1.1 FINANCIAL MANAGEMENT
   1.1.1 Concept of Finance Management
   1.1.2 Scope of Finance
   1.1.3 The fundamental principal of Finance
   1.1.4 Functions of Financial Management
   1.1.5 Organization of Finance Management
   1.1.6 Importance of Financial Management
   1.1.7 Evolution (Growth) of Financial Management
   1.1.8 Financial Manager’s Role
   1.1.9 Financial goal: Profit versus Wealth

1.2 INVESTMENT MANAGEMENT
   1.2.1 Concept of Investment management
   1.2.2 Other Concepts
   1.2.3 Characteristics of Investment
   1.2.4 Need of Investment management
   1.2.5 Process of Investment management
   1.2.6 Objectives of Investors
   1.2.7 Modes of Investment

1.3 MUTUAL FUNDS
   1.3.1 Concept of Mutual Fund
   1.3.2 Steps to Popularize Mutual Funds

1.4 CONCLUSION
In the present chapter researcher will provide the information about concept of finance management, scope of finance, principal of finance management, functions, organization, importance, growth, role of finance manager. The chapter also includes concept of investment management, characteristics of investment, need of investment management, process, objectives and modes of investment, concept of mutual fund and the steps to popularize mutual funds.
1.1 FINANCIAL MANAGEMENT

1.1.1 CONCEPT OF FINANCE MANAGEMENT:

Financial management is that managerial activity which is concerned with the planning and controlling of the firm's financial resources. Though it was a branch of economics till 1890, as a separate activity or discipline it is of recent origin. Still, it has no unique body of knowledge of its own, and draws heavily on economics for its theoretical concepts even today.

The subject of financial management is of immense interest to both academicians and practicing managers. It is of great interest to academicians because the subject is still developing, and there are still certain areas where controversies exist for which no unanimous solutions have been reached as yet. Practicing managers are interested in this subject because among the most crucial, decisions of the firm are those which relate to finance, and an understanding of the theory of financial management provides them with conceptual and analytical insights to make those decisions skillfully.

The term financial management has been defined by different experts as below:

- According to I.M. Pandey,
  “Financial management is that managerial activity which is concerned with the planning and controlling of the firm’s financial resources”

- According to Solomon Ezra,
  “Financial management is to review and control decisions to commit or recommit funds to new or ongoing uses.”
According to F.J. Weston,

“Finance management is directly concerned with production, marketing and other functions, within an enterprise whenever decisions are made about the acquisition or distribution of assets.”

According to Prasanna Chandra,

“Financial Management is an integral part of the job of managers which includes many tasks and allied areas (like accounting), which are specialized in nature and attended by key financial officers, like the treasurer and the controller.”

1.1.2 SCOPE OF FINANCE:

What is finance? What are a firm's financial activities? How are they related to the firm's other activities? Firms create manufacturing capacities for production of goods; some provide services to customers. They sell their goods or services to earn profit. They raise funds to acquire manufacturing and other facilities. Thus, the four most important activities of a business firm are:

- production
- marketing
- finance
- human resources

A firm secures whatever capital it needs and employs it (finance activity) in activities which generate returns on invested capital (production, marketing and human resource activities).

Real and Financial Assets

A firm requires real assets to carry on its business. Real assets can be tangible or intangible. Plant, machinery, office, factory, furniture and building are examples of tangible real assets, while technical know-how, technological collaborations, patents and copyrights are intangible real
assets. The firm sells financial assets or securities, such as shares and bonds or debentures, to investors in capital markets to raise necessary funds. Financial assets also include lease obligations and borrowing from banks, financial institutions and other sources. Funds applied to assets by the firm are called capital expenditures or investment. The firm expects to receive return on investment and distribute return as dividends to investors.

**Equity and Borrowed Funds**

There are two types of funds that a firm can raise: equity funds and borrowed funds. A firm sells shares to acquire equity funds. Shares represent ownership rights of their holders. Buyers of shares are called shareholders, and they are the legal owners of the firm whose shares they hold. Shareholders invest their money in the shares of a company in the expectation of a return on their invested capital. The return on the shareholders' capital consists of dividend and capital gain. Shareholders make capital gains by selling their shares.

Shareholders can be of two types: ordinary (or common) and preference. Preference shareholders receive dividend at a fixed rate, and they have a priority over ordinary shareholders. The dividend rate for ordinary shareholders is not fixed, and it can vary from year to year depending on the decision of the board of directors. The payment of dividends to shareholders is not a legal obligation; it depends on the discretion of the board of directors. Since ordinary shareholders receive dividend (or re-payment of invested capital, only when the company is wound up) after meeting the obligations of others, they are generally called owners of residue. Dividends paid by a company are not deductible charges for calculating corporate income taxes.

Equity funds can also be obtained by a company by retaining a portion of earnings available for shareholders. This method of acquiring
funds internally is called earnings retention. Retained earnings are undistributed profits of equity capital; they are, therefore, rightfully a part of the equity capital. The retention of earnings can be considered as a form of raising new capital. If a company distributes all earnings to shareholders, then, it can reacquire new capital from the same sources (existing shareholders) by issuing new shares called a rights issue. Also, a public issue of shares may be made to attract new shareholders.

Another important source of securing capital is creditors or lenders. Lenders are not the owners of the company. They make money available to the firm on a lending basis and retain title to the funds lent. The return on loans or borrowed funds is called interest. Loans are furnished for a specified period at a fixed rate of interest. Payment of interest is a legal obligation. The amount of interest is allowed to be treated as expense for computing corporate income taxes. Thus the payment of interest on borrowing provides tax shield to a firm. The firm may borrow funds from a large number of sources, such as banks, financial institutions, public or by issuing bonds or debentures. A bond or a debenture is a certificate acknowledging the money lent by a bondholder to the company. It states the amount, the rate of interest and the maturity of the bond or debenture.

**Finance and Other Management Functions**

There exists an inseparable relationship between finance on the one hand and production, marketing and other functions on the other. Almost all kinds of business activities, directly or indirectly, involve the acquisition and use of funds. For example, recruitment and promotion of employees in production is clearly a responsibility of the production department; but it requires payment of wages and salaries and other benefits, and thus, involves finance. Similarly, buying a new machine or replacing an old machine for the purpose of increasing productive capacity affects the flow of funds. Sales promotion policies come within
the purview of marketing, but advertising and other sales promotion activities require outlays of cash and therefore, affect financial resources; Where, then, is the separation between production and marketing functions and the finance function of making money available to meet the costs of production and marketing operations? Where do the production and marketing functions end and the finance functions begin? There are no clear-cut answers to these questions. The finance function of raising and using money although has a significant effect of other functions, yet it needs not necessarily limit or constraint the general running of the business. A company in a tight financial position will, of course, give more weight to financial considerations, and devise its marketing and production strategies in the light of the financial constraint. On the other hand, management of a company, which has a regular supply of funds, will be more flexible in formulating its production and marketing policies. In fact, financial policies will be devised to fit production and marketing decisions of a firm in practice.

1.1.3 THE FUNDAMENTAL PRINCIPLE OF FINANCE:

The key question that you have to ask before making a business decision is: will the decision raise the market value of the firm? To answer this question, let us look at the fundamental principle of finance;

A business proposal—regardless of whether it is a new investment or acquisition of another company or a restructuring initiative—raises the value of the firm only if the present value of the future stream of net cash benefits expected from the proposal is greater than the initial cash outlay required to implement the proposal.

The difference between the present value of future cash benefits and the initial outlay represents the net present value or NPV of the proposal:
Net present value = Present value of future cash benefits - Initial cash outlay

Note that the costs and benefits of a business proposal have to be measured in cash. As shown in Exhibit 1.1, investors who finance a proposal invest cash and are hence interested only in cash returns.

**Cash Alone Matters**

**Exhibit 1.1**

To convert the expected cash returns from the proposal into a present value figure, an appropriate discount rate has to be applied. The discount rate reflects the riskiness of the proposal.

**1.1.4 FUNCTIONS OF FINANCIAL MANAGEMENT:**

Although it may be difficult to separate the finance functions from production, marketing and other functions, yet the functions themselves can be readily identified. The functions of raising funds, investing them in assets and distributing returns earned from assets to shareholders are respectively known as financing, investment and dividend decisions. While performing these functions, a firm attempts to balance cash inflows and outflows. This is called liquidity decision, and we may add it to the
list of important finance decisions or functions. Finance functions or decisions include:

- Investment or long-term asset-mix decision
- Financing or capital-mix decision
- Dividend or profit allocation decision
- Liquidity or short-term asset-mix decision

A firm performs finance functions simultaneously and continuously in the normal course of the business. They do not necessarily occur in a sequence. Finance functions call for skilful planning, control and execution of a firm's activities.

Let us note at the outset that shareholders are made better off by a financial decision that increases the value of their shares. Thus while performing the finance functions, the financial manager should strive to maximize the market value of shares.

**Investment Decision**

Investment decision or capital budgeting involves the decision of allocation of capital or commitment of funds to long-term assets that would yield benefits in the future. Two important aspects of the investment decision are: (a) the evaluation of the prospective profitability of new investments, and (b) the measurement of a cut-off rate against that the prospective return of new investments could be compared. Future benefits of investments are difficult to measure and cannot be predicted with certainty. Because of the uncertain future, investment decisions involve risk. Investment proposals should, therefore, be evaluated in terms of both expected return and risk. Besides the decision to commit funds in new investment proposals, capital budgeting also involves decision of recommitting funds when an asset becomes less productive or non-profitable.
There is a broad agreement that the correct cut-off rate is the required rate of return or the opportunity cost of capital. However, there are problems in computing the opportunity cost of capital in practice from the available data and information. The decision maker should be aware of these problems.

**Financing Decision**

Financing decision is the second important function to be performed by the financial manager. Broadly, he or she must decide when, where and how to acquire funds to meet the firm's investment needs. The central issue before him or her is to determine the proportion of equity and debt. The mix of debt and equity is known as the firm's capital structure. The financial manager must strive to obtain the best financing mix or the optimum capital structure for his or her firm. The firm's capital structure is considered to be optimum when the market value of shares is maximized. The use of debt affects the return and risk of shareholders; it may increase the return on equity funds but it always increases risk. A proper balance will have to be struck between return and risk. When the shareholders' return is maximized with minimum risk, the market value per share will be maximized and the firm's capital structure would be considered optimum. Once the financial manager is able to determine the best combination of debt and equity, he or she must raise the appropriate amount through the best available sources. In practice, a firm considers many other factors such as control, flexibility, loan covenants, legal aspects etc. in deciding its capital structure.

**Dividend Decision**

Dividend decision is the third major financial decision. The financial manager must decide whether the firm should distribute all profits, or retain them, or distribute a portion and retain the balance. Like the debt policy, the dividend policy should be determined in terms of its
impact on the shareholders' value. The optimum dividend policy is one that maximises the market value of the firm's shares.\textsuperscript{13} Thus, if shareholders are not indifferent to the firm's dividend policy, the financial manager must determine the optimum dividend-payout ratio. The dividend payout ratio is equal to the percentage of dividends to earnings available to shareholders.\textsuperscript{14} The financial manager should also consider the questions of dividend stability, bonus shares and cash dividends in practice. Most profitable companies pay cash dividends regularly. Periodically, additional shares, called bonus shares (or stock dividend), are also issued to the existing shareholders in addition to the cash dividend.

**Liquidity Decision**

Current assets management that affects a firm's liquidity is yet another important finance function, in addition to the management of long-term assets. Current assets should be managed efficiently for safeguarding the firm against the dangers of illiquidity and insolvency. Investment in current assets affects the firm's profitability, liquidity and risk. A conflict exists between profitability and liquidity while managing current assets. If the firm does not invest sufficient funds in current assets, it may become illiquid. But it would lose profitability as idle current assets would not earn anything. Thus, a proper trade-off must be achieved between profitability and liquidity. In order to ensure that neither insufficient nor unnecessary funds are invested in current assets, the financial manager should develop sound techniques of managing current assets. He or she should estimate firms needs for current assets and make sure that funds would be made available when needed.

It would thus be clear that financial decisions directly concern the firm's decision to acquire or dispose of assets and require commitment or recommitment of funds on a continuous basis. It is in this context that
finance functions are said to influence production, marketing and other functions of the firm. This, in consequence, finance functions may affect the size, growth, profitability and risk of the firm and ultimately the value of the firm.

The function of financial management is to review and control decisions to commit or recommit funds to new or ongoing uses. Thus, in addition to raising funds, financial management is directly concerned with production, marketing and other functions, within an enterprise whenever decisions are made about the acquisition or distribution of assets.

Financial Procedures and Systems
For the effective execution of the finance functions, certain other functions have to be routinely performed. They concern procedures and systems and involve a lot of paper work and time. They do not require specialized skills of finance. Some of the important routine finance functions are:

- Supervision of cash receipts and payments and safeguarding of cash balances;
- Custody and safeguarding of securities, insurance policies and other valuable papers;
- Taking care of the mechanical details of new outside financing;
- Record keeping and reporting.

The finance manager in the modern enterprises is mainly involved in the managerial finance functions; the routine finance functions are carried out by executives at lower levels. Financial manager's involvement in the routine functions is confined to setting up of rules of procedures, selecting forms to be used, establishing standards for the employment of competent personnel and to check up the performance to see that the rules are observed and that the forms are properly used.
The involvement of the financial manager in the managerial financial functions is recent. About two or three decades ago, the scope of finance functions or the role of the financial manager was limited to routine activities.

1.1.5 ORGANIZATION OF THE FINANCE FUNCTIONS:

Financial management is in many ways an integral part of the jobs of managers who are involved in planning, allocation of resources, and control. The responsibilities for financial management are dispersed throughout the organization. For example:

- The engineer, who proposes a new plant, shapes the investment policy of the firm.
- The marketing analyst provides inputs in the process of forecasting and planning.
- The purchase manager influences the level of investment in inventories.
- The sales manager has a say in the determination of the receivables policy.
- Departmental managers, in general, are important links in the financial control system of the firm.

There are, however, many tasks of financial management and allied areas (like accounting) which are specialised in nature and which are attended to by specialists. These tasks and their typical distribution between the two key financial officers of the firm, the treasurer and the controller are shown in table 1.1. Note that the treasurer is responsible mainly for financing and investment activities and the controller is concerned primarily with accounting and control.
Table 1.1 Functions of the Treasurer and the Controller

<table>
<thead>
<tr>
<th>Treasurer</th>
<th>Controller</th>
</tr>
</thead>
<tbody>
<tr>
<td>Obtaining finance</td>
<td>Financial accounting</td>
</tr>
<tr>
<td>Banking relationship</td>
<td>Internal auditing</td>
</tr>
<tr>
<td>Cash management</td>
<td>Taxation</td>
</tr>
<tr>
<td>Credit administration</td>
<td>Management accounting and control</td>
</tr>
<tr>
<td>Capital budgeting</td>
<td></td>
</tr>
</tbody>
</table>

Typically, the chief finance officer, who may be designated as director (finance) or vice president (finance), supervises the work of the treasurer and the controller. In turn, these officers are assisted by several specialist managers working under them. The finance function in a large organisation may be organised as shown in chart 1.1.
The financial officers, in addition to their specialized responsibility, have significant involvement in injecting financial discipline in corporate management processes. They are responsible for emphasizing the need for rationality in the use of funds and the need for monitoring the operations of the firm to achieve desired financial results. In this respect, the tasks of financial officers have assumed new dimensions. Instead of just looking after routine financing and accounting
activities, they guide and participate in the tasks of planning, funds allocation, and control so that the financial point of view is sufficiently emphasized in the process of corporate management.

1.1.6 IMPORTANCE OF FINANCIAL MANAGEMENT:

Importance of finance cannot be over-emphasized. It is, indeed, the key to successful business operations. Without proper administration of finance, no business enterprise can reach its full potentials for growth and success. Money is a universal lubricant which keeps the enterprise dynamic, develops product, keeps men and machines at work, encourages management to make progress and creates values. The importance of financial administration can be discussed under the following heads:-

(i) **Success of Promotion Depends on Financial Management:**

One of the most important reasons of failures of business promotions is a defective financial plan. Hence sound financial plan is very necessary for the success of business enterprise.

(ii) **Smooth Running of an Enterprise:**

Sound financial planning is necessary for the smooth running of an enterprise. Money is to an enterprise, what oil is to an engine. As, finance is required at each stage of an enterprise, i.e., promotion, incorporation, development, expansion and administration of day-to-day working etc., proper administration of finance is very necessary. Proper financial management means the study, analysis and evaluation of all financial problems to be faced by the management and to take proper decision with reference to the present circumstances in regard to the procurement and utilisation of funds.
(iii) **Financial management Co-ordinates Various Functional Activities:**

Financial management provides complete co-ordination between various functional areas such as marketing, production etc. to achieve the organisational goals. If financial management is defective, the efficiency of all other departments can, in no way, be maintained. For example, it is very necessary for the finance-department to provide finance for the purchase of raw materials and meeting the other day-to-day expenses for the smooth running of the production unit. If financial department fails in its obligations, the Production and the sales will suffer and consequently, the income of the concern and the rate of profit on investment will also suffer. Thus Financial administration occupies a central place in the business organisation which controls and co-ordinates all other activities in the concern.

(iv) **Focal Point of Decision Making:**

Almost, every decision in the business is taking in the light of its profitability. Financial management provides scientific analysis of all facts and figures through various financial tools, such as different financial statements, budgets etc., which help in evaluating the profitability of the plan in the given circumstances, so that a proper decision can be taken to minimise the risk involved in the plan.

(v) **Determinant of Business Success:**

It has been recognised, even in India that the financial managers play a very important role in the success of business organisation by advising the top management the solutions of the various financial problems as experts. They present important facts and figures regarding financial position and the performance of various functions of the company in a given period before the top management in such a way so as to make it easier for the top management to evaluate the progress of
the company to amend suitably the principles and policies of the company. The financial managers assist the top management in its decision making process by suggesting the best possible alternative out of the various alternatives of the problem available. Hence, financial management helps the management at different level in taking financial decisions.

(vi) **Measure of Performance:**

The performance of the firm can be measured by its financial results i.e. by its size of earnings riskiness and profitability is two major factors which jointly determine the value of the concern. Financial decisions which increase risks will decrease the value of the firm and on the other hand, financial decisions which increase the profitability will increase value of the firm. Risk and profitability are two essential ingredients of a business concern.

Thus, financial management is very important or significant because it is related to funds of company. Financial management guides to finance manager to make optimum position of funds.

1.1.7 **EVOLUTION (GROWTH) OF FINANCIAL MANAGEMENT:**

Financial management emerged as a distinct field of study at the turn of the 20th century. Its evolution may be divided into three broad phases (though the demarcating lines between these phases are somewhat arbitrary)—the traditional phase, the transitional phase and the modern phase.

The traditional phase lasted for about four decades. The following are its important features:
• The focus of financial management was mainly on certain episodic events like formation, issuance of capital, major expansion, merger, reorganization, and liquidation in the life cycle of the firm.

• The approach was mainly descriptive and institutional. The instruments of financing, the institutions and procedures used in capital markets, and the legal aspects of financial events formed the core of financial management.

• The outsider's point of view was dominant. Financial management was viewed mainly from the point of view of the investment bankers, lenders, and other outside interests.

The transitional phase began around the early 1940s and continued through the early 1950s. Though the nature of financial management during this phase was similar to that of the traditional phase, greater emphasis was placed on the day-to-day problems faced by financial managers in the areas of funds analysis, planning, and control. The focus shifted to working capital management.

The modern phase began in the mid 1950s and has witnessed an accelerated pace of development with the infusion of ideas from economic theory and application of quantitative methods of analysis. The distinctive features of the modern phase are:

• The central concern of financial management is considered to be a rational matching of funds to their uses so as to maximise the wealth of current shareholders.

• The approach of financial management has become more analytical and quantitative.

Since the beginning of the modern phase, many significant and seminal developments have occurred in the fields of capital budgeting, asset pricing theory/capital structure theory, efficient market theory, option pricing theory, agency theory, valuation models, dividend policy,
working capital management, financial modeling, and behavioral finance. Many more exciting developments are in the offing making finance a fascinating and challenging field.

1.1.8 FINANCIAL MANAGER’S ROLE:

Who is a financial manager? What does he/she do? A financial manager is a person who is responsible in a significant way to carry out the finance functions. It should be noted at the outset that, in a modern enterprise, the financial manager occupies a key position. He or she is one of the members of the top management team, and his or her role, day-by-day, is becoming more pervasive, intensive and significant in solving the complex management problems. Now his or her functions are neither confined to that of a score-keeper maintaining records, preparing reports and raising funds when needed, nor is he or she a staff officer—in a passive role of an advisor. The finance manager is now responsible for shaping the fortunes of the enterprise, and is involved in the most vital decision of the allocation of capital. In his or her new role, he or she needs to have a broader and far-sighted outlook, and must ensure that the funds of the enterprise are utilised in the most efficient manner. He or she must realise that his or her actions have far-reaching consequences for the firm because they influence the size, profitability, growth, risk and survival of the firm, and as a consequence, affect the overall value of the firm. The financial manager, therefore, must have a clear understanding and a strong grasp of the nature and scope of the finance functions.

The financial manager has not always been in the dynamic role of decision-making. Till recently, he or she was considered to be an unimportant person, as far as the top management decision-making was concerned. He or she became an important management person only with
the advent of the modern or contemporary approach to the financial management.\textsuperscript{18}

The role of financial manager can be summarized as bellow:

1. Raising of Funds
2. Allocation of Funds
3. Profit Planning
4. Understanding Capital Markets

1. **Raising of Funds**

The traditional approach dominated the scope of financial management and limited the role of the financial manager simply to raising of funds. It was during the major events, such as promotion, reorganisation, expansion or diversification in the firm that the financial manager was called upon to raise funds. In his or her day-to-day activities, his or her only significant duty was to see that the firm had enough cash to meet its obligations. Because of its central emphasis on the procurement of funds, the finance text books, for example, in the USA, till the mid-1950s covered discussion of the instruments, institutions and practices through which funds were obtained. Further, as the problem of raising funds was more intensely felt in the case of an episodic event, these books also contained detailed descriptions of the major events like mergers, consolidations, reorganisations and recapitalisations. The Indian finance books simply followed the American pattern. The notable feature of the traditional view of financial management was the assumption that the financial manager had no concern with the decision of allocating the firm's funds. These decisions were assumed to be given to him, and he or she was required to raise the needed funds from a combination of various sources.

The traditional approach did not go unchallenged even during the period of its dominance. But the criticism related more to the treatment
of various topics rather than the basic definition of the finance function. The traditional approach has been criticised because it failed to consider the day-to-day managerial problems relating to finance of the firm. It concentrated itself to looking into the problems from management's — the insider's point of view.\textsuperscript{19} Thus, the traditional approach of looking at the role of the financial manager lacked a conceptual framework for making financial decisions, misplaced emphasis on raising of funds, and neglected the real issues relating to the allocation and management of funds.

2. **Allocation of Funds**

The traditional approach outlived its utility in the changed business situation since the mid-1950s. A number of economic and environmental factors, such as the increasing pace of industrialisation, technological innovations and inventions, intense competition, increasing intervention of government on account of management inefficiency and failure, population growth and widened markets, during and after mid-1950s, necessitated efficient and effective utilisation of the firm's resources, including financial resources.\textsuperscript{20} The development of a number of management skills and decision-making techniques facilitated the implementation of a system of optimum allocation of the firm's resources. As a result the scope of financial management also changed. The emphasis shifted from the episodic financing to the managerial financial problems, from raising of funds to efficient and effective use of funds. The new approach is embedded in sound conceptual and analytical theories.

The new or modern approach is an analytical way of looking into the financial problems of the firm. Financial management is considered a vital and an integral part of overall management. To quote Ezra Solomon:\textsuperscript{21}
In this broader view the central issue of financial policy is the wise use of funds and the central process involved is a rational matching of advantages of potential uses against the cost of alternative potential sources so as to achieve the broad financial goals which an enterprise sets for itself.

Thus, in a modern enterprise, the basic role of financial manager is to decide about the expenditure decisions and to determine the demand for capital for these expenditures. In other words, the financial manager, in his or her new role, is concerned with the efficient allocation of funds. The allocation of funds is not a new problem, however, it did exist in the past, but was not considered important enough in achieving the firm's long run objectives.

In his or her new role of using funds wisely, the financial manager must find a rationale for answering the following three questions:

- How large should an enterprise be and how fast should it grow?
- In what form should it hold its assets?
- How should the funds required be raised?

As discussed earlier, the questions stated above relate to three broad decision areas of financial management: investment (including both long and short-term assets); financing and dividend. The "modern" financial manager has to help making these decisions in the most rational way. They have to be made in such a way that the funds of the firm are used optimally. We have referred to these decisions as managerial finance functions since they require special care and extraordinary administrative ability.

As discussed earlier, the financial decisions have a great impact on all other business activities. The concern of the financial manager, besides his traditional function of raising money, will be on determining the size and technology of the firm, in setting the pace and direction of
growth and in shaping the profitability and risk complexion of the firm by selecting the best asset mix and by obtaining the optimum financing mix.

3. **Profit Planning**

The role of the financial manager may be broadened to include profit planning function. The term profit planning refers to the operating decisions in the areas of pricing, costs, volume of output and the firm's selection of product lines. Profit planning is, therefore, a pre-requisite for optimising investment and financing decisions. The cost structure of the firm, i.e. the mix of fixed and variable costs has a significant influence on a firm's profitability. Fixed costs remain constant while variable costs change in direct proportion to volume changes. Because of the fixed costs, profits fluctuate at a higher degree than the fluctuations in sales. Profit planning helps to anticipate the relationships between volume, costs and profits and develop action plans to face unexpected surprises.

4. **Understanding Capital Markets**

The financial manager has to deal with capital markets where the firm's securities are traded. He or she should fully understand the operations of capital markets and the way in which securities are valued. He or she should also know how risk is measured in capital markets and how to cope with it as investment and financing decisions often involve considerable risk. For example, if a firm uses excessive debt to finance its growth, investors may perceive it as risky. The value of the firms’ share may, therefore, decline. Similarly, investors may not like the decision of a highly profitable, growing firm to distribute dividend. They may like the firm to reinvest profits in attractive opportunities which would enhance their prospects for making high capital gains in the future. Investments also involve risk and return. It is through their operations in capital
markets that investors continuously evaluate the actions of the financial manager.

1.1.9  FINANCIAL GOAL: PROFIT VERSUS WEALTH

The firm's investment and financing decisions are unavoidable and continuous. In order to make them rationally, the firm must have a goal. It is generally agreed in theory that the financial goal of the firm should be the maximisation of owners' economic welfare. Owners' economic welfare could be maximised by maximising the shareholders' wealth as reflected in the market value of shares. In this section, we show that the shareholders' wealth maximisation (SWM) is theoretically logical and operationally feasible normative goal for guiding the financial decision-making.

**Profit Maximisation**

Profit maximisation means maximising the rupee (or any other currency such as dollar, pound etc. income of firms.) Firms produce goods and services. They may function in a market economy, or in a government-controlled economy. In a market economy, prices of goods and services are determined in competitive markets. Firms in a market economy are expected to produce goods and services desired by society as efficiently as possible.

Price system is the most important organ of a market economy indicating what goods and services society wants. Goods and services in great demand command higher prices. This results in higher profit for firms; more of such goods and services are produced. Higher profit opportunities attract other firms to produce such goods and services. Ultimately with intensifying competition, an equilibrium price is reached at which demand and supply match. In the case of goods and services which are not required by society, their prices and profits fall. Such
goods and services are dropped out by producers in favor of more profitable opportunities.\textsuperscript{22} Price system directs managerial efforts towards more profitable goods or services. Prices are determined by the demand and supply conditions as well as the competitive forces and they guide the allocation of resources for various productive activities.\textsuperscript{23}

In the economic theory, the behaviour of a firm is analysed in terms of profit maximisation. While maximising profit, a firm either produces maximum output for a given amount of output, or uses minimum input for producing a given output. Thus, the underlying logic of profit maximisation is efficiency. It is assumed to cause the efficient allocation of resources under the competitive market conditions, and profit is considered as the most appropriate measure of a firm's performance.

**Objections to Profit Maximisation**

The profit maximisation objective has, however, been criticised in recent years. It is argued that profit maximisation assumes perfect competition and in the face of imperfect modern markets, it cannot be a legitimate objective of the firm. It is also argued that profit maximisation, as a business objective, developed in the early 19th century when the characteristic features of the business structure were self-financing, private property and single entrepreneurship. The only aim of the single owner then was to enhance his or her individual wealth and personal power, which could easily be satisfied by the profit maximisation objective. The modern business environment is characterised by limited liability and a divorce between management and ownership. The business firm today is financed by shareholders and lenders but it is controlled and directed by professional management. The other interested parties are customers, employees, government and society. In practice, the objectives of these constituents (or stakeholders) of a firm differ and
may conflict with each other. The manager of the firm has the difficult task of reconciling and balancing these conflicting objectives. In the new business environment, profit maximisation is regarded as unrealistic, difficult, inappropriate and immoral.

It is also feared that profit maximization behaviour in a market economy may tend to produce goods and services that are wasteful and unnecessary from the society's point of view. Also, it might lead to inequality of income and wealth. It is for this reason that governments tend to intervene in business. The price system and therefore, the profit maximisation principle may not work due to imperfections in practice. Oligopolies and monopolies are quite common phenomena of modern economies. Firms producing same goods and services differ substantially in terms of technology, costs and capital. In view of such conditions, it is difficult to have a truly competitive price system and thus it is doubtful if the profit-maximising behaviour will lead to the optimum social welfare.

However, it is not clear that abandoning profit maximisation as a decision criterion would solve the problem. Rather, government intervention may be sought to correct market imperfections and to promote competition among business firms. A market economy, characterised by a high degree of competition, would certainly ensure efficient production of goods and services desired by society. Is profit maximisation an operationally feasible criterion? Apart from the aforesaid objections, profit maximisation fails to serve as an operational criterion for maximising the owner's economic welfare. It fails to provide an operationally feasible measure for ranking alternative courses of action in terms of their economic efficiency. It suffers from the following limitations:

- It is vague
- It ignores the timing of returns
• It ignores risk.

**Definition of profit**

The precise meaning of the profit maximisation objective is unclear. The definition of the term profit is ambiguous. Does it mean short- or long-term profit? Does it refer to profit before or after tax? Does it mean total profits or profit per share? Does it mean total operating profit or profit accruing to shareholders?

**Time value of money**

The profit maximisation objective does not make a distinction between returns received in different time periods. It gives no consideration to the time value of money and it values benefits received today and benefits received after a period as the same.

**Uncertainty of returns**

The streams of benefits may possess different degree of certainty. Two firms may have same total expected earnings, but if the earnings of one firm fluctuate considerably as compared to the other, it will be more risky. Possibly, owners of the firm would prefer smaller but super profits to a potentially larger but less certain stream of benefits.

**Maximising Profit After Taxes**

Let us put aside the first problem mentioned above and assume that maximising profit means maximising profits after taxes, in the sense of net profit as reported in the profit and loss account (income statement) of the firm. It can easily be realised that maximising this figure will not maximise the economic welfare of the owners. It is possible for a firm to increase profit after taxes by selling additional equity shares and investing the proceeds in low-yielding assets, such as the government bonds. Profit after taxes would go up but earnings per share would go down.
Maximising Earnings Per Share

If we adopt maximising earnings per share as the financial objective of the firm, this will also not ensure the maximisation of owners' economic welfare. It also suffers from the flaws already mentioned, i.e. it ignores timing and risk of the expected benefits.

For one thing, it implies that the market value of the company's shares is a function of earnings per share, which may not be true in many instances. If the market value is not a function of earnings per share, then maximisation of the latter will not necessarily result in the highest possible price for the company's shares. Such a dividend policy may not always be to the shareholders' advantage.

It is, thus, clear that maximising profits after taxes or earnings per share as the financial objective fails to maximise the economic welfare of owners. Both methods do not take account of the timing and uncertainty of the benefits. An alternative to profit maximisation, which solves these problems, is the objective of wealth-maximisation. This objective is also considered consistent with the survival goal and with the personal objectives of managers such as recognition, power, status and personal wealth.

Share holders Wealth Maximisation (SWM)

The objective of shareholders' wealth maximisation (SWM) is an appropriate and operationally feasible criterion to choose among the alternative financial actions. It provides an unambiguous measure of what financial management should seek to maximise in making investment and financing decisions on behalf of owners (shareholders).

What is meant by SWM? SWM means maximising the net present value (or wealth) of a course of action to shareholders. The net present value (NPV) of a course of action is the difference between the present
value of its benefits and the present value of its costs. A financial action that has positive NPV creates wealth for shareholders and, therefore is desirable. A financial action resulting in negative NPV should be rejected since it would destroy shareholders' wealth. Among a number of mutually exclusive projects, the one with the highest NPV should be adopted. Therefore, the wealth will be maximised if this criterion is followed in making financial decisions.

The objective of shareholders' wealth maximisation takes care of the questions of the timing and risk of the expected benefits. These problems are handled by selecting an appropriate rate (the shareholders' opportunity cost of capital) for discounting the expected flow of future benefits. It is important to emphasise that benefits are measured in terms of cash flows. In investment and financing decisions, it is the flow of cash which is important, not the accounting profits.

Maximising the shareholders' economic welfare is equivalent to maximising the utility of their consumption over time. With their wealth maximised, shareholders can adjust their cash flows in such a way as to optimise their consumption. From the shareholders' point of view, the wealth created by a company through its actions is reflected in the market value of the company's shares. Therefore, the wealth maximisation principle implies that the fundamental objective of a firm is to maximise the market value of its shares-. The value of the company's shares is represented by their market price which, in turn, is a reflection of the firm's financial decisions. The market price serves as the firm's performance indicator.
1.2 INVESTMENT MANAGEMENT

1.2.1 CONCEPT OF INVESTMENT MANAGEMENT:

An investment for one may be disinvestment of another as in the case of stock market trading or may be a fresh investment in a new issue. In the New Issue Market, one can only buy securities. Investments can also be made in non-marketable securities or instruments or other avenues also.

All purchases of securities are thus investment although for the economy as a whole, some investments are offset by corresponding disinvestments. There are two terms which are relevant for this context, namely, Gross and Net Investments. Gross are total investments made from all sources by an economy or a single economic unit. Net investments are those which are Gross investments, minus disinvestments for an economic unit. Gross Assets and Investments minus Depreciation for the economy or a company or Corporate Sector or Govt. Sector, is net Investment, which is termed also as Capital formation.

As referred, to earlier, investment refers to acquisition of some assets. It also means the conversion of money into claims on money and use of funds for productive and income earning assets.

The definitions of investment management given by different experts:

- **According to Donald Fischer and Ronald Jordan,**
  “The process of managing money, including investments, budgeting, banking and taxes, is called investment management”.24

- **According to V.A.Avadhani,**
  “A generic term that most commonly refers to the buying and selling of investments within a portfolio. Investment management can also include banking and budgeting duties, as well as taxes. But the term
most often refers to portfolio management and the trading of securities to achieve a specific investment objective”.25

- **According to Prasanna Chandra,**

  “Investment management is the professional management of various securities (shares, bonds and other securities) and assets in order to meet specified investment goals for the benefit of the investors”.26

**Chart 1.2 Chart showing investment activities**

<table>
<thead>
<tr>
<th>I. FINANCIAL ASSETS</th>
<th>II. PHYSICAL ASSETS</th>
</tr>
</thead>
<tbody>
<tr>
<td>CASH</td>
<td>1 HOUSE, LAND, BUILDINGS, FLATS</td>
</tr>
<tr>
<td>BANKS' DEPOSITS</td>
<td>2 GOLD, SILVER AND OTHER METALS</td>
</tr>
<tr>
<td>P.F., L.I.C. SCHEMES</td>
<td>3 CONSUMER DURABLES</td>
</tr>
<tr>
<td>PENSION SCHEME</td>
<td></td>
</tr>
<tr>
<td>P.O. CERTIFICATES AND DEPOSITS</td>
<td></td>
</tr>
</tbody>
</table>

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.
By extension, investment management is the art of administering the employment of money in financial instruments in the present, with the expectation of a positive rate of return in the future. These individual financial instruments are kept in a case called the portfolio. Now where does the money come from? At an individual level, a person does a job of work and earns an income comprising of pay and perks. Here money is the medium of exchange.

The person would sensibly use his income in the following fashion:

1. Provide for current living expenses (or consumption).
2. Provide for personal requirements and deferred expenses.
3. Savings:
   a) To provide for emergency requirements.
   b) Revitalize: Employ for gainful returns in the future (or invest).

To bring focus and concentration upon the subsequent action required to be taken, it would be appropriate to document and have at hand an executive summary. A sample outline of such a documentation is explained below:

To start with the investor may state his background, along with any prior experience he may have with regard to transacting in the stock market amongst the other financial markets and the level of success he may already have achieved. After which he may state his business concept with regard to how he would address the stock market with a view towards achieving his investment objectives. He would then list his funding and their sources; which would indeed initially be a part of his savings which he may have decided to revitalize. Of course, he may also source additional funds from likeminded individuals; where he would be required to state a minimum assured return to them.
After which he may conduct a market analysis. Usually he would be able to do this through a "top down" or a "bottom up" approach. The former (that is, the top down approach) would be to start the analysis from the macroeconomic aspects of the market and work his way down through the industries and service sector groups and finally list the specific corporate entities and their overlying stocks which are likely to do well during the investment time horizon. While in the latter (that is the bottom up approach) the analysis would start from the stocks and their underlying corporate entities and working their way up through the industries and service sector groups to the larger macro-economic parameters, with the same view towards short listing stocks which are likely to do well during the investment time horizon.

The investor would also be required to do a competitive analysis with regard to the tools and measures he may have at hand or developed along the way; with a view to assess whether he would have any competitive advantage over the investing population. At this stage it would be prudent on the part of the investor to also list his investment philosophy, investment system and investment methodology; while providing for their improvement through better risk control and investment capital management with the passage of time over the investment time horizon.

While providing for a measurement of portfolio performance, the investor may also consider listing and documenting a time line and milestones over the investment time horizon. Further, in case he projects a growth of his investment system and platform into an organization; he would be well placed to list a proposed management and executive team; while also providing for governance, ownership, control issues and its financials; even if these aspects are hypothetical at this initial stage.
1.2.2 OTHER CONCEPTS

Savings and Investments

Investors are savers but all savers cannot be good investors, as investment is a science and an art. Savings are sometimes autonomous and sometimes induced by the incentives like fiscal concessions or income or capital appreciation. The number of investors is estimated of about 50 million out of population of more than one billion in India.\textsuperscript{27} Savers come from all classes except in the case of the population who are below the poverty line. The growth of urbanisation and literacy has activated the cult of investment. More recently, since the eighties the investment activity has become more popular with the change in the Govt. policies towards liberalization and financial deregulation.\textsuperscript{28} The process of liberalization and privatization was accelerated by the Govt. policy changes, towards a market oriented economy, through economic and financial reforms started in July 1991.\textsuperscript{29}

Investment for Consumption and Business

The income is divided into two components, namely, consumption and investment. The amounts not consumed are saved and invested. But investments are also useful for present and future consumption in the case of consumer durables, cars, gold and silver etc. But investments generally promote larger consumption in future as they lead to more income and larger capital appreciation in the years to come.

Some investments in business are used in trade and transport and other services. Thus, doctors, lawyers, traders etc. spend money for making investments for their business, which lead to further consumption or income.

Investment and Speculation

Purchase of assets like shares and securities can be for either investment or speculation or for both. Investment is long-term in nature
while speculation is short-term. Investment aims at income and normal long-term capital growth while speculation aims only at short-term trade-gains through buying and selling. Investment is less risky and speculation is more risky.

Basically, both aim at income and capital appreciation. But the difference is in motives and objectives. All investments are risky to some extent but speculation is most risky as it involves short-term trading, buying and selling which may lead to profits sometimes and losses at other times.

**Investment Opportunities**

Investment avenues are multifold and each has it’s own risk-return characteristics. Riskless investments in the common parlance are bank deposits, Govt. securities, bonds of Govt. and semi Govt. bodies, post office savings schemes, P.O. deposits etc., Provident funds and pension fund schemes, Insurance for life, endowment, accident, etc.

**Financial Investments vs. Physical Investment**

Many savers will have their first preference for physical investments which are less productive and rarely income earning. Such investments are in consumer goods — non-durables or durables, gold, silver, cars and antiques and 'Curios.' These are satisfying the immediate consumer needs, for comfort, luxuries, social status, ego satisfaction, etc. Some investments of physical nature are more in real estate, land, buildings etc. Some of them if rented out to others give income and sometimes capital appreciation also, if the location is at good places or commercial areas. Similarly, gold, silver and other metals, diamonds, and antiques may present capital appreciation, without giving any regular income. Some investments are for social status and prestige as gold, diamonds, jewellery etc.
Bank Deposits

Commercial and cooperative banks accept deposits from public in the form of current account which bears no interest, savings Accounts which bear interest varying from 3.5% to 4% per annum, and fixed deposits of varying maturities from 15 days to 3 years or more. The interest rates will vary from bank to bank but the ceiling rates are fixed by the RBI. These deposits are also insured with the Deposit Insurance and Credit Guarantee Corporation. Besides the operation of the banks, being regulated and inspected by RBI, the deposits kept with them are supposed to be safer and risk free. Although the returns are lower, the risk is also lower and risk savers investors will prefer investments in these avenues.

Next to keeping in cash most savings generally flow into some form of the bank deposits. The average households in India keep about 10% of their savings in financial form in cash and nearly 40% in bank deposits of various forms. But these avenues of investment give a return which is zero in the case of cash or a return less than or equal to the inflation rate of about 8% per cent per annum which is the average annual rate of inflation in the Eighties and Nineties.

1.2.3 Characteristics of Investment

Characteristics of investment can be presented as below:

A. Risk
B. Return
C. Safety
D. Liquidity
E. Marketability

A. Risk: The risk depends on the following factors:

1. The longer the maturity period, the larger is the risk. Thus, deposits of two years carry a higher rate than one-year deposits.
2. The more the creditworthiness of the borrower or agency issuing securities, the less is the risk. Thus, the risk of loss of interest and principal is less with the Government or semi-Government bodies than with the private corporate units.

3. The nature of instrument, namely, the debt instrument or fixed deposit or ownership instrument like equity or preference share, also determines risk. The risk of loss of money is less in the case of debt instruments like debentures, as these are secured and fixed interest is payable on them. In the case of ownership instruments, the risk of loss is more due to their unsecured nature and variability of their return and ownership character which burdens them with all the risks connected with the enterprise.

4. The risk of variability of returns is more in the case of ownership capital as the return varies with the net profits after all commitments are met. As such, equity and preference shares of companies are more risky than debentures or bonds. Among the ownership instruments, equity is more risky than preference shares or other forms of ownership instruments such as partly or fully convertible debentures, convertible and cumulative preference shares, as equity holders are residual owners of the firm.

5. The nature of tax liability on the instruments — the tax provisions would influence the return as the net effective return for a tax-payer would be higher for tax-free instruments as in the case of NSS, NSC, (VI or VII Series) or those whose interest income is tax-free up to a limit as in the case of UTI dividends, RBI Relief Bonds or interest on P.O. deposits. The net return on such instruments is higher by different degrees to the tax-payers, depending upon the income tax brackets into which they fall. Thus, tax implications of investment are important factors in considering
the return on investment. Besides risk, investment decisions are based upon return, safety, liquidity, marketability, etc., which are examined below.

B. Return:

A major factor influencing the pattern of investment is its return, which is the income plus capital appreciation, if any. The difference between the purchase price and the sale price is capital appreciation and the yield is the interest or dividend by its purchase price. Thus, if Rs. 25 is the dividend on a share of the face value of Rs. 100 but purchased at Rs. 150, then the returns $25/150 = 16.6\%$. Suppose, there is capital appreciation also in a year, say, Rs. 10 on the purchase price of Rs. 150, then the total return is $(25+10)/150$, which is $23.3\%$ per annum.

C. Safety:

The safety of capital is the certainty of return on capital without loss of money or time involved. In all cases of money lent, some transaction costs and time are involved in getting the funds back. But leaving aside such general costs like stamp duty, postal charges, etc., the time involved is also an important factor. If money is returnable not on the same day but after a lapse of time, then the loss of liquidity is involved and if the time of return of funds is not certain and if costs of selling or realisation of proceeds are involved, then the safety of funds is also not perfect. Thus, if safety of capital is to be assured, then riskless return as in the case of Government bonds is to be chosen. If the return is higher, as in the case of private securities, then the degree of safety is less.

D. Liquidity:

If a capital asset is easily realizable, saleable or marketable, then it is said to be liquid. If an investment can be encased with a time lag as in the case of equity shares or with loss of money as in the case of corporate
deposits, then they are less liquid. If, on the other hand, there is a good market for the capital asset and no risk of loss of money or capital and no uncertainty of time involved, then the liquidity of the asset is good. If liquidity is high, then the return may be low as in the case of bank saving deposits or MF units.

An investor generally prefers liquidity for his investments, safety of his funds, a good return with a minimum risk or minimisation of risk and maximisation of return (dividend plus capital appreciation).

E. Marketability:

This refers to transferability or sale ability of an asset. Those listed on a stock market are more easily marketable than those that are not listed. Public limited companies will have their shares more easily transferable than those of private limited companies.

1.2.4 NEED OF INVESTMENT MANAGEMENT:

One of the reasons why mutual funds and fund managers are some of the biggest and most successful companies in the world is simply because the majority of people are "lazy" when it comes to investing. It is much easier to simply hand your money to someone else and let them do the hard work for you. After all, these are the professionals.

In fact this is a very bad and wrong approach to investing - even if people are just starting out with investing plan. Handing the responsibility of money over to someone else is suicide as many people experienced first-hand when the global markets started crumbling back in 2008. Mutual funds do have a place and should have a part in the overall investment plan, but when it comes to investing the money, you need to take responsibility.

Your money is something that you need to be responsible for at all times. Managing one’s own portfolio is very important simply because it
allows a person to know exactly where he/she stands at all the time. Managing all the investments may seem like a big task, but it is something that one can all learn to do. Not only one can make better investments but one will probably be much more secure in his/her investments.

The professional management of assets, such as real estate, and securities, such as equities, bond and other debt instruments, is called investment management. Investment management services are sought by investors, which could be companies, banks, insurance firms or individuals, with the purpose of meeting stated financial goals.

Thus, the need for investment management arises due to:
1) The existence of a large number of complex financial products
2) Financial market volatility
3) Changes in regulatory requirements

Investment Management: Who does it?

Every individual practices investment management to some degree, including budgeting, saving, investing and spending. However, an investment manager is one who specializes in placing money in diverse instruments in order to accomplish predetermined goals. Investment managers are also widely known as fund managers. Investment managers may specialize in advisory or discretionary management. When an investment manager merely offers suggestions regarding where to invest money and when to sell securities, the practice is known as advisory investment management. When an investment manager can take action in managing portfolios without requiring client approval, it is called "discretionary" investment management.

Investment management is often used synonymously with fund management. Moreover, terms like asset management, wealth management and portfolio management are used, with a thin line
differentiating them. Asset management is often used for the management of collective investments, which refers to investing money on behalf of a large group of clients in a wide range of investment options. An example of this is mutual funds. Investment management that involves managing the investments of high net worth individuals is often referred to as wealth management. Asset management and wealth management are also called portfolio management.

1.2.5 PROCESS (FUNCTIONS) OF INVESTMENT MANAGEMENT:

   The process of investment management generally consists of five steps as discussed below:

   1. Setting the investment objectives
   2. Establishing investment policy
   3. Selecting the portfolio strategy
   4. Selecting the assets
   5. Measuring and evaluating the performance

1) Setting the investment objectives:

   The first step for the investor is to set the investment objective. This would vary for individuals, pension and mutual funds, banks, financial institutions, insurance companies, etc.

   For instance, the objective for a pension or mutual fund or insurance company may be to have a cash flow specification to satisfy liabilities at different dates in the future. These liabilities would include redemption, dividends or claim settlement payouts.

   For a bank, it may be to lock in a minimum interest spread over their cost of funds.

   For the individual investor, the objective may be to maximize return on investment. A more appropriate word would be ‘optimize. As
the individual would achieve optimum return at optimum risk to maximize return would imply the maximization of risk, which would not be practical or sustainable.

It would be quite in order to present a sample investment objective for further analysis and modification to suit the requirements of individual investors. The objective would revolve around aspects of income generation, growth of the investment capital, stability and implementation.

At the time of the documentation and setting of the investment objective, the investor would be called upon to conduct a SWOT analysis to get a better perspective of his present financial condition and the strengths, weaknesses, opportunities and threats he is faced with. Aspects to consider have been listed below:

**Sample SWOT Analysis:**

**Strengths:**

- Whether he is living in own home/house.
- Whether he owns office space (may even be generating rental income).
- Whether the investment knowledge base is available.
- Whether the investment system, management process, and platform are available.
- Whether the investment capital is available.

**Weaknesses:**

- Level of risk tolerance; would be a weakness if it is high.
- Level of money management skills.
- Whether there is enough income generation through present investments.
- Whether there is a current expenses overrun.
Opportunities:

- Whether there is potential for growth.

Threats:

- Inflation risk.
- Interest rate risk.
- Conduct and actions of the peer group and extended family which may cause financial damage or harm.

Of course, the investor is welcome to list other strengths, weaknesses, opportunities and threats he may be faced with or even expects to be faced with sometime in the future. The purpose here would be to reinforce and/or increase the strengths and opportunities while restricting and/or reducing the weaknesses and threats.

Last but not the least, the investor must state and document the matters that would require his attention in the future. Some such matters are listed below:

Matters for attention in the future:

- Build human capital and knowledge base.
- Life and disability insurance.
- Investment in real estate (residential and office space).
- Children education and resource allocation.
- Financial security for the family.
- Savings for retirement.
- Wealth creation.
- Charitable activity.

As a word of caution and a disclaimer of sorts, the investor must appreciate that the above documented sample investment objective, is just a sample. The investor would be required to document his own investment objective; and subsequently analyze and appreciate whether
he has been able to achieve such investment objectives. It would be fair to say that the setting of, monitoring; and subsequent analysis and revalidation of the investment objective against real time investment results is a dynamic process.

2) Establishing investment policy:

Establishing or setting investment policy begins with asset allocation amongst the major asset classes available in the capital market. Which range from equities, debt, fixed income securities, real estate, foreign securities to currencies. This may also be understood as the establishing of investment policy begins with the allocation of the financial resource amongst the major asset classes available in the capital market, which range from equities, debt, fixed income securities, real estate, foreign securities and currencies, commodities, amongst others.

While establishing the investment policy the constraints of the environment and that of the investor have to be kept in perspective.

The environment would include: government rules and regulations (or restrictions); another would be the operating system of the market place. Individual constraints would include financial capability, availability of time to undertake the exercise, risk profile and the level of understanding the investor has of the investment environment.

From the perspective of the individual investor, it would be more a matter of strategy and tactics while engaging directly with the investment environment through the various markets he may have access to; and would include the stock market amongst other markets both regional and global.

It would be quite in order to present a sample investment policy for further analysis and modification to suit the requirements of individual investors. The investment policy would revolve around aspects of strategy and tactics.
The investor would be required to document his own investment policy; and subsequently analyze and appreciate whether he has been able to confirm or abide by his stated investment policy. It would be fair to say that the establishing of, monitoring and subsequent analysis and revalidation of the investment policy against real time investment results is a dynamic process.

3) Selecting the portfolio strategy:

The portfolio strategy selected would have to be in conformity with both the investment objective and investment policy guidelines. Any contradiction here would result in a systems break down and losses.

Let’s consider a person with a job that keeps him busy for 10-12 hours a day, five days of the week. On Saturday, he helps the family with household chores. On Sunday, he takes the day off and enjoys himself. Now with such a busy life, we cannot expect him to obtain optimal returns from investments in the equity market. Where is the time for thought, analysis and action? He would at best be playing a game of Russian roulette. For a person with such a busy life schedule it would be best to invest in fixed income securities. These would include RBI bonds, Bank deposits, insurance, etc.

Where there is a lower but assured return. However, if this average, hardworking and successful person still wants to invest in the equity market for a relatively higher rate of return. Then he would have to create the time for the thought, analysis and action required for success in this endeavour.

Portfolio strategies are mainly of two types; which are active portfolio strategies and passive portfolio strategies. Active portfolio strategies have a higher expectation about the factors that are expected to influence the performance of the asset classes. While passive portfolio
strategies involve a minimum expectation input. The latter would include indexing which would require the investor to replicate the performance of a particular index. Between these two extremes, we have a range of other strategies which have elements of both active and passive strategies. In the fixed income segment, structured portfolio strategies have become popular. Here the aim would be to achieve a predetermined performance in relation to a benchmark. These are frequently used to fund liabilities.

The individual investors who wish to adopt an active portfolio strategy would be required to look into the following matters:

- Market timing
- Sector rotation
- Stock selection
- Conceptualization

**Market timing:** The purchase of stocks in the stock market would by default reduce the subsequent holding period of the stocks held in the portfolio with the expectation of a reasonable expectation of return at the point of sale, with the advantage of the financial resources again being available to be applied with regard to other stocks which may provide both opportunities of purchase as well as a fair margin of safety at the point of their subsequent purchase. This would also result in the turning over of the investment capital during the financial period in which this strategy is implemented.

**Sector rotation:** It would require an understanding of the segregation of the various stocks into appropriate industries and service sector groups. The investor may now consider short listing the top three to five corporate entities from each of the lead industries and service sector groups for a further study to decide whether the stocks short listed are of investment grade. Thereafter, the investor would be required to move the investment capital from one industry and/or service sector
group to another depending on the availability of a fair margin of safety while engaging such stocks and adequate profits while disengaging from them.

**Stock selection:** It would require a short listing of the investment grade stocks for analysis based on fundamental parameters to confirm their present status of being investment worthy. A further study to check and confirm whether the current market price of such stocks is below its intrinsic value and offer a fair margin of safety; this may also require the application of technical tools to reconfirm a probable oversold condition at the time of such analysis.

**Conceptualization:** It would require the investor to have at hand an investment philosophy, upon which subsequent investment decisions would be based. This philosophy would be based on an understanding of various forces which affect the stock markets and the movement of the prices of stocks traded in them. Forces would include demand supply mismatches in the stock market itself as well as in other allied markets (like commodities and forex amongst other such markets including global, regional and national) which may influence its performance, stock market psychology (an oscillation between fear and greed), political (including government policies) stability or otherwise of the nation in which the stock market exists, amongst others. In addition, the investor would also be required to segregate the stocks short listed into categories of growth, bell weathers, stars, cyclical, technology based and asset rich. Thereafter, the investor would either choose a value based or growth based approach.

In the long run, the individual investor would find that the above selection of the portfolio strategy and its subsequent implementation would be intuitive. It would require the individual investor to ascertain whether he has the time to take on the challenges offered by this shift
form a passive portfolio strategy to an active portfolio strategy stance. If it is found that the time required for this exercise is not readily available, then the individual investor may continue to maintain the expected present stance of a passive portfolio strategy. Of course, a passive portfolio strategy stance would have the advantage of safety of the investment capital although at a lower rate of return or growth; but, then again the individual investor would have a larger investment capital base to start with, when he does get around to adopting an active portfolio strategy stance. The individual investor would also realize that selecting an appropriate portfolio strategy is but one link (or part) of what may be called the portfolio management framework. That the individual investor chooses to be cautious at all times would hold him in good stead in the long run.

As a word of caution and a disclaimer of sorts, the investor must appreciate that the above selection of the portfolio strategy is only indicative of aspects, the investor would have to consider while shifting from a passive portfolio strategy to an active portfolio strategy. The investor would be required to document his own investment objective and investment policy; and subsequently clearly state (or select) the appropriate portfolio strategy to be adopted for subsequent investment decision making. It would be fair to say that selecting the portfolio strategy, monitoring its performance and subsequent revalidation would indeed be a dynamic process. The saving grace of course would be that one part is linked to the other and therefore a change proposed to be implemented in any one part would require revalidation of the other parts. These parts include selecting the portfolio strategy, establishing investment policy and setting the investment objective.
4) **Selecting the assets:**

It is of importance for the investor to select specific assets to be included in the portfolio. It is here that the investor or manager attempts to construct an optimal or efficient portfolio, which would give the expected return for a given level of risk, or the lowest risk for a given expected return.

The asset classes he can choose from are:

- **Equity**
- **Fixed income securities** (which would include RBI bonds and bank deposits)
- **Debt instruments**
- **Real estate**
- **Art objects**
- **Rare stamps**
- **Currencies**

The investor would ideally have all the above in his investment portfolio. This would then require the investor to rebalance the various components of his overall portfolio from time to time, depending on his objectives with respect to this portfolio. These objectives may be time based or asset price based or a combination of both.

5) **Measuring and evaluating performance:**

This step would involve the measuring and evaluating of portfolio performance relative to a realistic benchmark.

We would measure portfolio performance in both absolute and relative terms, against a predetermined, realistic and achievable benchmark. Further, we would evaluate the portfolio performance relative to the objective and other predetermined performance parameters.

The investor or manager would consider two main aspects; namely risk and return. He would measure and evaluate, whether the returns were
worth the risk, or whether the risk was worth the return. The issue here is, whether the portfolio has achieved commensurate returns, given the risk exposure of the portfolio.

Measuring and evaluating portfolio performance, would be used to give the investor or manager feedback, and would help the investor or manager in improving the quality and performance of both the portfolio and its management process in the future.

1.2.6 OBJECTIVES OF INVESTORS

Investors generally invest for following objectives in view:

(a) Income
(b) Appreciation of Capital
(c) Safety
(d) Liquidity
(e) Hedge against inflation.
(f) A method of tax planning

The mix of these objectives may also depend on the time frame of his investment.

(a) Short-term/day-to-day trading gains.
(b) Short-term capital appreciation up to one year (short-term capital gains).
(c) Long-term appreciation of more than 1 to 3 years (long-term capital gains). Investment preferences of public may be set out in terms of their savings for:
(a) Transactions purpose (for daily needs or regular payments),
(b) Precautionary purposes (for contingencies or special needs).
(c) Speculative or asset purposes (for Capital gains and building- of assets)
1.2.7 MODES OF INVESTMENT

In continuation of the discussion of the Investment Avenues, it is attempted below to give specifically all modes of investment.

There are different types of securities conferring different sets of rights on the investors and different sets of conditions under which these rights can be exercised. The various avenues for investment, ranging from risk-less to high risk investment opportunities consist of both security and non-security forms of investment. All securitized forms given below are marketable.

A. Security Forms of Investment

1. Corporate Bonds/ Debentures
   (a) Convertible
   (b) Non-convertible
   (c) Redeemable
   (d) Irredeemable

2. Public Sector Bonds
   (a) Taxable
   (b) Tax free

3. Preference Shares

4. Equity Shares
   (a) New Issue
   (b) Rights Issue
   (c) Bonus Issue

B. Non-Security Forms of Investment (non-marketable)

1. National Savings Scheme
2. National Savings Certificates
3. Provident Funds
   (a) Statutory Provident Fund
   (b) Recognised Provident Fund
(c) Unrecognised Provident Fund
(d) Public Provident Fund

4. Corporate Fixed Deposits
   (a) Public Sector
   (b) Private Sector

5. Life Insurance Policies
   (a) Whole Life Policies
   (b) Limited-Payment Life Policy
   (c) Convertible Whole Life Assurance Policy
   (d) Endowment Assurance Policy
   (e) Jeevan Mitra
   (f) The Special Endowment Plan with Profits.
   (g) Jeevan Saathi
   (h) The New "Money Back Plan"
   (i) Marriage Endowment/Educational Annuity Plan with Profits
   (j) Bima Sandesh Premium Back Term Insurance Plan
   (k) New Children's Deferred Assurance Plan
   (l) Jeevan Dhara
   (m) New Jana Raksha Plan with Profits
   (n) Jeevan Akshay Plan
   (o) Jeevan Balya Plan
   (p) Jeevan Kishor
   (q) Jeevan Griha
   (r) Jeevan Santa and others

6. Unit Schemes of Unit Trust of India (Some are marketable among these)
   (a) Unit Scheme, 1964
   (b) Re-investment Plan, 1966
(c) Unit Linked Insurance Plan, 1971
(d) Capital Gains Unit Scheme, 1983
(e) Children's Gift Growth Funds, 1986
(f) Parents' Gift Growth Funds, 1987
(g) Monthly Income Unit Scheme with extra bonus plus growth
(h) Mastershares
(i) Mastergains
(j) Equity Linked Savings Scheme
(k) Growing Monthly Income Unit Scheme
(l) Mastershare Plus and Many More

There are many other UTI schemes on similar lines and a number of commercial banks and financial institutions have set up Mutual Funds. Various schemes for equity investment, Debt and Balanced investments or some specialized portfolio schemes have been launched by many public sector and private sector Mutual Funds, some of which have foreign partners.

7. Post Office Savings Bank Account
   (a) Recurring Deposits
   (b) Time Deposits
   (c) Monthly Income Scheme
   (d) National Savings Certificates

8. Others
   (a) RahatPatras or Relief Bonds
   (b) Senior Citizen’s Certificate
   (c) KisanVikas Patras

   (i) Recurring Deposits
   (ii) Time Deposits etc.
C. **Non-Corporate Investments**

In addition to securities of the corporate sector into which savings of the households flow to a minor extent, there are a number of other avenues for investment such as deposits with commercial and cooperative banks, post office savings banks, National Savings Certificates, Provident fund and pension fund contributions, insurance, deposits with companies, purchase of real estate, gold and silver etc. There are other lines of investment, more frequently resorted to by companies, financial institutions etc. such as securities of the Government and semi-Government bodies, viz., Treasury bills, Government bonds, public sector unit bonds, Government securities, etc. These investments are of many types and can be classified as follows:

1. ** Marketable and non-marketable:**

   Real estate, gold, silver, etc. are marketable and are most popular among the households. Treasury bills, bonds and Government securities are also marketable but are popular only with financial institutions and banks. Some of these like UTI units, tax-free bonds, etc. which enjoy a number of tax benefits are also popular with companies and institutions. The investments in the nature of deposits with banks, companies, National Savings Certificates, etc. are not marketable as they are not transferable by endorsement.

2. **Interest payable regularly or reinvested:**

   Some investment media like bank deposits pay interest quarterly or half-yearly. Some investments will have annual interest or dividends paid as in the case of UTI units or half yearly on P.O. savings certificates. Some media will have the interest reinvested as in P.O. cumulative time deposits etc. Repayments can also take the form of annuity, that is, to say, a payment combining interest with principal.
3. **Payment linked to an event:**

   In the case of life insurance, payment is at the event of death, accident-insurance, at the occurrence of an accident, provident fund at the time of retirement etc. Payment out of pension funds, or out of annuities, will be spread over a number of years.

4. **Regular savings media of investment vs. lumpsum investment at a time:**

   Some investment media like LIC insurance premium or contributions to PF and insurance are regular monthly savings either voluntarily or compulsorily. Similarly, contributions to the recurring deposit schemes of banks and post offices are regular monthly savings media. On the other hand, purchase of NSC or a fixed deposit with a notice period or for a fixed period of time are examples of the lumpsum investments at a time.

D. **Corporate Investments**

   The major avenues of investment among corporate securities are equity shares and preference shares, which are of ownership category and debentures and fixed deposits from the public, which are of debt category. Of these, preference shares debentures and deposits are having a fixed interest while equity shares are of variable dividend. The risk is in the case of fixed deposits of companies as they are unsecured, while equity shares are of high risk and high return category.

**Deposits with Banks**

   Among the non-corporate investments, the most popular are deposits with banks such as current accounts, savings accounts and fixed deposits. On current account deposits, no interest is paid as these are meant for regular transactions by businessmen and companies. Savings deposits are those on which interest is paid at 3.5%, which is the lowest
among the various categories of investments. There is also the category of fixed deposits, which has varying characteristics. Thus, fixed deposits may be recurring deposits wherein savings are deposited at regular intervals or fixed deposits of varying maturities or with varying notice periods such as 7 days, 15 days, etc. The interest rates on these deposits vary depending upon the maturity period, from 4.5 to 7.5% at present. Banks are permitted to affect offer higher rates for large amounts from October 1, 1995. The banks also provide other varieties of schemes for savings and for raising deposits from the public. The rates on them are now free from RBI control. The amounts interest on these deposits is payable half-yearly or quarterly calculated on the basis of simple interest. Some of the banks have reinvestment plans wherein the interest is reinvested as is accrued and paid at the end of the fixed period, say, of 1 to 5 years. The principal and the accumulated interest are paid to the investor on maturity.

1.3 MUTUAL FUNDS

1.3.1 CONCEPT OF MUTUAL FUND

In India, the only mutual fund operating for a long time since 1964 was the UTI. It is an open-ended mutual fund, whose units can be sold and repurchased at any time. It is in the public sector, enjoying a monopoly position and some unique tax benefits such as exemption from income-tax of its entire income. Although the UTI has operated a number of schemes linked to insurance and gifts, and some tax benefits, income declared by it to unit holders is not subject to any tax deduction at source and is exempt from income tax. Since 1995-96, there was a TDS, if the annual income is more than Rs. 10,000, which was removed in 1999-2000.
Mutual Funds have been set up since 1987 by the public sector banks following an Amendment to the Banking Regulation Act in 1983, which empowered the RBI to permit the banks to carry on non-banking business such as leasing, mutual funds, etc. under Section 6 of this Act. Since then, the SBI, Canara Bank, Punjab National Bank and some other nationalized banks have set up their own mutual funds. The business of mutual funds has caught the imagination of the financial community and has grown at a rapid pace in India. These funds cater mainly to individual investors and small savers. It was thrown open to private sector and foreign sector in 1992-93. Since 1996, this Mutual Fund business was in a bad shape due to depressed conditions of the capital market.

Mutual funds are associations or trusts of public members who wish to make investments in the financial instruments or assets of the business sector or corporate sector for the mutual benefit of its members. The fund collects the moneys of these members from their savings and invests them in a diversified portfolio of financial assets with a view to reduce risks and to maximize their income and capital appreciation for distribution to its members on a pro-rata basis. They enjoy collectively the benefits of expertise in investment by specialists in the trust, economies of scale which no single individual by himself could enjoy. Mutual fund is thus a concept of mutual help of subscribers for portfolio investment and management of these investments by experts in the field. These funds are set up under the Indian Trusts Act. UTI is governed by its own Act.

1.3.2 STEPS TO POPULARIZE MUTUAL FUNDS

One of the major shortcomings of the existing funds appears to be that a significant share of the funds mobilized comes from the corporate sector. Fiscal reliefs available to the corporate sector on dividends from
mutual funds have been encouraging corporate investment in such funds. There is obviously a lot to be done to attract the individual investor. Commercial banks with their vast network of branches and close relationship with the household sector are, of course, very well-placed to fulfill this function. The UTI is also geared to cater more to the individual investors.

With a view to make the mutual fund schemes more popular with the small investors, the Government of India has permitted various tax concessions to the investors. The Equity Linked Savings Scheme (ELSS) implemented by the Mutual Funds, is a further step in this direction. Investment in this scheme will have the benefit of tax concession. The LIC and GIC have additional benefits of insurance cover to a certain extent. Now, the income from investment in the UTI and other funds is treated on equal terms for tax purposes. A uniform treatment to all the mutual funds and even to venture capital funds is given so that there is a level playing field for all and performance comparisons are meaningful.

1.4 CONCLUSION

Financial management is in many ways an internal part of the jobs of managers who are involved in planning, allocation of resources and control. The responsibilities for financial management are dispersed throughout the organization, while performing the functions, the financial manager should focus on Investment decision, Financial decision, Dividend decision, Liquidity decision etc. Financial management is the key to successful business operations without which no business enterprise can reach its full potentials for growth and success.

The Investment Management consists of certain steps of setting the investment objectives, establishing investment policy, selecting the portfolio strategy, selecting the assets and measuring and evaluating
performance. The need of Investment management arises due to the existence of a large numbers of complex financial products, financial market volatility and changes in regulatory requirements.

Investment management is the art of administering the employment of money in financial instruments in the present, with the expectations of a positive rate of return in the future. The fundamentals of Investment management companies include the processing of the securities and assets in such a way so as to gain the maximum benefit for the client investors. The client investor in the investment management may either be an insurance company, a corporation or a pension fund or even may be private investor going for collective investment schemes like Mutual Fund.

Mutual Funds are association or trusts of public members wish to make investments in the financial instruments or assets of the business sector or corporate sector for the mutual benefits of its members. With a view to make the mutual fund schemes more popular with the small investors, the government of India has permitted various tax concessions to the investors. The Equity Linked Saving scheme implemented by the Mutual Funds, is a further step in this direction investment in this scheme has the benefit of tax concession. Detail discussion about Mutual Funds has been done in the next chapter i.e in Chapter no. 2.
REFERENCE

2. Ibid
8. Ibid
10. Ibid
17. Ibid
18. Ibid
20. Ibid
23. Ibid, p.7
28. Ibid
29. Ibid, p.19
32. V.A.Avadhani, Op.Cit, p.57
33. V.A.Avadhani, Op.Cit, p.57
35. Ibid
36. Ibid, p.16
37. Ibid, p.16
38. Ibid, p.16