
Chapter 5 : Research Methodology and Survey Analysis

5.1 Methodology

The nature and premises under which this project paper is using both quantitative and qualitative analysis of secondary and empirical data. There is a fair amount of relevant secondary literature on the financial futures in the forms of newspapers, statistical publications and financial and professional journals. The review of the financial futures is drawn from these data sources, to construct a synthesised view of the state of the financial futures.

Analysis of the companies uses of the Financial Futures instruments as risk management will be based on journal reports and data obtained directly from the companies via interview and questionnaire. Reasons for holding back the public from using the financial futures are also obtained via the same questionnaire.

5.2 Questionnaire

The research instrument is questionnaire consisting of sixty questions and the questionnaire was pre-tested with two financial institutions and two non financial institutions before the final version of the questionnaire was developed.

There were seven sections to this questionnaire. Nine questions in section A to collect back ground information of the corporations in terms of the size, Company sector and control, gearing and investment, the position of the respondents and the general opinion of the respondents on the various exchange in Malaysia. Section B consists of three main questions for non-users with the aim to assess the reasons for not participating in the Futures market based on various factors influencing the non users such as whether it is due to the resistance to change, Management attitude, lack of expertise, lack of policies and procedure and non tax benefit and incentive. Section C to G are for users of the financial futures. Section C is for users in general, Section D for Stock Index Futures users, Section E for interest rate futures users, Section F for currency futures potential users and Section G for comments from the respondents.

Section C to F attempts to measure the efficiency of the Futures as a tool for hedging, The degree of accuracy in hedging and request the respondents to rate the efficiency of the exchange, and to measure the recurrence of usage in the futures. The users are requested to state whether they strongly agree or strongly disagree on a five point Likert scale from 1 to 5, as to the reasons for not transacting in the Futures. Basically it attempts to measure factors such as lack of expertise, not exposed to risk, the cost factor, the attitude of management, the accounting and tax issue, and company's policy. A copy of this questionnaire is provided in the Appendix K.

5.3 Sample Selection

The study focuses on corporations in Malaysia. The sample consisted of Banks and Non-Bank Companies mainly listed in the KLSE. The sample was selected at random based on American Business in Malaysia Directory 1996 and the KLSE directory. These organisations were further divided into two categories; Financial Institutions and Non-financial institutions to investigate whether there were differences in the understanding of this financial instruments between Banks and Non-Banks.

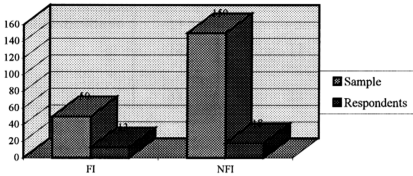
MME third market survey on the Financial Institution and a survey done for Uses of interest rate and Currency Swaps by Financial Managers in UK (*Christine Helliar 1995*) are used as secondary data to supplement and enhance observations made in this survey.

5.4 Data Collection and analysis

The questionnaires were mainly addressed to and completed by the Finance manager or treasurer of the corporations. Personal and telephone interviews were conducted with some of the corporations. Only 21% of the samples responded to this survey. 42% are financial institutions (FI) and 58% are non financial institution (NFI). 26% of the FI responded compared to only 18% from the NFI. Respondents rate is unexpectedly low.

Corporations	Total #	Total Surveyed	Respondents
i) Financial Institution *	50	13 (42%)	26 %
ii) Non Financial Institution*100		18 (58%)	18%
Total	150	31 (100%)	21%

- *FI denote Financial Institutions and NFI Other Corporations*

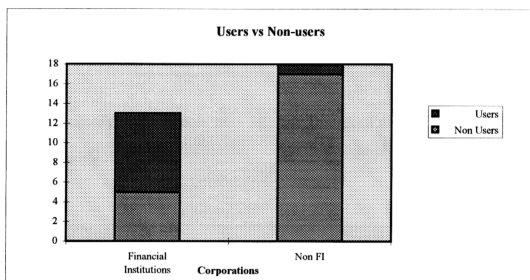


5.5 Survey Results

Of the 31 Companies surveyed, only 29% were currently trading. 89% of the users were FI and only 11% of the NFI participate in this Financial Futures. 62% of the FI participate in this financial futures. Only 5 % of the NFI participated in financial futures. Survey results show that participation rate among the NFI was much lower than the FI.

The survey results was close to the survey done by MME on the FI which shows that 53% of the commercial banks are currently trading and 47% are not when 37% of the FI were trading and 63% not. 74% of the FI participants were commercial banks.

Corporations	Total	Non User	%	User	%
Financial Institutions	13	5	38%	8	62%
Non FI	18	17	94%	1	6%
Total	31	22	71%	9	29%



5.5.1 Non-users

a Financial Institutions (FI)

All of the FI non-users were locally incorporated corporations. Of the FI non users, one indicated that there was a delay in entering the futures (will probably start in 1st Quarter 1997) awaiting approval from the Board of Directors, while the remaining indicated that they foresee the company to participate in the financial futures in near term. There was no prominent reasons given for not participating in the Futures as shown per table below:-

Occurrence	Reasons
1	Compliance with Bank Negara Guidelines
1	Lack of expertise
1	It is done at Head-office level
1	It will not be transferred from Head-office
2	No clear policy established by the Company to govern these transactions.
1	Awaiting Board Approval.
1	Use other Means -Match funding for exposure

However, majority of the FI non-users Strongly Disagreed with the following reasons for not participating:-

Occurrence	Reasons
5	Never considered
4	Do not believe hedging could help business
3	Difficulty in explaining to management the concept of hedging.
3	Not necessary to change
3	Done at HQ
3	Will not be transferred from HQ.

The FI strongly disagreed that their non participation in the financial futures were due to them never considered the instrument. They also disagreed that these instruments do not help their business.

It was indicated by one of the respondents that to start/be ready to trade/hedge in the futures market will cost about RM500K for software and hardware.

All the FI felt that there should be more courses designed for the Corporate users and the public in general. In talking to the FI, they felt that the brokers were not knowledgeable and not doing enough to promote and educate the market. They generally felt the accountants were the key players in Corporate users and they should be the target group to start with the education program. All of them were of the opinion that Seminars/ Training was the most effective way to increase level of confidence and competency in using Futures as a hedging tools. Attachment with international Banks and Demonstration by Bankers to the potential users were recommended as means to increase level of competency in this arena.

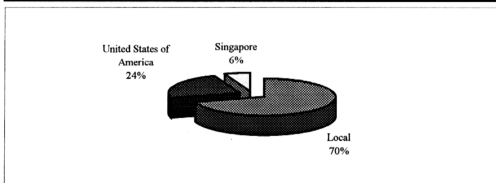
Most institutions showed concern about the accounting treatment of profit and loss arising from the Futures transactions which attract queries from Management and Shareholders. All financial institutions had no difficulty in explaining the concept of hedging to the Management. However, it was indicated that they need the BNM/ MME's assistance in convincing their board for approval to trade in Futures.

The above data suggested that the FI non-users were considering and would eventually participate in the financial futures. What is holding them back now seems to be the lack of expertise and this exists in the Local FI.

b. Non-financial bank (NFI) corporations.

70% of the NFI respondents were local, 24% were having head office in USA while 6% from Singapore.

Country	Occurrence
Local	12
United States of America	4
Singapore	1
Total	17



Out of the 19 respondents, 2 respondents indicated that they were not interested in this Financial product at all. 2 respondents indicated that they foresee themselves to participate in the financial futures in near term and the remainders indicated that they do not foresee using this instrument in future. Reasons given for not participating as below:-

Occurrence	Reasons
10	Never consider using the instrument
6	lack the expertise
4	Do not believe in Hedging
7	Do not need to hedge
5	Margin Requirements
2	Costs outweigh the benefits
4	Difficulty in explaining the concept of hedging to the Management.
5	Accounting Treatment
7	No tax benefit
6	No clear policy established in Company
7	Prohibited by the Company's policy
5	Not necessary to change the way to manage business
3	BNM guidelines
8	Done at Head office level overseas
6	Will not be transferred from Head office

2 of the respondents, holding the post of Senior/Chief Accountants indicated that they do not practise hedging in the company even though the interest rates fluctuations are very significant to their companies. All of the non users who were negative about participating in this instrument felt that the interest rates fluctuations are very significant to their companies.

One of the respondents expressed that the government effort in promoting and educating the corporate users extensively in utilising this new financial management tools were important in making up the liquidity in the market. Non-resident Controlled Company(NRCC) respondents expressed that BNM control on the uses of Financial Futures by NRCC to trade purposes or hedging of loan repayment not more than 12 months may in a way curb the development of the market.

All the US NRCC companies were fully financed by share capital indicated that the financial management is centralised in the head office overseas. This was further confirmed by the Corporations response that these hedging activities are currently carried out at head office level. In order to encourage these foreign companies to transfer their funds management or fund management expertise to Malaysia, the respondents suggested that some form of tax incentive be given specifically for financial futures relating activities such as training expense. Malaysian Institute of Accountants (MIA) should be encouraged to conduct more seminars and courses of this nature and higher point or due recognition be given to accountants attending these courses.

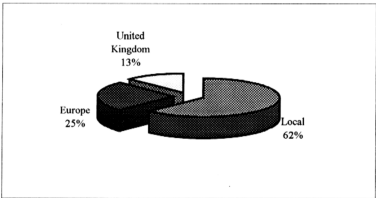
One respondent brought up concern about the tax treatment on using Futures to hedge. Where mark to market accounting treatment was recommended one important consideration arises. This was the allowability of any adjustments reflecting anticipated futures costs. The concern was that the subjective nature of these adjustments could either result in them being disallowed for tax purposes altogether or become the subject of extensive debate with the tax authorities concerned. (*Jonathan Hooley 1994*). It is recommended that the tax authorities of Malaysia makes a clear stand as to the acceptable tax treatment to comfort the users fear. However, mark to market accounting at least allows a snapshot of the current position. (*Jimmy Lau 1995*)

Most respondents felt that the most effective way of increasing the competency of the users were through Seminars and Training. One respondent suggested that this subject be incorporated into the syllabus of the accountancy course available in Malaysia such as MACPA.

5.5.2 Users

Country of Origin of the FI users as below :-

Country	Occurrence
Local	5
Europe	2
United Kingdom	1
Total	8



All users except one used the futures for Hedging, speculating and arbitraging between Markets. One bank was using the futures solely for speculation. 4 users transact more than 500 contracts thus far, or about 20 contracts per day and 1 less than 50 contracts. Reason given for low trading volume was lack of trading opportunity. All the users used other forms of Derivative instruments such as Forward, swaps etc. However, some respondents were of the opinion that it was the intention of BNM to watch the market develop slowly awaiting the general public to gain exposure before giving the industry a big bang debut. (*John Duggan, 1996*).

One of the users transacted the first options contract in Singapore and one in Hong Kong, while the rest in Malaysia. Some FI when interviewed mentioned that the derivatives transacted were mainly back-to back deals with Hong Kong or Singapore FI. Reasons being no expertise in Malaysia. **However, interviewed with BNM personnel cautioned that it would be difficult to build up the expertise base in Malaysia, if the FIs keep transacting back-to back.**

Users of Financial Futures in terms of types of instrument and number of users of the opinion the instrument was most useful to the business management of their companies is analysed as below:-

Types of Financial Futures	No of Users	Usefulness
Stock Index Futures	2	0
Interest Rate Futures	8	6
Currency Futures (intend to use)	6	3

The KLIBOR interest rate futures was regarded as most useful. Two of the users were of the opinion there was no urgency to have the Currency Futures in Malaysia. Reasons given being firstly the current method of hedging in foreign exchange market was sufficient and it has been proven not successful in other exchange such as SIMEX unless the Ringgit is an international currency and opened up to the whole world for trading and speculation. Liquidity will be the problem and this will hinder hedging trades to be executed. Second reason being the Bond Futures should be given priority.

All users felt Seminars/ Training was the most effective way to increase level of confidence and competency in using the Futures. One of the respondents suggest that TV media be used for the purpose.

Internal control established in the users' company :-

Occurrence	Internal Control
4	Accounting Control
4	Stress Simulation
4	Role of Senior Management
6	Independent Credit Risk Management
5	Authority and Controls

All users felt that the **internal control established in the Company is sufficient. Three major elements of control in a treasury environment: people, policy and systems.** All three were critical to the safe running of a treasury, and no one element should be thought of as more important than any other. *(David Letts 1995)*

One of the Bankers when interviewed said Directors of a company have the duty to manage, or supervise the management of, the business and affairs of the company. This included the obligation to manage, or, after consideration, to consciously decide for valid business reasons to leave unmanaged, the risk inherent in the company's business which were capable of management. **Refraining from using derivatives can be as dangerous as not using them prudently.** *(Paul M. Moore 1995)*. This does not mean that a director

must become an expert in every area of treasury. (David Letts 1995) . It does mean that directors must understand the basic concepts behind the treasury operation such as cash management tools and foreign exchange.

Except for the NFI, all users always set targets and mark futures to market but only meet these targets sometimes. 50% of them always use external bench marking. Majority of them always transacted Futures with different brokers. Only one of them did not have any master agreement in place and they fully understand the agreement including the NFI. Majority of the users rate the exchange in terms of its efficiency good or fair.

Degree of accuracy in hedging the interest rate of different tenor is analysed as below :-

Tenor	Degree of Accuracy
3-month Tenor	90% - 70%
6-month Tenor	90% - 50%
9-month Tenor	49% - 30%
12-month Tenor	below 30%

The longer the tenor, the lower is the accuracy level in hedging.

Major short comings of the Futures instrument as below:-

Occurrence	Major Shortcomings
8	Lack of expertise or knowledge
4	Accounting treatment of profit and loss
8	Lack of understanding by management when incurring opportunity losses for purpose of hedging.

5.5.3 Respondents of Financial Institution Versus Non-Financial Institution

There was a clear distinction between FI and NFI in terms of the reasons given for not transacting in the financial futures. FI is evidently more aware, knowledgeable and more comfortable with the financial futures. Participation of FI in financial futures was just a matter of time whereas the NFI would need a longer time to understand before they could participate in this financial instrument.

Person responsible for the risk control in the organisation is analysed as below :-

Description	Financial Institution		Non-Financial Institution
	Users	N-users	
<u>Interest Rate</u>			
Treasurer	8	3	3
Finance Director			4
Group/Chief Accountant			2
Accountant			1
Finance Manager			
Others		2	
<u>Foreign Exchange:</u>			
Treasurer	8	3	3
Finance Director			4
Group/Chief Accountant			2
Accountant			1
Finance Manager			2
Others		2	

It was noted that Treasurer was regarded as person responsible for the risk management in FI whereas in NFI only 3 corporations having treasurer responsible for risk management and they were all US owned subsidiaries, the remaining corporations were having the Non-treasurer responsible for fund management activities.

In general, larger companies were more interested in the financial futures market than smaller ones, and treasurers were more likely to transact than accountants, this findings were same as the survey done in UK (*Christine Helliar 1995*)

As one financial manager stated, “Financial Futures are very risky if accompanied by inadequate back office controls and systems, poor understanding by senior management of risk management policy and a failure to articulate a clear policy and strategy to guide the actions of the treasury department”.

Futures instrument thought to be most useful is analysed as below :-

Description	Financial Institution		Non-Financial Institution
	Users	N-users	
KLSE Composite Index Futures		1	4
KLIBOR Interest Rate Futures	5	4	8
Currency Futures	3	2	6

From the table above, majority of the respondents from FI and NFI regarded Interest rate Futures most useful, partly because the foreign exchange market can sometimes be used instead of the currency futures market. Non-users of the market regarded it is more important to get markets and products right rather than treasury policy. Most non-users, however, agree with users that there were positive benefits to be gained from using the market. (*Christine Helliar 1995*)

Generally, FI did not have any problems about using the financial futures market. They did not consider there to be any legal, accounting, regulatory or tax problems and they did not think that they are costly, complicated or difficult to arrange. Most treasurers thought it is helpful to use the market for interest rate risk management and matching asset and liability cashflows.

The Financial Futures market has seen enormous growth since its inception in 1981 because financial managers have found many uses of the market and did not think that there are nay major problems. As one treasurer in the Bank explained, ‘As an individual who was treasurer before derivatives existed, the contrast in the “before” and “after” is quite extraordinary. How did we do our job without their existence ?’ (Quentin Hills, 1996). We hope this would be the scenario in Malaysia in time to come.

5.6 Recommendations for Future Studies

Limitations of this study in terms of respondents size and methods can be eliminated by larger scale studies. SPSS can be used to analyse data when dealing with larger pool of respondents. This instrument being very new in Malaysia has definitely imposed constraint on the data collection. A more comprehensive research and analysis on the transaction volume would be possible when the industry move into a more mature state of operations.