CHAPTER – III

INVESTMENT AVENUES – AN OVERVIEW

Introduction

All investments are risky, as the investor parts with his money. An efficient investor with proper training can reduce the risk and maximize returns. He can avoid pitfalls and protect his interests. Companies and government sell securities, either for equity capital or debt capital. These securities may be in the form of shares, debentures, and bonds etc., which are marketable. They have different degrees of risk and return, variable with the instrument. Some instruments of investment are non-marketable and they are at more risk and may become sometimes waste paper. The management of risk and return requires expertise. Investment is an Art and Science at the same time. The performance of companies and changes in share prices are all based on some fundamental principles, sentiment and psychological expectations. As such, investor has to use his discretion, which is an art, to acquire by learning and experience. Principles of investment and the art of the management of investment are basic requirements for a successful investor.

Although anybody can be a saver, anybody cannot be an investor in the financial markets particularly in the stock market. It is not like purchasing a lottery ticket or betting on horses, which mostly depend on luck. Investment in financial market is not a gamble and speculation which some investors indulge in and it is highly risky. Investors should be those who invest with the objective of receiving some income, share in the prosperity of the company and gain capital appreciation in a longer time span.

3.2. What is Investment?

Investment refers to the acquisition of some assets. Its also means the conversion of money into claims on money and use of funds for productive and income earning assets. In essence, it means the use of funds for productive purposes, for securing some objectives like income appreciation of capital or
capital gains, or for further production of goods and services with the objective of securing profits.

Investment Activity involves the use of funds or savings for further creation of assets of acquisition of existing assets.

I. Financial Assets

II. Physical Assets

Figure - 1

Investment Activity (Acquisition of Assets)
3.3 Growing Popularity of Investments

Since the 1980s, Investments are becoming very popular. Factors such as healthy industrial climate, varied investment avenues, varying interest rates, larger incomes, burdensome tax rate, longer life expectancy etc., are growing popularity of investments.

3.3.1 Healthy Industrial Climate

In India, the industrial climate has become quite healthy which has activated direct participation in industrial financing by the public. This has further led to the availability of increased investment options for the investors. They are able to choose those forms of investment that suit their requirements. Both the debt instruments (debentures, bonds, loan certificates etc.) and ownership instruments (equity shares and preference shares) have become viable investment forms.

3.3.2 Good Investment Opportunities

Investment avenues are many which range between safe and risky ones. Bank deposits, government securities, bonds of government and semi-government bodies and post office savings schemes are some investments which are highly safe. Similarly, companies sell securities such as shares, debentures and bonds which carry different degrees of risk and return. Speculators tend to invest in risky securities in order to realize higher returns

3.3.3 Varying Interest Rates

Banks accept deposits from the public which bear lower interest. Although the returns are low, the risk is also less. Owing to this fact, risk averse investors prefer to invest in bank deposits. Apart from bank deposits, there are several investments schemes carrying varied interest rates. So, a prudent investor, regarding stable and reasonable rate of interest as his prime consideration, buys only the kind of investment that suits him.
3.3.4 Larger Incomes

After independence, the employment opportunities have become more in our country. The Government’s Five-year plans, large scale production, market-oriented economy and financial deregulations have brought into existence a number of new organizations and services. Public sector enterprises and the growing corporate sectors have provided more employment opportunities to people. With the rising level of income, a majority of the people (except those living below the poverty line), save a portion of their income. Apart from voluntary savings, savings are also induced by the various incentives offered by investments. As a result, savers have become investors.

3.3.5 Burdensome Tax Rates

The income tax levied in India aims to bring into its tax net a vast array of incomes. The Act imposes taxes at progressive rates thereby increasing the tax liability of the people. In order to reduce the burden of tax, certain approved saving schemes and investment avenues are offered under the income tax act. By investing a part of personal income in these schemes, one can induce several deductions from his taxable income and tax rebates. Life Insurance plan, unit linked insurance plan, pension schemes, development bonds, National Saving Certificate, National Savings Scheme and post office cumulative time deposits are some schemes which offer tax benefits.

3.3.6 Longer Life Expectancy

With advancement in the field of medicine and increasing health care, the life expectancy of the people has considerably increased. So, people plan to invest a part of their earnings realized while in service to lead their retired life peacefully. Of late, the growth of women entrepreneurship and preference in employing women workers in certain industries are becoming quite popular, because by nature women tend to save more. In addition, growing urbanization and literacy have also stepped-up investment activities.
3.4 Characteristics of Investment Management

3.4.1 Return

Return refers to expected rate of return from an investment. Return is an important characteristic of investment. Return is the major factor which influences the pattern of investment that is made by the investor. Investor always prefers high rate of return for his investment.

3.4.2 Safety

Safety refers to the protection of investor’s principal amount and expected rate of return. Safety is also one of the essential and crucial elements of investment. Investor prefers safety about his capital. Capital is the certainty of return without loss of money or it will take time to retain it. If an investor prefers less risk securities, he can choose Government bonds. In case, investor prefers high rate of return he/she will choose private securities but safety of these securities is low.

3.4.3 Liquidity

Liquidity refers to an investment ready to be converted into cash position. In other words, it is available immediately in cash form. Liquidity means that investment is easily realizable, salable or marketable. When the liquidity is high, then the return may be low. For example, in UTI units, an investor generally prefers liquidity for his investments, safety of funds through a minimum risk and maximization of return from an investment.

3.4.4 Marketability

Marketability refers to buying and selling of securities in market. Marketability means transferability or salability of an asset. Securities are listed in a stock market which are more easily marketable than which are not listed. Public limited companies’ shares are more easily transferable than those of private limited companies.
3.4.5 Concealability

Concealability is another essential characteristic of the investment. Concealability means investment to be safe from social disorders, government confiscations or unacceptable levels of taxation, property must be concealable and leave no record of income received from its use or sale. Gold and precious stones have long been esteemed for these purposes, because they combine high value with small bulk and are readily transferable.

3.4.6 Capital Growth

Capital growth refers to appreciation of investment. Capital growth has today become an important character of investment. It is recognizing in connection between corporation and industry growth and very large capital growth. Investors and their advisers are constantly seeking ‘growth stock’ in the right industry and buy at the right time.

3.4.7 Purchasing Power Stability

It refers to the buying capacity of investment in market. Purchasing power stability has become one of the important traits of investment. Investment always involves the commitment of current funds with the objective of receiving greater amounts of future funds.

3.4.8 Stability of Income

It refers to constant return from an investment. Another major characteristic feature of the investment is the stability of income. Stability of income must look for different path just as security of the principal amount. Every investor considers always the stability of monetary income and stability of purchasing power of income.

3.4.9 Tax Benefits

Tax benefits are the last characteristic feature of the investment. Tax benefits refer to planning an investment programme without regard to one’s status may be costly to the investor.
3.5. Necessity and Importance of Investments

An investment is an important and useful factor in the context of present day conditions. Some factors are important. They are outlined as below:

1. Longer life expectancy or planning for retirement
2. Increasing rates of taxation
3. High interest rates
4. High rate of inflation
5. Larger incomes
6. Availability of a complex number of investment outlets.

3.5.1 Longer Life Expectancy

Investment decisions have become more significant as most people in India retire from the age of 56 to 60. So that, they plan to save their money. Saving by themselves does not increase wealth, saving must be invested in such a way, that the principal and income will be adequate for a greater number of retirement years. Longer life expectancy is one of the major reasons for effective saving and further investment activity that helps for investment decisions.

3.5.2 Increasing Rates of Taxation

When tax rate is increased, it will focus for generating saving by tax payer. When the tax payers invest their income in provident fund, pension fund, Unit Trust of India, Life Insurance, Unit Linked Insurance Plan, National Saving Certificates, Development Bonds, Post Office Cumulative Deposit Schemes etc. it affects the taxable income.

3.5.3 Interest Rates

Interest rate is one of the most important aspects of a sound investment plan. The interest rate differs from one investment to another. There may be changes between degree of risk and safe investments. They may also differ due to different benefit schemes offered by the institutions. A high rate of interest may not be the only factor favoring the outlet for investment. Stability of interest is an important aspect of receiving a high rate of interest.
3.5.4 Inflation

Inflation has become a continuous problem. It affects in terms of rising prices. Several problems are associated and coupled with a falling standard of living. Therefore, investor’s careful scrutiny of the inflation will make further investment process delayed. Investor ensures to check up safety of the principal amount, and security of the investment. Both are crucial from the point of view of the interest gained from the investments.

3.5.5 Income

Income is another important element of the investment. When government provides jobs to the unemployed persons in the country, the ultimate result is ensuring of income than saving the extra income. More incomes and more avenues of investment have led the working people to be able and willing to save and invest their funds.
Figure - 2

Investment Avenues

1. Bank Deposits
2. Post office Deposits
3. Co-Operative Deposits
4. Public Provident Fund Deposits

1. Blue chip shares
2. Growth Share
3. Income Share
4. Cyclical Share
5. Speculative Share

1. Government Securities
2. GOI Relief Bonds
3. Govt. Agency Securities
4. PSU Bonds
5. Debenture of Private Sector Companies
6. Preference Schemes

1. Treasury Bill
2. Commercial Purpose
3. Certificate of Deposits

1. Equity Shares
2. Debt Schemes
3. Balanced Schemes

1. Endowment assurance Policy
2. Money Back Policy
3. Whole Life Policy
4. Premium Back Term Assurance Policy

1. Agriculture Land
2. Semi Urban Land

1. Endowment assurance Policy
2. Money Back Policy
3. Whole Life Policy
4. Premium Back Term Assurance Policy

1. Equity Shares
2. Debt Schemes

Equity Shares
Financial Assets

1. Equity Shares
2. Debt Schemes

LIC Policies
Financial Assets

1. Endowment assurance Policy
2. Money Back Policy
3. Whole Life Policy
4. Premium Back Term Assurance Policy

1. Equity Shares
2. Debt Schemes

Precious Objects

Financial Derivatives
Options
Futures

Non Marketable Financial Assets

Bonds

Mutual Fund Schemes

Real Estate

Money Markets Investments

LIC Policies Financial Assets

Precious Objects
3.6. Factors Favouring Investment

Favourable activities relating to investment consist of acquisition of assets, their maintenance and the liquidation of assets. A good investment market should facilitate these investment activities and foster their growth. There are certain factors which are conducive to the growth of investment market. They are-

3.6.1 Legal Protection

As investment is the result of savings, the government should introduce adequate measures to encourage savings accumulation. The rights of the investors who have invested their surplus in assets should be protected against any possible infringement. Indian economy is a mixed economy aimed at achieving the advantages of both socialistic and capitalist forms of government. Though private participation is allowed, the government exerts control over them to certain extent. Adequate government control results in a stable capital market.

3.6.2 Well Organized Monetary System

Existence of a well-organized monetary system is essential for the growth of investment market. Investment consists of channelization of surplus funds in specific form of assets. Payment of these assets in terms of currency of country calls for the existence of a proper monetary policy. Such a policy should protect the investments against the evil effects of inflation. In fact, it should generate a stable price level which, in turn, will contribute to a disciplined investment market.

3.6.3 Role of Financial Institutions

Financial institutions mobilize savings and channelize them for productive use in the industry. There are two types of financial institutions in Indian capital market, namely, developmental institutions and investment institutions. Developmental institutions include Industrial Development Bank of India (IDBI), Industrial Finance Corporation of India (IFCI), Industrial Credit and Investment Corporation of India (ICICI), etc., which have been organized on all India basis and state level bodies such as State Finance and Development Corporations. The national level bodies provide assistance to the all India projects and regional
projects. The state level bodies promote industrial growth in the respective states. Investment institutions include Unit Trust of India (UTI), Life Insurance Corporation of India (LIC), General Insurance Corporation of India (GIC), etc. Apart from these, Commercial Banks accept deposits from the public and make them available for productive use. These financial institutions encourage capital formation which is the function of savings and investment.

3.6.4 Forms of Business Organization

Most of the businesses are organized in the form of joint-stock companies. Perhaps the public limited companies are regarded as the most useful form for the investors in view of their characteristics such as limited liability of shareholders, perpetual succession and free transferability of shares. Other forms of organizations such as sole proprietorship and partnership firms carry unlimited liability. That is, a proprietor or a partner is fully liable to all the debts, whereby even his personal assets are attached to pay off the liabilities. Further, the life of sole proprietary concerns and partnership firms are comparatively short. A proprietary concern may come to an end on the death of the proprietor. Similarly, events such as death, retirement and insanity of partners may result in dissolution of the firm. So, investors do not wish to invest in these unstable forms of business. Not only the partnership firms are unstable, but also, they restrict free transferability of investment in them from one person to another. In view of these constraints in such organizations, investors prefer to invest in the wide range of securities offered by the joint-stock companies.

3.7. Investment Objectives

The objective of any investment is the maximization of the economic welfare of the investor in the long run. Welfare of the investor relates to two important aspects, namely, maximization of his wealth and the liquidity offered by the wealth. The term wealth maximization itself is further divided into three components namely cash return, capital appreciation and safety. Thus, the objectives of investors may be summarized as follows.
3.7.1 Return

An investment is a commitment of funds made in the expectation of some positive rate of return. So, it is the sacrifice of certain present value for the future reward. Though investment is primarily made for income, it is however associated with risks. But if one undertakes investment prudently, he is sure to earn income. Typically, investments can be evaluated in terms of return regardless of their individual types and characteristics. The investor while making investments, consider many aspects related to return such as the timing, frequency and quantum of returns.

3.7.2 Capital Appreciation

Capital appreciation is one of the important objectives of investment. Investment involves real assets or financial assets. Real assets are tangible assets such as land, automobiles and bullions, whereas financial assets refer to pieces of paper having an indirect claim to real assets held by some other stock certificates. Before investing, the investors will try to find out the kind of assets which may appreciate in value. Normally, they prefer to invest in growth stocks which will appreciate over time. Purchase of property at the right time and the ideal growth stocks ensure appreciation to investors.

3.7.3 Safety

Investors, while investing their hard earned money consider safety as the essential objective of investment. Safety is the vital aspect as to why many investors are quite contended with low yield investments. They keep away from other investment options which are not cent percent safe. Generally, securities are regarded safe, as only calculated and moderate risks are present in them. Such
securities are expected to repay the investor with his principal amount and returns thereon.

3.7.3 Liquidity

The liquidity of an investment refers to the degree of its ready encashability. Generally, investors prefer investments which offer higher liquidity. Typically savings accounts and term deposits with banks are readily encashable.

3.7.4 Hedge against Inflation

One of the important objectives of the investor while making investment is to hedge against inflation, i.e. seeking protection against inflation. Inflation is a serious problem which our economy is facing now. Inflation has the effect of rising of price with a falling standard of living. Further, it may erode the value of money which has been invested in assets. The investor seeks to invest in such assets which will give him adequate return as a safeguard against any possible erosion in investment. The return, besides being higher is also expected to be continuous. If an investor foresees any irregularity of return in an investment, he will decide not to invest in them.

3.7.5 Tax planning

In practice, many investors are taxpaying individuals. As the income tax rates vary from 10 percent to 30 percent with a surcharge, the tax liability of those with higher income brackets is somewhat heavy. The interest earned by the investor from his investment is a taxable income and in certain cases tax is to be deducted at source (TDS) of interest income. So, investors are anxious to buy tax free securities in order to maximize their cash returns on investments. Apart from this, capital gains which arise from the sale of securities are also taxable. While tax rate on short-term capital gains are normal, long term capital gains are taxable at lower rate. If corporate shares and securities are held for more than 12 months, they become long-term, while for others holding them for more than 36 months will be long term. So, a wise investor will certainly consider tax implications before investing his funds.
3.8 Investment Alternatives

Several investment opportunities are available to an investor in many types and in many combinations within each type. However, the returns offered by them vary depending upon their nature and qualitative features. According to Benjamin Graham, an investment is a security purchase which promises safety of principal and a reasonable return. So, knowledge of different avenues of investment enables the investor to choose investment wisely. As given below in the chart, investment avenues can be broadly classified into three broad categories namely, Real investments, Contingent investments and Titular investments.

![Figure - 4]

**Investment Alternatives**

3.8.1 Real Investments or Tangible Investments

The real assets always find a place in the portfolio of the investor. Real investments, otherwise, known as tangible investments have a physical or tangible existence. Typical examples are land, house, Jewellery, precious stones, gold, silver, property and antiques etc. These are non-financial investments in nature.
3.8.2 Gold and Silver

They are also called as precious metals or objects. Everybody likes gold and hence, acquire gold or silver. These two precious metals are used for making ornaments and they hold a prestigious value in India. In India, investment in gold is more psychological than calculated and many individuals think that gold is an investment which can never give negative returns. They act as a store of wealth. Gold bars are highly liquid and can be easily sold at anytime. The pricing depends on the purity of the objects. The risk faced is of theft and fraud. India is the largest consumer of gold in the world followed by China in the second position. India accounts for about 20 percent of global demand. Recently in India, Gold Exchange Traded Funds (ETF’s) were launched which made it easier for individuals to own gold in electronic format. It is less costly, high liquidity and guarantees purity to the investors.

3.8.3 Real Estate

Investment in real estate includes properties like building, lands, farm houses, flats or houses. Such properties attract the attention of affluent investors. As the demand increases and the supply of land are limited, the prices tend to increase. Therefore, it is an attractive form of investment but is the most liquid asset. It is a long term investment, requires payment of stamp duty and a lot of legal formalities along with registration. SEBI has recently come out with guidelines for introduction and functioning of Real Estate Investment Trust (REIT) in the Indian real estate market. Once introduced these REITs will benefit retail investors the most. REIT is a trust which issues real estate in the form of units as a result even small investors can benefit from capital appreciation, these are liquid and exchange traded.

3.8.4 Contingent Investments

Contingent investments are the second form of Investment Avenue available to investors. The typical example of contingent investment is the insurance policies. The important features of contingent investments are that their value is related to a contingency in the form of death, accident, injury, etc. If the contingency arises, a substantial sum reaches the nominee or the investor as case
may be. If no such contingency arises during the holding period, the money paid towards the investment may appear to be an unnecessary expense.

3.8.5 Life Insurance

When talking about insurance, Life insurance is a kind of investment which provides family protection to the investor as well as return on investment in the form of yearly bonus on the policy. The return is as low as 6 percent because of the risk coverage and tax incentives. The amount of premium paid on a Life Insurance policy is exempt u/s 80C of Income Tax Act. Some of its schemes include -

i) **Whole Life Assurance Plan** Basically, whole life assurance plan is a low cost insurance plan where the sum assured is payable on the death of the life assured and premia are payable throughout one’s life.

ii) **Endowment Assurance Plan** Under Endowment assurance Plan, the sum assured is payable on the date of maturity or at the death of the life assured i.e. whichever is earlier. So, under this plan, premia is paid for a limited period.

iii) **Jeevan Anurag Plan** LIC’s Jeevan Anurag plan is a “with profits plan”. Under this plan, benefits are payable at a pre-specified duration, irrespective of whether the life assured survives till the end of the policy term or dies during the term of the policy. In addition, the plan provides for an immediate payment of sum assured under the basic plan on the event of death of the life assured during the term of the policy. This plan is, therefore, suitable to take care of the educational and other needs of children.

iv) **Jeevan Nidhi Plan** It provides for death cover during the deferment period and on survival to the date of vesting. The maturity proceeds are compulsorily to be used for purchase of annuity.

v) **Jeevan Pramukh (Key man Insurance Plan)** In every organization, there are a few key people who play a vital role in its efficient functioning and profitability. Loosing them could have an adverse impact on the future of the organization. This plan is intended to provide the much needed protection to the company against such unfortunate loss of key men.
vi) **Jeevan Mitra (Triple cover plan)** Multiple cover life insurance policies have come to stay. LIC already offers Jeevan Mitra (Double cover) plan. Encouraged by the popularity of this plan, LIC has introduced Jeevan Mitra (Triple Cover) with profits. For a small extra cost, it provides a risk cover of three times the basic sum assured. In case of accidents, the risk cover goes up to four times. It is an attractive plan that provides a high risk cover for a comparatively lower cost.

vii) **Jeevan Saral** Under this plan, death cover will be the same irrespective of age at entry and term. The sum payable at maturity differs for different entry ages and terms. This plan is very appropriate for employees seeking life cover through salary saving schemes. The LIC of India claims that the policy offers higher cover, smooth return, liquidity and considerable flexibility.

viii) **Jeevan Aadhar** In response to the general need and also the special provision introduced under the Finance Act, 1995, LIC has designed a plan for the benefit of handicapped dependents. Under this plan, an individual or a member of a HUF can take an assurance on his/her own life to provide for payment of a lump sum and an annuity to the handicapped dependent. The payment will be made to the nominee under the policy, who will be either the handicapped dependent or any other person or a trust for the benefit of the handicapped dependent.

ix) **Money Back Policy** The money back policy provides cash at periodical intervals during the currency of the policy and guarantees full protection throughout the period. These timely payments help the investors satisfy important financial needs like children’s education and marriage (down payment for a house or a long awaited holiday).

x) **Bima Plus (Capital market linked insurance plan)** It is a new scheme which provides for life insurance cover, along with the prospect of high growth. Under this scheme, a portion of the premium is invested in equity and debt instruments in the capital market, where scope for high growth depends upon the type of fund the inventor chooses under the scheme. It gives the
investor the option of three funds- Secured fund, Balanced fund and Risk fund. Within the term of the policy, the investor can also switch from one fund to another.

3.9 Titular Investments

Titular investments come with merely a title to the investor by way of certificate, deposit receipt, and promissory note issued by the competent authority of the borrower. In other words, titular investments are the financial rights and claims enjoyed by the investor in return for his invested amount. By nature, they are not tangible or physical as in the case of real investments like land, building, and gold. Titular investments consist of a wide variety of new financial instruments.

3.9.1 Bank deposits

These are low risk and low-medium return investments. In India, people trust the banking system more than the stock markets, for their money. There are various types of deposits: Savings, Recurring, Current and Fixed. Savings a/cs give a return from 3-6 percent pre-tax. Current a/cs are for businessmen and they generate no returns. Fixed deposits generate a return from 7-12 percent pre-tax.

3.9.2 Savings Banks Account

There are millions of middle and low income group people who wish to save a portion of their earnings to meet contingencies at a future date. A person who intends to open a Savings Bank account should fill up a printed form supplied by the bank and submit it duly filled to the bank concerned. He/she should indicate in the application form the references with the help of which the banker makes enquiry about the honesty and integrity of the applicant. After the account is opened in the name of the customer, he is supplied with a pass book and a cheque book. The savings bank account gives the investor some return in the form of interest. Since this account is run to promote savings, banks do not allow frequent withdrawal of money from the account. Withdrawals are permitted through withdrawal slips, cheques and ATM cards.
3.10 Post Office Schemes

Post Office Monthly Income Scheme is a low risk saving instrument, which can be availed through any Post Office. The interest rate on deposits is slightly higher than banks. The interest is calculated half yearly and paid yearly.

i) **Post Office Monthly Income Scheme (POMIS)** Under the Post office monthly income scheme, an individual can invest from Rs.1,000 to Rs.3,00,000 or jointly by two individuals up to Rs.6,00,000. The period of deposit is 6 years and this scheme carries benefit in the form of interest at 8 percent and 10 percent bonus at the time of maturity of deposit amount. The investor is also entitled to tax benefit in the form of deduction under section 80C in respect of interest earned by him.

ii) **Kisan Vikas Patra (KVP)** It is a popular scheme operated by post offices. This has a face value of Rs.100, Rs.1,000, Rs.5,000 and Rs.10,000 and gives a compound interest. This investment doubles in 8 years and 7 months. The encashment of the Kisan Vikas Patras is permitted after the holding period of 2 years and 6 months. Individuals and trusts can purchase these investments and they are not transferable from one person to another.

iii) **National Saving Certificate (NSC)** Individuals and trusts can invest in National Saving Certificates which carry a compound interest of 8 percent. The principal amount plus the interest is payable at maturity. The investor can avail tax rebate under Section 88 and is also eligible to claim deduction under Section 80C. The minimum amount of investment in NSC is Rs.100 and there is no upper limit for this.

iv) **Public Provident Fund (PPF)** The investor can open public provident fund account in head post offices, State Bank of India and some nationalized banks. PPF carries a compound interest of 8 percent and the maximum limit for investment in a financial year is Rs.1,00,000. The period of investment is 15 years. The investors may also enjoy tax exemption under Section 80C.

v) **Post Office Recurring Deposit (PORD)** Under this scheme, an individual can open an account for 5 years. The minimum amount payable per month is
Rs.10 and there is no maximum limit for this. An amount of Rs.10 paid every month into the account, returns Rs.728.90 after the expiry of 5 years.

vi) **Post Office Time Deposits (POTD)** Fixed deposits are accepted in post offices for a period varying from 1 to 5 years. Depending upon the period of deposit, the interest offered by the POTD varies between 6.25 percent and 7.50 percent.

vii) **Deposit Schemes for Retired Government Employees or Public Sector Undertakings (DSRGE/DSRPSU)** Under the above scheme, the retired employees from Government service and Public sector undertakings can open an account in certain nationalized banks like SBI, situated in the district headquarters. It carries an interest of 7 percent and retirement benefits can be invested within 3 years from the date of retirement.

viii) **Post Office Savings Accounts (POSA)** Individual investors can open savings account in the post offices for a maximum amount of Rs.1, 00,000. Cheque facility is also offered under the savings account, and the interest income earned on savings account is exempt under section 10 of the Income Tax Act.

### 3.11 Provident Fund Schemes

Provident fund scheme is a retirement benefit scheme. Under this scheme, a stipulated sum is deducted from the salary of the employee as his contribution towards the fund while he/she is in service as his/her contribution. The employer also, generally, contributes simultaneously an equal amount to the fund. The employees’ and employer’s contributions are invested in gilt-edged securities. Interest earned thereon is also credited to the provident fund account of employees. Thus, credit balance in a provident fund account of an employee consists of employee’s contribution, interest on employee’s contribution, employer’s contribution, interest on employer’s contribution. The accumulated sum is paid to the employee at the time of his/her retirement or of resignation. In the case of death of an employee, accumulated balance is paid to his/her legal heirs. Since the scheme encourages personal savings at micro level and generates funds for investment at macro level, the Government provides tax incentives.
3.12 Mutual Fund Schemes

Recently, mutual funds have become popular all over the world. Mutual funds carry benefits in the form of safety of principal, capital appreciation, and interest or dividend. Under mutual fund scheme, an investor, even with a little money can be a participant in investing in big companies, which are otherwise inaccessible to him because of his small investment. Mutual funds collect the savings of small investors invest them in Government and other corporate securities and earn income in the form of interest and dividend. The income and capital appreciation arising out of investments are shared among the investors by careful selection of securities over a diversified portfolio, covering large number of companies and industries. Mutual funds are able to perform better than an individual investor. When mutual funds select a large share of equities, the investment in mutual funds is exposed to greater risks. So, the investor should be aware of the risks of these growth schemes while making an investment decision. When mutual funds have income schemes, then investment is made in securities of a guaranteed return. Under income schemes, mutual funds select a large share of fixed income securities like debentures and bonds.

3.13 Government Securities

The securities issued by the Central, State and Quasi-governments are known as Government securities or gilt edged securities. On the other hand, Government guaranteed securities are those securities, in which the income and capital are both guaranteed by the Government. So, a Government guaranteed security is a claim on the Government. The rates of interest on these securities are relatively lower because of their high liquidity and safety. Government securities in India have a large market. Promissory notes and stock certificates are the important forms of Government securities.

There are a large number of investment avenues for savers in India. Some of them are marketable and liquid while others are more risky and less safe. Risk and return are the major characteristics which an investor has to face and handle. So, the investor has to choose Proper Avenue among them depending on his
preferences, needs and abilities to take the minimum risk and maximize the returns. To enable investors to know the degree of risk on debt instruments, credit rating is now made compulsory for them.

3.14 Indian Household Sector in Economic Development

Introduction

The household sector represented by individuals occupies a strategic place among various economic units in a country as it contributes substantially to the domestic saving efforts. The economic system depends on adequate supply of capital from private investors. The savings of individual investors is the main source of capital investment for business expansion. The future of the free enterprise system, as it is often implied, depends mainly and almost exclusively on the continued ability and willingness of individuals with large income to provide the capital and funds needed to finance the growth. If the savings of the individuals is not tapped in a proper manner, then it may find its way into unproductive channels.

3.15 Savings and their Role in the Economic Development of the Country

According to Rudiger et al. (1990)116 “Economic development takes place when the economic welfare of the people of a country increases over a long period”. According to Bhole (1997)117 “Economic development is to a great extent depends on the rate of investment or capital formation which are necessary for fast development. According to Dewett et al. (1998)118 “Capital formation refers to an increase in the stock of real capital like machines, plants, tools, equipment, buildings and inventories of raw materials. It leads to increases in the supply of real capital thereby enhancing productive capacity of an economy. As a result the economy of a country would be in a position to make a larger utilization


of natural and manpower resources, to achieve high rate of growth in real national income.

Thus, countries which have higher rates of capital formation are found to have much longer base for accelerated development as compared to countries with lower rate.

According to Kewal Krishan Dewett and Adarsh Chand (1998)\textsuperscript{119} “Huge funds are needed to accelerate capital formation and economic development. Savings are one of the best sources of financing for economic development”.

3.16 Motives for Savings

According to James and Sarah Tanner (1999)\textsuperscript{120} “To build up a reserve against unforeseen contingencies (the precautionary motive), to provide for an anticipated future relationship between the income and needs of the individual (the life cycle motive), to enjoy interest and appreciation (the intertemporal substitution motive), to enjoy a gradually increasing expenditure (the improvement motive), to enjoy a sense of independence and the power to do things, without a clear idea, or definite intention of specific action (the independent motive), to secure the masse demanoeuvre to carry out speculative business projects (the enterprise motive), to bequeath a fortune (the bequest motive), to satisfy pure miserliness (the avarice motive), and to accumulate deposits to buy cars, house and other durables (the down- payment motive) are some of the (reasons) motives which influence the individuals to incur their savings”.


3.17 Factors that Determine Volume of Savings

According to Bhole (1997)121 “A number of factors have a bearing on the volume of savings in the economy. The level of current and expected income, cyclical changes in income, age wise variations in income distribution of income in the economy, degree of certainty of income, wealth, inflation, desire to provide for old age, family members, contingencies, thrift, rate of interest, availability of savings media with preferred investment characteristics and other variables are the relevant factors in this respect”.

According to Sundaram and Sundaram (1996)122 “In the classical approach, savings depend upon the rate of interest. Higher the rate of interest the greater would be the volume of savings. According to Keynes, on the other hand, saving depends upon the level of income, and $S = F(Y)$, the higher the level of income, the larger will be the volume of savings”. They argued that the relationship between savings and interest is not as strong as the classical writers argued. In some cases, people may not be able to save at all and in certain. Other cases, people may save when the rate of interest is even zero.

According to Rudiger et al. (1988)123 “The life cycle theory of saving predicts that people save more when their income is relatively higher than the life time average income and disave when their income is relatively lower than the life time average”. According to Paul et al. (1992)124 “Economic studies have shown that income is the primary determinant of consumption and savings”.

---


3.18 Domestic Savings

According to Ruddar Dutt (1977)\textsuperscript{125} “Domestic savings are the sum total of the savings arising from the three sectors to put in an algebraic language”.

\[ SD = SH + SC + SG \]

Where,

- SD = Domestic Savings
- SH = Savings of the Household Sector
- SC = Saving of the Corporate Sector
- SG = Saving of the Government Sector

According to Constantiono Lluch et al. (1977)\textsuperscript{126} “These are the sources of financing in the domestic economy. It has to be mobilized to make feasible the growth targets of developing nations”. According to Mahajan (1992)\textsuperscript{127} “Without generating a higher ratio of domestic savings it would be difficult to achieve targeted growth rate. That is why the rate of domestic savings assumes importance”. According to Raghu Palat (1995)\textsuperscript{128} “Proper and effective utilization of domestic savings will ensure economic growth. It may be mentioned here that Indian’s economic growth is due to increased rate of domestic savings”. According to Sadhak (1997)\textsuperscript{129} “India is one of the few countries today to maintain a steady growth rate in domestic savings. Domestic savings comprise the savings of the Household sector, Corporate sector and Government sector are the major contribution to the nation.

\textsuperscript{125} Ruddar Dutt, 1977, “Evolution of the Indian Economy”, S.Chand and company Ltd, New Delhi, P.90.

\textsuperscript{126} Constantiono Lluch, Alan A.Powell, Ross A. Williams, 1977, “Patterns in Household Demand and Savings”, Oxford University press, USA


### 3.19 India’s Savings Performance over the Five Year Plans

#### Table 3.1

**India’s Average Saving Rates over the Five year Plans**

<table>
<thead>
<tr>
<th>Five Year Plan</th>
<th>Gross Domestic Savings Rate (percent)</th>
<th>Average annual rate of change in the savings rate (percentage points)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fist Plan (1951-56)</td>
<td>9.2</td>
<td>-</td>
</tr>
<tr>
<td>Second Plan (1956-61)</td>
<td>10.6</td>
<td>0.3</td>
</tr>
<tr>
<td>Third Plan (1961-66)</td>
<td>12.1</td>
<td>0.3</td>
</tr>
<tr>
<td>Fourth Plan (1969-74)</td>
<td>14.7</td>
<td>0.5</td>
</tr>
<tr>
<td>Fifth Plan (1974-79)</td>
<td>18.5</td>
<td>0.8</td>
</tr>
<tr>
<td>Sixth Plan (1980-85)</td>
<td>17.9</td>
<td>-0.1</td>
</tr>
<tr>
<td>Seventh Plan (1985-90)</td>
<td>20.0</td>
<td>0.4</td>
</tr>
<tr>
<td>Eighth Plan (1992-1997)</td>
<td>22.9</td>
<td>0.6</td>
</tr>
<tr>
<td>Ninth Plan (1997-2002)</td>
<td>23.6</td>
<td>0.1</td>
</tr>
<tr>
<td>Tenth Plan (2002-2007)</td>
<td>31.3</td>
<td>1.5</td>
</tr>
<tr>
<td>Eleventh Plan so far</td>
<td>33.7</td>
<td>0.6</td>
</tr>
<tr>
<td>(2007-2011)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Source:** Central Statistics Office

From the Eighth to the Eleventh Plan during an 18-year period that coincided with the structural reforms process the average rate of Gross Domestic Savings (GDS) increased by around 14 percentage points. This was higher than the increase of around 11 percentage points in the GDS rate that occurred over the First to the Seventh Plans, a period of around 40 years. The maximum increase (of around 8 percentage points) in the average GDS rate occurred over the Tenth plan (2002-2007).
3.20 Trends in Household Sector Savings Rate and Composition

Table 3.2

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>1970s</td>
<td>6.0</td>
<td>1.5</td>
<td>4.5</td>
<td>7.3</td>
<td>11.8</td>
</tr>
<tr>
<td>1980s</td>
<td>8.9</td>
<td>2.4</td>
<td>6.5</td>
<td>7.2</td>
<td>13.7</td>
</tr>
<tr>
<td>1990s</td>
<td>11.2</td>
<td>1.6</td>
<td>9.6</td>
<td>8.2</td>
<td>17.9</td>
</tr>
<tr>
<td>2000s</td>
<td>14.2</td>
<td>3.4</td>
<td>10.8</td>
<td>12.3</td>
<td>23.2</td>
</tr>
<tr>
<td>2000-05</td>
<td>12.8</td>
<td>2.4</td>
<td>10.3</td>
<td>12.9</td>
<td>23.1</td>
</tr>
<tr>
<td>2005-2011</td>
<td>15.5</td>
<td>4.2</td>
<td>11.3</td>
<td>12.2</td>
<td>23.5</td>
</tr>
</tbody>
</table>

**Source:** Central Statistics Office

A striking feature of the 2000s is the general leveling off of the household savings rate at about 23 percent from around the middle of the decade in contrast to the upward movement in the previous years. Moreover, this leveling off occurred even as the economy generally cruised along a high growth trajectory (barring a brief hiccup in 2008-09). The factors underlying the stability in the household savings rate are discussed next.

The total saving of the households comprises financial savings and physical savings. Financial savings are treated on a net basis i.e. households (change in gross) financial assets less their (change in gross) financial liabilities. It is evident from the table that while physical savings of the households increased sharply during the first half of 2000s the pace of increase in gross financial assets as well as gross financial liabilities slowed down. With the net financial savings rate resultanty showing a modest increase most of the overall increase in the households savings during the first half of the 2000s was on account of physical savings. The household sector’s preference for savings in the form of physical assets since 2000-01 could be attributed partly to the robust economic growth as well as rising availability of credit to meet financial needs of the household sector.
During the second half of the decade even though the gross financial savings (assets) and gross financial liabilities of the households increased sharply the increase in net financial savings rate remained modest. At the same time the rate of physical savings declined partly in response to the tightening in credit norms offsetting the increase in the financial savings rate. Consequently the households overall savings rate remained largely unchanged (at around 23 percent) since mid-2000s.

Since the 1970s, the allocation of household savings between financial assets and physical assets had been progressively moving in favour of the former with the notable exception of the first half of the 2000s. The allocation became almost evenly balanced during the second half of the 2000s.

The extent to which household physical assets were funded through loans and advances increased sharply during 2004-05 to 2006-07 coinciding with the high growth phase and real estate boom. Subsequently this ratio has declined.

3.21 Evolving Structure of Households’ Gross Financial Savings

Table 3.3
Composition of (Changes in) Gross Financial Assets

<table>
<thead>
<tr>
<th>Items (1)</th>
<th>1970s (2)</th>
<th>1980s (3)</th>
<th>1990s (4)</th>
<th>2000s (5)</th>
<th>2000-05 (6)</th>
<th>2005-11 (7)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Currency</td>
<td>13.9</td>
<td>11.9</td>
<td>10.3</td>
<td>9.6</td>
<td>8.9</td>
<td>10.7</td>
</tr>
<tr>
<td>Bank Deposits</td>
<td>45.6</td>
<td>40.3</td>
<td>34.7</td>
<td>44.7</td>
<td>37.8</td>
<td>49.9</td>
</tr>
<tr>
<td>Non-banking deposits</td>
<td>3.0</td>
<td>4.6</td>
<td>6.8</td>
<td>1.3</td>
<td>2.0</td>
<td>1.7</td>
</tr>
<tr>
<td>Life insurance fund</td>
<td>9.0</td>
<td>7.5</td>
<td>10.1</td>
<td>17.4</td>
<td>14.7</td>
<td>19.9</td>
</tr>
<tr>
<td>Provident and pension fund</td>
<td>19.6</td>
<td>17.5</td>
<td>18.8</td>
<td>12.4</td>
<td>15.1</td>
<td>10.3</td>
</tr>
<tr>
<td>Claims on government</td>
<td>4.2</td>
<td>11.1</td>
<td>9.5</td>
<td>11.1</td>
<td>19.5</td>
<td>3.5</td>
</tr>
<tr>
<td>Shares and debentures</td>
<td>1.5</td>
<td>3.9</td>
<td>7.0</td>
<td>4.1</td>
<td>2.8</td>
<td>4.3</td>
</tr>
<tr>
<td>Units of UTI</td>
<td>0.5</td>
<td>2.2</td>
<td>3.8</td>
<td>-0.5</td>
<td>-0.9</td>
<td>-0.2</td>
</tr>
<tr>
<td>Trade Debt (Net)</td>
<td>2.7</td>
<td>0.9</td>
<td>-1.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.4</td>
</tr>
<tr>
<td>Gross Financial Assets</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

The composition of (changes in) the gross financial assets of households has also changed substantially over the years.

i) The share of currency has declined to around 11 percent during 2005-10 as compared with 14 percent in the 1970s, reflective of the spread of banking facilities the declining share of agriculture in GDP and moderation in inflation.

ii) Bank deposits continue to account for the predominant share of gross financial assets with their share increasing sharply in the second half of 2000s, in contrast to the declining trend in the previous years and part of the recent increase in the share of bank deposits could be attributable to the increase in deposit rates and aggressive deposit mobilization by banks.

iii) The share of Life Insurance funds continued to increase during 2000s in line with higher insurance penetration and robust economic growth. As indicated in the Economic Survey 2010-11. Life Insurance penetration in the year 2000 when the sector was opened up to the private sector was 1.77 and it has increased to 4.73 in 2009. The increase in levels of insurance penetration has to be assessed against the average growth of over 8 percent GDP in the last five years.

iv) The share of provident and pension funds has progressively declined over the years.

v) The share of claims on Government that largely reflect Small Savings which had picked up over the years, particularly during the first half of 2000s, declined during the second half largely in response to the unchanged (administered) interest rates on Small Savings since 2003-04. In fact, households disinvested their holdings of Small Savings during 2007-08 and 2008-09.

vi) The share of shares and debentures in the gross financial assets of households has remained quite small (less than 10 percent on an average) even though it increased sharply during the (early) 1990s, spurred by the reforms in the capital market. Subsequently the share of shares and debentures started
declining largely reflecting stock market conditions impacted by irregularities and the downturn in industrial activity, and was placed at less than 3 percent in the first half of 2000s. The share of shares and debentures picked up very sharply during 2005-06 to 2007-08 largely coinciding with the high growth phase and buoyant stock market trends but plummeted in 2008-09 in the face of knock on effects of the global financial crisis on the average however, the share of shares and debentures improved during the second half of 2000s.

vii) Contrasting movements were observed in the shares of bank deposits, shares and debentures in the households gross financial assets till around the first half of 2000s, indicative of household’s perception of substitutability between the two instruments in the allocation of their financial savings. In the second half of 2000s, however the average shares of both the instruments increased sharply in response to the very buoyant economic conditions picked up in primary market activity (in the case of shares and debentures) and increased in deposit rates (in the case of bank deposits) and disinvestment of Small Savings holdings by households during 2007-09.

viii) The share of Units of UTI, Mutual Funds, etc has generally been small and these turned negative during 2000s and trade debt (net) has been negligible.

ix) In sum, bank deposits continue to account for the predominant share of gross financial savings of the households and their share has increased sharply during the second half of 2000s. The share of Life Insurance Funds has also increased progressively over the years. Provident and Pension Funds, non-banking deposits, claims on Government and currency have lost momentum over the years. Shares and debentures constitute a relatively small portion of household financial savings, even though their share has picked up in the recent period.

3.17 Projections during the Twelfth Plan

Against this the backdrop working decided to use the latest three year moving average (2008-09 to 2010-11) of the elasticity of household savings for obtaining projections over the Twelfth Plan and this average worked out 1.14. The projections of household savings for the three scenarios of real GDP growth
and inflation (and the implied growth rate of GDP at current market prices) turn out to be near identical and thus the common set of projections is set out.

**Table 3.4**

Projections of Household Savings Rate (in Percent of GDP)

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate</td>
<td>23.2</td>
<td>23.6</td>
<td>24.0</td>
<td>24.4</td>
<td>24.8</td>
<td>25.2</td>
<td>24.4</td>
</tr>
</tbody>
</table>

**Source:** Hand book of statistics on the Indian Economy RBI 2012-13

It is evident that the projected household savings rate increases from 23.2 percent in 2011-12 to 25.2 per net in 2016-17, giving an average of 24.4 percent during the Twelfth plan.

This present chapter has enumerated the overview of investment avenues and analysis of domestic savings in India. The following chapter would present the analysis of the primary source of data collected to analyze the preference for investments among the household investors.