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Social Functions of Financial Derivatives

Culp

In this paper Culp describes the social functions of derivatives markets. Some of these social functions are:

Facilitating risk transfer

Derivatives markets allow for firms to selectively transfer risk at a relatively low cost. This frees up managers to focus more on the business and not managing these types of risks.

Serving as arenas for price discovery

Trading in a market brings new information to prices. This would happen even without deritivies markets but they usually are seen in these markets first providing this information more efficiently.

Promoting the efficient allocations of resources

Derivatives are very effective at rationing scarcity overtime.

Mitigating under investment problems by creating opportunities for asset based financing

Derivatives give firms the ability to engage in markets especially if they have limited access to outside financing.