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A STUDY ON RETAIL TRADERS IN THE INDIAN FOREX MARKET

[1]Manisha De and [2]Dr. Pradeep Kour Chawala
[1]Research Scholar, Mansarovar Global University, M.P.
[2]Research Guide, Mansarovar Global University, M.P.

Abstract:

According to Ph and Rishad (2020), retail participation in the Indian Forex market is growing rapidly. However, the retail participation is less compared to the institutional investors. The retail investors indicate the individual investors who buy and sell securities for their benefit. The retail investors are not considered as professionals, and they invest a smaller amount of money than the institutional investors. At the same time, the retail investors use the brokerage firms for buying and selling the securities and funds. These investors also invest in the stocks, crypto currency and small-cap stocks. The retail investor's trade less frequently and they trade at minimal volumes. The retail investors in India use the online platforms for trading. On a similar note, the RBI's FX retail trading initiatives provide fair and competitive rates for the customers. At the same time, the discount brokers offer lower brokerage charges and use the mobile apps for participating in the forex trading. The main goals of the retail traders are to make higher profits by taking advantage of currency price fluctuations. These retail traders also aim to get the best value of the foreign exchange market. The retail traders in the Indian forex market can also start trading with a relatively smaller amount of capital. The trading platforms in India, in turn, provide tools and other essential resources which help the beginners to learn and participate in the market.

Keyword: Retail, Forex, Investor, Currency, Market

Introduction:

In the opinion of Sadhwani (2020), it is very important to understand the relationship between the different currencies. Various currencies offer different levels of risk and return under certain market conditions. The forex trading account mainly refers to an investment account that helps people to trade their currencies. To open a forex trade account, the individual needs to fill out the personal details, upload their HYC documents including PAN card and Aadhar card. All these documents need to be verified for further processing. After verification, the forex trading account of the individuals gets activated. Further, for activating the currency segment, one needs to submit the proof of their income. There are two types of forex accounts which include the Micro account and the Cent Account. Having a trading account provides the trader's easier access to the markets, provides them with trading tools and makes them aware of the risk management tools. By using the trading account, the individuals can trade in the foreign exchange market. Moreover, the trading account also provides easier access to the trading platforms and other essential tools, which further helps the individuals to perform the trading activities. On a similar note, the trading account also provides tools which help the traders to manage the risks. These tools mainly include the stop-loss and take-profit order tools. For starting forex trading, the individuals can start with small trading activities, and then they can gradually increase their trading size. At the same time, they can set some goals and break them into some measurable steps and start trading. The retail investors can develop a trading plan with a set of rules, which can guide them in trading. They can keep a regular track on their position and ensure that they have enough funds in their accounts. The rentals investors can further use the stop-loss and take-profit orders for tracking the risks and protecting their profits in the long run.

In the opinion of Gona and Sahoo (2020), the forex trading is open 24/7 for five days a week. The retailer traders access the forex markets through online brokers who provide trading platforms and further access to the currency pairs. In comparison to the other large institutions, the retail traders trade smaller volumes of currencies. The retail traders do no more to the overall forex trade market, however, the collective activities further influence the price movements, in case of volatile situations. The individuals can further open a trading account with a broker, and then deposit their funds and start trading.

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The traders can also select their currency pairs for trading based on the market analysis and their trading strategies. With the development of online trading platform, the forex trading has become more accessible to everyone. In comparison to the other markets, forex trading requires relatively smaller initial investments. Therefore, more retailers are choosing forex trading over the traditional trading practices.

The easier and more accessible forex market has been made possible largely by the rising online platforms and mobile trading applications. The National Stock Exchange (NSE) has been serving as an important factor by means of introducing the most advanced digital solutions to facilitate forex trading in India. As inferred from the study by Kim *et al.,* (2020), as forex trade takes over among traders, there is now unfettered availability to the forex market via simple platforms that offer real-time data and analytical tools as well as secure transaction processing. In an effort to overcome these barriers, traditional limits have been broken and institutional as well as retail traders have been brought into forex trading with more convenience and efficiency.

Since forex trading in India has been revolutionized by online trading platforms, forex traders have been provided with all the tools to simplify the decision-making and execution process. The real-time price, certain technical indicators, automated trading choices and straight access to the international currency pairs are provided in these mentioned platforms. Stop loss along with take profit can be technically used by different traders to monitor market trends, execute variant transactions within potential seconds and manage subsequent risks. With the adequate availability of online platforms, the traders are not bound to traditional brokerage services as much as they are given a hand in participating in their transactions. Also, artificial intelligence (AI) and machine learning integration in these platforms have improved predictive analytics by making traders make informed decisions on the basis of historical data and market patterns.

As referred to by Apesteguia*et al.,* (2020), Forex Trading has further been changed by mobile trading applications that have made it accessible to a more populous audience. The increasing smartphone penetration along with access to the internet in India have empowered traders to access the forex market from anywhere and anytime. Forex trading mobile applications have a great interface, essential trading tools, real-time notification and instant order execution. These apps offer uninterrupted connectivity making it possible for traders to be updated on forex prices, global news and market fluctuations as well as economic indicators that drive forex prices. In addition, they allow mobile users to make decisions quickly if the market behaviour changes, avoiding losses for spending a longer time making a decision.

The National Stock Exchange of India acknowledges that forex trading requires solutions in the digital era, and is in the process of collaborating with financial technology firms to improve its forex trading infrastructure. These are the excellent mobile-friendly platforms and web-based trading systems used by NSE to assist traders in accessing the forex market at all times. Due to security measures and regulatory compliance integrated in these platforms, there are no concerns about fraud and data breaches. Besides, NSE's continuing efforts to enhance technological advancement to forex trading lead to faster functioning speeds, lower transaction costs, and superior liquidity for the traders.

Further, forex trading in India is made easy due to the ease of account creation and transfer of funds. From this assistance, almost every trading platform or mobile application has been easy to trading on boarding, making it possible to have an account open without any documentation. There was integration with digital payment gateways, e-wallets and net banking which made deposits and withdrawals instant and hassle-free. Also, these platforms have come to be available with demo accounts which have enabled new traders to practice trading strategies before investing real capital, cutting down the learning curve and increasing the market confidence.

Opportunities for Profit: Short-term speculation, arbitrage, and hedging opportunities.

Through short-term speculation in arbitrage and hedging, forex trading in India within the completed deal of the National Stock Exchange (NSE) provides various avenues of profit. Forex trading through these strategies gives traders the

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opportunity to take advantage of currency price movements, market inefficiencies and techniques for risk management of profitable trades making forex trade a lucrative venture for both institutional and retail investors. With high liquidity and volatility, the forex market provides great opportunities for forex traders to generate substantial returns with proper exposure to risks.

As asserted by Lyócsa*et al.,* (2021), Forex markets are one of the most common places that traders go to in order to seek profit via short-term speculation. Buying and selling currency pairs within a short period of time is called this approach, which is used to gain an advantage from price fluctuations. Technical analysis, certain market trends alongside real-time economic indicators, are technically utilised to trade currency movements using vivid speculative trading. Short-term forex trading is facilitated via advanced electronic trading platforms with high-frequency execution of trades, charts, and automated trading features at the National Stock Exchange. There are frequent day traders and scalpers who execute multiple trades within minutes or hours to extract small profits respectively. Speculative trading also benefits from the advantage of leveraged forex brokers, but on the other hand also brings associated risks.

In the forex business, arbitrage opportunities are there whenever there are price differences between the forex markets or perhaps trading platforms. Based on the analysis of Rösch (2021), Forex arbitrage is a great way for traders to buy a certain currency in market A, at a cheaper price and sell that same currency in the second market B, at a higher price and make risk-free profit. The technologically advanced forex market in India offers high speed of execution as well as access to the multiple trading platforms to which this strategy thrives. Algorithmic trading tools and real-time data feeds integrated within the NSE enable the traders to identify and capitalise the arbitrage opportunities efficiently. Interest rate arbitrage also adds profit opportunity as traders take advantage of different interest rates in two money. Indian traders would therefore be free to engage in arbitrage opportunities across global forex markets when the global forex markets wake up or when the Indian forex market winds down throughout the day, exploiting inefficiencies in the global forex markets.

Forex trading has a set of opportunities that can help manage financial risks and they are hedging opportunities. Hedging strategy is used by businesses, importers, exporters, and institutional investors to shield against bad currency movements. In hedging, currency pairs are taken and the offsetting positions are taken to lessen potential losses arising from the market's volatility. Forex futures and options contracts are offered by the NSE for hedging purposes in order to lock exchange rates in and protect traders from adverse movements. It gives a particular advantage for Indian businesses dealing in international trade in view of the cancellation of the uncertainties about depreciation or appreciation of the currency. Beyond these, forex hedging techniques serve as a means of risk diversification and stabilization of investment returns through uncertain economic conditions by portfolio managers.

The purchasing power parity theory

Professor Gustav Cassel proposed the theory of purchasing power parity. As per this theory, the exchange rate between two countries mainly depends upon the relative purchasing power of their respective currencies. The Purchasing Power Parity Theory (PPP), states that in the long run, exchange rates should adjust for equalizing the price of identical goods across the different countries (Vo and Vo, 2023). This theory is mainly based on the Law of One Price, which is also known as LOOP. The Law of One Price states that a basket of goods should cost the same in two countries when the exchange rates are adjusted. This theory in turn provides a valuable tool for comparing the living standards and the economic size between the countries by adjusting for differences in price levels. With the help of PPP, economists can compare the GDP, per capita income, and various other indicators across different countries (Costa *et al.,* 2022). By considering the purchasing power of a currency within any country, the PPP can help in understanding the true living standards and the living affordability of goods and other services across various regions. The data of PPP can therefore be used by the policymakers for making decisions related to international trade, economic planning and development aid, by focusing on the disparities in living standards between countries. This theory also helps in assessing whether a currency is overvalued or undervalued relative to other currencies based on its purchasing power.

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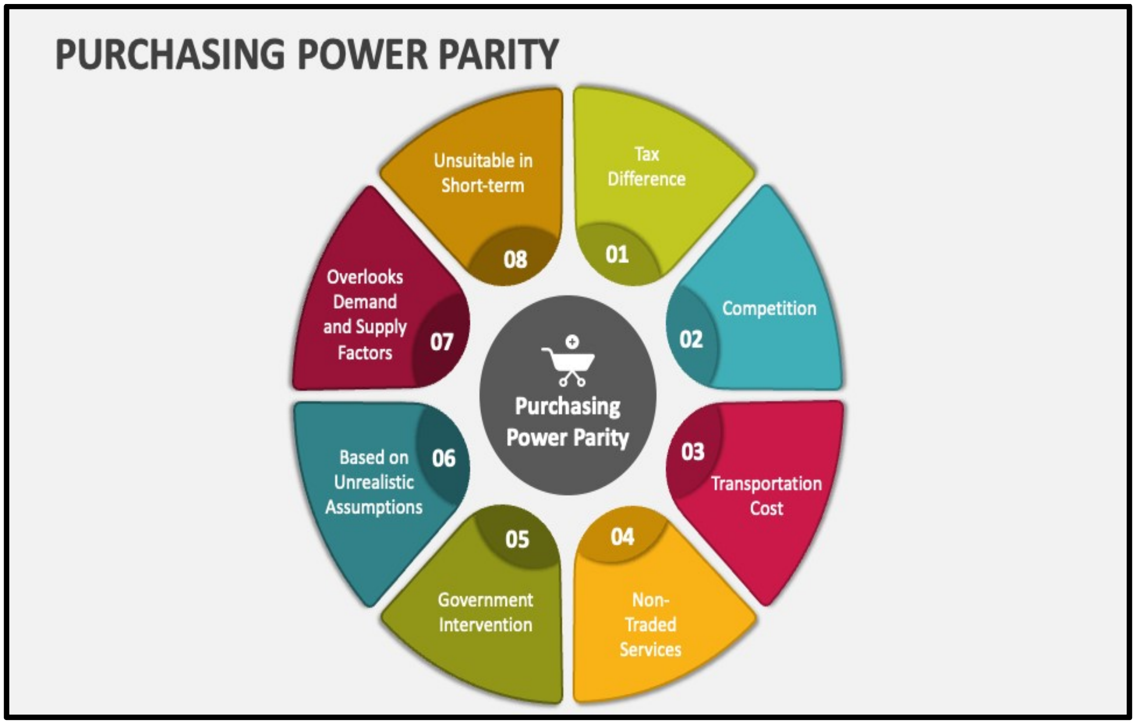

Figure 1: The purchasing power parity theory

(Source: Runtime, 2024)

The Purchasing Power Parity Theory can help in determining whether the Indian Rupee (INR) is undervalued or overvalued against the other currencies (Mehrotra and Munjal, 2021). In case the inflation rate is higher in India in comparison to the USA, the INR should depreciate against the USD to maintain parity. On a similar note, short-term fluctuations occur due to speculative trading, capital flows and policy interventions. Speculative trading mainly refers to the practice of buying and selling the assets such as stocks and real estate, to gain profit from price fluctuations (Slobodiany and Abuselidze, 2021). Therefore, the PPP theory is used in forex trading for identifying the exchange rate misalignment, which can help traders make money. The traders in India can, with the help of this theory, compare the purchasing power parity of two currencies and determine if one is overvalued or undervalued. They can also use the PP for developing long-term strategies based on currency misalignment and global economic trends. The Indian traders, with the help of this theory, can anticipate how a currency pair might move in the future.

Behavioural Finance Theory

Behavioural Finance Theory mainly refers to an economic concept that examines how psychological biases and emotions influence people's financial decisions (Rismanet *et al.,*2022). This suggests that investors often make irrational choices due to cognitive limitations, which further leads to market anomalies and deviates from the traditional rational economic models. This theory also highlights various psychological biases, including overconfidence, anchoring bias, herd mentality, loss aversion and framing effects, which can further affect financial judgments and lead to wrong investment decisions. The economic models suggest that investors behave rationally; however, the Behavioural Finance theory suggests those cognitive biases and emotions impact individuals' financial decisions. The understanding and usage of the behavioural finance bias theory can be applied to the stock and other trading market movements regularly (Fama, 2021). Due to the herd mentality bias, traders follow market trends without interdependence analysis. When they see others investing in some stocks, they sometimes copy the traders and invest in stocks without actually analysing the market conditions. At the same

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time, due to the overconfidence bias, the traders sometimes overestimate their knowledge and underestimate the risks. This also leads to major investment failures. The traders also fear the losses more than they appear to gain, which in turn leads to irrational decisions.

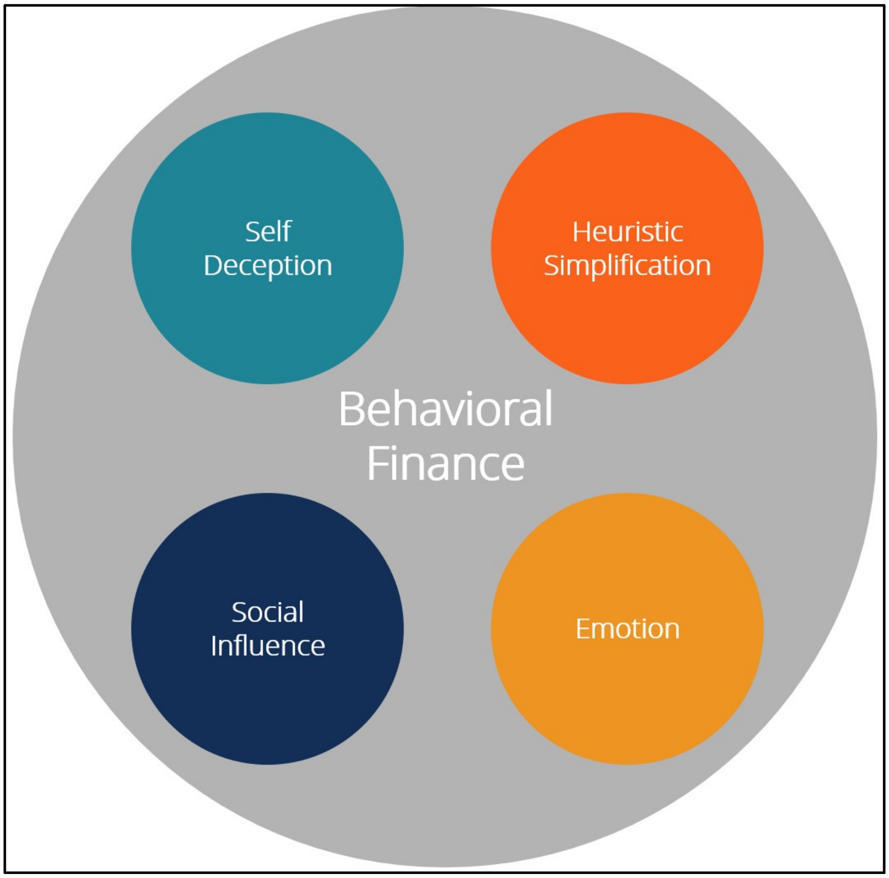

Figure 2: Behavioural Finance Theory

(Source: Vipond, 2024)

In the context of forex trading, the forex traders in India often react to global events such as geopolitical tensions and the US Federal Reserve announcement, which further leads to volatility. On a similar note, the speculative behaviours in the NSE Currency Derivatives Segment often cause deviations from the fundamental value (Kumar, 2023). The behavioural finance theory helps explain why even seasoned investors in the Indian market can fall prey to emotional reactions and biases, which can lead to poor trading decisions. Moreover, it helps in explaining the market anomalies, the mistakes of the investors and the irrational behaviour. This theory, therefore, provides some proper insights into the decision-making process, helps in choosing better financial strategies and improves the understanding of the market dynamics. As a result, Indian traders can make better investment decisions and participate in the forex trading market.

Conclusion:

The Regulation and Institutional Theory mainly refers to the study of how external rules, norms and various other expectations can influence the behaviour of organisations and individuals (Risi*et al.,* 2023). This theory also suggests that organisations must follow the rules and requirements if they are to receive any support and be perceived as legitimate. The Institutions therefore shape the way regulations are created, implemented and followed within a society. According to this

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theory, there are three main types of pressures that organisations face from their environment, which include coercive, normative and mimetic. The organisations mostly comply with regulations to gain legitimacy in the eyes of the stakeholders. The forex trading market mainly operates within a regulatory framework that is designed to prevent excessive speculation and ensure financial stability.

The regulatory bodies in India, that impact forex trading, mainly include RBI, SEBI and FEMA (Kashyap, 2024). The RBI manages the exchange rate policies as well as the forex reserves. On the other hand, the SEBI regulates the forex derivatives trading on the NSE. The FEMA, at the same time, governs the capital flows and the currency conversion rules. The policy changes in India, such as the liberalization of forex trading for retail investors, further impact the forex market growth in India. As a result of this policy change, Indian traders can now easily access the global markets, the business firms hedge against the currency fluctuations related to international trade, mitigate the risks associated with exchange rate volatility and access a wider range of forex instruments, which improve the risk management practices. The RBI, therefore, sets the framework for forex trading, including the currency pairs that can be traded by Indian residents (Devi and Singh, 2023). The FEMA governs all foreign exchange transactions in India and outlines rules for individual traders and the business firms that are involved in trading. The SEBI, at the same time, ensures that the brokers who are facilitating forex trading are registered and comply with the regulatory standards for protecting Indian investors.

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