# 4. Selling a Call Option.

In last two lectures we understood buying of Call and Put Option. In today's article we will discuss about selling call option.

In second chapter you understood that when you buy a call option then you have the right to buy one option contract of then you have probably asked yourself the question of "who exactly am I buying it from?" In order to have the right to buy the stock at the strike price, then somebody has had to take the other side of that transaction and agreed to give you the right to buy it from them. That person that takes the opposite side of the call option buyer is the "call option seller." Sometimes it is also referred as the "call option writer".

Just to be clear here, there are really two types of call option selling. If you bought a call option and the price has gone up you can always just sell the call on the open market. This type of transaction is called a "Sell to Close" transaction because you are selling a position that you currently have. If you do not currently own the call option, but rather you are creating a new option contract and selling someone the right to buy the stock from you, then this is called "Sell to Open", "Writing an Option", or sometimes just "Selling an Option."

**Definition:**

Selling a Call option is when you give the buyer of the call option the right to buy a stock from you at a certain price by a certain date. In other words, the seller of the call option can be forced to sell a stock at the strike price. The seller of the call receives the premium that the buyer of the call option pays.

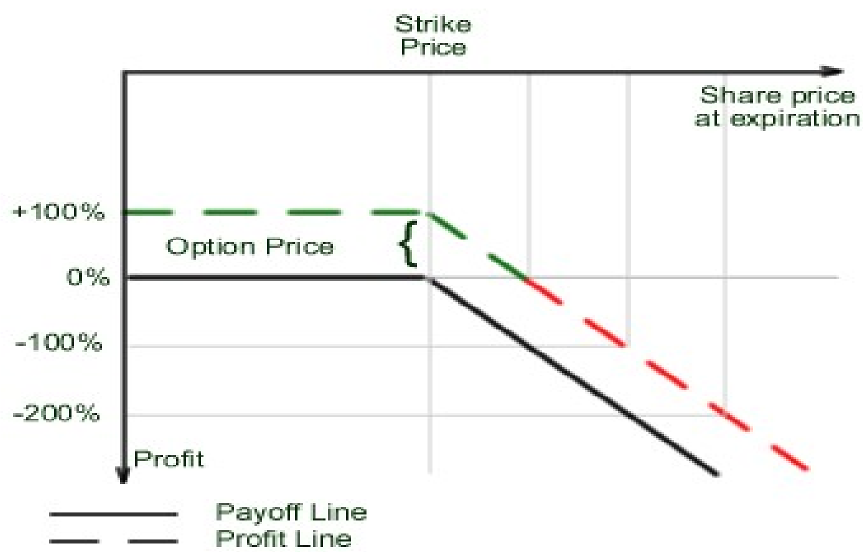
**Example of selling a call Option:**

Mr. Ajay thinks that the price of Cipla is going to stay the same or drop in the next month, currently share is trading at Rs.600. Therefore Mr. Ajay gets quote on the January Rs.610 call of Cipla and sees the price at bid Rs.5 and ask Rs.5.10. He places an order to SELL 1 Co Cipla January Rs.610 call as a market order. Mr. Pessimist's order immediately gets filled at Rs.5. So he receives Rs.500 (As each option contract covers number of shares so here we are assuming Cipla is having 100 shares.) in his account for selling the call option. Once the trade is made Mr. Pessimist hopes that Cipla stays below Rs.610.

If Cipla closes at Rs.610 or below then the call option will expire worthless and Mr. pessimist profits the Rs.500 he received for selling the call; If Cipla closes at Rs.620, the opposite party to which Mr. Pessimist has given the right to buy will exercise the call option and Mr. Pessimist has to sell 100 share of Cipla at Rs.610 thought the price of Cipla is at Rs.620

Mr. Pessimist has now received Rs.500 for selling the call option, but he has also lost Rs.1000 because he had to sell a stock that was worth Rs.620 for Rs.610. therefore his net loss is Rs.500.

**Payoff for Selling a Call Option:**




In above diagram as we can see Profits are limited and losses are unlimited in selling a call option. In our example, if stock price goes below or stays at Rs.610 then option expires worthless and Mr. Pessimist receives premium of Rs.500. If share price goes above strike price say Rs.620 then Mr. Pessimist makes a loss.

In next chapter we will discuss selling of a PUT Option. Feel free to contact us on research@grovalue.in for queries related to above topic.