CHAPTER - V

PREFERRED INVESTMENT AVENUES AMONG THE RETAIL INVESTORS – A COMPARATIVE STUDY
5.1 INTRODUCTION

Investment is the employment of funds with the objective of receiving return on it. In finance, investment means the purchase of a financial product with an expectation of positive returns in future. Investment by retail investors is the commitment of funds which have been saved from current consumption with the hope that some benefits will be received in future. Savings of the people are invested in assets depending on their risk perception and expected return demanded. Investment refers to the concept of deferred consumption, which involves purchasing an asset, giving a loan or keeping funds in a bank account with the aim of generating future returns. Since there are various investment options available with varying degree of risk-reward trade-offs. Therefore, for an effective decision, a retail investor must explore, where and how much to invest.

In the year 1991, India instrumented major structural changes in the financial market and personal investment arena. From a highly regulated and inward oriented to an outward looking economy where participation from foreign institutional investors has increased in Indian debt and equity instruments. Along with foreign and domestic instructional investors, retail investor’s participation has also grown manifold. Domination of state owned public sector units across various sectors is giving way to private sector companies thereby enhancing the organic and inorganic growth of financial sector in India.

The financial service sector has played an important role in bringing about this change. It is the development of the financial system in India over the years, has led to a sea change in financial transactions which has transformed economy from stagnant & backward position to dynamic & vibrant ones. Various studies conducted on the financial markets, stated that the share of rural & semi-urban areas in both money & capital market are very low. Previous studies suggested that for a balanced development of financial market, tapping of rural & semi-urban savings is necessary. It will be a challenge for market regulators to reduce the gap between rural and urban cities in terms voluminous participation of investors in various investment options depending upon their investment objectives. The regulators, operators and participants of money and capital market are continuously trying to tap the unexplored capital of rural and semi-urban cities in India. Many positive changes have been brought into the
regulatory front since 1991 so that penetration of Indian financial services sector in the acceleration of savings and investments in rural, semi-urban and urban areas.

Capital Issues (Control) Act, 1947 has been abolished and the office of Controller of Capital Issues repealed so that the control over price and premium of shares can be removed. Companies are now free to raise funds from securities markets after filing prospectus with SEBI. The power to regulate the issuance of financial assets/securities by corporate has been fully delegated to SEBI by the government of India. SEBI thereby introduces number of regulations for secondary and primary market to enhance the flow of information among the market participants including small individual investors in debt and equity segments. Furthermore SEBI has made loads of changes in the existing provisions and added new regulations to increase the transparency in capital market and derivative segments so that retail investors can generate confidence in parking their hard earned savings in equities, mutual funds and bonds/debentures. SEBI’s regulations also encompasses activities of stock brokers, merchant bankers, corporates (issuers of equity or debt instruments), credit rating agencies, foreign investors, domestic intuitional investors, so that fraud and unfair practices can be restricted and unfolded at an early stage thereby safeguarding the savings of retail investors.

Since 1991, Government of India has initiated through SEBI a lot of innovative changes such as allowing private mutual funds to set up and operate within the frame work of SEBI. Regulations for mutual funds have been revised in 1996, giving more flexibility to fund managers while increasing transparency, disclosure and accountability. Apart from this in 2001, National Stock Exchange of India (NSE) has set up as a stock exchange with nationwide electronic trading. To give more thrust upon the investment activities in terms of trade volume, foreign direct investment allowed in stock broking, asset management companies, merchant banking and other non-bank finance companies. Foreign institutional investors (FIIs) were allowed access to Indian capital markets on registration with SEBI. Since the transfer of shares is done electronically, to facilitate the electronic book entry transfer of securities, Depositories Act 1996 has been enacted. Depository act has elicted a very positive impact on the individual investors, in terms of their participation. All these changes in the regulations are done to make the market more participative and liquid so that retail investors from urban and rural areas can confidently participate.
Samudra and Burghate (2012) saving and investment behaviour of individual investor has always been an area of interest to the economists and researchers. The economic cycles of boom, depression, recession and recovery affects the level of GDP and income of the households in terms of their saving ration and investment behaviour as a whole. Movement of economic cycle moves from one phase to another bringing overall change in the savings and investment behaviour of the individuals. Apart from the macro economic factors, a global financial market also affects the investments and saving of investors as financial globalisation has led to the integration of various financial markets of the world. In India, major stock indices such as SENSEX and CNX NIFTY get affected by the influence of foreign financial markets. Andres Solimano (2006) in his book named “Vanishing Growth in Latin America: The Experience of Late 20th Century, states that deeper financial markets and strong prudential regulations for financial institutions helps to enhance savings and investments opportunity for investors and provides more security. In India, Government of India has launched a unique campaign in 2011, named as “Swabhiman” to provide banking facilities across the length and breadth of the country, especially in rural areas where the population is more than 2000. On 15th August'2014, Government of India launched “Pradhan Mantri Jan Dhan Yojana” to end the ‘financial untouchability’. On the inauguration day itself, 1.5 Crore (15 million) bank accounts were opened under this scheme.

With the wide-ranging options available, investment is like a cafeteria approach where investors can choose as per their self and family needs. This has been instrumental in innovation and development of more specialized and tailor-made customised products for Indian market targeting various sections of income group. Nevertheless, with these innovations, the charm of investment in banks and property has not lost its sheen. A number of studies took place in India to examine the investment habits and preference of investment avenues across the households which indicates the strong positive preference for bank deposits.

According to the report — “How Households Save And Invest: Evidence from National Council of Applied Economic Research (NCAER) Household Survey 2011” — released by SEBI, though Investor population in India has grown significantly during last decade, the participation by Indian households in the securities market continues to remain low. A survey revealed fifty percent of all households consider commercial
banks deposits and insurance schemes as their primary choice for savings at national level. The degree of risk aversion is extremely high in Indian households. Education plays a significant role in influencing risk preferences. Villages that are close to urban centres, significantly participate in financial markets particularly in the mutual funds. Some of the interesting findings of NCEAR survey (2011), related to investment preference of Indian household are:

1. Twenty percent of investors are in urban areas as compared to six per cent in rural India.

2. In India, the estimated number of investor households is 24.5 million who constitute approximate eleven per cent of total households.

3. Retail investors are found to have strong preference towards mutual funds which is forty three percent and preference for dealing and investing in secondary markets is twenty two percent. It shows that investor has more trust in investing in mutual funds which provides cushion to erratic fluctuations in stocks prices.

4. In urban areas, nearly forty one per cent of investors invest in mutual funds and twenty one per cent secondary markets, whereas, forty six per cent of rural population chooses mutual funds and twenty two percent opt for investment in stocks through secondary markets.

5. More that sixteen per cent of the highly educated non-participants, middle and upper income groups feel that non-participation in capital market is mainly due to the perceived non-safety of returns.

6. There is a significant size of small savers among all households who puts more confidence in various postal savings schemes sponsored by government of India. Around eleven to twenty five per cent of all households save in post office savings schemes for long term basis.

7. On the risk taking capability front, it is identified that the degree of risk aversion is extremely high among the Indian households. It is a normal tendency of the Indian middle-class household investors not to engage in risky ventures. The data shows that risk taking increases only at very high income levels or if there is a significantly large windfall gain.

8. Out of the total households investors surveyed, fifty three per cent fall in the least risk taker category.
9. Another interesting finding related to gender is that married investors are less risk averse than their unmarried counterparts. Female investors were found to be risk averse than their male counterparts.

10. The study shows the degree of risk-taking is inversely proportional to age; risk-taking declines with the age of the investors.

The diversification of the financial services sector has provided the retail investor with a wide range of opportunities to invest. The retail investor’s decision to invest in the financial market (equity and debt instruments) or in small saving schemes sponsored by government of India is greatly influenced by the variety of benefits from each investment options. Studying the investor’s behaviour along with their purpose of investing will help to explain the anomalies in investment in various investment options. Study of investor’s behaviour will also help policy makers, investment agencies, researchers and managers of investment companies or asset management companies to prepare themselves to respond to the varying moods of investors.

Investments can be defined as the purchase of financial products of value with an expectation of future positive returns. Investment can also be referred as the employment of funds in an asset with the aim of achieving additional income or growth in value over a given period of time. Today, investors have various attractive investment options with different features matching with their needs, not only in India but also in the global markets. The art of investment refers to maximisation of return with minimum involvement of risk. In India, funds are allocated to various investment avenues based on the investment objectives. A rational investor, who can control his emotions, can use his hard earned money on right investment objectives. They can also identify the right avenue by giving sufficient time for investment decisions and can invest in the stock market operations.

Somasundaram (1998) in his study has found that bank fixed deposits and chit funds offered by finance companies were the best known mode of savings among investors on the contrary, investors doesn’t favour schemes of mutual funds offered by Unit Trust of India (UTI) schemes and plantation schemes. Attitudes of retail investors were highly positive and revealed their intention to save for a financially healthy future.
Gavini and Athma, (1999) in their survey found three major factors which influence the investors from urban areas to invest. These are social considerations, tax benefits, and provision for old age. The study reveals that one of the main reasons for saving money by rural investors is for old age. Among the various post office schemes available for individual investors, Indira Vikas Patra (IVP), KVP and Post Office Recurring Deposit Account (PORD) were the most popular, in both urban and rural areas.

According to the study conducted by SEBI and NCAER, 2000 titled ‘Survey of Indian Investors’, it has been found that safety and liquidity were the key factors which determined the choice of an asset. As per the level of preference and order of risk perception, investors has cited bank fixed deposit accounts as safest investment option available and it is followed by gold, units of UTI-US64, company deposits and bond issued by Indian corporates, mutual funds, equity shares, and debentures. Households’ preference for investment options is influenced by risk perception involved in the investment option. It is thus concluded that higher proportions of household investors invest in instruments with a lower risk perception. Bank deposits, appeals to all income classes whereas tax-saving schemes, were mainly preferred by middle-income and higher-income groups. There is a correlation between the income levels and investments of households in market-related securities. Another study conducted jointly by the NCAER and Economic and Political Weekly Research Foundation in 2002 titled “Household savings and investment behaviour in India”, observed that female-headed households in urban sector have a better track record of savings than the households headed by males counterparts. However, the trend is reverse in rural areas where male-headed households are more inclined to savings, as reported by the same study.

5.2 VARIOUS INVESTMENT OPTIONS FOR RETAIL INVESTORS IN INDIA

Retail investor as defined in section 4.2 as an individual those who invest in small amount as opposed to institutional investors. There are various investment options available for retail investors, but for the present study, ten investment options selected, are:

1) Fixed Deposits with banks & post office, 2) Insurance Policies (both Life & endowment), 3) Public Provident Fund / EPF / Pension schemes, 4) Bonds / Debentures
5.2.1 Deposits with Banks and Indian Post Office: Fixed deposits with banks and post offices in India provide a safe custody for retail investors, to keep their money. In 1969 the government of India nationalized all the major banks and these have remained under government ownership. Thus banks in India are properly structured, organized and reliable financial institutions. It offers varied amount of allied services to its clients and deposit holders. Indian bank deposits are in the form of three major accounts such as savings account, current account and fixed deposit accounts, which allow the customer to deposit a sum of money in the bank and withdraw depending on the type of account. Every banks in India offer fixed deposits schemes with a wide range of tenures for periods ranging from seven days to ten years. The word "fixed" itself defines the meaning, parking the money in a bank or Indian post office for a fixed period of time with a predetermined rate of interest.

Bank Fixed deposits (FD) are issued by banks with a fixed tenure which cannot be withdrawn before the maturity date. In case, the holder of FD withdraws before due date, penalty is charged. Banks and post office both provides interest to their respective depositors. Interest rate structure on fixed deposits may be different for each bank and may also differ from time to time. In India, interest rates are influenced by money market regulator that is Reserve Bank of India (RBI). Time deposit (FD) of banks and post offices gives liquidity to the deposit holders as they can withdraw any time before the maturity date. This kind of investment helps in meeting the financial requirement of investors which is estimated well before such as construction of house, major expenses for child’s marriage or for higher education.

Sunil Gupta (2008) has undertaken a study on the investment pattern among individual investors groups in Shimla. It is revealed that majority of investors in Shimla prefer to deposit their surplus in saving and fixed deposits in banks, post offices, and different UTI schemes. The attitude of the investors towards the other financial assets in general was desolate. Salaried and self-employed professional investor is investing in stocks, debentures and mutual fund schemes. Most of the horticulturists in Shimla city who...
belong representing the Apple belt though being rich but their tendency are to invest their surpluses in FD of banks, provident funds, Post Office savings and real estate for safety and suitability of returns.

Savings Bank account (SB): SB account of a bank or post office serves the need of regular deposits and withdrawals. It offers cheque facility for frequent withdrawals thereby provides full liquidity to the product.

Recurring Deposit account (RD): This product offers a monthly investment option with a handsome return at the end of fixed term with an option to extending the tenure. As per the terms and conditions of RD, once the periodical investment amount is decided, investors cannot modify that till the date of maturity. The amount deposited amount cannot be withdrawn before the maturity. These kinds of investment options are good to culminate disciplined investment habit from an early stage.

Monthly Income Scheme (MIS): This type of product comes either with one time investment or recurring investment plan for a fixed time period. Under this scheme, every month, interest on the invested amount is paid to depositor. This product is very popular amongst the investors, who are retired or about to retire from the regular employment.

Senior Citizens Savings Scheme (SCSS): This scheme offers fixed investment option for senior citizens for five years of time period, at a higher rate of interest that are paid in quarterly basis. The account may be opened by an individual, who has attained age of sixty years or above on the date of opening of the account. No withdrawal is permitted before the expiry of five years from the date of opening of the account. Premature closure of account is permitted but with penalty.

5.2.2 Insurance Schemes: Life insurance is a contract between the policy owner and the insurer where the insurer agrees to pay premium for a particular sum assured. Insurance should be considered, a key component of economic development and best mechanism to take care of multidimensional risks in modern economies (Lindley 2007). The growth of the Indian life insurance industry has been further boosted by the entry of private players following the deregulation of the industry in 2000 (Enz 2000).
A term policy is a pure life insurance which provides a sum assured in case of the policy holder's unfortunate demise. Most people are not in favour of a term policy, as there is only a death benefit. Also, it is believed that since the insurance is available only for a particular term after which there is no cover, it is not a comprehensive policy. An endowment policy covers risk for a specified period, at the end of which the sum assured is paid back to the policyholder, along with the bonus accumulated during the term of the policy. The returns on endowment policies are typically very low - approximately three to four percent per annum and do not beat inflation. Unit Linked Insurance Plans (ULIP) is insurance policies with an investment component. In these policies, the policy holder pays regular premiums (or a single premium) of which part of the money is invested and another part goes towards providing the life insurance cover. ULIPs are combination of protection with wealth creation opportunities.

Das. K. Sanjay (2011), has conducted their research survey in Nagao district of Assam in which it is revealed that in most cases investors across all categories find insurance policies to be safe. Majority of respondents showed keen preference towards unit linked insurance policies (ULIP) for short term gains. It is also observed that most of the respondents are keen to buy insurance products with an object to avail tax benefits and life protection. Further, it is observed that the level of income also influences the investment decisions. Higher income group shows relatively high preference towards investment in share market, conversely lower and average income group shows keen preference towards investment option floated by insurance and banking companies.

5.2.3 Public Provident Fund (PPF): PPF is a long term saving instrument for retail investors. This is a scheme in which capital is protected and interest payment is assured with incremental tax benefit. It is an excellent retirement-planning tool for those who are not covered under any pension plan. The account can be opened in designated post offices and branches of some nationalized banks. Investors who chose this investment option may deposit any amount between Rupees five hundred to Rupees one lakh per year for a fifteen year period. Investors investing in PPF are eligible for income tax benefit under section 80C of Indian Income Tax Act 1961. PPF offers loan and withdrawal facilities at nominal interest rates after five years of regular deposits which also ensures the liquidity. This investment option generates long term wealth for the
investors at fairly good interest as compare to banks. Here interest receivable per year and maturity amount receivable at the end of the 15th year is not taxable.

5.2.4 Debt Instruments (Bonds and Debentures): Bonds and debentures are debt instruments which guarantee interest during the holding period and initial capital invested at the end of maturity period to the bondholder. Investing in bonds and debentures is advisable for investors who have a very low risk appetite. They offer a periodical fixed rate of return and are independent of market fluctuations.

5.2.5 Stocks: Stock investment refers to the buying and holding of equity or preference shares from primary or secondary market by retail and institutional investors in anticipation of income in the form of dividends and capital gains. Capital gain comes with rise in stock price in secondary market. Preference share holders receives dividend prior to equity share holders at a predetermined rate. Investing in equity is risky because of two main reasons: a) amount of dividend is not fixed every year and b) current market price of equity stock in the stock exchanges can fluctuate due to number of micro and macro-economic factors. Retail investors are not always updated and aware of the event which may affect the stock market and that is why the investment in stocks becomes risky for them at times.

5.2.6 Mutual Funds: These are financial instruments which are issued by various SEBI approved mutual funds organization to retail and corporate investors. Mutual funds pool money from the investors and build a corpus. Corpus is managed by asset management companies (AMC) who invest the investor’s money in different financial and real assets as per the investment objective of the fund. AMC can invest in equity stocks, debt instruments, real estate properties, etc. Risk of the mutual funds depends on the quality and type of the assets where AMC is investing. Mutual funds schemes are suitable for retail investors because of its low initial investment and diversified portfolio.

5.2.7 Real Estate: It is a non-financial asset and initial investment requirement for buying land and building is very high. Every individual during their working life, dreams of having own house before retirement. Affluent class investors usually plan for more than one real estate property. Individual investors buy house or land for
residential purpose or for commercial purpose with an object of selling at a higher price. Retail investors buy these assets with loan money. For lower income group family, buying a real estate property is always a distant dream if not planned from early stage. Investment in real estate generates two types of income, rental income and capital gain income. High income group individual investors own multiple pieces of real estate, which serves as a primary residence, while the others are used to generate rental income and profits through price appreciation.

5.2.8 Bullion: In India, individuals whether salaried, self-employed or retired everyone fantasize of investing in gold. Study conducted by World Gold Council (2013) shows that over sixteen thousand tons of gold possessed by Indian households predominantly in the form of jewelry with a market valuation of twenty seven lakhs crores Indian rupees. Jewellery, the most traditional and the dominant form of buying gold in India, is in fact not an investment idea. The reason is that there are heavy losses in the form of wastage and making charges. This can vary from a minimum of ten per cent to as high as thirty five per cent for special and complex designs. Bullion bars are good modes for investment but the minimum investment here is much higher than a common investor can think of. Gold Exchange Traded Funds (Gold ETFs) are an alternative option these days to hold gold in paper form. These are like mutual funds that invest only in gold and safer way to buy gold. In India, gold is utmost required at the time of marriage or other social ceremonies and therefore this asset has been considered for the present study.

5.2.9 Postal Saving Schemes: Financial service offered by Indian post office includes fixed deposit savings schemes similar to FD offered by banks. In India the network of post offices is deeply penetrated to every nook and corner of the country. Therefore, the acceptability of such schemes is much more accessible to uneducated and backward communities of India. Indian Post office’s small savings scheme provides a secure, risk free and attractive investment option for the small investors and offers the savings products across its one lakh fifty thousand post offices in rural and urban India as on Dec 2013. In India, Indian post office, offers couple of one time deposit schemes and recurring deposit schemes for retail investors. These savings and investment schemes are suitable for salaried and low to medium income group of investors. In the semi-urban and rural areas these schemes are popular enough and due
to large and wide coverage of Indian post office the subscriber base is very large. In one of the study made by Tamilkodi, (1983) it is found that small savings schemes sponsored by government of India, have a psychological appeal and it provides an opportunity for ordinary men, women, and even children to park their savings. It reaches a large number of people and penetrates deep into every corner of geographical areas. Further, in the paper it has been suggested an increase in the rate of interest of small savings schemes to meet the challenges of commercial banks as well as to simplify the process of investment. In a similar study done by Karthikeyan, (2001) explored the perception of small investors’ on post office saving schemes and found that there is significant difference with in the age groups, in the level of awareness for Kisan Vikas Patra (KVP), National Savings Schemes (NSS), and Deposit Scheme for Retired Employees (DSRE). The level of awareness among investors in the old age group was higher than comparatively younger age group. Gender wise no difference was observed between male and female investors regarding postal schemes. Mukhi, (1989) has revealed that National Savings Certificate (NSC) has been one of the most popular tax savings instruments in this country across the age group. He also stated that the major attraction of NSC is its simplicity. Presently NSC has lost its sheen because of its low return as compared to other government sponsored.

5.2.10 Others: In this category, investment in options and futures contracts is considered. Options and futures contracts as per the SEBI guidelines have a settlement cycle of three months. These assets are very much volatile due to the fluctuations of the underlying assets. Investors of these assets are found to be very much updated and aware about the financial and commodities market.
REFERENCES


