CHAPTER 3

CONCEPTUAL FRAMEWORK

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3.1 Introduction

The economic development process involves a larger role of financial intermediation and shifting of savings away from investment in physical assets to investment in financial assets. Investing wisely is an important part of financial security. In recent years Indian peoples are well paid when compared to last few decades, the reason behind it was development in the sector of Information Technology, service industry and overall strong economy. So people are able to save more money. Selecting a proper investment option is very difficult because it is essential to balance the risks and returns. Majority of Indians choose Fixed Deposits, Real Estate and Life Insurance as their primary investment method. Also many prefers for NSC, PPF and other safe investment methods to invest their hard earned money. Postal Saving Schemes also popular in retired people and senior citizens.

Thus, savings in financial form of the household sector has increased from around 30% in fifties to 45% to 55% in recent years. The economic development process involves a larger role of financial intermediation and shifting of savings away from investment in physical assets to investment in financial assets. In recent years variety of financial instruments available for investment and trading. Thus the investors can deposit their surplus amount in a bank account to earn a fixed rate of interest or purchase a speculative shares on the stock market or buy gold or contribute to a provident fund account or buy a piece of land or invest in some other form.

3.2 Area of Research

This research is related with the investment preferences of investors about various investment avenues as per their Life Cycle Stages. So concepts related with investment avenues and Life Cycle Stages is included in this chapter.

3.3 Related Concepts

3.3.1 Savings: Savings are excess of income over expenditure for any economic unit. Excess funds or surplus in profits or capital gains are also available for investment. Saving is abstaining from present consumption for a future use. Savings are sometimes autonomous coming from households as a matter of habit. But bulk of the savings come for specific objectives like interest income, future needs, contingencies, precautionary purposes or growth in future wealth, leading to rise in the standard of living etc.

3.3.2 Investment: It 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. In essence, it means the use of funds for productive purposes, for securing some objectives like income, capital appreciation or capital gains or for further production of goods and services with the objective of securing profits. Investment activity involves the use of funds or savings for further creation of assets or acquisition of existing assets.

3.3.3 Investment Opportunities: Investment avenues are multifold and each has it own risk-return characteristics. Riskless investments in the common parlance are bank deposits, Govt. Securities, bonds of government and semi Govt. bonds, post savings schemes, post office deposits etc., Provident fund and pension fund schemes, Life Insurance etc.

3.3.4 Classification of Investment: A major classification is Physical Investments and Financial Investments. They are physical, if savings are used to acquire physical assets, useful for consumption or production. Some physical assets like plough, tractors are useful in agricultural production. Many items of physical assets are not useful for further production of goods or create income as in the case of consumer durables, gold, silver etc. But most of the financial assets barring cash are used for production or consumption, or further creation of assets, useful for production of goods and services.

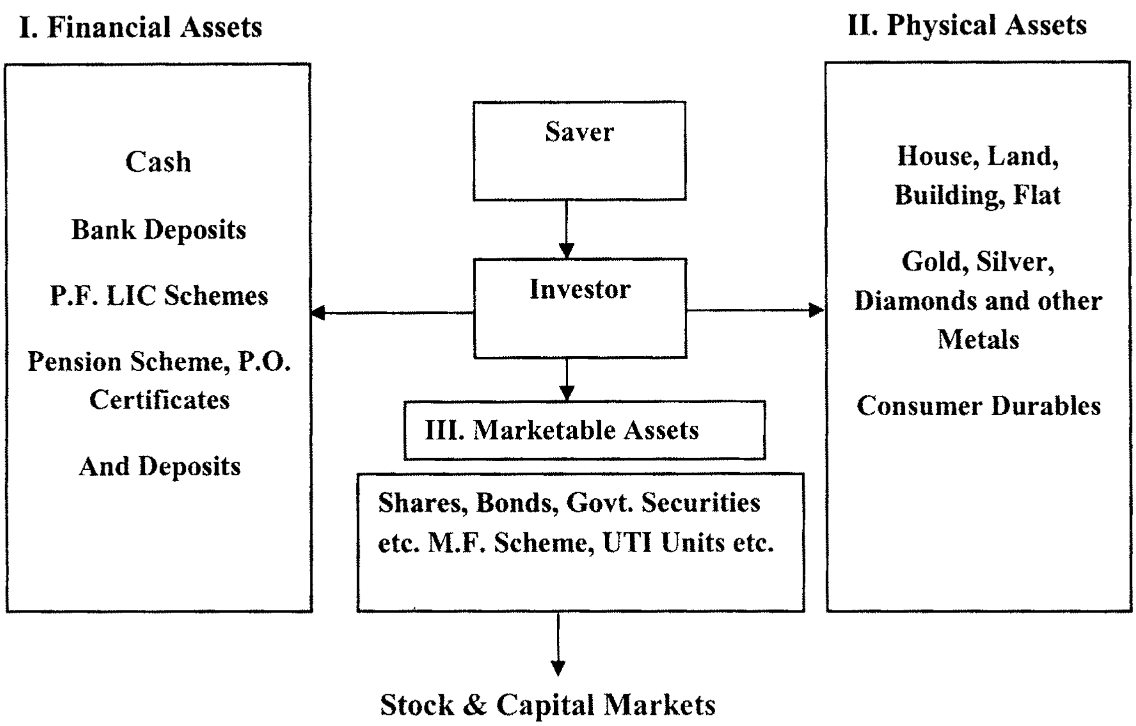
Among different types of investments, some are marketable and transferable and others are not. Marketable assets are shares and debentures, bonds, Government securities etc. Non marketable securities or investments are bank deposits, provident and pension funds, Insurance certificates, post office deposits, National savings certificates, company deposits etc.

3.3.5 Investment Activity: Investment is an activity, which is made with the objective of earning some sort of positive returns in the future. It is the commitment of the funds to earn future returns and it involves sacrificing the present investment for the future return. Following figure shows types of investments which are available to savers for converting their savings into investments. [5]

Diagram 3.1

Investment Activity

Acquisition of Assets



3.3.6 Impact of Inflation: All investments lose in value due to inflation or rise in prices leading to depreciation of the rupee. When the rate of inflation is about 10% the real value of money is lost by 10% every year. The investors have therefore to protect themselves from this loss of real values of their assets by proper investment planning and by securing returns, higher than the inflation rate.

Some investments give only income like bank deposits, P.O. certificates, company deposits etc. Some assets show capital appreciation if they are in shares in companies or bullion, land

[5]. Dr. Avadhani V.A., Investment Management, Himalaya Publishing House, 5th Edition, p. 41

and buildings. Some are safe and liquid like the investment in government securities, bonds of P.S.U. etc. A few investments like Indira Vikas Patra, Kisan Vikas Patra are easily transferable and marketable. But all the above investments do not satisfy all the needs and objectives of investors, including securing a hedge against inflation. Hence the investors need to preserve the purchasing power of what they save. The only way to hedge inflation is to invest in shares, debentures, bonds, mutual funds, insurance and gold to earn returns from these assets that compensate for the decline in the purchasing power.

3.3.7 Interrelation between Savings and Investment: 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 total population of India. Savers come from all classes except in the case of the population who are below the poverty line. The growth of the urbanization and literacy has activated the cult of investment. More recently since the nineties the investment activity has become more popular with the change in the government policies towards liberalization and financial deregulation. The process of liberalization and privatization was accelerated by the government policy changes towards a market oriented economy, through economic and financial reforms started in July 1991. [6]

3.3.8 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.

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[6]. Dr. Avadhani V.A., Investment Management, Himalaya Publishing House, 5th Edition, p. 18.

3.3.9 Marketability and Liquidity: Some instruments are not marketable like company and bank deposits, P.O. deposits, NSC, NSS, etc. Only advances can be secured against bank deposits and NSC subject to margins from bank. Some instruments like preference shares and debentures are marketable but there are no buyers in many cases and hence liquidity is negligible in respect of these instruments. Liquidity arises from the availability of marketing and trading facilities as also buyers and sellers.

3.3.10 Safety and Riskiness: Safety is another feature which the investor desires for investments. Normally savers invest only in safe or risk free investment. Only a few opt for risky investment for which the returns would also be higher. The maturity period of the instrument, the creditworthiness of the issuer and the nature of the instrument, whether debt or ownership instrument would all influence the risk, return and other features of the instrument. The government policy or tax treatment of the instrument etc. would also determine the yield on the instruments.

3.4 Life Cycle Stages of Individual Investors

For the study of investment pattern and investment behaviour of investor, researcher has firstly understood the stages of life cycle of the investors. It provides insight into investment behaviour at various ages of investor's life cycle. These stages of life cycle of the investor's, provide the essential insights into causes for underlying behaviour.

The life cycle has been found to be a powerful predictor of economic and social behaviour, that many different categorizations have been made. Human Life Cycle can be divided into six basic stages:

1. **Stage I (Alpha)** Young Unmarried Stage – Stage which Consists of Young, Single, Childless persons who are financially independent from their parents.
2. **Stage II (Bravo)** Young Married Stage - Stage in which these persons are married, but still childless.
3. **Stage III (Charlie)** Young Married with Children Stage – Stage begins with the birth of the first child and continues until the youngest child is of school going age.
4. **Stage IV (Delta)** Married with Older Children Stage – Stage in which there are dependent children who are no longer of Pre-School age.

5. Stage V (Echo) Pre-Retirement Stage – When the last child has finished his or her schooling and is no longer dependent on the parents. This is the Pre-Retirement or empty nest stage.

6. Stage VI (Foxtrot) Retirement Stage. [7]

3.4.1. Demographic Trends underlying the Life Cycle: Despite the changing world Indian traditional family still consists of a never divorced mother and father living together with their biological children under age 18 constituting a majority of Indian families. However joint or extended family which includes grandparents is declining slowly. These changes will occur due to bilateral bargaining position of women, enabling them to function economically outside of a marriage. It is due partly to the growing proportion of women with higher education. It is also due to the fact that women are marrying later in life.

Increase in the age of marriage is due to a tendency for young adults to live independently. Also delaying the onset of marriage is a somewhat recent tendency for young adults to live with their parents. This is particularly pronounced among the more affluent since it takes these young people longer to achieve a level material comfort equivalent to that enjoyed by their parents.

3.4.2. The Changing Workforce

Life Cycle is also related to labour force participation. The traditional concept of a career involved the careful selection of a lifetime career. New Hire and Fire culture will force average worker to have three careers in his lifetime. Instead of a Linear Life Plan which involves continuous participation today's worker has a more cyclic life plan which may involve periodic interruptions for schooling, travel and other such things.

As the labour force participation rates of women continue to increase relative to those of men, the composition and needs of the labour force also change. It is expected that women will account for major portion of the growth in the work force. The increase in the labour force participation by women is due to at least two factors. First, most middle income families realize that is takes two workers to attain a comfortable existence. Psychological

[7]. Mr. Arun Ohri and Mr. Sunder Sankaran, (2007) "Introduction to Financial Planning" Indian Institute of Banking and Finance, Taxmann Publications Pvt. Ltd. Second Edition p.66.

image of staying at home is no longer held in high regard. For many reasons, women want to develop independence and have careers equal to men.

3.5 Financial Planning Process

Financial planning is an important process for everyone for the present as well as the future. While most people spend to satisfy their immediate needs, they would also like to save and invest to secure their future needs and emergencies. Some of the needs of people at different stages of life are:

i. Protection against premature death
ii. Retirement Planning
iii. Protection from disability and ill health
iv. Education and marriage of children
v. Wealth creation
vi. Wealth preservation

While doing financial planning for a client, it is important for a professional to first create a financial and risk profile of the customer. Based on that, the professional can develop different options of investments for the client as per his financial capacity and risk appetite along with expected return on investment. [8]

3.5.1 Steps in Financial Planning Process

Every investor has to consider the following process of financial plan. Investors can take the help from chartered accountant or tax consultant for his/her financial planning. The financial planning process is discussed as under:

1. Conducting Need Analysis

In this step, analyzing the macro and socio economic trends is called for Growth of the economy & progresses of society are essential for all round development of the individual. Other concerns include inflation, longevity and after retirement spans to name a few. Some of the common goals of investors include: Education and marriage of children, Down payment for a house & Retirement.

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[8]. www.tax4india.com/financial-planning-process.htm 20.5.2012 1634 hrs

2. Evaluating Existing Resources

The financial planner also needs to understand and quantify the present and future financial flows of the customer. This helps in quantifying the surpluses available from time to time. A financial balance sheet of the customer also needs to be drawn to arrive at their net worth. The planner should be able to understand various classes of assets and their correlation with each other.

3. Conducting Risk Assessment

The financial planner also needs to assess the Risk profile & Asset Allocation of the investor. It is important to determine the style of the investor before investing. Investors may be - Aggressive Investor - who likes to take risks to earn an extra bit of return, Moderate investor - who is content and believes in earning slow and steady gains, Conservative investor - is risk averse investor whose primary objective is capital preservation and wants a steady growth in income. They are also known as passive investors. Asset allocation is the key to performance of portfolio. Assets can be sacred, serious or aggressive assets. Sacred assets are sacrosanct such as house, gold or fixed deposits which have low risk and low returns. Serious assets could be debt funds or bonds with higher returns and higher risks. Direct equity or equity mutual funds are of this type. Investors, who are willing to accept considerable volatility in their portfolios, invest in aggressive assets.

4. Developing the Financial Plan

Then financial planner needs to develop the plan for fulfilling protection, retirement, health, and wealth creation / preservation needs of the customer. Also explain the plan and rationale to the customer. Giving both upside potential and downside risk, keeping in mind customer's profile & risk appetite and understanding tax laws and operating regulatory framework.

5. Implementing the Financial Plan

This step involves executing the plan through optimal investment. After getting the customer's approval, the financial plan needs to be implemented with the help of various service providers. It is important to create a proper record of the financial plan and its implementation. Recording of essential details, due dates, and dates of receipt of flows is important.

6. Monitoring the Financial Plan

This is the last step of the plan. In this step financial planner needs to establish a systematic way of monitoring each investment. Also he has to ensure that monitoring should be practical and routine function. He has to always contact to the clients in good as well as bad situations. He has make sure that investment advisory accessible to client through conference calls.

3.6 Investment Avenues

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 forms of investment avenues is: Corporate Bonds/Debentures, Public Sector Bonds, Preference Shares, Equity Shares, National Savings Schemes/Certificates, Provident Funds, Corporate Deposits, Life Insurance Policies, Mutual Funds and other such avenues.

3.6.1 Saving Schemes

Savings has an important place in the mobilization of resources for development expenditure because the investors would not only get back their money ,but also some interest and they would therefore prefer to lend money in this way instead of paying it as outright tax. Further in a developing economy in which there will be always surplus money available with some sectors to the extent that the savings are tapped the money available for circulation is taken away and to that extent pressure on prices and inflationary trend is reduced. So therefore savings have got a very important role to play in the sphere of economy. [9]

Following are the Saving Schemes:

3.6.1.1 Post Office Saving Scheme.

3.6.1.2 Company Fixed Deposits.

[9]. http://www.tax4india.com/savings-schemes-in-india. 20.5.2012 1633hrs

3.6.1.3 Bank Deposits.

3.6.1.4 Bonds and Debentures in India.

3.6.1.5 Equity Linked Savings Scheme.

The above savings Schemes has been discussed as under:

3.6.1.1 Post Office Savings Schemes: Trapping rural savings has been a pressing need since time immemorial. The authorities have taken undue advantage of the existence of post office even in remote nooks and corners of the country. The systems and procedures handling these schemes are laborious and outdated. However these schemes offer better return most other avenues.

The silent features of the current schemes are given below:

i. National Savings Certificates (NSC)
ii. National Savings Schemes (NSS)
iii. Post Office Time Deposits.
iv. Post Office Recurring Deposit Account (RDA)
v. Post Office Monthly Income Scheme
vi. Senior Citizen Scheme
vii. Kisan Vikas Patra (KVP)

i. National Saving Certificates (NSC)

National Savings Certificates (NSC) are certificates issued by Department of post, Government of India and are available at all post office counters in the country. It is a long term safe savings option for the investor. The scheme combines growth in money with reductions in tax liability as per the provisions of the Income Tax Act, 1961. The duration of a NSC scheme is 6 years.

ii. National Savings Schemes (NSS)

National Savings Scheme (NSS) offers an assured return and tax rebates under Section 88 of the Income Tax Act, 1961. The rate of interest is 9 per cent per annum, compounded annually. NSS has a duration of four years as compared to NSC, which has a duration of six years. You can extend the duration of your NSS units thereafter if you so desire. NSS does not offer the benefits of liquidity. There is no premature withdrawal facility except in case of the death of the holder. However, the interest accrued on NSS can be withdrawn at any point. The deposit (principal) can be withdrawn only on maturity of the instrument at the end of four years and the account can be closed at the discretion of the investor.

iii. Post Office Time Deposit Scheme

A Post-Office Time Deposit Account (RDA) is a banking service similar to a Bank Fixed Deposit offered by Department of post, Government of India at all post office counters in the country. The scheme is meant for those investors who want to deposit a lump sum of money for a fixed period; say for a minimum period of one year to two years, three years and a maximum period of five years. Investor gets a lump sum (principal + interest) at the maturity of the deposit. Time Deposits scheme return a lower, but safer, growth in investment.

iv. Post Office Recurring Deposit Account (RDA)

A Post-Office Recurring Deposit Account (RDA) is a banking service offered by Department of post, Government of India at all post office counters in the country. The scheme is meant for investors who want to deposit a fixed amount every month, in order to get a lump sum after five years. The scheme, a systematic way for long term savings, is one of the best investment option for the low income groups.

v. Post Office Monthly Income Scheme

The post-office monthly income scheme (MIS) provides for monthly payment of interest income to investors. It is meant for investors who want to invest a sum amount initially and earn interest on a monthly basis for their livelihood. The MIS is not suitable for an increase in your investment. It is meant to provide a source of regular income on a long term basis. The scheme is, therefore, more beneficial for retired persons.

vi. Post Office Senior Citizen Scheme

A new savings scheme called Senior Citizens Savings Scheme has been notified with effect from August 2, 2004. The Scheme is for the benefit of senior citizens and maturity period of the deposit will be five years, extendable by another three years. Initially the scheme will be available through designated post offices through out the country.

vii. Kisan Vikas Patra (KVP)

Kisan Vikas Patra (KVP) doubles your money in 7 years and 3 months with the advantage of premature withdrawal. KVP is sold through all Head Post Offices and other authorised post offices throughout India. The rate of return is 9.75 per cent, compounded annually. KVP accumulates money at a fixed rate, and your money doubles in 7 years and 3 months. But KVP is not meant for regular income. It is for those looking for a safe avenue of investment without the pressing need for a regular source of income.

3.6.1.2 Company Fixed Deposits

Company Fixed Deposit market in India has an interesting phase of evolution. It basically grew out of the need of Corporate Sector for raising short term finance and requirements of small investors to earn superior returns as compared to returns offered by the Banks. The concept of company fixed deposits was started in India in 1964 by Bajaj Capital Ltd .by launching first ever Company Fixed Deposit of Oberoi Group - East India Hotels Ltd.(now EIH Ltd.).The success of East India Hotels prompted others private and public sector companies which started accepting deposits from public.

Since then company deposit market has grown by leaps and bounds. Today, company deposit market has grown to approximately Rs.25,000 crores. Hundreds of top companies belonging to reputed industrial houses like Tata, Birla, Escorts, Godrej etc. and government companies like HUDCO are accepting deposits from public. The number of depositors have increased to around 5 million. The benefits of company deposit are numerous like superior returns from reputed companies, fixed and assured returns, premature encashments, simplicity of transactions, TDS benefits, wide choice, All these features have made company deposits a preferred instrument of investment.

3.6.1.3 Bank Deposits

Followings are the various bank deposits; where investors can deposit their money for moderate returns as well as whose risk taking capacity is lower. These schemes have been discussed as under:

i. Savings Account: A Saving account is meant to promote the habit of saving among the people. It also facilitates safekeeping of money. In this scheme fund is allowed to be withdrawn whenever required, without any condition. Hence a savings account is a safe, convenient and affordable way to save your money. Bank deposits are fairly safe because banks are subject to control of the Reserve Bank of India with regard to several policy and operational parameters. Bank also pays you a minimal interest for keeping your money with them. [10]

ii. Recurring Deposit: The Recurring deposit in Bank is meant for someone who want to invest a specific sum of money on a monthly basis for a fixed rate of return. At the end, you will get the principal sum as well as the interest earned during that period. The scheme, a systematic way for long term savings, is one of the best investment option for the low income groups.

iii. Fixed Deposits: A fixed deposit is meant for those investors who want to deposit a lump sum of money for a fixed period; say for a minimum period of 15 days to five years and above, thereby earning a higher rate of interest in return. Investor gets a lump sum (principal + interest) at the maturity of the deposit. Bank fixed deposits are one of the most common savings scheme open to an average investor. Fixed deposits also give a higher rate of interest than a savings bank account. The facilities vary from bank to bank. Some of the facilities offered by banks are overdraft (loan) facility on the amount deposited, premature withdrawal before maturity period (which involves a loss of interest) etc. Bank deposits are fairly safer because banks are subject to control of the Reserve Bank of India. [11]

[10]. http://www.tax4india.com/savings-schemes-in-india/saving-bank-account.html 20.5.2012 1633hrs
[11]. http://www.tax4india.com/savings-schemes-in-india/bank-fixed-deposits.html 20.5.2012 1633hrs

3.6.1.4 Bonds and Debentures

A Bond is a loan given by the buyer to the issuer of the instrument. Bonds can be issued by companies, financial institutions, or even the government. Over and above the scheduled interest payments as and when applicable, the holder of a bond is entitled to receive the par value of the instrument at the specified maturity date.

Bonds can be broadly classified into:

a. Tax-Saving Bonds

b. Regular Income Bonds

Tax-Saving Bonds offer tax exemption up to a specified amount of investment. Regular-Income Bonds, as the name suggests, are meant to provide a stable source of income at regular, pre-determined intervals.

3.6.1.5 Equity Linked Saving Schemes (ELSS)

Equity linked Savings schemes are equity funds floated by mutual funds. They offer a 20 per cent tax rebate on investments upto Rs 10,000 in a given financial year. There is a three year lock-in on investments and there is no assurance on returns. The ELSS funds have to invest more than 80 per cent of their money in equity and related instruments. Returns form ELSS funds tend to fluctuate widely, in line with the performance of the stock markets. Young people should definitely invest in the ELSS funds as they have the ability to take on higher risk. Ideally one should invest in them when the markets are down. These funds are now open all the year round. Therefore, investors can time their investment. The other way of investing in these funds could be a systematic investment, which essentially means investing a small sum regularly (monthly or quarterly).

3.6.2 Mutual Funds

Mutual funds are money-managing institutions set up to professionally invest the money pooled in from the public. These schemes are managed by Asset Management Companies (AMC), which are sponsored by different financial institutions or companies. Mutual Fund is an ideal investment vehicle where a number of investors come together to pool their money with common investment goal. Each Mutual Fund with different type of schemes is managed by respective Asset Management Company (AMC). An investor can invest his money in one or more schemes of Mutual Fund according to his choice and becomes the unit holder of the scheme. The invested money in a particular scheme of a Mutual Fund is then invested by fund manager in different types of suitable stock and securities, bonds and money market instruments. Each Mutual Fund is managed by qualified professional man, who use this money to create a portfolio which includes stock and shares, bonds, gilt, money-market instruments or combination of all. Thus Mutual Fund will diversify your portfolio over a variety of investment vehicles. Mutual Fund offers an investor to invest even a small amount of money.

Mutual Funds schemes are managed by respective Asset Management Companies sponsored by financial institutions, banks, private companies or international firms. The biggest Indian AMC is UTI while Alliance, Franklin Templeton etc are international AMC's. Mutual Funds offers several benefits to an investor such as potential return, liquidity, transparency, income growth, good post tax return and reasonable safety. There are number of options available for an investor offered by a mutual fund.

3.6.2.1 Systematic Investment Planning (SIP): Systematic Investment Planning is a simple process of investing a certain amount of money every month over an extended period of time, not considering whether the market is up or down.

3.6.2.2 Types of Mutual Funds

Wide variety of mutual fund schemes exist to cater to the needs such as financial position, risk tolerance and return expectations etc. The following are the types of schemes in the Industry. [12]

a. Mutual Fund Scheme by Structure

b. Mutual Fund Scheme by Investment Objective

c. Mutual Fund Scheme other schemes

a. Mutual Fund Scheme by Structure: Following are the schemes of mutual funds by structure

i. Open-End Funds: An open-end fund is one that is available for subscription all through the year. These do not have a fixed maturity. Investors can conveniently buy and sell units at Net Asset Value ("NAV") related prices. The key feature of open-end schemes is liquidity.

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[12]. http://www.tax4india.com/indian-mutual-funds/types-of-mutual-funds.html 16.5.2012 1635 hrs

ii. Close-End Funds: A closed-end fund has a stipulated maturity period which generally ranging from 3 to 15 years. The fund is open for subscription only during a specified period. Investors can invest in the scheme at the time of the initial public issue and thereafter they can buy or sell the units of the scheme on the stock exchanges where they are listed. In order to provide an exit route to the investors, some close-ended funds give an option of selling back the units to the Mutual Fund through periodic repurchase at NAV related prices. SEBI Regulations stipulate that at least one of the two exit routes is provided to the investor.

iii. Interval Funds: Interval funds combine the features of open-ended and close-ended schemes. They are open for sale or redemption during pre-determined intervals at NAV related prices.

b. Mutual Fund Scheme by Investment Objective: Following are the mutual funds schemes by investment objectives under which investors can invest their money:

i. Growth Funds: The aim of growth funds is to provide capital appreciation over the medium to long term. Such schemes normally invest a majority of their corpus in equities. It has been proved that returns from stocks, have outperformed most other kind of investments held over the long term. Growth schemes are ideal for investors having a long term outlook seeking growth over a period of time.

ii. Income Funds: The aim of income funds is to provide regular and steady income to investors. Such schemes generally invest in fixed income securities such as bonds, corporate debentures and Government securities. Income Funds are ideal for capital stability and regular income.

iii. Balanced Funds: The aim of balanced funds is to provide both growth and regular income. Such schemes periodically distribute a part of their earning and invest both in equities and fixed income securities in the proportion indicated in their offer documents. In a rising stock market, the NAV of these schemes may not normally keep pace, or fall equally when the market falls. These are ideal for investors looking for a combination of income and moderate growth.

iv. Money Market Funds: The aim of money market funds is to provide easy liquidity, preservation of capital and moderate income. These schemes generally invest in safer short-term instruments such as treasury bills, certificates of deposit, commercial paper and inter-bank call money. Returns on these schemes may fluctuate depending upon the interest rates prevailing in the market. These are ideal for Corporate and individual investors as a means to park their surplus funds for short periods.

c. Other Schemes: Other mutual funds schemes which are available to the investors. These schemes has been discussed as under-

i. Tax Saving Schemes: These schemes offer tax rebates to the investors under specific provisions of the Indian Income Tax laws as the Government offers tax incentives for investment in specified avenues. Investments made in Equity Linked Savings Schemes (ELSS) and Pension Schemes are allowed as deduction u/s 88 of the Income Tax Act, 1961. The Act also provides opportunities to investors to save capital gains u/s 54EA and 54EB by investing in Mutual Funds.

ii. Special Schemes: Industry Specific Schemes: Industry Specific Schemes invest only in the industries specified in the offer document. The investment of these funds is limited to specific industries like Infotech, FMCG, Pharmaceuticals etc. Index Schemes: Index Funds attempt to replicate the performance of a particular index such as the BSE Sensex or the NSE 50. Sectoral Schemes: Sectoral Funds are those which invest exclusively in a specified sector. This could be an industry or a group of industries or various segments such as 'A' Group shares or initial public offerings.

3.6.2.3 Benefits of Investment in Mutual Funds

Mutual Funds offer several benefits to an investor that unmatched by the other investment options. The major benefits are good post-tax returns and reasonable safety, the other benefits in investing in mutual funds are:

1. Professional Management: Mutual Funds provide the services of experienced and skilled professionals, backed by a dedicated investment research team that analyses the performance and prospects of companies and selects suitable investments to achieve the objectives of the scheme.

2. Diversification: The best mutual funds design their portfolios so individual investments will react differently to the same economic conditions. For example, economic conditions like a rise in interest rates may cause certain securities in a diversified portfolio to decrease in value. Other securities in the portfolio will respond to the same economic conditions by increasing in value. When a portfolio is balanced in this way, the value of the overall portfolio should gradually increase over time, even if some securities lose value.

3. Convenient Administration: Investing in a Mutual Fund reduces paperwork and helps you avoid many problems such as bad deliveries, delayed payments and follow up with brokers and companies. Mutual Funds save your time and make investing easy and convenient.

4. Potential Return: Mutual Funds have the potential to provide a higher return to an investor than any other option over a reasonable period of time.

5. Liquidity: In open-end schemes, the investor gets the money back promptly at net asset value related prices from the Mutual Fund. In closed-end schemes, the units can be sold on a stock exchange at the prevailing market price or the investor can avail of the facility of direct repurchase at NAV related prices by the Mutual Fund.

6. Low Costs: Mutual fund expenses are often no more than 1.5 percent of your investment. Expenses for Index Funds are less than that, because index funds are not actively managed. Instead, they automatically buy stock in companies that are listed on a specific index.

7. Flexibility: Investment in Mutual Funds offers a lot of flexibility with features of schemes such as regular investment plan, regular withdrawal plans and dividend reinvestment plans enabling systematic investment or withdrawal of funds.

8. Affordability: Small investors with low investment fund are unable to high-grade or blue chip stocks. An investor through Mutual Funds can be benefited from a portfolio including of high priced stock.

9. Transparency: You get regular information on the value of your investment in addition to disclosure on the specific investments made by your scheme, the proportion invested in each class of assets and the fund manager's investment strategy and outlook.

10. Well regulated: All Mutual Funds are registered with SEBI and they function within the provisions of strict regulations designed to protect the interests of investors. The operations of Mutual Funds are regularly monitored by SEBI.

3.6.3 Life Insurance

Investors prefer Life insurance not only as an insurance cover but also as an investment option according to the policy selection. Due to increasing knowledge and more investment options, investors preferred secure low riskier and maximum return avenues for investment purpose. Insurance has been a federal subject in India. The insurance sector has gone through many phases and changes. Since 1999, when the government started with the insurance sector by allowing private companies to solicit insurance & also allowing FDI up to 26%, the insurance sector has been observed to be a booming market. However, the largest life-insurance company in India is still very much owned by the government. Insurance is a form of risk management that is primarily used to hedge the risk of a contingent loss. Insurance is defined as the equitable transfer of the risk of a loss, from one entity to another, in exchange for a premium, and can be thought of as a guaranteed and known small loss to prevent a large, possibly devastating loss.

An insurer is a company that sells insurance; insured or the policyholder is a person or entity buying the insurance. The insurance rate is a factor that is used to determine the amount which is to be charged for a certain amount of insurance coverage, and is called the premium. The contract of Insurance is a promise of compensation for certain potential future losses in exchange for a periodic payment [known as premium]. Insurance is intended to protect the financial well-being of an individual or a company or any other entity in case of unexpected loss. An agreement to the terms of an insurance policy creates a contract between the insured and the insurer. In exchange for the premiums paid by the insured, the insurer agrees to pay the policy holder a certain sum of money upon the occurrence of a specific event or on maturity. In most cases, the policy holder pays part of the loss (called the deductible), while the insurer pays the rest. Examples include health insurance, car insurance, life insurance, disability insurance, and business insurance.

3.6.3.1 Advantages of Insurance Policies: Following are the advantages of the insurance police. Investors have invested in life insurance policies due to various reasons and have various advantages. These advantages have been discussed as under:

i. Protection: Savings through life insurance guarantee full protection against risk of death of the saver. In life insurance, on death, the full sum assured is payable (with bonuses wherever applicable) whereas in other savings schemes, only the amount saved (with interest) is payable.

ii. Aid to Thrift: Life insurance encourages 'thrift'. Long term saving can be made in a relatively 'painless' manner because of the 'easy installment facility built into the scheme (method of paying premium either monthly, quarterly, half yearly or yearly). Take, for example, our Salary Saving Scheme popularly known as SSS. This scheme provides a convenient method of paying premium each month by deduction from one's salary. The deducted premium is remitted by the employer to the LIC. The Salary Saving Scheme can be introduced in an institution or establishment subject to specified terms and conditions.

iii. Liquidity: Loans can be raised on the sole security of a policy which has acquired loan value. Besides, a life insurance policy is also generally accepted as security for even a commercial loan.

iv. Tax Relief: Tax relief in Income Tax and Wealth Tax is available for amounts paid by way of premium for life insurance subject to Income Tax rates in force. Assesses can avail themselves of provisions in the law for tax relief. In such cases the assured in effect pays a lower premium for his insurance than he would have to pay otherwise.

v. Money When You Need It: A suitable insurance plan or a combination of different plans can be taken out to meet specific needs that are likely to arise in future, such as children's education, start-in-life or marriage provision or even periodical needs for cash over a stretch of time. Alternatively, policy moneys can be so arranged to be made available at the time of one's retirement from service to be used for any specific purpose, such as for the purchase of a house or for other investments. Subject to certain conditions, loans are granted to policyholders for house building or for purchase of flats.

3.6.3.2 ULIP- (Systematic Insurance cum Investment Plan)

A ULIP is nothing but a market-linked insurance plan. There is a difference between a ULIP and other insurance plans viz the way in which the premium money is invested. Premium from traditional insurance plan or an endowment plan is invested mainly in risk-free instruments like government securities (Gsecs) and AAA rated corporate paper, while in case of ULIP, the premiums can be invested in stock markets in addition to corporate bonds and/or Govt. sec. This option makes ULIPs an attractive investment for an individual. The following few reasons make ULIPs irresistible as an investment option -

i. Transparency: ULIPs provide a transparent option to customers for planning their various life stage needs through market-led investments as compared to the traditional investment plans.

ii. Insurance cover plus savings: ULIPs serve 2 main purposes - of providing life insurance along with savings at market-linked returns. Hence, ULIPs can be termed as a two-in-one plan in terms of offering an individual the twin benefits of life insurance plus savings. This option is not available in comparable instruments such as mutual fund for instance, that does not offer a life cover. ULIPs offer a variety of investment options unlike traditional life insurance plans.

iii. Flexibility: Individuals may switch between the ULIP fund options in order to capitalize on investment opportunities across the debt and equity markets. Some insurance companies also allow a certain number of free switches. This is an extremely important feature which allows the investor to benefit from the vagaries of stock/debt markets. Switching also helps individuals as they can shift from an aggressive to a balanced or conservative ULIP as they are approaching retirement based on their risk appetite.

3.6.4 Derivatives

Any financial instrument that is derived from an underlying asset like index, event, value or condition is known as a derivative. Derivative traders enter into an agreement to exchange assets or cash over time based on the underlying asset. Derivatives are highly leveraged - a small movement in the value of underlying asset can lead to a large difference in value of the derivative. Investors can use derivatives to speculate and earn profit if the value of the underlying asset moves in the expected way. Else wise, traders can use derivatives to mitigate or hedge the risk in the underlying, by entering into such a derivative contract whose value moves in the opposite direction to their underlying position and cancels either part or all of it. [13]

Derivatives are broadly categorized depending on:

i. Hedging: Hedging is a means to reduce or completely eliminate risk. Incase of derivatives, the risk about the price of an underlying asset can be transferred from one party

[13]. http://en.wikipedia.org/wiki/Derivative_(finance) 16.5.2012 1639 hrs

to another. For example, a person wants to buy a TV which costs Rs. 35,000/- but does not have that much money at present. So he enters into an agreement with the TV dealer to pay this amount after 3 months irrespective of the price of that TV after 3 months. This is nothing but a type of derivative contract known as futures contract. Here, we can see that the risk in change of price of the TV [underlying asset] is hedged against through a derivative contract.

ii. Speculation and Arbitrage: Derivatives can also be used to acquire risk, rather than to hedge/insure against risk. Some individuals as well as institutions enter into a derivative contract to speculate on the value of the underlying asset, betting that the judgment of the party about the future value of the underlying asset will be wrong. When the future market price is high, speculators will buy the asset in the future at a low price according to the derivative contract, and when the future market price is low, speculators will sell the asset in the future at a high price according to the derivative contract. Individuals and institutions may also look for arbitrage opportunities arising because of the differences present in the prices of assets in different markets.

3.6.5 Real Estate

An estate is the total of all personal and real property owned by an individual. Real property is real estate and personal property is everything else such as cars, household items, shares, units, and bank accounts. Estate planning refers to the process by which an individual or his/her family arranges the transfer of assets to the legal heirs in the event of death or disability of the individual. It includes the distribution of the real and personal property of an individual to his/her heirs. One of the goals of an individual will be to protect the needs of the loved ones during lifetime and after his death. This can be achieved by way of estate planning by distributing assets among his beneficiaries. An estate plan aims to preserve the maximum amount of wealth possible for beneficiaries and flexibility for the individual prior to his death.

3.6.6 Hedge Funds

Over the last 15 years, hedge funds have become increasingly popular with high net worth individuals, as well as institutional investors. The number of hedge funds has risen by about

20% per year and the rate of growth in hedge fund assets has been even more rapid. A hedge fund is a private investment fund, charging a performance fee and is open to only a limited number of investors. These funds are like mutual funds, which collect money from investors and use the proceeds to buy stocks and bonds. They can invest on almost any type of opportunity; in any market where in good returns are expected with low risk levels.

Protecting capital and producing good return in all kinds of market conditions, while attempting to minimize the risk, is the main objective of most of the hedge funds. Hedge funds have grown in size and have a great influence on public securities and private investment markets. Hedge funds are not currently subject to any direct regulation, unlike mutual funds, pension funds and insurance companies. They are limited only by the terms of contacts governing the particular fund. Hedge funds may be either long or short assets and may enter into futures, swaps, and other derivative contracts. In this way, hedge funds are able to follow complex strategies, intending to profit from market volatility or from falling market.

3.6.7 Equity Shares

Stock market is an investment opportunity that can offer both high risks and high returns. Capital is the money required to run a business. When a business wishes to expand or commercialize a new product or service, it needs to raise capital. Equity capital represents ownership capital. Equity shareholders collectively own the company. They bear the risk and enjoy the rewards of ownership. The potential rewards and the downsides of equity shares make this an exciting, attractive and at the same time a risky proposition for investment. In financial markets, the stock capital or equity capital of a corporation or a joint stock company is the capital raised through the issuance, sale, and distribution of shares. A person or organization that holds at least a partial share of stock is called a shareholder. [14]

3.6.7.1 Types of Share Capital

The share capital or stock capital exists in 2 forms:

i. Ordinary Shares: Ordinary shares or Common stock is the most usual and commonly held form of stock in a company. Common stock holders typically have voting rights in

[14]. http://en.wikipedia.org/wiki/Equity_(finance)16.5.2012 1643 hrs

corporate decision matters. In order of priority for receipt of their investment in the event of liquidation of a corporation, the owners of common stock are the last.

ii. Preferred Shares: These have priority over common stock in the distribution of dividends and assets. Most preferred shares do not provide voting rights in corporate decision matters. However, some preferred shares have special voting rights to approve certain extraordinary events such as the issuance of new shares, the approval of the acquisition of the company, or to elect directors.

3.6.7.2 Equity Market

Equity market is a place where a company can raise its fund and give an opportunity to investors to invest in the companies listed on the market. Segments of the equity market are:

i. Primary Market: It is also called the new issues market where in a company can raise fresh capital for its use. It is the market in which investors have the first opportunity to buy a newly issued security directly through the company. All IPOs [Initial Public offerings] come under primary market.

ii. Secondary Market: Secondary market facilitates trading of securities after these securities are initially offered to the public in the primary market and/or listed on a stock exchange. A huge volume of trading takes place in the secondary market. This market is also known as the stock market. [15]

3.6.8 Investment in Art

Today, we find that an increasing number of individuals are looking at alternative investments, which provide them with a diversification away from a particular asset class. People are willing to invest and looking for areas other than the stock market for investing. Investing in the vintage wine, coins, stamps and Art, is now an indulgence which gives them an opportunity to cash in on their hobbies, without having the level of expertise that is required for other direct investments.

Art is being incorporated into the investor's overall asset allocation decision. The art scene around the world is growing significantly. With more and more investors looking at art as an

[15]. http://en.wikipedia.org/wiki/Capital_market 16.5.2012 1644 hrs

alternative asset class and a store of a long term value, average annual art valuations have outpaced average annual stock market valuations by more than three times since 2000. Now this market is much stronger. In terms of returns one can see the market price has gone up four to five times, in some cases ten times in the past four years. With a sharp rise in the value of art and a comparatively disappointing performance in the stock markets and the real estate, individuals with money are now tapping Art as an alternate investment avenue. This is the reason why Citigroup and others are buying paintings as an investment for their very important private-banking clients. Wealthy clients who switch to art collection, as a way of diversifying investments, can find it an unexpectedly pleasurable experience. Unlike incase of stocks and shares, investors can literally admire their expensive investment.

3.6.9 ETF Investment Strategies

Exchange traded funds provide considerable flexibility in implementing several different investment strategies or building investment portfolios. Strategies range from very simple, like diversifying an existing portfolio, to various sophisticated hedging strategies.

i. Core Holding: An investor can consider using some ETFs as core portfolio holdings. A low-cost diversified portfolio can be easily constructed with help of a few ETFs for covering the major equity asset classes and fixed-income market. The investor can customize a portfolio with the help of additional securities, mutual funds or other ETFs.

ii. Asset Allocation: With ETFs, creating a portfolio for any asset allocation strategy is quite simple. It is even possible to purchase an ETF that is already diversified across many different asset classes. An investor can take a passive approach for asset allocation by rebalancing the portfolio just to ensure it returns back to the long-term or strategic asset mix. Otherwise, the investor can take an active role in the asset allocation process, by tactically rebalancing the portfolio, overweighting those asset classes which are expected to outperform in shorter term and by underweighting the others.

iii. Diversification: ETFs provide an option to the investor not only to diversify across several major asset classes, such as foreign equity, U.S. equity, or fixed income, but also to diversify into investments that have a low correlation to the major asset classes. This includes areas such as commodities, emerging markets, small cap stocks, real estate, and others.

iv. Hedging: Investors who want to hedge against a drop in the market can purchase inverse ETFs or leveraged inverse ETFs that rise when the market falls. Investors concerned about inflation can also hedge against it by investing in commodities or inflation-protected bond ETFs. Many ETFs also have options that can be used for various other hedging strategies, either separately or in conjunction with the underlying ETF.

v. Cash Management: ETFs can also be used to "equitize" cash, allowing investors to put their money in the stock market till the time a long-term investment decision is made. This way, investors can ensure that they do not miss out on price rises or forego income when their money is parked temporarily.

vi. Tax-Loss Harvesting: Tax-loss harvesting is a strategy in which capital losses are realized in a taxable account, and then redeploying sale proceeds among similar investments, leaving the investor's portfolio principally unchanged. The wash-sale rule prevents an investor from selling security at a loss and then immediately repurchasing it by not allowing the purchase of "substantially identical" securities within a period of 30 days of a sale. With the availability of a wide variety of ETFs, buying an ETF that is identical to the fund or stock being sold is very easy. The end result is a portfolio that strongly resembles the one before the capital losses were realized without invoking wash-sale rule.

vii. Completion Strategies: An investor may want to quickly gain exposure to specific sectors, asset classes or styles without having any expertise in these areas. As an example, an investor who has absolutely no expertise in emerging markets can buy an ETF depending on an emerging market index.

viii. Portfolio Transitions: Many investors shift portfolio assets between different advisors, managers or funds. In this transition period, the assets might be allowed to sit idle. ETFs allow investors to keep their assets invested rather than having them idle / dormant.

3.6.10 Forex Trading (Currency Future)

Forex trading [FX trading] involves the buying and selling of currencies of various different nations. In this type of trade, currencies are exchanged on a continuous basis in the forex market that covers the globe. People have several opportunities for profit-making in forex trading when value of one currency fluctuates against that of another. Forex trading is quite popular due to several factors like the leverage available, the high liquidity 24 hours a day and the very low dealing costs.

Evidently many commercial organizations participate in such trades purely due to the currency exposures created through their import and export activities, but the major part of the turnover is accounted for by financial institutions. Investing in foreign exchange remains mainly the domain of the big professional players in the market, such as funds, banks and brokers. Nonetheless, any investor having the necessary knowledge of the market's functions can also benefit from the advantages stated above. [16]

3.6.11 Commodity Trading

Commodity trading is a type of financial trading in which primary products, like food, metals & energy, are bought and sold. Trading in commodities is mainly undertaken on contracts that are based on such commodities. Commonly Traded Commodities

Agricultural products such as wheat, soybeans, corn, cocoa and oats

Energy products like ethanol, crude oil, natural gas and uranium

Precious metals such as gold, silver and platinum

Industrial metals such as lead, zinc, copper and tin

Commodities trading are also known as futures trading. When one trades futures, he/she does not actually buy or own anything. The contract is bought in order to speculate on the future direction or movement of the price of the commodity. [17]

3.6.11.1 Benefits of Commodity Trading

Commodity trading is much cheaper in comparison to stock trading, since the margins associated with commodity trading are much lower. The brokerage in commodity trading is also extremely low. Commodity trading proves highly useful for speculators.

3.6.12 Public Provident Fund

PPF is the best fixed income investment for high tax payers. The PPF deposits can be made in monthly installments with a minimum of 100 Rs and a maximum of Rs 60000 p.a. It gives return at around of 8% i.e. more than bank deposits PPF is a very attractive long term fixed

[16]. http://en.wikipedia.org/wiki/Currency 16.5.2012 1647 hrs
[17]. http://en.wikipedia.org/wiki/Commodities 16.5.2012 1650 hrs

income investment option for small investors because, It gives tax deduction of 20% of the amount invested from tax liability for the year subject to a maximum amount of Rs.60000 for the tax deduction. PPF is also gives less risk to investors as compared to other investment avenue. Lack if liquidity is negative point of PPF. Investors can withdraw money from investment made once in 7 years only.

3.6.13 Gold and Precious Stones

Gold investment is a long-term investment scheme involving low risks. People willing to invest in gold have a natural advantage because the demand for gold is much more than its actual supply. The price of gold is generally in a continual rise. However, investors should not invest all their funds in one kind of gold investment. The gold industry is huge and has many facets, and a savvy investor can exploit this. Money can be invested directly in gold mines, for example, which can be more lucrative than investing in physical Gold.

Benefits of gold investment:

1. Gold is a popular form of saving.
2. Gold is indestructible
3. Gold is a major requirement in the jewelry industry
4. The malleability and ductility of gold make it very useful
5. Gold can be transported easily
6. It retains as well as appreciates in value

Precious stones such as diamonds, Diamonds purchased in raw form and through a wholesaler may be the best investment potential. Since the price of diamonds keep on increasing in the same way as the price of gold, they have good investment value. The price of diamond increases as the diamond caret becomes higher. Diamond is valued in carets. Diamond is to be judged in terms of weight, size, shape and luster. In India, the investor must be cautious to buy diamonds because each jeweler decides the value of the diamond according to his own judgment. The investor must be careful that he is not cheated. It is an extremely risky form of investment because a large extent the value of diamond is based on judgment. Immediate acquisition and sate of diamond will not fetch price increase.

3.7 Conclusion

Thus it is concluded that, during the second half of the 1990's the growth of infrastructure industry was stagnant. These achievements are in no way insignificant and can be attributed mainly to the growing role of financial intermediation in India during 80's and 90's. In recent years, more varieties of financial institutions have come up like securities firms by offering variety of financial instruments. The new economy of the new millennium is characterized by growth of knowledge based industries, I.T., Multi-Media etc.