Derivative:

- It Is the value of a underlying assets, which is traded in forward or future market

- A derivative is a financial contract that derives its value from an underlying asset. The buyer agrees to purchase the asset on a specific date at a specific price.
- Derivatives are often used for commodities, such as oil, gasoline or gold. Another asset class is currencies, often the U.S. dollar. There are derivatives based on stocks or bonds.

Derivatives As Risk Management Tools

A derivative is a contract between two parties which derives its value/price from an underlying asset. The most common types of derivatives are futures, options, forwards and swaps.

- It is a financial instrument which derives its value/price from the underlying assets. Originally, underlying corpus is first created which can consist of one security or a combination of different securities. The value of the underlying asset is bound to change as the value of the underlying assets keep changing continuously.

  Generally stocks, bonds, currency, commodities and interest rates form the underlying asset.

Underlying securities for derivatives are:

- Commodities (castor seeds, grains, beans, guar gum seeds, pepper, potatoes)
- Precious metals(gold, silver)
- Short term debt securities(treasury bills)
- Interest rates
- Common shares or stock
- Stock index value

- **Commodity trading in India** has a long history. In fact, commodity trading in India started much before it started in many other countries. However, years of foreign rule, droughts and periods of scarcity and government policies caused the commodity tradi minish

- Commodity trading was restarted in India recently. Today, apart from numerous regional exchanges, India has six national commodity exchanges namely,
- Multi Commodity Exchange(MCX),
- National Commodity and Derivatives Exchange (NCDEX),
- National Multi-Commodity Exchange (NMCE)
- Indian Commodity Exchange (ICEX),
- ACE Derivatives exchange (ACE)
- Universal Commodity Exchange (UCX).

Characteristics of derivatives

- It has one or more underlying assets
- The value of derivatives depends on other underlying assets price movements
- It is a hedging devices which reduces the risks involved in the transaction
- It requires negligible initial investment compared to other types of financial contracts
- It should provide for net settlement i.e offsetting of initial contract position
- The contracts are fulfilled or transacted through a recognised exchange or through a clearing houde

Advantages of derivatives

- They help in transferring risks from adverse people to risk oriented people
- They help in the discovery of future as well as current prices
- They catalyze entrepreneurial activity
- They increase the volume traded in markets because of participation of risk adverse people in greater numbers
- They increase savings and investment in the long run

Traders in derivatives market

- Arbitrageurs
- Hedgers
- Speculators

Meaning of hedgers:

- Hedgers are those traders who wish to eliminate the price risks associated with the underlying securities being traded, there intention is not making profits

Meaning of arbitrageurs

- It is the process of simultaneous purchase of securities or derivatives in one market at lower prices and sell in other market when there are high profits

Meaning of speculators

- Speculators are people who analyse and forecast the future price movements. Speculators put their money at risk and must be prepared to accept outright losses in the future market