1

INTRODUCTION

Investing in securities such as shares, debentures and bonds is profitable as well as exciting. It is indeed rewarding, but involves a great deal of risk and calls for scientific knowledge as well as artistic skill. In such investments, both rational as well as emotional responses are involved. Investing in financial securities is now considered to be one of the best avenues for investing one's savings while it is acknowledged to be one of the most risky avenues of investment.

It is rare to find investors investing their entire savings in a single security. Instead, they tend to invest in a group of securities. Such a group of securities is called a **portfolio.** Creation of a portfolio helps to reduce risk without sacrificing returns. Portfolio management deals with the analysis of individual securities as well as with the theory and practice of optimally combining securities into portfolios. An investor who understands the fundamental principles and analytical aspects of portfolio management has a better chance of success.

WHAT IS PORTFOLIO MANAGEMENT

An investor considering investment in securities is faced with the problem of choosing from among a large number of securities. His choice depends upon the risk-return characteristics of individual securities. He would attempt to choose the most desirable securities and like to allocate his funds over this group of securities. Again he is faced with the problem of deciding which securities to hold and how much to invest in each. The investor faces an infinite number of possible portfolios or groups of securities. The risk and return characteristics of portfolios differ from those of individual securities combining to form a portfolio. The investor tries to choose the optimal portfolio taking into consideration the risk-return characteristics of all possible portfolios.

As the economic and financial environment keeps changing, the risk-return characteristics of individual securities as well as portfolios also change. This calls for periodic review and revision of investment portfolios of investors.

An investor invests his funds in a portfolio expecting to get a good return consistent with the risk that he has to bear. The return realised from the portfolio has to be measured and the performance of the portfolio has to be evaluated.

It is evident that rational investment activity involves creation of an investment portfolio. Portfolio management comprises all the processes involved in the creation and maintenance of an investment portfolio. It deals specifically with security analysis, portfolio analysis, portfolio selection, portfolio revision and portfolio evaluation. It also makes use of analytical techniques of analysis and conceptual theories regarding rational allocation of funds. Portfolio management is a complex process which tries to make investment activity more rewarding and less risky.

PHASES OF PORTFOLIO MANAGEMENT

Portfolio management is a process encompassing many activities aimed at optimising the investment of one's funds. Five phases can be identified in this process:

1. Security analysis
2. Portfolio analysis
3. Portfolio selection
4. Portfolio revision
5. Portfolio evaluation

Each phase is an integral part of the whole process and the success of portfolio management depends upon the efficiency in carrying out each of these phases.

Securities Market

Investment in securities involves buying and selling of securities. Construction of a portfolio and its periodic revision require several such transactions of buying and selling securities. These transactions have to be carried out in the securities market, which is the market where trading in securities takes place. Investors may directly purchase securities from the company when it is issuing securities. To issue new securities, companies go through several steps and use services of different intermediaries such as merchant bankers, share transfer agents, registrars to the issue, bankers to the issue, underwriters, brokers, etc.

Securities already issued by companies are traded between investors in the *stock exchanges,* which constitute the secondary market for securities. Stock exchanges provide liquidity to the investments made in the corporate sector. They also provide valuation of the securities of different companies listed in the stock exchanges for trading. There are two national level stock exchanges in the country—the National Stock Exchange of India (NSE) and the Stock Exchange, Mumbai (BSE), and several regional stock exchanges located in different parts of the country.

The functioning of stock exchanges is regulated by certain Acts, rules, regulations, by-laws and guidelines so as to ensure fair and transparent processes in all their transactions.

The Securities and Exchange Board of India (SEBI) acts as the regulator for both the primary and secondary markets in India, supervising and monitoring their functioning in every respect.

A stock exchange is primarily a market for trading in securities. But it is a market with several peculiar features and is quite unlike other ordinary markets we are familiar with. The trading system in a stock exchange, including placing of orders, execution of orders, exchange of cash and securities between the trading parties, etc. is unique. It has been evolved and reformed over the years to ensure an efficient and transparent trading mechanism.

The continuous fluctuations in the prices of securities lead to speculative activities in stock exchanges. An understanding of the different types of speculative activities and the speculators is useful in studying the price movements in stock exchanges. The stock market indices indicate the direction of market movements.

Security Analysis

The securities available to an investor for investment are numerous and of various types. The shares of over 7000 companies are listed in the stock exchanges of the country. Traditionally, the securities were classified into ownership securities such as equity shares and preference shares and creditorship securities such as debentures and bonds. Recently a number of new securities with innovative features are being issued by companies to raise funds for their projects. Convertible Debentures, Deep Discount Bonds, Zero Coupon Bonds, Flexi Bonds, Floating Rate Bonds, Global Depository Receipts, Euro-currency Bonds, etc. are some of these new securities. From this vast group of securities the investor has to choose those securities which he considers worthwhile to be included in his investment portfolio. This calls for a detailed analysis of the available securities.

Security analysis is the initial phase of the portfolio management process. This step consists of examining the risk-return characteristics of individual securities. A basic strategy in securities investment is to buy underpriced securities and sell overpriced securities. But the problem is how to identify underpriced and overpriced securities, or, in other words, 'mispriced' securities. This is what security analysis is all about.

There are two alternative approaches to security analysis, namely fundamental analysis and technical analysis. They are based on different premises and follow different techniques. **Fundamental analysis**, the older of the two approaches, concentrates on the fundamental factors affecting the company such as the EPS of the company, the dividend pay-out ratio, the competition faced by the company, the market share, quality of management, etc. A fundamental analyst studies not only the fundamental factors affecting the company, but also the fundamental factors affecting the industry to which the company belongs as also the economy fundamentals.

According to this approach, the share price of a company is determined by these fundamental factors. The fundamental analyst works out the true worth or intrinsic value of a security based on its fundamentals; then compares this intrinsic value with the current market price. If the current market price is higher than the intrinsic value, the share is said to be overpriced and vice versa. The mispricing of securities provides an opportunity to the investor to acquire the share or dispose of the share profitably. An investor would buy

those securities which are underpriced and sell those securities which are overpriced. It is believed that notable cases of mispricing will be corrected by the market in future. Prices of undervalued shares will increase and those of overvalued shares will decline.

Fundamental analysis helps to identify fundamentally strong companies whose shares are worthy to be included in the investor's portfolio.

The second alternative approach to security analysis is **technical analysis.** A technical analyst believes that share price movements are systematic and exhibit certain consistent patterns. He, therefore, studies past movements in the prices of shares to identify trends and patterns. He then tries to predict the future price movements. The current market price is compared with the future predicted price to determine the extent of mispricing. Technical analysis is an approach which concentrates on price movements and ignores the fundamentals of the shares.

A more recent approach to security analysis is the **efficient market hypothesis.** According to this school of thought, the financial market is efficient in pricing securities. The efficient market hypothesis holds that market prices instantaneously and fully reflect all relevant available information. It means that the market prices of securities will always equal their intrinsic values. As a result, fundamental analysis which tries to identify undervalued or overvalued securities is said to be a futile exercise.

The efficient market hypothesis further holds that share price movements are random and not systematic. Consequently, technical analysis which tries to study price movements and identify patterns in them is of little use.

Efficient market hypothesis is a direct repudiation of both fundamental analysis and technical analysis. An investor cannot consistently earn abnormal returns by undertaking fundamental analysis or technical analysis. According to efficient market hypothesis, it is possible for an investor to earn normal returns by randomly choosing securities of a given risk level.

Portfolio Analysis

A portfolio is a group of securities held together as investment. Investors invest their funds in a portfolio of securities rather than in a single security because they are risk averse. By constructing a portfolio, investors attempt to spread risk by not putting all their eggs into one basket. Thus, diversification of one's holdings is intended to reduce risk in investment.

Security analysis provides the investor with a set of worthwhile or desirable securities. From this set of securities an indefinitely large number of portfolios can be constructed by choosing different sets of securities and also by varying the proportion of investment in each security. Each individual security has its own risk-return characteristics which can be measured and expressed quantitatively. Each portfolio constructed by combining the individual securities has its own specific risk and return characteristics which are not just the aggregates of the individual security characteristics. The return and risk of each portfolio has to be calculated mathematically and expressed quantitatively.

Portfolio analysis phase of portfolio management consists of identifying the range of possible portfolios that can be constituted from a given set of securities and calculating their return and risk for further analysis.

Portfolio Selection

Portfolio analysis provides the input for the next phase in portfolio management which is portfolio selection. The goal of portfolio construction is to generate a portfolio that provides the highest returns at a given level of risk. A portfolio having this characteristic is known as an **efficient portfolio**. The inputs from portfolio analysis can be used to identify the set of efficient portfolios. From this set of efficient portfolios, the optimal portfolio has to be selected for investment. Harry Markowitz's portfolio theory provides both the conceptual framework and the analytical tools for determining the optimal portfolio in a disciplined and objective way.

Portfolio Revision

Having constructed the optimal portfolio, the investor has to constantly monitor the portfolio to ensure that it continues to be optimal. As the economy and financial markets are dynamic, changes take place almost daily. As time passes, securities which were once attractive may cease to be so. New securities with promises of high returns and low risk may emerge. The investor now has to revise his portfolio in the light of the developments in the market. This revision leads to purchase of some new securities and sale of some of the existing securities from the portfolio. The mix of securities and their proportion in the portfolio changes as a result of the revision.

Portfolio revision may also be necessitated by some investor-related changes such as availability of additional funds, change in risk attitude, need of cash for other alternative use, etc.

Whatever be the reason for portfolio revision, it has to be done scientifically and objectively so as to ensure the optimality of the revised portfolio. Portfolio revision is not a casual process to be carried out without much care. In fact, in the entire process of portfolio management, portfolio revision is as important as portfolio analysis and selection.

Portfolio Evaluation

The objective of constructing a portfolio and revising it periodically is to earn maximum returns with minimum risk. Portfolio evaluation is the process which is concerned with assessing the performance of the portfolio over a selected period of time in terms of return and risk. This involves quantitative measurement of actual return realised and the risk born by the portfolio over the period of investment. These have to be compared with objective norms to assess the relative performance of the portfolio. Alternative measures of performance evaluation have been developed for use by investors and portfolio managers.

Portfolio evaluation is useful in yet another way. It provides a mechanism for identifying weaknesses in the investment process and for improving these deficient areas. It provides a feedback mechanism for improving the entire portfolio management process.

The portfolio management process is an ongoing process. It starts with security analysis, proceeds to portfolio construction, and continues with portfolio revision and evaluation. The evaluation provides the necessary feedback for designing a better portfolio next time. Superior performance is achieved through continual refinement of portfolio management skills.

EVOLUTION OF PORTFOLIO MANAGEMENT

Portfolio management is essentially a systematic method of managing one's investments efficiently. Many factors have contributed to the development and growth of this systematic approach to investment management. It would be interesting to trace the evolution of investment management through the years.

In the early years of this century analysts used financial statement data for evaluating the worth of securities of companies. This started with the analysis of railroad securities in U.S.A. A booklet entitled *The Anatomy of a Railroad Report* was published by Thomas F. Woodlock in 1900. It was regarded as a classic in railroad analysis. Financial statement analysis became more popular in the investment field, although most writers on investment were not clear about the procedure to be adopted. They generally advocated the calculation and use of certain financial ratios for the purpose. John Moody in his book *The Art of Wall Street Investing*, published in 1906, strongly supported financial statement analysis for investment purposes. Lawrence Chamberlain, in his book *The Principles of Bond Investment* which was published in 1911, proposed an analysis which later came to be known as common-size analysis.[1]

During the early part of this century another group of analysts concentrated their attention on the behaviour of the stock market. Their investment strategy consisted in studying the stock price movements with the help of price charts. This method came to be known as **technical analysis**. It evolved during 1900–1902 when Charles H. Dow, the founder of the Dow Jones and Co., presented his views in a series of editorials in the *Wall Street Journal* in U.S.A. The advocates of technical analysis believed that stock price movement was orderly and systematic and that definite patterns could be identified in these movements. Their investment strategies were built around the identification of trends and patterns in stock price movements.

Another prominent author who supported technical analysis was Ralph N. Elliot who published a book in 1938 entitled *The Wave Principle*. After analysing seventy five years of share price data, he concluded that the market movement was quite orderly and followed a pattern of waves. His theory has come to be known as the **Elliot Wave Theory**.

According to J.C. Francis[2], the development of investments management can be traced chronologically through three different phases.

The first phase could be characterised as the **speculative phase**. Investment was not a widespread activity; it was carried on only by the wealthy; moreover, it was of a speculative nature. Investment management was an art and needed skill. Price manipulation was resorted to by the investors. During this time 'pools' and 'corners' were used for manipulation. All these led to the stock exchange crash in 1929. Finally, the daring speculative ventures of investors were made illegal in the United States by the Securities Act of 1934.

During the 1930s investments management entered its second phase, a **phase of professionalism**. After the first US regulations governing investment trading were passed in 1933–34, the investment industry began the process of upgrading its ethics, establishing standard practices and generating a good public image. As a result the investment markets became safer places and ordinary people began to invest. Investors began to analyse the securities seriously before undertaking investments.

During this period the research work of Benjamin Graham and David L. Dodd was widely publicised and publicly acclaimed. They published the results of their research in a book titled *Security Analysis* in 1934. This was considered the first major work in the field of security analysis and laid the ground work for the security analysis profession. They are considered pioneers of security analysis as a discipline.

Investments management has now entered its third phase, the **scientific phase.** The publication of a paper on portfolio selection in the *Journal of Finance* in 1952 by Harry Markowitz, marked the beginning of this third phase. The foundations of Modern Portfolio Theory were laid by Markowitz. His pioneering work on portfolio management is described in his 1952 article in the *Journal of Finance* and in the subsequent book published in 1959 titled *Portfolio Selection: Efficient Diversification of Investments.*

Markowitz attempted to quantify risk. He showed how the risk in investment could be reduced through proper diversification of investment which required the creation of a portfolio. He provided analytical tools for the analysis and selection of the optimal portfolio. This pioneering portfolio approach to investments management won him the Nobel prize for economics in 1990.

The work done by Markowitz was extended by William Sharpe, John Lintner and Jan Mossin through the development of the **capital asset pricing model (CAPM).** In fact, Sharpe shared the Nobel prize for economics in 1990 with Markowitz and Miller, for his contribution to the development of CAPM.

The developments in the field of portfolio management are continuing apace. In fact, the last two phases in the development of portfolio management practice, namely professionalism and scientific analysis, are currently advancing simultaneously.

ROLE OF PORTFOLIO MANAGEMENT

There was a time when portfolio management was an exotic term, an elite practice beyond the reach of ordinary people, in India. The scenario has changed drastically. Portfolio management is now a familiar term and is widely practised in India. The theories and concepts relating to portfolio management now find their way to the front pages of financial newspapers and the cover pages of investment journals in India.

In the beginning of the nineties India embarked on a programme of economic liberalisation and globalisation. This reform process has made the Indian capital markets active. The Indian stock markets are steadily moving towards higher efficiency, with rapid computerisation, increasing market transparency, better infrastructure, better customer service, closer integration and higher volumes. The markets are dominated by large institutional investors with their diversified portfolios. A large number of mutual funds have been set up in the country since 1987. With this development, investment in securities has gained considerable momentum.

Along with the spread of securities investment among ordinary investors, the acceptance of quantitative techniques by the investment community changed the investment scenario in India. Professional portfolio management, backed by competent research, began to be practised by mutual funds, investment consultants and big brokers. The Securities and Exchange Board of India (SEBI), the stock market regulatory body in India, is supervising

the whole process with a view to making portfolio management a responsible professional service to be rendered by experts in the field.

With the advent of computers the whole process of portfolio management has become quite easy. The computer can absorb large volumes of data, perform the computations accurately and quickly give out the results in any desired form. Moreover, simulation, modelling etc. provide means of testing alternative solutions.

The trend towards liberalisation and globalisation of the economy has promoted free flow of capital across international borders. Portfolios now include not only domestic securities but also foreign securities. Diversification has become international. In this context, financial investments cannot be conceived of without portfolio management.

Another significant development in the field of investment management is the introduction of derivative securities such as options and futures. The trading in derivative securities, their valuation, etc. have broadened the scope of investment management.

Investment is no longer a simple proccess. It requires scientific knowledge, a systematic approach and also professional expertise. Portfolio management which combines all these elements is the method of achieving efficiency in investment.

Financial Derivatives

Investment in securities is inherently risky because of the volatility in the price movements of securities. This volatility creates uncertainty regarding future price movements. This, in turn, exposes the investors to risk. Since investors are likely to suffer losses on account of the uncertain future price movements, they like to avoid such risk, or at least, to minimize such risk.

Financial derivatives have evolved as a mechanism for reducing or hedging the risk involved in financial investments. Futures and options are the most common derivative instruments. Each derivative instrument has as underlying asset such as a security, a foreign currency, etc. whose price fluctuations can be hedged by trading in the derivatives market. An investor buying or selling a financial asset can reduce the risk involved by simultaneously trading in the derivative instrument. Thus, investment in securities can be profitably combined with derivatives trading to achieve the objectives of maximizing returns and minimizing risk.

Futures

The uncertainty regarding the future price movement of shares, foreign currencies, etc. can be managed by entering into "futures contracts". A **futures contract** is essentially an agreement to buy or sell an underlying asset such as a security or foreign currency at a certain time in the future for a predetermined price. Such a contract effectively eliminates the uncertainty regarding the future price of the underlying asset to be traded in the future. Futures contracts are regularly traded in futures exchanges. The assets underlying futures contracts may be financial assets such as shares, foreign currencies, etc., or commodities such as wheat, coffee, gold, petroleum, etc. or even stock market indices.

Options

An option is another type of derivative instrument regularly traded in the derivatives

2

INVESTMENT

The income that a person receives may be used for purchasing goods and services that he currently requires or it may be saved for purchasing goods and services that he may require in the future. In other words, income can be what is spent for current consumption or saved for the future consumption. Savings are generated when a person or an organisation abstains from present consumption for a future use. The person saving a part of his income tries to find a temporary repository for his savings until they are required to finance his future expenditure. This results in investment.

MEANING OF INVESTMENT

Investment is an activity that is engaged in by people who have savings, i.e. investments are made from savings, or in other words, people invest their savings. But all savers are not investors. Investment is an activity which is different from saving. Let us see what is meant by investment.

It may mean many things to many persons. If one person has advanced some money to another, he may consider his loan as an investment. He expects to get back the money along with interest at a future date. Another person may have purchased one kilogram of gold for the purpose of price appreciation and may consider it as an investment. Yet another person may purchase an insurance plan for the various benefits it promises in future. That is his investment.

In all these cases it can be seen that investment involves employment of funds with the aim of achieving additional income or growth in values. The essential quality of an investment is that it involves waiting for a reward. Investment involves the commitment of resources which have been saved in the hope that some benefits will accrue in future

Thus, investment may be defined as "a commitment of funds made in the expectation of some positive rate of return"[1]. Expectation of return is an essential element of investment. Since the return is expected to be realised in future, there is a possibility that the return actually realised is lower than the return expected to be realised. This possibility of variation in the actual return is known as investment risk. Thus, every investment involves return and risk.

FINANCIAL AND ECONOMIC MEANING OF INVESTMENT

In the financial sense, investment is the commitment of a person's funds to derive future income in the form of interest, dividend, premiums, pension benefits or appreciation in the value of their capital. Purchasing of shares, debentures, post office savings certificates, insurance policies are all investments in the financial sense. Such investments generate financial assets.

In the economic sense, investment means the net additions to the economy's capital stock which consists of goods and services that are used in the production of other goods and services. Investment in this sense implies the formation of new and productive capital in the form of new constructions, plant and machinery, inventories, etc. Such investments generate physical assets.

The two types of investments are, however, related and dependent. The money invested in financial investments are ultimately converted into physical assets. Thus, all investments result in the acquisition of some assets either financial or physical.

CHARACTERISTICS OF INVESTMENT

All investments are characterised by certain features. Let us analyse these characteristic features of investments.

Return

All investments are characterised by the expectation of a return. In fact, investments are made with the primary objective of deriving a return. The return may be received in the form of yield plus capital appreciation. The difference between the sale price and the purchase price is capital appreciation. The dividend or interest received from the investment is the yield. Different types of investments promise different rates of return. The return from an investment depends upon the nature of the investment, the maturity period and a host of other factors.

Risk

Risk is inherent in any investment. This risk may relate to loss of capital, delay in repayment of capital, non-payment of interest, or variability of returns. While some investments like government securities and bank deposits are almost riskless, others are more risky. The risk of an investment depends on the following factors.

1. The longer the maturity period, the larger is the risk.

2. The lower the credit worthiness of the borrower, the higher is the risk.
3. The risk varies with the nature of investment. Investments in ownership securities like equity shares carry higher risk compared to investments in debt instruments like debentures and bonds.

Risk and return of an investment are related. Normally, the higher the risk, the higher is the return.

Safety

The safety of an investment implies the certainty of return of capital without loss of money or time. Safety is another feature which an investor desires for his investments. Every investor expects to get back his capital on maturity without loss and without delay.

Liquidity

An investment which is easily saleable or marketable without loss of money and without loss of time is said to possess liquidity. Some investments like company deposits, bank deposits, P.O. Deposits, NSC, NSS, etc. are not marketable. Some investment instruments like preference shares and debentures are marketable, but there are no buyers in many cases and hence their liquidity is negligible. Equity shares of companies listed on stock exchanges are easily marketable through the stock exchanges.

An investor generally prefers liquidity for his investments, safety of his funds, a good return with minimum risk or minimisation of risk and maximisation of return.

OBJECTIVES OF INVESTMENT

An investor has various alternative avenues of investment for his savings to flow to. Savings kept as cash are barren and do not earn anything. Hence, savings are invested in assets depending on their risk and return characteristics. The objective of the investor is to minimise the risk involved in investment and maximise the return from the investment.

Our savings kept as cash are not only barren because they do not earn anything, but also loses its value to the extent of rise in prices. Thus, rise in prices or inflation erodes the value of money. Savings are invested to provide a hedge or protection against inflation. If the investment cannot earn as much as the rise in prices, the real rate of return would be negative. Thus, if inflation is at an average annual rate of ten per cent, then the return from an investment should be above ten per cent to induce savings to flow into investment.

Thus, the objectives of an investor can be stated as:

1. Maximisation of return
2. Minimisation of risk
3. Hedge against inflation.

Investors, in general, desire to earn as large returns as possible with the minimum of risk. Risk here may be understood as the probability that actual returns realised from an investment may be different from the expected return. If we consider the financial assets available for investment, we can classify them into different risk categories. Government securities would constitute the low risk category as they are practically risk free. Debentures

and preference shares of companies may be classified as medium risk assets. Equity shares of companies would form the high risk category of financial assets. An investor would be prepared to assume higher risk only if he expects to get proportionately higher returns. There is a trade-off between risk and return. The expected return of an investment is directly proportional to its risk. Thus, in the financial market, there are different financial assets with varying risk-return combinations.

The investors in the financial market have different attitudes towards risk and varying levels of risk bearing capacity. Some investors are risk averse, while some may have an affinity to risk. The risk bearing capacity of an investor, on the other hand, is a function of his income. A person with higher income is assumed to have a higher risk bearing capacity. Each investor tries to maximise his welfare by choosing the optimum combination of risk and expected return in accordance with his preference and capacity.

INVESTMENT vs SPECULATION

Investment and speculation are two terms which are closely related. Both involve purchase of assets like shares and securities. Traditionally, investment is distinguished from speculation with respect to three factors, viz. (1) risk, (2) capital gain and (3) time period.

Risk

It refers to the possibility of incurring a loss in a financial transaction. It arises from the possibility of variation in returns from an investment. Risk is invariably related to return. Higher return is associated with higher risk.

No investment is completely risk free. An investor generally commits his funds to low risk investment, whereas a speculator commits his funds to higher risk investments. A speculator is prepared to take higher risks in order to achieve higher returns.

Capital Gain

The speculator's motive is to achieve profits through price changes, i.e. he is interested in capital gains rather than the income from the investment. If purchase of securities is preceded by proper investigation and analysis to receive a stable return and capital appreciation over a period of time, it is investment. Thus, speculation is associated with buying low and selling high with the hope of making large capital gains. A speculator consequently engages in frequent buying and selling transactions.

Time Period

Investment is long-term in nature, whereas speculation is short-term. An investor commits his funds for a longer period and waits for his return. But a speculator is interested in short-term trade gains through buying and selling of investment instruments.

Analysis of these distinctions helps us to identify the role of an investor and a speculator. An investor is interested in a good rate of return earned on a rather consistent basis for a relatively longer period of time. He evaluates the worth of a security before investing in it. A speculator seeks opportunities promising very large returns earned rather quickly.

He is interested in market action and price movements. Consequently, speculation is more risky than investment.

Basically, both investment and speculation aim at good returns. The difference is in motives and methods. As a result, the distinction between investment and speculation is not very wide. Investment is sometimes described as 'a well grounded and carefully planned speculation'.

INVESTMENT vs GAMBLING

Investment has also to be distinguished from gambling. Typical examples of gambling are horse races, card games, lotteries, etc. Gambling consists in taking high risks not only for high returns, but also for thrill and excitement. Gambling is unplanned and non scientific, without knowledge of the nature of the risk involved. It is surrounded by uncertainty and is based on tips and rumours. In gambling artificial and unnecessary risks are created for increasing the returns.

Investment is an attempt to carefully plan, evaluate and allocate funds to various investment outlets which offer safety of principal and moderate and continuous return over a long period of time. Gambling is quite the opposite of investment.

TYPES OF INVESTORS

Investors may be individuals and institutions. Individual investors operate alongside institutional investors in the investment arena. However, their characteristics are different.

Individual investors are large in number but their investable resources are comparatively smaller. They generally lack the skill to carry out extensive evaluation and analysis before investing. Moreover, they do not have the time and resources to engage in such an analysis.

Institutional investors, on the other hand, are the organisations with surplus funds who engage in investment activities. Mutual funds, investment companies, banking and non-banking companies, insurance corporations, etc. are the organisations with large amounts of surplus funds to be invested in various profitable avenues. These institutional investors are fewer in number compared to individual investors, but their investable resources are much larger. The institutional investors engage professional fund managers to carry out extensive analysis and evaluation of different investment opportunities. As a result their investment activity tends to be more rational and scientific. They have a better chance of maximising returns and minimising risk.

The professional investors and the unskilled individual investors combine to make the investment arena dynamic.

INVESTMENT AVENUES

There are a large number of investment avenues for savers in India. Some of them are marketable and liquid while others are non marketable. Some of them are highly risky

while some others are almost riskless. The investor has to choose proper avenues from among them depending on his preferences, needs and ability to assume risk.

The investment avenues can be broadly categorised under the following heads:

1. Corporate securities
2. Deposits in banks and non-banking companies
3. UTI and other mutual fund schemes
4. Post office deposits and certificates
5. Life insurance policies
6. Provident fund schemes
7. Government and semi-government securities.

Let us discuss briefly the important investment avenues available to savers in India.

Corporate Securities

Corporate securities are the securities issued by joint stock companies in the private sector. These include equity shares, preference shares and debentures. Equity shares have variable dividend and hence belong to the high risk—high return category, while preference shares and debentures have fixed returns with lower risk.

Deposits

Among the non-corporate investments, the most popular are deposits with banks such as savings accounts and fixed deposits. Savings deposits have low interest rates whereas fixed deposits have higher interest rates varying with the period of maturity. Interest is payable quarterly or half-yearly. Fixed deposits may also be recurring deposits wherein savings are deposited at regular intervals. Some banks have reinvestment plans wherein the interest is reinvested as it gets accrued. The principal and accumulated interest are paid on maturity.

Joint stock companies also accept fixed deposits from the public. The maturity period varies from three to five years. Fixed deposits in companies have high risk since they are unsecured, but they promise higher returns than bank deposits.

Fixed deposit in non-banking financial companies (NBFCs) is another investment avenue open to savers. NBFCs include leasing companies, hire purchase companies, investment companies, chit funds, etc. Deposits in NBFCs carry higher returns with higher risk compared to bank deposits.

UTI and other Mutual Fund Schemes

Mutual funds offer various investment schemes to investors. UTI is the oldest and the largest mutual fund in the country. Unit Scheme 1964, Unit Linked Insurance Plan 1971, Master Share, Master Equity Plans, Mastergain, etc. are some of the popular schemes of UTI. A number of commercial banks and financial institutions have set up mutual funds. Recently mutual funds have been set up in the private sector also.

Post Office Deposits and Certificates

The investment avenues provided by post offices are generally non-marketable. Moreover, the major investments in post office enjoy tax concessions also. Post offices accept savings

deposits as well as fixed deposits from the public. There is also a recurring deposit scheme which is an instrument of regular monthly savings.

Six-year National Savings Certificates (NSC) are issued by post offices to investors. The interest on the amount invested is compounded half-yearly and is payable along with the principal at the time of maturity which is six years from the date of issue.

Indira Vikas Patra and Kissan Vikas Patra are savings certificates issued by post offices.

Life Insurance Policies

The Life Insurance Corporation (LIC) offers many investment schemes to investors. These schemes have the additional facility of life insurance cover. Some of the schemes of LIC are Whole Life Policies, Convertible Whole Life Assurance Policies, Endowment Assurance Policies, Jeevan Saathi, Money Back Plan, Jeevan Dhara, Marriage Endowment Plan, etc.

Provident Fund Schemes

Provident fund schemes are compulsory deposit schemes applicable to employees in the public and private sectors. There are three kinds of provident funds applicable to different sectors of employment, namely Statutory Provident Fund, Recognised Provident Fund and Unrecognised Provident Fund.

In addition to these, there is a voluntary provident fund scheme which is open to any investor whether employed or not. This is known as the **Public Provident Fund (PPF)**. Any member of the public can join the scheme which is operated by the post offices and the State Bank of India.

Government and Semi-Government Securities

The government and semi-government bodies like the public sector undertakings borrow money from the public through the issue of government securities and public sector bonds. These are less risky avenues of investment because of the credibility of the government and government undertakings.

Let us now summarise the discussion on investment.

SUMMARY

Investment is a financial activity that involves risk. It is the commitment of funds for a return expected to be realised in the future. Investments may be made in financial assets or physical assets. In either case there is the possibility that the actual return may vary from the expected return. That possibility is the risk involved in investment.

Risk and return are two important characteristics of any investment. Safety and liquidity are also important for an investor. The objective of an investor is specified as maximisation of return and minimisation of risk.

Investment is generally distinguished from speculation in terms of three factors, namely risk, capital gains and time period. Gambling is the extreme form of speculation. Investors may be individuals or institutions. Both type of investors combine to make investment activity dynamic and profitable.