# INTRODUCTION TO INVESTMENT

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# Plan

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## Introduction:

Investment is the employment of funds on assets with the aim of earning income or capital appreciation. Investment has two attributes namely time and risk. Present consumption is sacrificed to get a return in the future. The sacrifice that has to be borne is certain but the return in the future may be uncertain. This attribute of investment indicates the risk factor. The risk is undertaken with a view to reap some return from the investment. For a layman, investment means some monetary commitment. A person’s commitment to buy a flat or a house for his personal use may be an investment from his point of view. This cannot be considered as an actual investment as it involves sacrifice but does not yield any financial return.

## I. Investment definition :

To **the economist**, investment is the net addition made to the nation's capital stock that consists of goods and services that are used in the production process.  A net additionto the capital stock means an increase in the buildings, equipments or inventories. These capital stocks are used to produce other goods and services.

**Financial investment** is the allocation of money of assets that are expected to yield some gain over a period of time. It is an exchange of financial claims such as stocks and bonds for money. They are expected to yield returns and experience capital growth over the years.

The financial and economic meanings are related to each other because the savings of the individual flow into the capital market as financial investments, to be used in economic investment. Even though they are related to each other, we are concerned only about the financial investment made on securities.

Thus, investment may be defined as “a commitment of funds made in the expectation of some positive rate of return”. Expectation of return is an essential element of investment.

## II. Characteristics of Investment

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

### A. Return

All investments are characterized 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.

## B. 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.

## C. Safety

The safety of on 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

## D. 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 minimization of risk and maximization of return

## III. 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 objectives of the investor are minimizing the risk involved in investment and maximize the return from the investment.

The objectives of an investor can be stated as:

- Maximisation of return.
- Minimization of risk
- Hedge against inflation.

## VI. 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.

## 1. 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.

## 2. Capital Gain

The speculator’s motive is to achieve profits through price charges, 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.

## 3. 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.

## V. 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 rumors. 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.

## IV. Types of Investors

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

**1. 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.

**2. Institutional investors**, on the other hand, are the organizations with surplus funds who engage in investment activities. Mutual funds, investment companies, banking and non-banking companies, insurance corporations, etc. are the organizations with large amounts of surplus funds to be invested in various profitable avenues.


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