ISSN–2278-5655

AMIERJ Aarhat Multidisciplinary International Education Research Journal

Volume–XV, Special Issue– I (d) March – April, 2026

OPEN ACCESS Original Research Article

A STUDY ON EXPLORING FINANCIAL DERIVATIVES BEYOND FUNDAMENTALS: STRATEGIES AND MARKET IMPLICATIONS

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Abstract:

In today's world where there is advanced technology and numerous AI driven sectors there is a financial market which is quite different from the conventional stock market that is " Derivatives". Derivatives are contracts whose worth comes from the underlying asset. Through this research we should have a peak into the derivatives market , its types , how to select the appropriate derivative , how much the general public and investors are aware of the same.

Keywords: *Derivative , Conventional , Market , General Public , Investors*

Introduction to Financial Derivative:

The word "derivative" is used to describe a type of financial instrument whose value is dependent on an underlying asset, a number of assets, or a benchmark. Derivatives are agreements entered into between two or more parties that are tradeable on an exchange or over the counter (OTC). These agreements can be used to trade any number of assets and have their own risks. The prices of derivatives are based on the fluctuations in the prices of underlying assets. These financial instruments are often used to provide access to a particular market and can be traded to hedge risk. Derivatives can be used to either hedge risk or assume risk with the hope of earning an equal reward. Derivatives can transfer risk levels (and the associated rewards) from the risk-averse to the risk-takers.

Scope of study:

The scope of this research work is to analyze the awareness, understanding, and usage of financial derivatives such as futures, options, and other sophisticated derivative instruments among investors. The scope of this research work is limited to the data collected using the questionnaire technique from selected investors to analyze their knowledge level, risk perception, and decision-making behaviour regarding derivative instruments. The scope of this research work also covers the perceptions of selected investors regarding the benefits, risks, and market implications of derivatives in today's financial markets. The scope of this research work is limited to the opinions of the investors and does not cover the technical pricing models or institutional trading strategies.

Objectives of the study:

1. To make people aware about Financial Derivatives.
2. To introduce them with the different types of financial derivatives by understanding their source of gaining information about the same.
3. To understand their pattern of investment in derivative market and their purpose.
4. To bring into light more advanced derivatives which the common man is unaware of by helping them overcome their challenge and make financial derivative more talked about topic in the developing economy.

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5. To understand the reason for non participation in the derivative market.

Hypothesis of study:

H_0: There is no significant relationship between investor awareness, knowledge level, and participation in derivative trading.

H1: Advanced Derivative strategies have a significant impact on market efficiency and stability

Research Methodology:

Sampling Frame: The data was collected from Students, Salaried Employees, Investors wherein some are aware about the topic while others are not completely aware of the same.

Sampling Elements: Respondents were the sampling elements.

Sampling Technique: Simple Random sampling were used to collect the samples.

Sampling Size: Sample Size taken for the survey is 100 respondents.

Sample Area: The sample is taken from Panvel and Navi Mumbai region.

Data Collection Method: This study consists of collection of primary data.

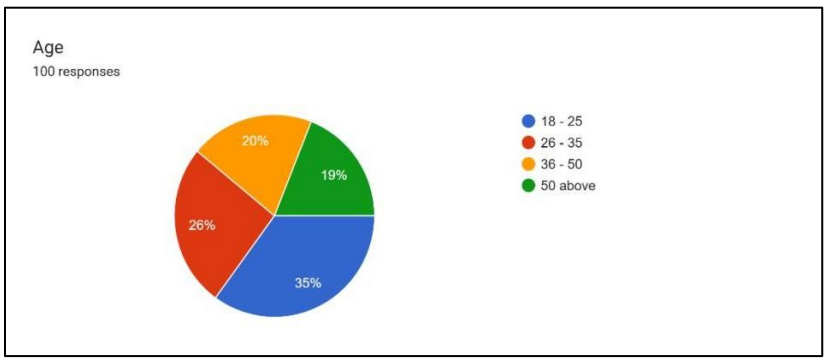
Characteristics of Financial Derivatives

Types of Financial Derivatives:

a) Forward Contract
b) Future Contract
c) Options Contract
d) Swap
e) Credit Derivatives
f) Exotic Derivatives
g) Hybrid Derivative

Data Analysis and Presentation:

a) Age Group



Graph 1

Interpretation: The pie chart demonstrates the survey is filled majorly by the respondents aged between 18 – 25 (35%) followed by the respondents between the age of 26 - 35 (26%). Whereas the no. of respondents decrease between the age of 36 – 50 and 50 above indicating only 20% and 19% respectively.

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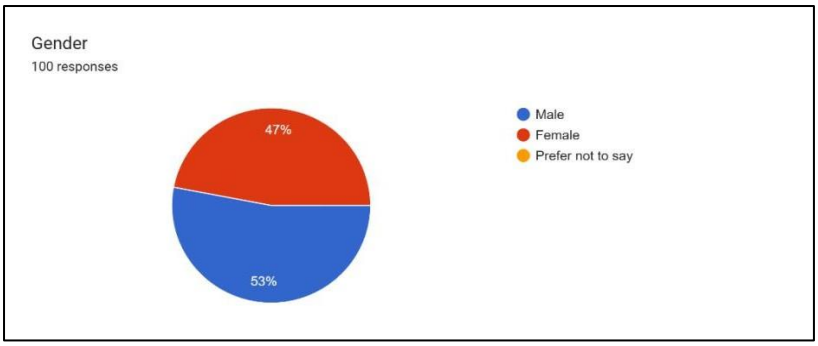
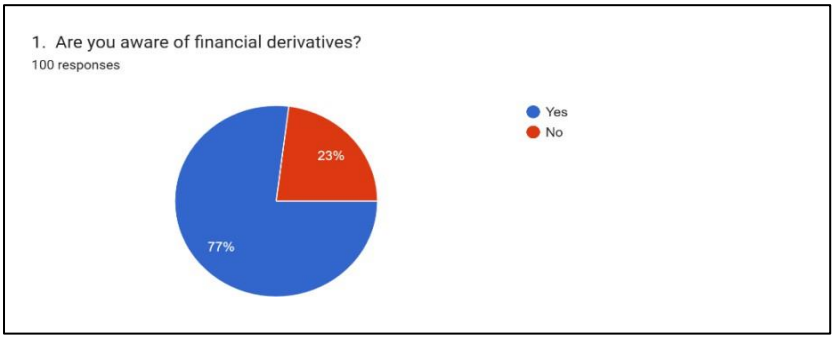
b) Gender



Graph 2

Interpretation: The results suggest more than half i.e 53% respondents are male while comparatively less that is 47% respondents are female, suggesting a lean towards females lacking awareness towards derivatives market.

b) Awareness about Financial Derivative



Graph 3

Interpretation: The graph shows majority of the respondents that is 77% are somewhat aware about financial derivative while the other 23% are not aware about the same. This question is based on the basic understanding of derivative rather than having an indepth knowledge about the subject.

c) Familiarity about derivative instrument

Criteria	No. of Respondents	Percentage
Futures	35	35%
Options	34	34%
Swaps	27	27%
Forwards	27	27%
Structured Products	18	18%
Exotic Products	13	13%

Graph 4

Interpretation: The table demonstrates how respondents are largely aware of the common derivative which we usually hear if we follow the news , media etc. It indicates 35% and 34% people are aware about futures and options respectively whereas exactly 27% people are aware about both Swaps and Forwards and further the count drops since only 18% people know about Structured Products and 13% people know about Exotic Products. This puts stress on the importance to educate people more about the latter ones.

ISSN–2278-5655

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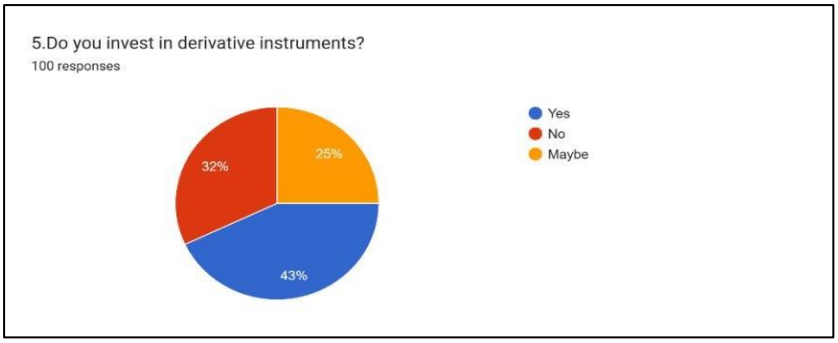
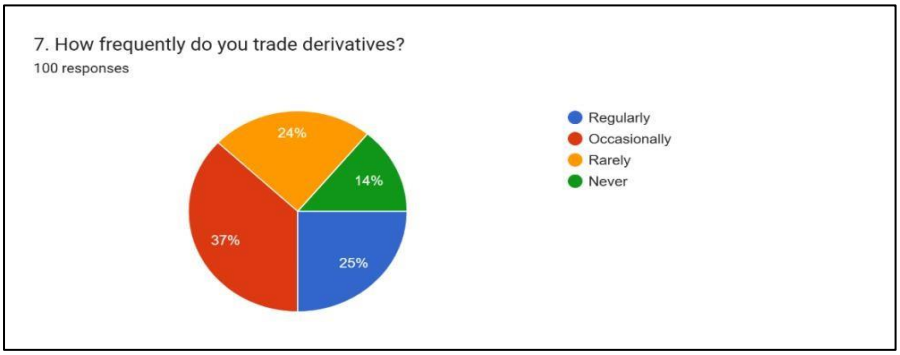
d) Investment in derivative instrument



Graph 5

Interpretation: The pie chart demonstrates 43% of the respondents already make their investment in the derivative market while 32% gave a negative response regarding their investment in the same. Further, 25% are not sure about their decision indicating there is still a gap between the knowledge about this market.

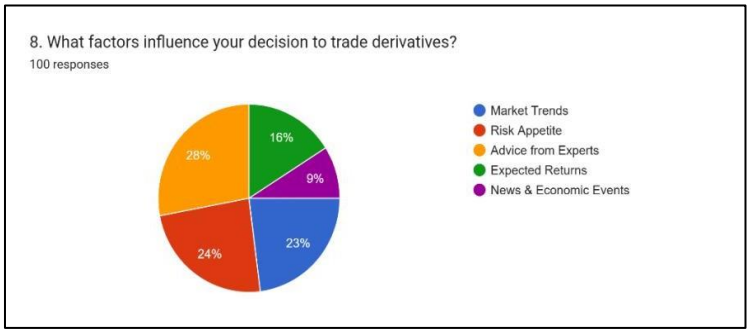
e) Frequency of trading



Graph .6

Interpretation: This results indicate only 25% respondents trade derivatives regularly and comparatively more people that is 37% people trade occasionally. Further, 24% people rarely trade in derivatives and 14% people never trade in derivatives at all. These results show the lack of awareness and knowledge affects the frequency of trading in the derivative market.

f) Factors influencing the decision to trade derivatives



Graph 7

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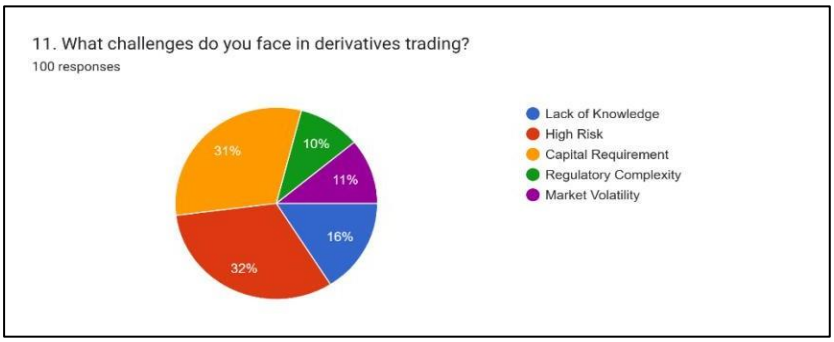
Interpretation: The responses suggest advice from experts in the major factor influencing decision to trade derivative since 28% people have agreed upon the same followed by risk appetite and market trends which makes upto 24% and 23% respectively. Expected Returns and News & Economic Events does not influence the most amounting to only 16% and 9%. Thus it can be concluded
that experts play a major role in trading derivatives as their opinion matter the most.

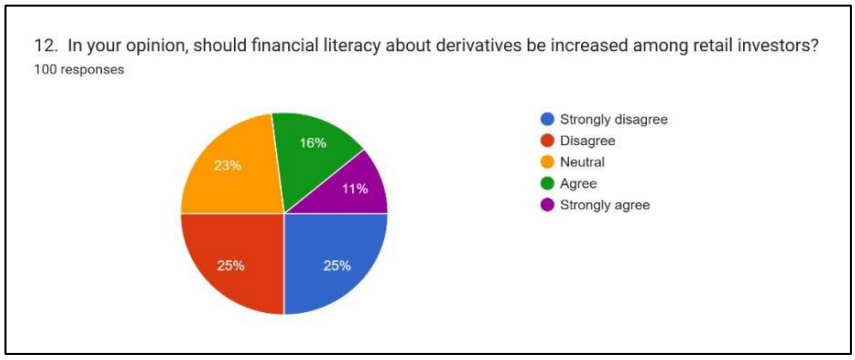
g) Challenges faced in derivative trading



Graph 8

Interpretation: The data shows that High Risk and Capital Requirement are the problems. They make up two-thirds of the challenges people talk about. This means that even people who want to do more than the basics are stopped by how much money's at risk and how much money they need to start.
High Risk and Capital Requirements are really hurdles for people. Some people, sixteen percent, do not know enough about this stuff. Then there is Market Volatility and Regulatory Complexity which're also problems for people. This tells us that people want to try things but they are scared of High Risk and they do not have enough money for Capital Requirement. So people think about Market Volatility and Regulatory Complexity in terms of whether they can afford to take the risk or not.

h) Increase in financial literacy about derivatives among retail investors



Graph 9

Interpretation: People think that financial literacy about derivatives is important. A total of 27% of people believe that we should know more about derivatives. Out of these people 16 percent. 11 Percent strongly agree that we need to know more about derivatives.. A lot of people 50 percent do not think we should learn more about derivatives. These people are split into two groups: 25 percent who disagree and 25 percent who strongly disagree that we should learn more about derivatives. The rest of the people 23 percent are not sure.

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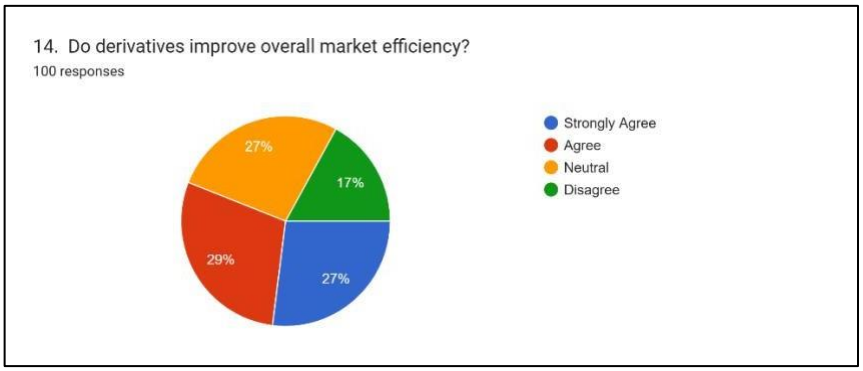
i) Opinion on derivatives improve overall market efficiency



Graph 10

Interpretation: The result prescribes total 56% respondents have given a positive response out of which 27% strongly agree whereas 29% agree that derivatives improve overall market efficiency. Further, 27% people keep their opinion neutral followed by 17% people strongly disagreeing with the fact indicating lack of knowledge about the derivatives.

Hypothesis Testing:

Hypothesis is put to test considering responses in respect of awareness and activeness in the derivative market.

Table 11

Knowledge Level	Invested (yes)	Not Invested (no/maybe)	Total
High/Very High	22	4	26
Moderate	15	20	35
Low/Very Low	6	33	39
Total	43	57	100

Using Chi Square test $X^2 = (O_i - E_i)^2/E_i$

Where,

O_i = Observed Frequency E_i = Expected Frequency

(Row total * Column total)/Grand total

- Degrees of Freedom(df):
  (R – 1) * (C -1) = (3 – 1) *(2 – 1) = 2
- Expected Values (E) :
  - High knowledge/Invested = (26*43)/100 = 11.18
  - Low knowledge/Invested = (39*43)/100 = 16.77
- Resulting X^2 value based on the distribution above is approximately 28.45
- Calculated X^2 : 28.45
- Critical Value (at df= 2 , α = 0.05) = 5.99
- P – value = <0.00001

  Since the calculated value (28.45) is significantly higher than the critical value (5.99) the null hypothesis is rejected.

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Findings:

1. 77% of respondents are aware of financial derivatives.
2. Futures and options are the most familiar instruments, while awareness of advanced products is low.
3. Many respondents rate their knowledge as moderate or low.
4. Financial advisors are the primary source of information.
5. 43% invest in derivatives, and many trade regularly or occasionally.
6. Portfolio diversification and speculation are the main reasons for investing.
7. High risk and capital requirements are major concerns.
8. A majority (64%) have faced losses in derivatives trading.
9. Over half believe derivatives improve market efficiency.
10. There is a clear gap between awareness and advanced knowledge.

Conclusion:

The paper has analyzed the awareness, involvement, and difficulties of investors in financial derivatives. The results indicate that although investors are generally aware of simple financial derivatives such as futures and options, their understanding of complex derivatives is poor.

Investors are actively involved in trading financial derivatives but have only moderate or poor understanding, and most of them have suffered losses because of the high risk and capital involved. Although financial derivatives are believed to enhance market efficiency, they are also considered to be complex and risky instruments. The paper concludes that investors need to have good financial knowledge, effective risk management, and prudent trading practices to trade financial derivatives safely and efficiently.

Suggestions:

1. Organize workshops, webinars, and awareness sessions can be organized to enhance knowledge about derivatives and their application.
2. investors on stop-loss techniques, hedging, and appropriate position sizing to minimize losses, simulated trading platforms before investing actual funds in advanced trading strategies.
3. Simple guides and examples on structured and exotic derivatives should be developed to fill the knowledge gap.
4. Financial advisors should adequately brief investors on risks, costs, and returns to enable informed decision-making.

Limitations:

a) Study is based on the responses of 100 the respondents situated in Mumbai and Navi Mumbai region thus providing a narrow scope.

b) Many of the respondents were only aware of the mainstream financial derivatives.

c) Some of the respondents may have provided biased information.

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Volume–XV, Special Issue– I (d) March – April, 2026

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Cite This Article:

Mrs. Fakih R., Kumawat K., Solanki L., NairA., Nair A. (2026). *Analytical Study on Money Management Practices amongst Working Women (Small Business) in Navi Mumbai.* **In Aarhat Multidisciplinary International Education Research Journal**: Vol. XV (Number II, pp. 116–123) Doi: https://doi.org/10.5281/zenodo.20459906