CHAPTER - III

INVESTMENT OF UNIT TRUST OF INDIA

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GENERAL

3.1 : WHAT IS INVESTMENT ?

There happens to be a great confusion about the precise meaning of the term investment. The term 'Investment' doesnot appear to be a simple as it has been defined. There are basically three concepts of investments ; economic investment, general investment i.e. the man on street, and financial investment. Economic investment includes net addition to the capital stock by the society. To the man on street general investment is usually referd to a money commitment of some sort. Financial investment means an exchange of financial claims- stock & bonds (securities), real estate, mortgage etc.

a) Investment is defined as " the commitment of funds with the hope of gain which includes compensation for risk "[2]

b) It is also defined as " it is the use of money in the purchase of any species of property or in the deposit of money for the purpose of earning interest "[3]

c) Investment is the employment of funds with the aim of achieving additional income or growth in value.

Thus it is clear that the term investment is treated in different ways. But the present study is based the meaning of investment stated in (c)

There are mainly two types of investors ;

a) individual investors, and

b) institutional investors.

Individual investors are those who on their own initiative invest directly their own savings in the industry. On the other hand institutional investors are those who invest other people's money placed on trust with them in the development of industry. So, the act of handing over money to trade or industry on the part of the investors, individual or institutional, is known as investment in financial sense. Unit Trust of India is one of the institutional investors. It generally doesnot give loan to trade or industry as part of investment activities but invest its funds in various securities of various companies. Therefore, in this chapter the term investment is confined mainly to security investment.

3.2: INVESTMENT POLICY OF UNIT TRUST -

Investment policies of the Unit Trust are generally, directly related to the basic objectives of the Unit Trust. On the basis of the character of investment portfolio, the nature of capital structure and management policies, the following types investment objectives are reflected.

1. Primarily capital appreciation.

2. Emphasis on income.

3. Moderate income and moderate appreciation.

4. Maintenance of principal value and suitable income etc.

Thus, various investment objectives are found in various Unit Trusts. The investment policy to be persued to carryout the particular objective is set down by the Unit Trust. While implementing the investment policy, the Unit Trust takes into account the procedures and restrictions laid down in the Trust Deed about investment, and the provisions of investment in the Act which governs the Unit Trust.

3.3: GUIDING PRINCIPLES OF INVESTMENT OF UNIT TRUST -

Securities must be selected after careful research on the yield, price change, instrinsic worth and other publicity value of each security. Because, the ultimate success or failure of a Unit Trust will depend upon the selection of the securities. Further, the following other factors are also to be taken into account.

1, Basic Character and national scope of the industry.

2. Earning capacity and soundness of management.

3. Satisfactory dividend returns over a period of years and substantial increase in reserves.

4. The securities must be listed and actively traded in on the principal stock exchanges of the country.

5. The share capital of the company should be sufficiently large [4]

In order to minimise the loss of princopal and loss of yield in investment, the Unit Trust allows the following guiding principles of investment in addition to the above factors.

1. Safety of Principles.
2. Income Stability
3. Diversification.

1. Safety of Principles -

It is one of the important principles. The Unit Trust to be certain of safety of principle, should carefully review the economic and industry trend before choosing types of investment. By safety it is meant that a unit trust is in a position to get back the amount it invested as an when it needs without any loss. This is consideration of the highest importance, as the reserves that go to build up the unit fund should free from the risk of being defleted due to loss of capital. But the absolute safety of priniciple does not exist. Therefore, the Unit Trust should not taken undue risks while selecteing various securities.

2. Income Stability -

It may be taken as second important principle of sound investment. Regularity of income at a consistent rate is necessary in any investment pattern of Unit Trust. Not only stability but also stability of income after tax is essential for any Unit Trust. The Unit Trust must earn adequate income to pay salaries to the staff and dividend to unit holders and to meet operating expenses of Unit Trust. Unit Trust is not a trading business. It earns its income by way of interest and dividend on the investment in various securities. Unit Trust tries to maximise the income by investing its funds in various income yielding securities in such a way that it will meet all its operating expenses and at the same time it will declare adequate amount of dividend to unitholders. But one should be aware of the negative correlationship between security and profitability of investments. It would, therefore, be proper to consider the second as subordinate to the first.

3. Diversification -

Diversification is the essence of Unit Trust. Diversification means that putting too many eggs in many baskets instead of single basket. It is an effort to distribute the risk of investment somewhat in accordance with insurance principles. Unit Trust tries to have adequate diverisification investment committments by industry, geographically, by management, by financial type and by maturities. But the important points is that within the limits that are prescribed by " Trust Deed" and legal restrictions, the Trust attempts to secure diversification.

The diversification can be achieved in many ways. The important ways are as follows-

1. By Company - Holdings are split among various company issues. Sometimes the percentage limit is set by law.

2. By Industry - Funds with general portfolios diversify by industry as well as company. Investment is made in securities of various industries such as capital goods, consumer goods, service and financial institutions.

3. By security Types: Funds are invested in different classes of securities e.g. common shares, prefernce shares, debentures, or bonds.

4. Geographic Diversification: Investment in securities of different industries located in different areas or regions.

With these principles of investment, the Unit Trust can invest its funds in the various investment outlets.

3.4: INVESTMENT POLICY OF UTI

While investing its funds, the Trust has to keep in mind its basic policy for unit holders regarding the following to considerations:

1. To obtain maximum return on invested funds including capital appreciation.

2. To ensure the securityof capital.

Because, the investment policy of the UTI has the impact on the unit holders in two ways. In one way the income is received by the unit holders from the Trust depends upon the return on investment made but by it. And another way is the appreciation or depreciation in the values of the investments brings about similar appreciation or depreciation in the value of units.

In other words, security of capital and growing dividend income to unit holders are the basic determinants of investment policy of the Trust.

Thus, with these ends in view, the Trust tries to build up a sound and balanced portfolio maintaining a judicious balance as amongst the fixed income bearing securities and variable income bearing securities including in this category new issues with growth prospectus. The extent to which the Trust has succeeded in maintaing a balanced and diverisified portfolio can be examined with reference to its investment pattern during certain period.

3.5 : LEGAL PROVISIONS OF INVESTMENT OF UTI:

The General Regulations of the UTI Act, 1963, contains the provisions about the investment of Trust's funds, In the regulations of the functioning of the Unit Trust, guidelines have been provided in this respect.

1. Investments by the Trust in any one company are not exceed 5% of the value of the total invested funds of the Trust or 10% of the value of the securities issued and outstanding of such company, wherever is lower.

2. Not more than 5% of the invetible funds are be inv--ested in the initial issues of securities of new industrial undertakings.[5]

It is to be noted that the investible funds under the Unit Schemes,1964, 1971, 1981, 1983, 1986 and 1987 are invested in various securities according to the above provisions. As regards these investment provisions, it is also to be noted that for the utilisation of the Trust's funds, the Trust is authorised to invest in securities or to keep money on deposit with scheduled banks or other institutions as may be prescribed.

3.6: PROCEDURE OF INVESTMENT -

The general procedure of investing the Trust's Funds is briefly described here.

The Board of Trustees laysdown the policy and guidelines for investment of the Trust's funds. The individual proposals for investment or underwriting are approved by the Board of Trustees.

The investment of the Trust are acquired by either of the following ways:

a) Purchasing shares and debentures on the recognised stock markets;

b) Underwriting of shares and debentures;

c) Subscribing directly to shares and debentures of companies.

In deciding on individual investments, the Trusts considers the financial soundness, efficient managment and the long term profitability prospects of the companies concerned, and then makes a proper selection of securities which have good income or growth potential.

The trust always keeps watch over its portfolio, From time to time, it makes the adjustments in the invest--ment portfolio acco ding to the changing conditions on the investment market. Moreover, it sells some securities now and then, in order to make profits or reduce losses or to take advantages of other investment securities. Thus, the Trust's investment portfolio is under constant review of the management which keeps itself in regular touch with brokers, and trends in the stock market as well as with the management of the companies concerned[5].