A

PROJECT REPORT ON

"DERIVATIVES OF SHARE KHAN STOCK BROKERS PVT.LTD"

Submitted To Department Of Commerce

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DEPARTMENT OF COMMERCE

DR. BRR. GOVT. DEGREE COLLEGE JADCHERLA

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CERTIFICATE

THIS IS TO CERTIFY THAT THE MAJOR PROJECT REPORT ENTITLED "DERIVATIVES OF SHARE KHAN STOCKBROKERS PVT. LTD" IS THE BONAFIDE WORK CARRIED OUT BY

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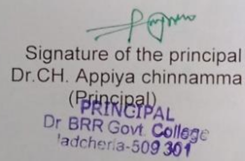

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ABSTRACT

With the approval of the derivatives bill in the union cabinet, the investors are now in the position to trade through futures and options, which provides the investors a greater hedging facility. Derivatives products initially emerged as hedging devices against fluctuations in commodity prices, and commodity linked derivatives offer organizations the opportunity to break financial risks into smaller components and then to buy and sell those components to best meet specific risk management objectives.

Financial derivatives came into the spotlight in the 1970 period due to growing instability in the financial markets. However, since their emergence, these accounted for about two-third of total transactions in derivatives products. In recent years, the market for financial derivatives has grown tremendously in terms of the variety of instruments available, their complexity & also turn over. In the class of equity derivatives. Futures & options on stock also turn over. In the class of equity derivatives, futures & options on stock indices gained more popularity than individual stocks, especially among institutional investors, who are major users of index-linked derivatives. Even small investors find these useful due to the high correlation of popular indexes with various portfolios and ease of use; the lower costs associated with index derivatives vis-à-vis derivatives products based on individual securities is another reason for their growing use.

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CHAPTER-I

INTRODUCTION

Introduction

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THE NEED FOR A DERIVATIVES MARKET

The derivatives market performs a number of economic functions:

1. They help in transferring risks from risk averse people to risk oriented people.

2. They help in the discovery of the future as well as current prices.

3. They catalyze entrepreneurial activity.

4. They increase the volume traded in markets because of participation of risk averse people in greater numbers.

5. They increase savings and investment in the long run.

Stock options and stock futures were introduced in both the exchanges in the year 2001. Thus started trading in derivatives in India stock exchanges (both BSE & NSE) covering index options, index futures, stock options and futures in the wake of the new millennium. In a short span of three years the volume traded in the derivative market has outstripped the turnover of the cash market.

OBJECTIVES OF THE STUDY

- ✓ To analyze the derivatives market in India.
- ✓ To study risk management with the help of derivatives.
- ✓ To analyze the operations of futures and options by calculating the intrinsic values.
- ✓ To acquaint the investors with the advantages of derivatives.

SCOPE OF THE STUDY

The study is limited to “Derivatives” With special reference to Futures and Options in the Indian context and the ICICI Securities Limited has been taken as representative sample for the study.

The study cannot be said as totally perfect, any alteration may come. The study has only made a humble attempt at evaluating Derivatives Markets only in Indian Context. The study is not based on the International perspective of the Derivatives Markets

METHODOLOGY

Methodology is a systematic procedure of collecting information in order to analyze and verify the phenomenon. This collection of information is done on the basis of two principle sources. They are:

- ✓ Primary data.
- ✓ Secondary data.
  - Primary data used are in the form of annual reports, company manuals, brochure, records, etc.,
  - Direct interviews with senior managers and personal observation

- were employed to collect the information.
- Library research to gather literature on the topic.

LIMITATIONS OF THE STUDY:

✓ Since the procedures & policies of the company do not allow disclosing of all financial information, hence the project has to be completed with the available data collected with the maximum effort.

✓ The study is made for only a short period which is 45 days.

✓ Most of the information is collected as secondary data.

✓ The scripts chosen for analysis are ACC Cement & Infosys &hl and the contract taken is Oct- 2008 ending on three –month's contract.

✓ The data collected is completely related to the ACC Cement & Infosys &Hll Oct-Dec 2008 contract; as the analysis limited to 3 companies, the report doesn't representing whole industry status

CHAPTER-II

INDUSTRY PROFILE

➢ HISTORY OF THE STOCK EXCHANGE

The only stock exchanges operating in the 19th century were those of Bombay set up in 1875 and Ahmedabad set up in 1894.these were organized as voluntary non profit making organizations of brokers to regulate and protect their interests. Before the controls on securities trading became a central subject under the constitution in 1950,it was a state subject and the Bombay securities contract (control) Act of 1952 used to regulate trading in securities. Under this Act, the Bombay stock exchange in 1972 and the Ahmedabad in 1973.

During the war boom, a number of stock exchanges were organized in Bombay, Ahmedabad and other centers, but they were not organized. Soon after it became a central subject, central legislation proposed on a committee headed by A.D.Gorwala went into the bill securities regulation. On the basis of committee's recommendations and the public discussion the securities contract (regulation) Act became law in 1956.

Definition of the stock exchange

"Stock exchange means any body or individuals whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities.

It is an association of member brokers for the purpose of self regulation and protecting the interest of its members. It can operate only if the government recognizes it. Under the securities contract (regulation) act 1956, the recognition is granted under section 3 of the act by the central finance ministry.

Securities Exchange Board of India (SEBI)

SEBI was set up an autonomous regulatory authority by the government of India in 1988 "to perform the interest of investors in securities and to promote the development of and to regulate the securities the securities markets and for matters connected therewith or incidental thereto". It is empowered by acts namely the SEBI Act, 1982 and the securities contract (regulation) Act, 1956 to perform the function of protecting investor's rights and regulating the capital market.

National Stock Exchange (NSE):

The NSE was incorporated in NOVEMBER 1994 with an equity capital of Rs.25 Crores. The International Securities Consultancy (ISC) of Hong Kong has helped in setting up NSE. ISC has prepared the detailed business plans and installation of hardware and software systems. The promotions for NSE were financial institutions, insurance companies, banks and SEBI capital market ltd, Infrastructure leasing and financial services ltd. and Stock Holding Corporation Ltd.

It has been set up to strengthen the move towards professionalism of the capital market as well as provide nationwide securities trading facilities to investors.NSE is not an exchange in the traditional sense where the brokers own and manage the exchange. A two tier administrative setup involving a company board and a governing board of the exchange is envisaged.

NSE is a national market for shares, PSU bonds, debentures and government securities since infrastructure and trading facilities are provided.

The genesis of the NSE lies in the recommendations of the Pherwani Committee (1991).It has been setup to strengthen the move towards

At present, there are 24 stock exchanges recognized under the securities contract (regulation) Act, 1956. They are

Name of The Stock Exchange	Year
Bombay Stock Exchange.	1875
Ahmedabad share and stock brokers association.	1957
Calcutta stock exchange association Ltd.	1957
Delhi stock exchange association Ltd.	1957
Madras stock exchange association Ltd.	1957
Indore stock brokers association.	1958
Bangalore stock exchange.	1963
Hyderabad stock exchange.	1943
Cochin stock exchange.	1978
Pune stock exchange.	1982
U.P. stock exchange.	1982
Ludhiana stock exchange.	1983
Jaipur stock exchange.	1983-84
Gawhati stock exchange.	1984
Mangalore stock exchange.	1985
Maghad stock exchange Ltd., Patna.	1986
Bhubaneswar stock exchange association Ltd.	1989
Over the counter exchange of India, Bombay.	1989
Saurastra Kuth stock exchange Ltd.	1990
Vadodara stock exchange Ltd.	1991
Coimbatore stock exchange Ltd.	1991
The Meerut stock exchange.	1991
National stock exchange.	1991

Integrated stock exchange.	1999

- **Bombay Stock Exchange (BSE):**

This stock exchange, in Mumbai popularly known as “BSE” was established In 1875 as “The native share and stock brokers association”, as a voluntary non-profit making association .It has evolved over the years into its present status as the premier stock exchange in the country. It may be noted that the stock exchange is the oldest one in Asia, even older than the Tokyo Stock Exchange, which was founded in 1878.

A governing board comprising 9 elected directors, 2 SEBI nominees, 7 public representatives and an executive director is the apex body, which decides the policies and regulates the affairs of the exchange.

The executive director as the Chief Executive Officer (CEO) is responsible for the day-to-day administration of the exchange. The average daily turnover of the exchange during the year 2000-01(April-March) was Rs.3984.19 Crores and average no of daily trades was 5.69 lacks.

However the average daily turnover of the exchange during the year 2000-01 has declined to Rs1244.10 Crores and average daily trades during the period to 5.17 lacks.

CHAPTER-III
COMPANY PROFILE

COMPANY PROFILE

Share khan, India's leading stockbrokers, the real arm of SSKI, an organization with over eight decades of stock market experience. With more than 175 share shops in over 80 cities, and a presence on the internet through www.sharekhan.com, India's premier online trading destination, we reach out to customers like no one else.

Share khan offers you trade execution facilities on the BSE and the NSE, for cash as well as derivatives, depositary services and most importantly, investment advice tempered by 80 years of research and broking experience. To ensure that your trading experience with share khan is fast, secure and hassle free. We offer a suite of products and services, providing you with a multi-channel access to the stock markets.

SSKI group also comprises institutional broking and corporate finance. While the institutional broking division caters to the largest domestic and foreign institutional investors. The corporate finance division focuses on niche areas such as infrastructure. Telecom and media. SSKI holds a sizeable portion of the market in each of these segments.

As the forerunner of investment research in the India market, we provide the best research coverage amongst broking houses in India. Our research team is rated as one of the best in the country. Voted four times as the top domestic brokerage house by Asia money survey. SSKI is consistently ranked almagest the top domestic brokerage houses in India

COMPANY PROFILE

SHAREKHAN:

Share khan, India's leading stockbroker is the retail arm of SSKI (S.S.kantilal Ishwarlal Investments Securities pvt. Ltd), an organization with more than eight decades of trust & credibility in the stock market.

- Leading domestic player in Indian institutional business
- Over US$ 5 billion of private equity deals
- Awarded "Top Domestic Brokerage House four times by Euro money & Asia money".
- Amongst pioneers of investment research in the Indian market
- In 1984, ventured into Institutional Broking & Corporate Finance.

India's largest chain of branded retail Share Shops – 310 shops in 137 towns!

THEIR SERVICES:

1. Broking in Equities & Derivatives on NSE & BSE.
2. Depository Services.
3. Commodities Trading on MCX & NCDEX.
4. IPO Services.
5. Portfolio Management Services.
6. Distribution Services.

AWARDS:

- Rated among the top 20 wired companies along with Reliance, HLL, Infosys etc by Business Today Jan 2004 edition.
- PIONEERS of online trading in India.
- Amongst the top 3 online trading websites from India.
- Most preferred financial destination amongst online banking customers.

Benefits of SPEED TRADE:

- Instant order Execution and confirmation.
- Single screen trading terminal (cash and Derivatives).
- Real-time streaming quotes, tie-by-tie chart.

- Market summary (most traded scripts, highest value).
- Hot keys similar to broker's terminal.
- Alerts and reminders.
- Trading in Derivatives.

POWER-PACKET FEATURES OF SPEED TRADE PLUS:

1. Report for personal account details.
2. Per-defined detailed sector-wise script list.
3. Ability to customize the terminal screen.

DIAL AND TRADE: -

The investor can now use the "dial 'n' trade" back up option. Share khan tram will help them place a trade after a security check right over the phone; the investor account statement will get updated with this information automatically. This service is available both in Hindi and English. They can even use this service to place aftermarket hours.

FEATURES OF DIAL 'N' TRADE: -

- Dedicated toll-free number for order placements.
- Automatic fund transfer with phone banning.
- Simple and secure IVR based system for authentication.
- No waiting time. Enter your TPIN to be transferred to share khan's tale broker.
- After-hours order placement facility between 8am to 9:30pm.

IPO ONLINE: -

AT THE CLICK OF AN INVESTOR'S MOUSE THEY CAN SELECT THE INITIAL PUBLIC OFFER OF THEIR CHOICE (FIXED PRICE OF BOOK BUILDING) AND SUBSCRIBE TO IT ONLINE. WHAT AND INVESTOR SHOULD DO IS SELECT THE NUMBER OF SHARES/MONEY THAT THEY WISH TO

REVIEW OF LITERATURE
DERIVATIVES

Derivatives are products whose value is derived from one or more variables called bases. These bases can be underlying asset such as foreign currency, stock or commodity, bases or reference rates such as LIBOR or US treasury rate etc. Example, an Indian exporter in anticipation of the ric9ipt of dollar denominated export proceeds may wish to sell dollars at a future date to eliminate the risk of exchange rate volatility by the data. Such transactions are called derivatives, with the spot price of dollar being the underlying asset.

Derivatives thus have no value of their own but derive it from the asset that is being dealt with under the derivative contract. A financial manager can hedge himself from the risk of a loss in the price of a commodity or stock by buying a derivative contract. Thus derivative contracts acquire their value from the spot price of the asset that is covered by the contract.

The primary purpose of a derivative contract is to transfer “risk” from one party to another i.e. risk in a financial sense is transferred from a party that is willing to take it on. Here, the risk that is being dealt with is that of price risk. The transfer of such a risk can therefore be speculative in nature or act as a hedge against price movement in a current or anticipated physical position.

Derivatives or derivative securities are contracts which are written between two parties (counterparties) and whose value is derived from the value of underlying widely-held and easily marketable assets such as agricultural and other physical (tangible) commodities or currencies or short term and long-term and long term financial instruments or intangible things like commodities price index (inflation rate), equity price index or bond piece index. The counterparties to such contracts are those other than the original issuer (holder) of the underlying asset.
Derivatives are also known as “deferred delivery or deferred payment instruments”. In a sense, they are similar to securitized assets, but unlike the latter, they are not the obligations which are backed by the original issuer of the underlying asset or security. It is easier to take a short position in derivatives than in

other possible ways to combine them to match specific requirements, i.e.,

they are more easily amenable to financial engineering.

Definition:

Contracts, whose values are to be derived from the asset covered by them (such as paddy), are commonly named as “derivatives". These are basically, financial instruments whose value depends on the value of the other, more basic underlying variable-such as commodity, stock, currency, etc…

“A contract or an agreement for exchange of payments, whose value derives from the value of an underlying asset or underline reference rates or indices' '.

A derivative is a security whose price ultimately depends on that of another asset called underling.

“Derivatives means forward, futures or options contracts of predetermined fixed duration, linked for the purpose of contract fulfillment to the value of specified real or financial asset or to an index security”.

With securities Laws (second Amendment) Act, 1999, derivatives have been included in the definition of securities. The term derivative has been defined:

History:

Derivatives have probably existed ever since people have been trading with another. Forward contracting dates back to the twelfth century and may well have been around before then. However the development and growth of the derivatives products has been one of the most extraordinary things to happen in the financial markets. In 1972, the Bretton Woods agreement, the post-war pact that instituted a fixed exchange rate regime to the world's major nations, effectively collapsed, when the US suspended the dollar convertibility into gold. This resulted in exchange rate volatility derivative products

have come quite handy. They have established themselves as irreplaceable tools to hedge against risks in currency, stock and commodity markets.

The history of the derivatives can be traced to the Middle Ages when farmers and traders in gains and other agriculture products used certain specific types of futures and forwards to hedge their risks. Essentially the former wants to ensure that he receives a reasonable price for the grain that he would harvest (say) three to four months later. An oversupply will hurt him badly. For the grain merchant, the opposite is true. A fall in agricultural production will push up the prices. It made sense therefore for the both of them to fix a price for the future. This was now the future market first developed in agricultural commodities such as cotton, coffee, petroleum, Soya bean, sugar and then to financial products such at interest rates, foreign exchange and shares. In 1995 the Chicago Board of Trade commenced trading in derivatives.

For the derivatives market to develop, three kinds of participants are necessary. They are the hedgers, the speculators and the arbitrageurs. All the three must co-exist. For a hedging transaction to be completed three must be another person willing to take advantage of price movements. That is a speculator.

Contrary to the hedger who avoids uncertainties the speculator thrives on them. The speculator may lose plenty of money if his forecast goes wrong but a stand to gain enormously if he is proved correct.

The third category of participant is the arbitrage, who looks at risk less profit by simultaneously buying and selling the same or similar financial products in different financial markets.

With the government of India permitting futures trading in several commodities and with futures trading having arrived in the stock markets, index based derivative trading has finally arrived in India. For smooth functioning of derivative trading the government of India has commenced the process of dematerialization of shares, short sale facility, electronic fund transfer facility and rolling settlements in

stock markets. This will hopefully bring transparency in the process of price discovery of the derivative and also attract a broad spectrum of hedgers and speculators.

- **The economic functions of these activities are quite different.**

1. Hedging and speculation generates information about the pricing of risks.
2. While arbitrages create a consistent price system.

Uses of derivatives

There can be a variety of uses of derivatives.

CHAPTER-IV
ANALYSIS

Derivatives products:

Derivatives are in fact as old as trading but their dramatic rise in popularity took place in the last thirty years. The breakdown of Bretton Woods system of fixed exchange rates and the resulting volatility in forex markets put the derivative on a pedestal. The key reason for their popularity has been that derivatives such as futures and options have indeed filled a gap in the financial system. Prior to their emergence, there was no mechanism that could protect trades, banks, etc, from price risk. Secondly, they are highly flexible and thus have a universal applicability. For instance, stock market index futures provide insurance against stock price risk due to market fluctuations, while currency futures provide insurance against price risk due to exchange rate fluctuations.

All derivatives can be classified based on the following features:

1. Nature of contracts
2. Underlying assets
3. Market mechanism

Nature of contract: based on the nature of contract, derivatives can be classified into three categories:

- Forward rate contract and futures
- Options
- Swaps

Underlying assets: Most derivatives are based on one of the following four types of assets:

- ❖ Foreign exchange
- ❖ Interest being financial assets
- ❖ Commodities (grain, coffee, cotton, wool, etc.)
- ❖ Equities
- ❖ Precious metals (gold, silver, copper, etc.)
- ❖ Bonds of all types

Market mechanism:

- ❖ OTC products
- ❖ Exchange traded products

Role of clearing house

A clearing house is a key institution in the derivatives market. It performs two critical functions. Offering customer's deals and assuring the financial integrity of the transactions that take place in the exchange. The clearing house could be a part of the exchange of a separate body coordinating with the exchange.

Trading in derivatives

Indian securities markets have indeed waited for too long for derivatives trading to emerge. Mutual funds, FIIs, and other investors who are deprived of hedging opportunities will now have a derivatives market to bank on. First to change are the globally popular variety – index futures.

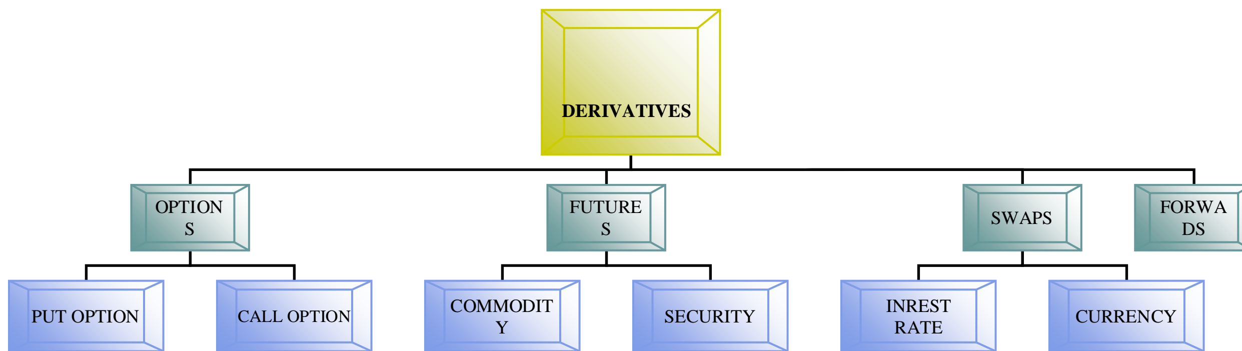
While derivatives markets flourished in the developed world Indian markets remained deprived of financial derivatives to the beginning of this millennium. While the rest of the world progressed by leaps and the bonds on the derivatives front, the Indian market lagged behind. Having emerged in the market of the developed nations in the 1970s, the derivatives market grew from strength to strength. The trading volumes nearly doubled in every three years making it a trillion-dollar business. They have become so ubiquitous that, now one cannot think of the existence of financial markets without derivatives.

Two broad approaches of SEBI is to integrate the securities market at the national level, and also to diversify the trading banks, financial institutions, insurance companies, mutual funds, primary dealers etc, choose to transact through the exchanges. In this context the introduction of derivatives trading through Indian stock exchanges permitted by SEBI in 2000 AD is a real landmark.

SEBI first appointed the L.C.Gupta committee in 1998, to recommend the regulatory framework for derivatives suggested buy-laws for regulation and control of trading and settlements of derivatives contracts. The board of SEBI in its meeting held on May 11, 1998 accepted the recommendations of the Dr.L.C.Gupta committee and approved the phased introduction of derivatives trading in India beginning with stock index futures. The board also approved the “suggestive Bye-laws' ' recommended by the committee for regulation and control of trading and settlement of derivatives contracts.

SEBI subsequently the J.R.Varma committee recommended risk containment measures in the Indian stock index futures market. The report was submitted in the same year (1998) in the month of November by the said committee.

Types of derivatives



There are four most commonly traded derivative instruments: Forwards, Futures, Options, and Swaps. Futures and options are actively traded on many exchanges. Forward contracts and swaps and certain kinds of options are mostly traded as over the counter (OTC) products.

FUTURES

A financial future is an agreement between two parties to buy or sell a standard quantity of a specific asset at a future date at a price agreed between the parties through an open outcry on the floor of an organized futures exchange. The underlying asset could as well be a commodity such as gold, crude oil, stock market index, individual stocks, interest rates, etc. the futures contracts are standardized in terms of quantity of underlying, quality of underlying, the date and month of delivery, the units of the price quotation and minimum change in price and location of settlement.

In short, futures contract is an exchange traded version of the usual forward contract. There are significant differences between the two and the same can be appreciated by the characteristics of futures.

Commodity to index futures, it tends to become quasi-gambling. Futures or futures contracts are transferable specific delivery forward contracts. They are agreements between two counterparties that fix the terms of an exchange, or that lock in the price today of an exchange, which will take place between them at some fixed future date. They are highly standardized contracts between the sellers or “writers” or “shorts” and the buyers or “longs” which obligate the former to deliver, and the latter to receive, the given assets in specified quantities, of specified grades, at fixed times in future at contracted prices. The period of contract (deferment) may be several months; it normally varies between three to 21 months abroad. Depending on the underlying assets, one can talk of (**a**) commodity futures and (**b**) financial futures; stock index futures, interest rates futures and currency futures are the examples of the latter. While the stock index futures are traded on the basis of different share price indices rather than on any individual share, interest rates futures are written on the basis of interest rates or price indices of fixed interest securities such as treasury bills and bonds, industrial bonds (debentures), commercial paper, certificates of deposits and mortgage loans.

Example: A farmer who is growing corn, says the month running is April and corn is likely the harvest in the month of July. There is uncertainty about the price you will receive for the corn. In the year of low supply or scarcity of corn, he might obtain a relatively high price – especially if you are not in a hurry. In the year of over supply of corn, you may have to dispose of it at lower prices. In the latter case, you are exposed to a great deal of risk.

On the other hand, consider a merchant who has an ongoing requirement for corn. In the year of over supply, he could fetch the corn at a competitive rate. But, in the ear of scarcity, he is exposed to price risk, as the prices may be highly exorbitant.

The prime objective of using the futures market is to manage price risk.

The largest futures exchanges in the world are the Chicago Mercantile Exchange (CME) and Chicago Board of Trade (CBOT).

Definition of futures:

A futures contract can be defined as an
agreement to buy and sell a standard quality of a specific instrument at a predetermined future date and at a price agreed between the parties through open outcry on the floor of an organized futures exchange.

Futures are considered to be a better when compared to forward because of the following reasons:

1. Standard volume
2. Liquidity
3. Counterparty guarantee by exchange
4. Intermediate cash flows

Differences between the Forward and Futures

Futures	Financial Futures	Forwards

CHAPTER - V
FINDINGS AND SUGGESTIONS

FINDINGS

- ✓ Derivatives market is an innovation to the cash market. Approximately its daily turnover reaches to the equal stage of the cash market.
- ✓ In the cash market the profit/loss of the investor depends upon the market price of the underlying asset. The investor may incur huge profits or he may incur huge loss. But in the derivatives segment the investor enjoys huge profits with limited downside.
- ✓ In the cash market the investor has to pay the total money, but in derivatives the investor has to pay premiums or margins, which are some percentage of total money.
- ✓ In the derivative segment the profit/loss of the option writer is purely dependent on the fluctuations of the underlying asset.
- ✓ One of the main factors deriving from the high levels of derivatives activity is that these instruments provide a more efficient platform for executing hedging, arbitraging or on speculative strategies.

SUGGESTIONS

- In order to increase its customer base share, Khan has to educate the existing and new investors through awareness programs, which can be conducted periodically.
- For an effective trading process, share khan should provide perfect sources of information for the investors or traders.
- There is a need to create awareness in the female investors in order to make them enter into the security market.
- Share khan can increase its business by reaching more potential investors by appointing sales persons and proper advertisements and setting up new branches in potential areas.
- It would be more advantageous for share khan if it can explore global stock markets.

Conclusion

- The above analysis Futures and Options of ACC, INFOSYS, HLL, had shown a positive market in the week.

- The derivatives are mainly used for hedging purpose

- The major factors that will influence the futures and options market, FII involvement, News related to the underlying asset, National and International markets, Researchers view etc.

- In a bearish market it is suggested to an investor to opt for Put Option in order to minimize losses.

- In a bearish market it is suggested to an investor to opt for Call Option in order to minimize profits.

- In a cash market the profit/loss is limited but where in futures and options an investor can enjoy unlimited profit/loss.

- It is recommended that SEBI should take measures in improving awareness about the futures and options market as it was launched very recently.

- It is suggested to an investor to keep in mind the time and expiry duration of futures and options contracts before trading. The lengthy the time, the risk is

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