Chapter: 1:

Introduction:

1.1: The need for savings.
1.2: Capital formation, savings and Investment.
1.3: Investment Avenues.
1.4: Channels of Investments.
1.1: The need for savings:

It is not an exaggeration to say that ancient Indian society was economy oriented. From the Vedic period to the seventh century, the economy was well organized. They had properly realized the importance of financial matters. That is why a materially prosperous society gives its best thought to finance. Arya Chanykya was the first to discuss finance systematically. Chanykya has postulated four principles in the verse, "अर्थः, मुल्यः, धर्मः, कामः". "Finance, Religion, Married life and Salvation" are the four main duties of man and they are the pillars of Indian civilization. These four aspects are based on money. Money is the foundation of these four principles. Unfortunately only two of the four principles survive in today's modern society. To earn money is man's nature and there is nothing wrong in having a desire to earn money properly and to prosper. Once you realise the importance of money, it becomes natural to earn it. Saving money is the most important aspect, but it is rather more difficult, than earning money. Every one must try to create wealth and understand the meaning of "धनं निघानम् अनुपमम्", "Wealth depends on savings" and its importance is universally acknowledged. Protection of wealth includes savings and the wise have always advised the common people to save money. Chanykya said, "जलविवृतं निपातन क्रमां: पुर्यते घटः", "you become wealthy by saving bit by bit". The proverb "बेचे बेचे तरे सावे" has its origin in chanyakya's verse. Samarth Ramdas has
convincingly stated the importance of saving in ancient times. He says that the one who spends all that he earns, doesn’t survive in difficult times, if the common man fails to save money and it is not good for his own economic well being. As Saint Tukaramas says, ‘Through good business one earns, money and is careful in spending it’. If we understand what he says, we will never be poor and the future generations will come out of poverty. Lack of education is not a hurdle in earning money. Thomas Edison the great scientist went to school only for four months. Millionaire Henry Ford had passed only the sixth standard. So with will power and self-confidence we can also become millionaires. One cannot say when one can get an opportunity while waiting for it. Everyone gets a chance, but we must take advantage of that opportunity. It is bad to withdraw thinking that we will not get an opportunity.

There are many ways of earning money. Decide what you wish to do, write it down before going to bed and plan in the morning accordingly. You will definitely get what you want. Just don’t dream, do it. You need to start working. Every person has confidence, but it is dormant you need to awake it. If you think that you are unlucky, then you cannot do it. Create confidence that you can do what you want to do. Confidence gives you determination of doing something.

You are the master of your own destiny. You can change it. The best example of what efforts combined with confidence can do is G.D.Madgulkar. This great poet, struggling with hunger and poverty,
kept on writing and won all honors in life. Poor people are angry with those who win all honors in life. Poor people are angry with rich people, but they never think about how these men become rich. Rich people work harder than many of the poor. They make use of their imagination. Tata, Birla started with a penny in their pockets. Instead of learning lessons, we blame rich people. We know the proverb that those who stop they are finished; those who don’t stop become great in life.

Take decisions without wasting time in thinking and don’t change the decision in difficult times. This is the decision difference between rich and poor. Crores of people lead a miserable life, because sometimes somebody had given their adverse opinion resulting in the loss of their self—confidence.

Any one can dream about becoming rich but very few make a determined effort, systematic planning and strong desire to become rich. Life is a game of chess and the player opposite you is ‘time’. You make an error when you waste time. So I say if others can get what they want, why not you?
1.2: Capital Formation, Savings and Investment:

Introduction: Budget proposals to curb in GPF interest rates, increase in surcharge on income, increase in prices, increase in government expenditure due to the Kargil war, cyclone in Orissa, fifth pay commission implementation have a direct effect on individuals in general and on salaried sections in particular. It is expected that all these will cumulatively affect the domestic savings. Due to the decline in the interest rates and government policies, the investor has to make a proper decision for investment and saving.

1.2.1: Capital Formation: It can be said that capital formation plays a central role in the process of economic development. Capital is treated as the life and blood of the economy. Capital is a part of the wealth of a country, which is utilized for further creation of wealth. Capital formation, as a matter of fact, leads to the maximum utilization of resources, accelerates the quantum of national output, income and employment and as such solves the problems of inflation, balance of payments and foreign debt. The concept of capital formation consists of fixed capital and inventories. Fixed capital includes machines, buildings etc., which do not change their form in the process of production. Inventories like raw materials, components etc., are kept in stock to ensure a continuous production or sale. Capital, while in use for the production of goods, undergoes wear and tear. This is called depreciation of capital. When one estimates capital formation,
including depreciation, it is gross capital formation. Excluding
depreciation, it is net capital formation. The gross domestic capital
formation is all the capital formation that takes place within a country.

According to economist Nurkse, the meaning of Capital
formation is that society does not apply the whole of its current
productivity activity to the needs and desires of immediate
consumption, but direct a part of it to the making of capital goods, tools
and equipments, machines and transport facilities, plant and
equipments, all the various forms of real capital that can so greatly
increase the efficacy of productive efforts. The essence of the process
then is the diversion of a part of society's currently available resources
to the purpose of increasing the stock of capital goods, so as to make
possible an expansion of consumable output in the future. In the
words of Singer, 'Capital formation consists of both tangible goods like
plants, tools and machinery and tangible goods like high standard of
education health, scientific tradition and research.' The following are
some of the factors, which make capital formation essential in the
process of economic development.

1) Capital formation is essential in building of capital equipments to
increase productivity in agriculture industry. It also develops economic
and social overhead capital like construction of roads, railways,
airways, hospitals etc.
2) More savings followed by more investment are essential for the growth rate of capital formation. This helps in raising the level output income and employment.

3) It is essential for the technological progress by way of increasing the efficiency of labourers and modernized machines and equipments.

4) It is essential to increase the horizon of market of different commodities both in the country and abroad.

5) It is essential to provide self-sufficiency of an economy.

6) It leads to proper utilization of resources, establishes various industries and satisfies the varied demands of the people and hence economic welfare increases.

The process of capital formation includes three inter-dependent activities. The first activity is the formation of saving. The second activity is the mobilization of savings for productive purposes. The third activity is to use the saving for investment that leads to increase in the productivity. The capital formation depends on the savings and investment. The rate of capital formation in underdeveloped countries is low as compared to the developed countries. There are some causes of low rate of capital formation say, poverty and low level of income, lack of proper financial structure, demographic features, lack of infrastructure facilities and poor sources of savings. However necessary measures should be taken to increase the capital formation.
1.2.2: Savings:

The concept of savings plays an important role in the economic analysis. Saving is defined as the difference between income and consumption. The term saving means the activity by which the claims to resources, which might be put to the current consumption, are set aside and so become available for other purposes. Saving is the excess of income over expenditure. Thus,

\[ \text{Savings} = \text{Income} - \text{Expenditure}. \]

During the pre-independence period in India, people spent most of their income on consumption and only a small amount of income was left in the form of saving. As a result, the saving rate was very low. After independence, the major objective of the government policy has been the promotion of saving and capital formation as they are the primary instruments of economic growth. The total volume of saving depends upon the size of income and its consumption. It also depends upon other many factors like power to save, desire to save and the opportunities for collecting the saving. As the size of income increases, the volume of savings may be expected to rise.

**Domestic Saving**: Domestic savings or total savings are composed of the public sector savings, the private corporate savings and the household savings.

The Public sector savings constitute the savings of the Government through the budgetary channels and the retained earnings of public
enterprises. The volume of such savings depends largely upon the functions assumed by the state, economy, and tax structure, fiscal policy of the government, its pricing and investment policies. It is the excess of current revenue over current expenditure of the government's departmental and the profits of the non-departmental undertakings. The private corporate savings include the business savings in the form of retained earnings and depreciation after meeting all the expenses of the business. The size of household savings depends on the capacity and ability and willingness to save, which are influenced by a multitude of social, psychological and political factors. The household sector is comprised of individuals, farmers, businessmen and non-profit organizations. The saving of this sector comes out of the surplus income after meeting the consumption expenditure.

The domestic savings of India shows, a large rise that has taken place since early 1950's. In absolute terms, the gross savings have jumped up massively by over 500 times. The gross savings (at current prices) was Rs.887 crores in 1950-51. In 1999-00, it came to as much as Rs.447208 crores. (Refer statistical data) In India, the nationalized and private banks, co-operative banks and regional rural banks largely mobilize the savings of the people. Apart, from banking institution, there are a large number of non-bank financial institutions, also collect savings from the people.
Saving is abstaining from present consumption for a future use. Savings are autonomous coming from households as a habit. Huge amount of savings is necessary for specific purposes like future needs, interest incomes, and contingencies and for the precautionary purposes.

1.2.3: Investment:

The term investment means different things to different persons. If one person has given money to some other, it may be his loan, which may be considered his investment for a return. If a person has purchased 10 grams of gold for the purpose of price appreciation, it is his investment. If he purchases a pension or insurance plan, it is an investment. Thus there are different types of investments, for different persons.

Investment may be defined as the flow of expenditure on new fixed capital goods like, houses, machinery, factories etc. or an addition to inventories. In ordinary usage, the term investment means investment in securities, shares, debentures equities etc. For the individual, it is the exchange of money or cash for a future claim or money or the purchase of security of a promise to pay at a later date along with interest as in the case of shares, bonds and debentures.

It is said that, the investors are savers but all savers cannot be good investors, as investment is a science and an art. All investments are risky, as the investor parts with his money. An efficient investor with proper training can reduce the risk and maximize returns.
term investment refers to the acquisition of some assets. It also means the conversion of money into claims on money and use of funds for productive and income earning assets. The investment or the flow of expenditure on capital goods and stocks refers to gross investment. A gross investment minus capital consumption gives us the net investment.

There are different methods of classifying the investment avenues. A major classification is the physical investment and the financial investment. They are physical, if savings are used to acquire physical assets, useful for production or consumption. Some physical assets like tractors, ploughs, cows, bullocks or harvesters are useful in agricultural production. A few physical assets like cars, jeeps, matador etc. are useful in business. The financial assets, barring cash are used for lending, for production or consumption or creation of assets and also useful for the production of goods and services.

Among different types of the investments, some are marketable and transferable and others are not. Shares, debentures, bonds, government securities are the examples of marketable investments. Non-marketable investments are the bank deposits, provident funds, insurance certificates and the company deposits.

The following are the main types of investments:

i) Autonomous Investment: It takes place irrespective of the rate of profit or income. It depends upon the technological changes like new technique of production, inventories of new goods etc.
ii) Induced Investment: It is based on the profit motive. It results from the changes in income and consumption.

iii) Public Investment: It is undertaken by the Central or State Governments to fulfill socio-economic goals of economic planning and ownership lies with the public or society.

iv) Private investment: Individuals, farmers, businessman, and owners of firms with the objective of earning income undertake it.

Investment activity involves the use of funds or savings for further creation of assets or acquisition of existing assets. The following chart shows details of it:

**INVESTMENT ACTIVITY**

<table>
<thead>
<tr>
<th>A) Financial Assets</th>
<th>B) Physical Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>House, land, Building,</td>
</tr>
<tr>
<td>Bank Deposits</td>
<td>Flats</td>
</tr>
<tr>
<td>P.F., LIC, Schemes</td>
<td>Gold, Silver, Other</td>
</tr>
<tr>
<td>Pension Schemes</td>
<td>Metals,</td>
</tr>
<tr>
<td></td>
<td>Consumer Durable</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>C) Marketable Assets</td>
<td></td>
</tr>
<tr>
<td>Shares, Bonds, Govt.</td>
<td></td>
</tr>
<tr>
<td>Securities</td>
<td></td>
</tr>
</tbody>
</table>

- 11 -
1.3: Investment Avenues:

There are different types of securities conferring, different sets of rights which can be exercised. The various avenues for investment, ranging from risk-less to high-risk investment opportunities consists of both security and non-security forms of investment, are listed below:
1.3.1: NON-MARKETABLE FORMS OF INVESTMENT:

A Majority portion of the financial assets of individual investors is held in the form of non-marketable investments. It represents the personal transaction between the investors and issuer. The important non-marketable investments held by the investors are described below.

1.3.1.1: Bank Deposits:

‘Bank needs two things to survive: 10% of your money and 90% of your faith’ - Anon.

The most popular type of investment is the deposit with banks such as current account deposits, savings account deposit, fixed deposits and the recurring deposits. On current account deposits no interest is paid as these are meant for businessmen and companies. Deposits in other kinds of bank accounts earn interest as per the norms of the R.B.I. On saving account deposit interest @ 3% to 4.5% is paid by the banks. On the fixed deposits interest @ 7% is given to the deposit holders. The important features of bank deposits are:

- The interest on bank deposits is tax exempt within certain limits under section 80 “L” of the Income Tax Act. (I.T.Act)
- Deposits in scheduled bank are safe because of the regulations of R.B.I. and guarantee of DIC.
- The interest rate on the fixed deposits varies with the term of deposit.
• If deposit period is less than 90 days, the interest is paid on maturity otherwise it is paid quarterly.
• Bank deposits enjoy high liquidity.
• Loans can be raised against bank deposits.
• Bank offer extraordinary convenience to the customers.

1.3.1.2: Post office Small Saving Schemes:
‘He that will not stoop for a pin will never be worth a pound’.

English Proverb.

The investment avenues provided by the post offices are non-marketable as they are savings media. The only exception is the Indira and Kisan Vikas Patra, which are the bearer bonds transferable by delivery. Now a day only KVP are issued by the post offices. All the post office small saving schemes are free from TDS.

1.3.1.2. [1] Post office Savings Bank Account: The important features are:

- Secured rate of interest.
- Interest is totally tax-free.
- Ceiling on a single holding upto Rs.100000 and on joint holding upto Rs.200000.
- No restriction on the number of withdrawals.
1.3.1.2. [2] Post Office Time Deposits (POTDs):

Similar to the fixed deposits of the commercial banks, the POTDs has the following features:

- Deposits can be made in multiple of Rs.50 without any limit and no withdrawal is permitted.
- Interest is calculated half yearly and paid annually.
- Interest is tax exempt within certain limits under section 80 “L” of the income tax act.
- A POTD account can be pledged.

1.3.1.2. [3] Monthly Income Scheme (MIS):

The most popular scheme of post office is the monthly income scheme. It is meant to provide regular monthly income to the depositors. It has the following features:

- Account can be opened at any post office by depositing minimum of Rs.1000 or multiple thereof. Any number of accounts can be opened but the total deposit should not exceed Rs.300000 in case of single account and Rs.600000 in case of joint account.
- Deposit can be made in cash or cheque or demand draft having a maturity period of 6 years.
- Interest @ 8.0%p.a. is paid every month plus 10% bonus on maturity on initial amount.
- Nomination Facility is available.
• Interest is tax deductible within certain limits under section 80 “L” of the income tax act.

1.3.1.2. [4] 5-Years Recurring Deposit:

• The account can be opened for a minimum amount of Rs.10 per month and in multiples of Rs.5 thereafter.

• Maturity period is 5 years however it can be further extended for 5 years.

• Withdrawal is permitted after first year on the balance at 50%.


Essentially a scheme for determining tax payment, the NSS has following features:

• Interest @ 7% p.a. compound.

• Account can be opened at any post office by depositing Rs.100 or a multiple thereof.

• Interest is taxed exempt within the limits of 80 “L” of the income tax Act. Similarly tax rebate is allowed under section 88 of the income tax act.

• After 3 years, one withdrawal is permitted annually.

• The amount that is withdrawn during a year is taxable.
• No defined maturity period, however can be closed at the option of the subscriber after the expiry of four years from the end of the year in which the account was opened.

1.3.1.2. [6] National Saving Certificate (NSC):

There are various series of this issue with slight changes, with regard to payment of interest rates. The features are:

• It comes in denominations of Rs.100, Rs.500, Rs.1000, Rs.5000 and Rs.10000.

• It has a term of 6 years and compound interest is paid.

• The investment is eligible for tax rebate exemptions under section 88 up-to a certain limit.

• Interest accruing every year qualifies for tax rebate u/s 88 of the Act and interest amount is deductible under section 80 'L' of the I. T. Act.

• No tax deduction at source.

1.3.1.2. [7] Kisan Vikas Patra (KVP):

KVP and IVP have solved the problems of the rural population with investable savings very effectively. The features are:

• Denominations of Patras are Rs.100, Rs.500, Rs1000, Rs.5000, Rs.10000 and Rs.50000.
• Certificates may be issued to an adult singly or jointly, to an adult on behalf of a minor.

• Investment doubles in 7 years and 8 months.

• No tax deduction at source.

1.3 1.2. [8] Public Provident Fund Scheme (PPF):

One of the most attractive investment avenues available in the country, the PPF scheme has the following features:

• Individuals, HUF and an adult on behalf of the minor can open PPF account.

• PPF is 15 financial years scheme but the account can be extended beyond 15 years.

• Minimum amount of Rs.500 is to be deposited in a financial year. Maximum amount that can be deposited is Rs.70000.

• Tax free interest at the rate of 8% p.a.

• Subscriptions in a PPF Account qualify for income tax rebate under section 88 of Income Tax Act up-to Rs.70000 in a financial year at the rate of 20% of investment made if gross salary is up-to Rs.150000 and 15% of the investment made if gross salary is more than Rs.150000.

• Deposits can be made through cheque, cash or demand draft. The date of presentation of local cheque is treated as date of deposit.
• A subscriber can avail the loan facility in the third financial year from the financial year in which the account was opened, up-to 25% of the amount.

• A subscriber can withdraw 50% of the balance standing to the credit of account after the expiry of 5 years from the end of the financial year in which the initial subscription was made.

• Credit balances in PPF Act cannot be attached by any order or decree of any court in respect of any debt.

Employees Provident Fund Scheme (EPF):

It is a major vehicle of savings available for the salaried employees. The employees provident fund scheme has the following features:

• Each employee has a separate A/c in which both the employer and employee are required to contribute a certain minimum amount.

• Contribution made by the employer is fully tax-exempted upto 12% of the basic pay, while employees' contributions qualify for tax rebate under section 88 of the Income Tax Act.

• Compound Interest @ 9.5% per annum is totally exempt from taxes.

• The employee is eligible to take a loan against the provident fund balance.
1.3.1.3: Government Securities:

Another investment avenue available to the investor is the government securities issued by the Government of India. Through auctions the RBI handles the Government securities. The investors can participate in these auctions through the specified banks and the primary dealers. These securities don’t carry any default risk as both interest and principal amount is guaranteed by the Central Government. U/S 80 “L” of the I.T.Act, the interest earned on G- Secs. up to Rs.3000 is totally exempted from the income tax.

1.3.1.4: Company Deposits:

Believe nothing and be on your guard against everything—Latin Proverb.

The company deposits is the most popular investment avenue available to the investors. Many companies, large and small, solicit fixed deposits from the public. The company law board regulates the Fixed Deposits (F.D) mobilized by the manufacturer companies and the RBI regulates the FD mobilized by the finance companies. The features are:

- For a manufacturing company the maturity period is one to three years whereas for a finance company the maturity period is 25 months to 5 years.
• Interest is paid monthly, quarterly, semi-annually and annually at the maximum rate of 12.5% p.a.
• It represents unsecured loan taken by borrowings companies.
• Interest on company deposits is fully taxable.
• FD of a company has to be necessarily credit rated.

1.3.1.5: Life Insurance:

'The insurance company is your only real well-wisher. It is the only institution which prays for your long life'. ---Anonymous.

Life Insurance is the major investment avenue through which the investor can inculcate saving habits. The basic needs met by the life insurance policies are the protection against the un-welcome events like, death or long-term sickness and saving. In practice many policies provide a mixture of savings and protection benefits. The common features of life insurance are:

• The most important objective of life insurance is to provide something for the family in case of an unexpected and pre-mature death of its breadwinner.
• It is a regular saving scheme by sheer compulsion especially through monthly salary saving scheme.
• There are various tax benefits available for investment in life insurance. The premiums are eligible for income tax reduction.
Certain types of policies are exempt from gift tax, estate duty and also from the wealth tax.

- LIC schemes provide the best way to buy a house.
- LIC provide quite handy lump-sum amount at the time of retirement so that the retirement may not create any undue financial worries.
- Policy-holders get bonus on policies taken by them and the amount of bonus depend on the profit earned by LIC.
- It provides benefits like double accident benefit, disability benefit, extended disability benefit etc.
- Insurance companies pay bonus to their policyholders on all with profits policies.

There are seven major types of insurance policies. These are:

[a] Whole-life policies.
[b] Endowment policies.
[c] Money back policies.
[d] Term policies.
[e] Specified policies.
[f] Annuities and pension plans.
[g] Single premium policies.
### Table: 1.3.1.5: Tabular presentation of whole-life and money pay back policies:

<table>
<thead>
<tr>
<th>WHOLE-LIFE POLICIES</th>
<th>MONEY PAY BACK POLICIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Premiums are payable throughout the lifetime of the life assured.</td>
<td>1. Combination of savings, regular cash payments and life insurance.</td>
</tr>
<tr>
<td>2. Coverage for almost whole of life. Sum assured is payable only on death.</td>
<td>2. A proportion of the sum assured will be paid at regular intervals.</td>
</tr>
<tr>
<td>3. Premiums paid for three years &amp; then discontinued will secure a reduced paid up policy.</td>
<td>3. On survival to maturity you will get the sum assured plus any bonuses minus payments already made.</td>
</tr>
</tbody>
</table>

The latest policies of LIC are:

The Social security group scheme, Janashree Bima yojana, krishi shramik suraksha yojana and the shiksha sahayog yojana are the latest policies launched by the LIC.

- **Jeevan Rekha**: It is the combination of money back and whole life policy. It offers you both regular returns all through the term, and a life long cover. A policy that not only provides for financial needs at every stage of life but also ensures the security of family too.
• **Jeevan Anand**: Basically the plan is a combination of the whole life plan and the most popular endowment assurance plan. The plan provides the pre decided sum Assured and Bonus at the end of the stipulated premium paying term, but the risk cover on the life continues till death. Loans will be granted against the surrender value of the policy after payment of premium for at-least three years.

• **Komal Jeevan**: This plan is introduced to meet life financial needs for providing the best education to the children. A Komal Jeevan plan with payment of premium ceasing on policy anniversary immediately after the child attains 18 years of age. The plan, besides offering risk cover, also offers payment of sum assured in installments of age 18, 20, 22, 24 and guaranteed loyalty additions if any at age 26.

• **Jeevan Bharati**: LIC introduces the first policy for females only on the lines of money back.

• **Varistha Pension Bima Yojana**: LIC introduced the first policy for the senior citizens. [55 years] It provides the lifetime pension at the assured rate of 9% on the one time lump sum premium. The minimum pension under the scheme will be Rs.250 per month and the max. at Rs.2000 a month. The minimum onetime premium has been fixed at Rs.33335 and the max. Rs.277490. The scheme provides for pension during the lifetime of the pensioner and in the
event of death of the pensioner the purchase price will be returned to the nominee.

- **Universal Health Scheme**: It offers health protection and easy access to good health services to the disadvantaged sections. Under this scheme a premium of Rs.365 p.a. for an individual, Rs.552 p.a. for family of five and Rs.730 p.a. for a family of seven will entitle eligibility to get reimbursement of medical expenses up-to Rs.30000 towards hospitals.

The other insurance companies that have recently started as a result of privatization of insurance sector by the Government, have been explained in Chapter V.

1.3.1.6: **Unit schemes of Unit Trust Of India**:

The UTI was set up in 1964 with the objectives of mobilizing savings from the low and middle group, to channelise these savings into productive investment and to provide assured income to the savers. It provides the savers with the expert investment service, portfolio management and assured income. It provides expert management of their funds; steady income and liquidity for their investment through repurchase facility. It is a financial intermediary between investor and the stock markets. It protects the investors against capital risk by giving him the benefit of professional expertise. Generally there are two types of investment schemes operated by UTI:
a) Open-ended schemes are those in which sale and purchase of units is open throughout the year.

b) Close ended schemes are those in which sale and purchase of units is open for a fixed period only.

The main features are:

• Ease in buying the units.
• You can at any time sell your units back to UTI at the prevailing repurchase price.
• Prices are published every day in the financial columns of all-important newspapers.
• Units can be transferred and all banks consider units as security for granting loans.
• No tax deduction at the source.
• Exemption from income tax and wealth tax benefits.

The following are open-ended schemes of UTI:

Unit Scheme 1964
Reinvestment Plan 1966
Unit Linked Insurance Plan 1971
Children's Gift Growth Plan 1986
Rajlaxmi Unit Plan 1994
Retirement Benefit Plan 1995
Children's College and career fund 1993
Senior Citizens Unit Plan 1993
Special Plan for the Handicapped

UTI Bond Fund

Masters shares and Indian Fund

Mutual funds pool the savings of many individual investors and combine into a large and well-diversified portfolio of investments. Keeping in view the varied needs of the different groups of investors, UTI launched many schemes. Today, various private and public sector companies sponsor mutual funds.

UTI has also set up its own bank i.e. UTI bank and some subsidiaries to serve its inventors.

1.3.1.7: Real Estate:

‘A little house well filled, a little land well tilled, a little wife well willed are great riches’ --- Anon.

The greatest attraction of real estate investments is that it acts as a hedge against inflation. The prices of real estate had reached an unsustainable level. The real estate investments include agricultural land, farmhouses, urban land, and house property.

Agricultural land: Agricultural land is the most popular of tax planning devices. The value of agricultural land has been rising in the country. Agricultural land is also exempt from wealth tax and agricultural income is tax-free. However agricultural land is subject to land revenue imposed by the state government.
Farmhouses: According to a report, the hottest trend in the country is farmhouses. Bought cheaply by developers, these properties are done up luxuriously and sold off as weekend retreats. On certain kinds of farmhouses there is no need to pay wealth tax.

Urban Land: It is the best investment avenue against the inflation. The price of urban land has been shooting up in every city and town. However there are ceilings on urban land holdings.

House Property: Encouragement has been given to housing investments by the government and hence the government announced a new national housing policy. It represents an attractive investment proposition for the following reasons:

- Total return from a residential house is satisfactory.
- Loans are available for buying and or constructing a residential property.
- Interest on loans taken is tax deductible within certain limits and also repayment of principal amount is eligible for tax rebate.
- Ownership of residential property provides a psychological satisfaction.
- Appreciation in the capital value.
- Exemption from wealth tax.
1.3.1.8: Precious Objects:

‘Gold is the life belt for all seasons, especially the dangerous ones’ - Timothy Green.

Precious objects are items that are generally small in size but highly valuable in monetary terms. The important precious objects are:

- Gold and Silver
- Precious Stones
- Art Objects

Gold and Silver are two most widely held precious metals, appeal to almost all kinds of investors for the following reasons:

- They are highly liquid.
- They are aesthetically attractive.
- They have been good hedges against inflation.
- They possess a high degree to appreciate value.
- Industrial applications.
- Purchases by central banks and IMF.

1.3.2: Security forms of investment:

1.3.2.1. Bonds or Fixed income Securities: It represents long-term debt instruments. The issuer of a bond promises to pay a stipulated amount at the end. Generally the periodic interest is paid over the life of bonds and principal payment at the time of redemption.
• The central, state or quasi government issues government securities. Government securities have maturities ranging from 3 to 20 years and carry interest rates that vary between 6 and 9 percent. It carries some tax advantages.

• RBI Relief Bonds is a popular instrument for earning a tax-exempt income. Individuals, HUFS and NRI’s can invest with a minimum amount of Rs.1000. The maturity period is 5 years. The interest rate is 6 to 7% p.a. payable half yearly. The interest earned is exempt from Income tax. The bonds are transferable and nominations facility is available.

• Private sector Debenture is another avenue for investment. It gives a fixed rate of return, which is secured by a charge on the unmovable properties. All debentures with a maturity period of more than 18 months must be credit-rated. Debentures may have a convertible clause, which gives the debenture-holders the option to convert the debentures into equity shares.

• Public sector undertakings (PSU) issue debentures that are called as PSU Bonds which are taxable bonds and interest is exempt only up-to a certain limit as per section 80L of Income tax Act while interest on tax free bonds is fully tax exempt. PSU can issue tax-free bonds only with the prior approval of the Ministry of Finance. There is no deduction of tax at source
on the interest paid and are transferable. They are related to the stock exchanges.

Bonds for Small Investors:

Financial institutions like ICICI and IDBI issue various Bonds to attract the middle class investors. These bonds are unsecured. Now a day these bonds yield 7.25% p.a. The interest received on these bonds is eligible for deduction under section 80 ‘L’ of I.T.Act. Rebate under section 88 of I.T.Act is also available on these bonds. These bonds are highly credit rated from credit agencies and listed on the Stock Exchange. These are redeemable after 3 years. Loan facility, Nomination facility and Transfer facility is available on these bonds. However investors are gambling on how interest rates move by investing in long-term bonds.

1.3.2.2: Preference Shares:

The investor can avail the preference share as investment avenues. The preference shares investment is the investment in which a preference shareholder can enjoy two rights. One is the fixed rate of dividend and the other, preference over others at the time of repayment of the principal amount. The preference share dividend is payable only out of the distributable profits hence the question of paying preference dividend does not arise. There are different types of preference shares like, cumulative and non-cumulative preference shares, convertible and non-convertible preference shares,
redeemable and irredeemable preference shares and participating and non-participating preference shares. The investors can participate in the stock exchange activities through the preference shares.

1.3.2.3: Equity Shares:

The aggressive investors can purchase the equity shares issued by the companies. The investors taking the risks can avail equity share as an investment avenue. The equity share investment avenue can pay high returns in the form of dividends. However, the equity investment is a variable income investment option. There is no such obligation to pay dividend on equity shares, it may be declared in certain years and skipped in others. Since equity shares represent ownership in the company, equity capital is risk capital. If a company does well, the investors are benefited not otherwise. The position of investors in deposits, debentures relates to the lenders. The lenders get preference over its owners at the time of winding up. The market prices of the shares fluctuate depending upon a variety of reasons. There are many advantages of investing in the equity shares of a well-managed company:

[2] Issue of bonus shares from time to time.
[4] Right shares are offered to the existing members first.
[5] Voting rights are available to these shareholders.
[6] Shares can be pledged as security to raise loans.

[7] No difficulty in selling shares, which listed & traded on stock exchanges.

[8] No wealth tax on the investment in shares.


On the basis of qualitative difference equity shares can be classified as Blue chips, Growth stocks, Defensive stocks, cyclical stocks, Turnaround stocks, PSU stocks and MNC stocks.

Investment Options and their Broad Features:

L-Low, M-Moderate, H-High

<table>
<thead>
<tr>
<th>Investment Option</th>
<th>Safety</th>
<th>Liquidity</th>
<th>Cash Return</th>
<th>Capital Appreciation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Account with banks</td>
<td>H</td>
<td>H</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Savings Bank Account</td>
<td>H</td>
<td>H</td>
<td>L</td>
<td>-</td>
</tr>
<tr>
<td>Bank Deposits</td>
<td>H</td>
<td>H</td>
<td>M</td>
<td>-</td>
</tr>
<tr>
<td>Company Deposit</td>
<td>M</td>
<td>M</td>
<td>M</td>
<td>-</td>
</tr>
<tr>
<td>Government Securities</td>
<td>H</td>
<td>M</td>
<td>L / M</td>
<td>-</td>
</tr>
<tr>
<td>Company Bonds / Debentures</td>
<td>M</td>
<td>M</td>
<td>M</td>
<td>-</td>
</tr>
<tr>
<td>Company Shares</td>
<td>L</td>
<td>M</td>
<td>L</td>
<td>M</td>
</tr>
<tr>
<td>Gold, Jewellery &amp; Precious Stones</td>
<td>M</td>
<td>M</td>
<td>-</td>
<td>M</td>
</tr>
<tr>
<td>Real Estate</td>
<td>H / M</td>
<td>L</td>
<td>L</td>
<td>M</td>
</tr>
<tr>
<td>Tax Savings Investment Options with Gov.</td>
<td>H</td>
<td>L</td>
<td>M</td>
<td>-</td>
</tr>
<tr>
<td>(PPF, NSC)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
1.4: Channels of Investment:

How savings are invested?

The economic development of a nation depends upon its financial structure. In the long run, the larger the proportion of financial assets to real assets, the greater the scope for economic growth. Investment is a pre-condition of economic growth. The major function of the financial institutions, whether short term or long term, is to provide maximum financial convenience to the public. This may be done in three ways:

i) Promoting the overall savings of the nation by deepening and widening the financial structure.

ii) Distributing the existing savings in a more efficient manner so that, those in greater need, get priority in allotment.

iii) Creating credit and deposit money and facilitating the transactions of trade, production and distribution in furtherance of the economy.

Finance is a bridge between the present and future and the financial system is the important institutional and functional vehicle for economic transformation. The financial system is a set of inter related activities of different markets, the institutions working together to achieve some predetermined object like generation of savings, investments, capital formation and growth. The primary function of financial system is the mobilization of savings, their distribution for industrial investment and stimulating capital formation to accelerate the process of economic growth. The financial institutions like banks,
mutual funds, post office, insurance companies promote savings. The
growth of household savings is inter-linked with the growth of the
financial system and varied savings products.

Financial intermediaries are the institutions, which collect
savings from others. They play a very important role in the saving-
investment process by raising the level of saving and investment and
allocating scarce savings among most productive investments.

**Instruments of the Savings Market:**

<table>
<thead>
<tr>
<th>Bank Deposits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Life Insurance</td>
</tr>
<tr>
<td>General Insurance</td>
</tr>
<tr>
<td>Units</td>
</tr>
<tr>
<td>Post Office</td>
</tr>
<tr>
<td>Provident Fund</td>
</tr>
<tr>
<td>Public Provident Fund</td>
</tr>
<tr>
<td>National Savings Schemes</td>
</tr>
<tr>
<td>Bonds</td>
</tr>
<tr>
<td>Debentures</td>
</tr>
<tr>
<td>Company Deposits</td>
</tr>
<tr>
<td>Equity</td>
</tr>
</tbody>
</table>
The channels of investment are broadly classified into two groups:

i) Organized sector or Markets and

ii) Unorganized sector or Markets.

The organized sector of the Indian money market and capital market is comparatively well developed in terms of organized relationships and specialization of functions. The unorganized markets have been functioning for ages in almost all parts of India. They follow well-set patterns, both as regards their lending policies and their interest rates.

![Diagram of Organised Markets]

The organized financial market comprises of an impressive network of banks, other financial and investments, which together
function in fairly developed money and capital markets. The short-
term funds are provided by the commercial and co-operative banking
sector. Nine-tenth of such business is managed by the leading banks,
which are in public sector. There is also the network of the co-
operative banks and the land development banks at state, district and
block levels. The Indian banks have also diversified into areas such as
merchant banking, mutual funds, leasing and factoring.

The organized financial system comprises the following subsystems:

i) Banking System.
ii) Co-operative System.
iv) Money Markets.
v) Financial Companies.

In the stock and capital markets, there are various types of term
lending institutions, all-India and state financial corporations and
finance companies and the development corporations, which deal in
money debt claims. The Stock Exchange deals with trading in which
are companies of an ownership category. The financial institutions,
like ICICI, IFC or SFC can raise the resources directly in the form of
deposits or by issues of bonds. These are called Development
Corporations. The institutions like UTI, GIC, LIC collect savings of the
public directly in the form of units or premiums. These are called
investment institutions. These institutions are the part of the stock and
capital markets. Gold, silver, bullion and real estate can be considered

- 37 -
as monetary assets as people prefer to hold them as alternatives for
the company deposits and debentures in the organized sector. The
bullion market is thus an adjunct of capital market in the sense that
funds, which could not be deployed in the capital or stock market, may
sometimes flow into the bullion market.

The Classification of Indian Money Market on the basis of
Organization:
A money market is a center where borrowers and lenders of money
and near money assets are put together. On this basis, the Indian
Money Market can be divided into Organized and Un-organized.

Organized Sector: The organized sector of the Indian Money
Market is well organized. It consists of managed financial institutions.

1) Reserve Bank of India: The Reserve Bank of India, as the
leader of the Indian Money Market, functions at the apex level of
the organized sector.

2) Commercial Banks: Another constituents of the Indian Money
Market are the large networks of the commercial banks. It
includes the State Bank of India and its subsidiaries, the
nationalized banks, regional rural banks, private sector
commercial banks and non-scheduled banks.

3) Co-operative Banks and others: Co-operative credit institutions
are also important constituents of the Indian Money Market. The
Post Office Saving Bank is also an important segment of the Indian Money Market.

4) **Other Institutions:** It includes public sector institutions and private sector institutions.

[a] **Public Sector Institutions:** It includes the following:

[i] All India Term Lending Institutions like, IDBI, ICICI, IFCI, NABARD, NHB, SIDBI and Discount and Finance House of India.

[ii] State Level Institutions like, SFC, SIDC etc.

[iii] Investment Institutions like, LIC, GIC, UTI.

[iv] Other Institutions includes Export Credit and Guarantee Corporation of India and Deposit Insurance and Credit Guarantee Corporation of India.

[B] **Private Sector Institutions** includes Chit Fund Companies, Hire Purchase Companies, Investment Companies and Corporations and Other Institutions.

**Unorganized Sector:**

1. Indigenous Bankers

2. Money Lenders

3. Brokers

4. Traders, Landlords etc.

We have an un-organized system, which is not controlled by the Reserve Bank directly. In this market, there are a number of moneylenders, traders, landlords, who lend money to the public and
indigenous banks who also accept deposits from them. There are also Private Finance Companies, Nidhis, and host of other un-corporate bodies whose activities are not controlled by the RBI. The rates of interest may vary from 20% to even 50%. The small businessmen like retailers in Pune city divert their savings to big businessmen through brokers. There are about 200 brokers in Pune city which are linked between the organized system and unorganized system.

**Sub-Market**: The Indian Money Market can also be classified as follows:

2. Treasury Bill Market.
3. Collateral Loan Market.

**Small Businessmen**

(Retail)

- Saver
- Brokers

**Big Businessmen**

- Builders
- Wholesale-merchants
- Distributors for Co.

White collar-savers do not turn to this market. The small businessmen or retail traders through their savings without mentioning payee's
name, divert the money to big businessmen. The circulation of unofficial cash i.e. black money or number two transactions is considerable in Pune city. However statistics as well as official data in this respect is not available.

**Tabular Presentation in a summarized form of the Indian Money Market:**

<table>
<thead>
<tr>
<th>Organized Sector</th>
<th>Unorganized Sector</th>
<th>Cooperative Sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reserve Bank of India</td>
<td>Money Lenders</td>
<td>Apex Cooperative Banks</td>
</tr>
<tr>
<td>Commercial Banks-</td>
<td>Indigenous Bankers</td>
<td>Central Cooperative Banks</td>
</tr>
<tr>
<td>Public and Private Sector</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Development Banks, Investment Banks,</td>
<td></td>
<td></td>
</tr>
<tr>
<td>and Other Institutions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>i. All India Term Lending Institutions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>ii. Investment Institutions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>iii. State Level Institutions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>iv. Other Institutions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nidhis Chit Funds</td>
<td></td>
<td>Primary Agricultural Cooperative Societies</td>
</tr>
<tr>
<td></td>
<td></td>
<td>State Land Development Banks,</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Primary Land Development Banks.</td>
</tr>
</tbody>
</table>

The **Money Market Mutual Funds** (MMMFs) are a special category of mutual funds that invest in money market instruments of very high quality and of very short maturities. Participation in MMMFs is a good investment avenue. The funds portfolio includes money market instruments like treasury bills, certificate of deposits and promissory notes of commercial banks, commercial papers, gilt edged securities of the government. These investments can be considered as safe but provides low or moderate returns.
Capital Market:

The capital market is an indispensable institution for the growth of any economy. It accelerates the pace of capital formation in the economy because it encourages saving by offering relatively secure and reasonable returns on capital.

Classification of Capital Market: The capital market can be classified broadly on the basis of status and stages.

I] On the basis of the status of the Market: The Organized Capital Market includes Central Bank of the country, long-term financing commercial banks, special financial institutions and stock market. The Un-organized Capital Market consists of indigenous bankers, money Lenders, chit-funds, hire purchase and investment companies.

II] On the basis of stages: The capital market on the basis of stages comprises of the Following:

[a] Primary Capital Market is the market wherein funds are raised by issue of shares, debentures and bonds issued by industrial enterprises. Such type of market is concerned with the company issuing new shares to the public.

[b] Secondary Capital Market is the market, which facilitates transfer of ownership of securities. It makes purchase and sale of securities easy and creates liquidity.
Summary: The more important points that were discussed in this chapter are the need for savings, capital formation, savings and investment, the different investment avenues and the channels of investment.
The Evolution Of The Indian Financial System:

- UNIVERSAL BANKING
- MERCHANT BANKING

SPECIALISED FINANCIAL INSTITUTIONS
- MARKET OPERATIONS
- STOCK EXCHANGES

INVESTMENT INSURANCE COMPANIES

DEVELOPMENT FINANCIAL INSTITUTIONS
- INVESTMENT BANKS
- NATIONALISATION
- COMMERCIAL BANKS
- CONSOLIDATION
- JOINT-STOCK BANKS

COOPERATIVE MOVEMENT
- SOCIETIES
- BANKS

INDIGENOUS BANKING
- NIDHIS/CHIT FUNDS

MONEY LENDER
- BARTER
The Classification Of Indian Capital Market:

SAVER

DEVELOPMENT BANKS
UNIT TRUST
LIFE INSURANCE
COMMERCIAL BANKS
STOCK EXCHANGES
INVESTMENT
COMPANIES
MERCHANT BANKING

INVESTOR

The Classification Of Indian Money Market:

MONEY MARKET

CALL MONEY MARKET
GILT EDGE MARKET
CAPITAL MARKET
COLLATERAL LOANS MARKET
ACCAPATANCE MARKET
BILL MARKET
Types of Non-Banking Financial Services:

2. Underwriting and Loan Syndication.
4. Housing Finance.
5. Lease and Higher Purchase Financing.
6. Venture Capital Funds.
7. Investment Financing.
8. Investment Consultancy and Advise.
12. Corporate Asset Management Services.
14. Mutual Funds.
15. New Issue House services.