onward. In case of Currency Derivatives Market, USD-INR futures dominates the market share in terms of number of contracts in currency derivatives segment followed by USD-INR options. The currency derivatives segment on NSE and MCX-SX has witnessed an increasing growth over time, indicating an increase of 93.5 per cent and 115.7 per cent in trading volume over the year. In case of Interest Rates Derivatives, Trading in 10 year notional coupon bearing Government of India (GoI) security futures started at NSE on August 31, 2009 and it also gaining importance. In terms of the growth of derivatives markets, and the variety of derivatives users, the Indian market has equaled or exceeded many other regional markets, but large gaps exist in the range of derivatives products that are traded actively. In equity derivatives, almost 90 per cent of activity is due to stock futures or index futures, whereas trading in options is limited to a few stocks and exchange-traded derivatives based on interest rates and currencies are virtually absent. In India, derivative market making is primarily the province of Indian private and foreign banks, with public sector banks lagging in this area. Similarly, credit derivatives, the fastest growing segment of the market globally, are absent in India and require regulatory action if they are to develop. As Indian derivatives markets grow more sophisticated, greater investor awareness will become essential. In addition, institutions will need to devote more resources to develop the business processes and technology necessary for derivatives trading.

Key words : Derivative market, Currency derivative, Interest rate derivative

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The global economic order that emerged after World War II was a system where many less developed countries administered prices and centrally allocated

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resources. Even the developed economies operated under the Bretton Woods system of fixed exchange rates. The system of fixed prices came under stress from the 1970s onwards. High inflation and unemployment rates made interest rates more volatile. The Bretton Woods system was dismantled in 1971, freeing exchange rates to fluctuate. Less developed countries like India began opening up its economies and allowing prices to vary with market conditions. Price fluctuations make it hard for businesses to estimate their future production costs and revenues. But Derivative securities provide them a valuable set of tools for managing this risk (Asani Sarkar, 2005).

Definition and uses of derivatives:

A derivative security is a financial contract whose value