Chapter - I

Introduction
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1.1 INTRODUCTION

The secret of success in investment is to increase its value. That is a simple statement. It is like advising an investor in the stock market to “BUY LOW, SELL HIGH,” The problem is how to do it?

These days life seems to be more complicated than ever, with precious little time for a walk in the park or settling down with a good book, leave alone taking time out from one's busy schedule to make and monitor wise personal investment decisions. Investment is never an easy process.

Every individual moving in the pyramid of the hierarchy of needs should first satisfy the need for basic necessities in life and then save for their future. In today's environment, it is prudent for any investor to look into the real interest earned as inflation is moving out of gear. It is imperative that the returns be higher without the risk of losing the principal in an investment. This necessitates for optimization of risk and reward.

Unlike investments, cash in your hand, pays no returns. On the other hand, cash provides more liquidity than investment. People who
hold cash must believe that this additional liquidity offsets the loss of returns.

Investing is a complex field of study involving knowledge of various investment tools, terms, concepts, strategies and processes. A study of investment is best accompanied by training-and experience in the field of investment.

Some one who has the knowledge, training and experience to perform financial planning does not necessarily need a planner, advisor or broken to execute a stock trade. However, being able to execute a stock trade is no way under estimating the importance of knowledge, training and experience in the lifetime pursuit of financial goals.

In the last couple of decades with technological and regulatory advancements like arrival of scrip less trade and involvement of Securities and Exchange Board of India [SEBI], execution of trade has been made accessible to individuals themselves through discount brokers and online trading firms.
1.2 REVIEW OF LITERATURE

R.K. Gupta, CEO, Taurus Mutual Fund says "Now the time has come for the mutual fund industry to address the problem of size and its impact on the investors. The Indian mutual fund industry is tightly regulated by the SEBI. Many shortcomings faced by the industry in adhering to these regulations are being regularly discussed by the top management or SEBI with the Captains of industry directly as well as through the Association of Mutual Funds in India (AMFI). The industry has also realized that managing the others’ money is more risky and therefore, they have to be vigilant in their operations. The industry is so sensitive that the media and other competitors can exploit wrong action of even the junior staff of a fund. The main challenge before the industry is how to attract retail investors, who are the backbone and provide stability for the growth of the mutual fund industry. The SEBI chairman has also expressed his concern on many occasions on this issue. The percentage of retail investors in the overall assets under management of the mutual fund industry is reducing. SEBI, time and again is emphasizing that mutual fund instruments are meant for retail investors. However, looking at the present scenario, the situation is unlikely to improve in the near future, unless it is critically analyzed and addressed by the regulator and various players,"
According to R. Swami Nathan, Head, Sales and Distribution, Canbank Investment Management Services Limited, "There is no doubt mutual funds are here to stay. The challenges are formidable, but they can be overcome. The government and regulators with tax sops and investor, protection guideline nurture the industry. Now it is also the responsibility of the industry members to spread across the country for development, to ensure consistent growth in numbers as well as the much sought after AUM,"

Sanjay Sinha, Fund Manager, UTI Mutual Fund, expresses his view, as "Corporate profit and liquidity will primarily drive markets. In March 2005 corporate results were very good. A recent study by a broking firm pointed out that the composite EPS or the sensex companies was between 563 and 570. This gave a price-earning multiple of less than 26 at the peak of 8500. Markets still holds a lot of value even at these levels. FIIs inflows will continue to provide more liquidity. The appreciation of the rupee is adding comfort. There is also the concern of asset bubble taking place. But this will happen only if the growth of profit is not able to keep pace with the rise in the markets. This is not visible at this point of time. Investors may allocate 40 percent for equity, based on their risk appetite."
Amit Chandra, Joint MD, DSP Merrill Lynch Limited, says, in 2006 the Indian market will be driven a lot more by investment demand than consumption demand. The big story will be impact of increasing, corporate capex, due to rising capacity utilization and the need to accelerate infrastructure spends across sectors. "We accept a sharp rise of over 60 percent in infrastructure spend across sectors. Annual spending could hit $25 billion a year over the next three years and the impact of a at will be felt at a macro level and in the stock markets," he adds. Talking about sectors, Chandra is of the opinion that the pharma and textile sectors will be carefully watched in 2006- for the impact of major changes (adoption of patent laws and removal of quota system) in the regulatory environment on these sectors.

Gagan Banga, Director, India Bulls, expressed that at a time when the Sensex is ruling at 6500 levels, it is still at a moderate PE levels, feels Banga. Reason: if the industry is able to sustain a 25 per cent growth rate, FII inflows will surely continue. "I also sense that the government is trying to address the fiscal deficit situation. Progress needs to be made on managing fiscal deficit, with infrastructure development and industrial growth. If we have progress on these fronts, markets will continue to respond positively, because FIIs will continue to buy the India story," he said. Talking about valuation, Banga feels that valuations
in some stocks are stretched. "That will always happen in a dull market scenario. But we have new sectors emerging with many companies reporting robust growth. I sense that stock-specific positive momentum will continue," says Banga who, as a firm believer in fundamentals, recommends splitting the portfolio allocations into sectors like steel, infrastructure, construction, retail, financial services and some of it in cement, FMCG and IT.

S.A. Narayan, Managing Director, Kotak Securities said that Forecast equities at the very conservative levels will give a return between 15 and 20 per cent. In case of debt, even in the best scenario, it may not be possible to get more than 6 percent. This may not give any real returns (after factoring inflation 6-7 per cent). Even on international comparison, equities look good. Fundamental factors favour investment in equities. Bullion is also good and will give returns. However, problems of storage handling safety remain a concern for retail investor. Strategy allocate and stay invested. Don’t get carried away by daily fluctuation. Look at portfolio allocation. Take advice of professionals if required. Follow a systematic investment plan approach to spread risks.
In India, unfortunately, not many investors look at bullion as an investment. Indian consumers buy about 20 percent of the global gold supply every year. This works out to about Rs.40,000 crore, bulk of which is in the form of jewellery. About Rs.6,000 crore is held in physical bars and coins form, according to Sanjeev Agarwal, Managing Director, Indian Subcontinent, World Gold Council, who is of the view that this category of holders of bars and coins is on the increase and would continue to do so. Agarwal for one justifies the investment. "Gold is the only universal asset with no geographic, religious or socio-economic boundaries. Any government or industry does not influence its performance and prices and it acts a currency and inflation hedge. And above all it does not have a storage or liquidity problem. It has an adornment value and gets translated into a financial asset as a last resort."

**MEANING OF INVESTMENT**

Investment is the employment of funds with the aim of achieving additional income or growth in value. The essential quality of an investment is that it involves waiting for a reward. It involves the commitment of resources which have been saved or put away from current consumption in the hope that some benefits will accrue in future. The term Investment does not appear to be as simple as it has been defined. Investment has been further categorised by financial experts
and economists. It has also often been confused with the term speculation. The following discussion will give an explanation of the various ways in which investment is related or differentiated from the financial and economic sense and how speculation differs from investment. However, it must be clearly established that investment involves long-term commitment.

FINANCIAL MEANING

Investment is the allocation of monetary resources to assets that are expected to yield some gain or positive return over a given period of time. These assets range from safe investments to risky investments. Investments in this form are called “financial investment”.

ECONOMIC MEANING

To the Economist, ‘investment’ means the net additions to the economy’s capital stock, which consists of goods, and services that are used in the production of other goods and services. In this context, the term investment, therefore, implies the formation of new and productive capital in the form of new construction, new producers’ durable equipment such as plant and equipment. Inventories and human capital are included in the economists’ definition of investment.
From the point of view of people, who invest their funds, they are the suppliers of ‘capital’ and in their view; investment is a commitment of a person’s funds to derive future income in the form of interest, dividend, rent or the appreciation of the value of their principal capital.

IMPORTANT OF INVESTMENTS

Investments are both important and useful in the context of present-day conditions. Some factors that have made investment decisions increasingly important are:

(a) Longer life expectancy or planning for retirement, (b) Increasing rates of taxation, (c) High interest rates, (d) High rate of inflation, (e) Larger incomes, (f) Availability of a complex number of investment outlets.

(a) Longer Life Expectancy: Investment decisions have become significant as most people in India retire between the ages of 55 and 60. Also, the trend shows longer life expectancy. The earnings from employment should, therefore be calculated in such a manner that a portion should be put away as savings. Savings by themselves do not increase wealth; these must be invested in such a way that the principal and income will be adequate for a greater number of retirement years.
The importance of investment decisions is further enhanced by the fact that there is an increasing number of women working in organisations. These women will be responsible for planning their own investments during their working life so that after retirement, they are able to have a stable income.

Increase in the working population, proper planning for life span and longevity have ensured the need for balanced investments.

(b) Increasing Rates of Taxation: Taxation is one of crucial factors in any country, which introduces an element of compulsion in a person's savings. There are various forms of savings outlets in our country in the form of investments, which help in bringing down the tax level by offering deductions in personal income. These will be discussed in greater detail under availability of investment media "later in the chapter. Some examples, however, may be cited here. Benefits in tax accrue out of investment in Unit Trust Certificates, Unit Linked Insurance Plan, Life Insurance, National Savings Certificates, Development Bonds, Post Office Cumulative Deposit Schemes etc.

(c) Interest Rates: Another aspect which is necessary for a sound investment plan is the level of interest rates. Interest rates vary between
one investment and another. These may vary between risky and safe investments, they may also differ due to different benefit schemes offered by the investments. These aspects must be considered before actually allocating any amount. A high rate of interest may not be the only factor favouring the outlet for investment. The investor has to include in his portfolio several kinds of investments. Stability of interest is as important as receiving a high rate of interest. This book is concerned with determining whether the investor is getting an acceptable return commensurate with the risks that are taken.

(d) Inflation: Inflation has become a continuous problem since the last decade. In these years of rising prices, several problems are associated coupled with a falling standard of living. Before funds are invested, erosion of the resources will have to be carefully considered in order to make the right choice of investments. The investor will try and search an outlet which will give him a high rate of return in the form of interest to cover any decrease due to inflation. He will also have to judge whether the interest or return will be continuous or there is a likelihood of irregularity. Coupled with high rates of interest, he will have to find an outlet which will ensure safety of principal. Besides high rate of interest and safety of principal, an investor also has to always bear in mind the taxation angle. The interest earned through investment should not unduly
increase his taxation burden. Otherwise, the benefit derived from interest will be offset by an increase in taxation.

(e) Income: Another reason why investment decisions have assumed importance is the general increase in employment opportunities in India. After independence, with the stages of development in the country, a number of new organisations and services were formed. The Banking Recruitment Services, the Indian Administrative Services, Public Sector Enterprises, expansion in the Private Corporate Sector, establishing of Financial Institutions, Tourism, Hotels, and Education are some examples. The employment opportunities gave rise to both male and female working force. More incomes and more avenues of investment have led to the ability and willingness of working people to save and invest their funds.

(f) Investment Channels: The growth and development of the country leading to greater economic activity has led to the introduction of a vast array of investment outlets. Apart from putting aside savings in savings banks where interest is low, investors have the choice of a variety of instruments. The question to reason out is which is the most suitable channel? Which media will give a balanced growth and stability of return? The investor in his choice of investment will have to try and achieve a proper mix between high rate of return and stability of return to reap the benefits of both. Some of the instruments available are corporate
stock, provident fund, life insurance, fixed deposits in the corporate sector, Unit Trust schemes and so on. These will be discussed in greater detail in this chapter under Investment Media."

FACTORS FAVOURABLE FOR INVESTMENT

The investment market should have a favourable environment to be able to function effectively. In India where all business activities are marked by social, economic and political considerations, it is important that the political and economic institutions are favourable. Generally, there are four basic considerations which foster growth and bring opportunities for investment. These are (a) legal safeguards, (b) stable currency, (c) existence of financial institutions to aid savings and (d) form of business organisation.

(a) Legal Safeguards: A stable government, which frames adequate legal safeguards, encourages accumulation of savings and investments. Investors will be willing to invest their funds if they, have the assurance of protection of their contractual and property rights.

In India, the investors have the dual advantage of free enterprise and government control. Freedom, efficiency and growth are ensured from the competitive forces of private enterprise. On the other hand, being a mixed economy, government control exerts discipline and curtails some
element of freedom. A combination of the public sector controlled by the
government and private sector left free to operate, hopes to achieve the
benefits of both socialistic and capitalist forms of government without
their disadvantages. In India, the political climate is conducive to
investment as government control lends stability to the capital market.

(b) A Stable Currency: A well organised monetary system with
definite planning and proper policies is a necessary pre-requisite to an
investment market. Most of the investments such as bank deposits, life
insurance and shares are payable in a fixed amount of the currency of the
country. A proper monetary policy will give direction to the investment
outlets. As far as possible, the monetary policy should neither promote
acute inflationary pressures nor prepare for a deflation model. Neither
condition is satisfactory.

Price inflation destroys the purchasing power of investments. Thrift
is also penalised when the net interest after taxes received by the investor
is less than the rise in the price level, leaving the investor with less total
purchasing power than he had at the time of saving. Inflation occurs
generally in unstable conditions like war or floods but in the last decade,
it is also discernible in peace conditions especially in developing
countries because of huge government deficit financed by bank credit.
Deflation is equally disastrous because the nominal values of inventories,
plant and machinery and land and building tend to shrink. An example of
the evil effects of deflation can be cited for the period 1929-1933 in the
United States when the shrinkage in nominal values came to a point of
producing wholesale bankruptcy.

A reasonable stable price level which is produced by wise monetary
and fiscal management contributes towards proper control, good
government, economic well-being and a well disciplined growth-oriented
investment market and protection to the investor.

(c) Existence of Financial Institutions to Encourage Savings: The
presence of financial institutions which encourage savings and direct
them to productive uses helps the investment market to grow. The
financial institutions generally in existence in most countries are
commercial banks, life insurance companies and investment companies

CLASSIFICATION OF INVESTOR

The investor can be classified into two groups :

a. Risk Group,

b. Income Group
A. RISK GROUP

Investor can be classified into different groups depending on their attitude towards risk. Investor also has an indifference point at which his own expectations of return match with the risk that he can take. A well diversified portfolio carefully chosen from the numerous securities available in the market will help the investor in achieving his objectives. The investor should also be able to access his own behavior pattern before he aims at a particular goal which he wishes to attain. Broadly, he should be able to identify whether he is a risk averter, risk neutral or risk taker. If he identifies himself as risk averter, his normal behavior pattern will show his preference for investments of low market rate risk and interest rate risk. He would prefer Government Securities, Life Insurance Policies, Unit Trust Certificates that he is sure would give him a continuous return. He would not be able to pay any extra amount for any uncertain or unexpected action. Another class of investors is called risk neutrals. Such investors are willing to pay for making an investment provided they get a return of an equal value. Their investment trends show that they try to take some risky stocks in their total investment programme but have a larger number of securities, which give them a firm return. The risk takers for the third category of investors. They do not mind paying more than the expected value of an asset for an uncertain future. They believe in high return for a greater risk. Such
investors have the potentialities to be gamblers.

While investors can be classified in categories of high risk, no risk and medium risk takers, it can be said that the major group of investors are those who can absorb medium risk. Most investors are willing to sacrifice some expected income or return, if the income is certain.

### CLASSIFICATION OF INVESTORS

<table>
<thead>
<tr>
<th>Type</th>
<th>Risk Acceptable</th>
<th>Type of Investment</th>
<th>Behaviour</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk Averters</td>
<td>No Risk</td>
<td>Life Insurance, Unit Certificates, Government Certificate,</td>
<td>Will pay less for uncertain action.</td>
</tr>
<tr>
<td>Risk Neutrals</td>
<td>Some Risk</td>
<td>Common Stocks, Units Life Policies.</td>
<td>Will pay equal to expected return of uncertain action.</td>
</tr>
<tr>
<td>Risk Takers</td>
<td>High Risk</td>
<td>Common Stock, Bonds, Convertible Securities</td>
<td>Will pay more than expected value for an uncertain action</td>
</tr>
</tbody>
</table>
CHART

(A) THE RISK AVERTOR PREFERS LESS RISKY AVENUES

1. Bank Deposits
2. Mutual Funds
3. Debentures
4. New Issues

CHART

THE RISK TAKERS PREFER RISKY AVENUES

Equities
  • Fixed Deposits
  • Venture Funds
  • New Companies
    • Blue Chips
    • Emerging Blue Chips
B. INCOME GROUP

The income group of an investor evokes responses to the available investment outlets. The higher the income group of an investor the greater will be his desire for purchasing assets which will give him a favourable tax treatment. The Source of income usually has a bearing on deduction of tax. Certain sources of income are taxed like ordinary income. Other income may be exempted from income tax. These investment outlets should be identified. The investments must be geared in a manner that combines the features of low risk and low taxation to the maximum benefit. Low-income group investor will not look towards tax benefit. His maximum utility will be at a point of greater reward.

Expectation Level of Investors

<table>
<thead>
<tr>
<th>Income Group</th>
<th>Return</th>
<th>Risk</th>
<th>Tax Benefits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>High</td>
<td>Medium</td>
<td>Nil</td>
</tr>
<tr>
<td>Medium</td>
<td>High</td>
<td>Medium</td>
<td>Some</td>
</tr>
<tr>
<td>High</td>
<td>High</td>
<td>Medium</td>
<td>Maximum</td>
</tr>
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OBJECTIVES, METHODOLOGIES AND LIMITATIONS

OBJECTIVES

The objectives of the study are as follows:

a. to study the factors that influences the investors to invest.
b. to know, whether the investors prefer direct investments or indirect investments.

c. to find out, whether the investors are going for the financial instruments or other assets (like gold, silver, land, etc.,)

d. to analyse whether the investors prefer fixed income securities or variable income securities.

e. to know, whether the investors are taking the decision by themselves or with the help of financial advisors.

**HYPOTHESIS**

a. Whether there is any significant difference between the investment behaviour of the investors between direct investments (bank deposits) and indirect investments (insurance).

b. Is there any difference between the investment behaviour of the investors between financial securities (shares) and non-financial securities (land&buildings).

c. Whether there is any difference between the investment attitude of the investors between fixed income securities (bank deposits) and variable income securities (mutual funds)

**METHODOLOGY**

The study is based both on primary and secondary data. 100 respondents have been selected by random sampling method. For the
purpose of collecting data from the respondents, questionnaire has been circulated. For the purpose of testing the hypothesis percentage analysis and chi-square test are used.

**LIMITATIONS**

This study subject to the following limitations: -

a. The study is limited for the year 2005-2006.

b. The study is limited to 150 respondents only.

c. The study is limited to coimbatore city only.