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Devina Mehra: How derivative dreams can turn into nightmares but still lure investors

Devina Mehra | 16 July 2025

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SUMMARY

Retail investors think they'll make winning bets on derivatives but lose large sums. And it's not just Jane Street and other big market players that have gained from India's F&O frenzy. It suits several other large interests not to drive rookie traders away.

We hear a lot about the Securities and Exchange Board of India's (Sebi) finding that about 93% of all participants in the futures and options (F&O) market lose money. Given the peculiarities of the human mind, everyone seems sure that they will be among the 7% who are winners. In this belief lies a business opportunity for those offering derivative training courses. Of course, anyone who has a magic wand that can make 1% everyday in financial markets can turn ₹1 crore into ₹20,000 crore in five years and has no economic reason to sell you a course for a few thousand rupees.

But the point is not just that 93% lose money, it is who the losers and winners are. Sebi data is clear: those losing money are individuals and another category of 'others,' under which NRIs, trusts, etc, are clubbed. Those making money also are in two categories. One is of foreign portfolio investors and the other is called 'proprietary.' These are large Indian set-ups that are probably using algorithmic trading or some other systems to trade. Interestingly, there are only a few hundred players registered under the proprietary and foreign portfolio investor groups, whereas those in loser categories number almost 10 million.

My own October analysis based on Sebi data (*shorturl.at/POTdW*) showed that the few who profit are mostly institutions or sophisticated players. Retail traders, especially those from non-metro, lower-income or less-educated backgrounds, are the worst hit.

Let’s not glorify outliers. Clearly, when you pit human traders against machines, especially highly sophisticated algorithms, it’s an uneven fight. Even without manipulation, the odds are stacked against retail traders. You’re playing a zero-sum game where the big guys have better tools, data and speed. Even when some make money, it’s peanuts. NSE data shows that among retail traders whose trading activity was profitable, the median annual gain was just ₹60,000. That’s less than what a gig job earns.

Even the late Rakesh Jhunjhunwala, when asked, “Why do you ask people not to trade when you yourself made your initial capital as a trader?" had said, “I smoke but I tell my children not to." Plus, when people like him and other big names in the Indian market made their money through trading, it was a different time and place, with many market inefficiencies leaving opportunities to be exploited, including some simple ones like the differential in prices of the same stocks across exchanges. That is no longer the case, with sophisticated real-time trading systems in place.

However, the Jane Street issue goes deeper into actual manipulation. With most trading strategies, the bigger you become, the harder it is to get returns. In fact, most people in the trading or algorithm business talk in terms of limits on how much money a strategy can be used for. Unlimited money cannot be deployed in normal opportunities to exploit market inefficiencies.

But Jane Street was not only making more money as its size grew, its strategy was dependent solely on its volumes being large enough to move the market. That’s a red flag. The Sebi order shows how it might have used its size to extract unfair profits. The game’s profitability increased with scale, which shouldn’t be the case in a competitive market.

Some people think that if norms are tightened on derivatives trading, it will reduce volumes. Whether or not that happens, it’s clear that volumes do need to be curbed. Derivatives trading volumes in India, after peaking at 400 times the cash market, are still about 230 times—more than five times the ratio in any other market in the world. India’s market capitalization is less than 5% of the world’s but the country accounts for about 60% of global derivatives volumes.

Now we get to the interesting part. The high trading volumes in derivatives is a profit gravy train that a range of players over and above the traders themselves will find hard to get off. The higher the trading volumes, the more the profits for stock brokers and tech platforms. Then, with stock exchanges being listed or nearly listed, there is profitability pressure on them, which makes it tempting for them to keep trading volumes high. This creates a conflict of interest, as stock exchanges are the first-level regulators in the market. In a Jane Street type of scenario, a handful of entities displaying a pattern of actions at particular times on certain days should have first been visible to stock exchanges.

Not just capital market participants, even government coffers have been boosted by F&O volumes. As I wrote during the budget in February: India’s personal income tax mop-up is expected to grow 14.4% in 2025-26, faster than nominal GDP. Corporate tax and GST are expected to grow 10.5% and 10.9%, respectively, which is why the budget projects an acceleration in personal income tax collections despite a cut in tax rates. And while Sebi might be trying to curb speculation, the government appears to be banking on it.

It is easy to blame the regulator for not acting quickly. But in any case of manipulation, a detailed case has to be built that withstands legal scrutiny. Action can rarely be taken in real time.

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