Volume : 3 | Issue : 4 | April 2014 • ISSN No 2277 - 8160

Research Paper Commerce

A Study on The Basics of Investment – "With Special Reference to Investment Risks and Investment Alternatives"

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ABSTRACT

An investment is a sacrifice of current money or other resources for future benefits. Every investment has risk and dealing with risk is a normal part of investing. It is generally said that higher potential returns usually come with higher risk. The paper in hand tries to give a brief overview of various investment alternatives available for the investors as well as highlight the various investment risk which are confronted by the investors while making investment. The study would help the investors in making proper portfolio selection through proper evaluation of various investment alternatives. The study is based on secondary data.

KEYWORDS: Investment, Investment Alternatives, Investors, Risk

INTRODUCTION

An investment is a sacrifice of current money or other resources for future benefits. A sacrifice takes place now and it is certain but the benefits are expected in the future and tend to be uncertain. The two main elements of investment are risk and return. Whenever an investor makes investment, his main concern is to have maximum return and that too at a minimum risk. The basic premise for starting a detailed investment process is to allow the money to grow, as opposed to it lying idle.

An investment is made because it serves some objective for an investor. Depending on the life stage and risk appetite of the investor, there are three main objectives of investment: safety, growth and income. Every investor invests with a specific objective in mind, and each investment has its own unique set of benefits and risks.

MAJOR CHARACTERISTICS OF INVESTMENTS

Certain features characterize all investments. The following can be said to be as the main characteristics of investments: -

1. 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. Different types of investment alternative promise different rates of return. The return from an investment depends upon the nature of investment, the maturity period & a host of other factors.

2 .Risk: - Risk is inherent in any investment. The 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 & bank deposits are almost risk less, others are more risky. The risk varies with the nature of investment. Investments in ownership securities like equity share carry higher risk compared to investments in debt instrument like debentures & bonds.

3. Safety: - The safety of an investment implies the certainty of return of capital without loss of money or time. Safety is another features which an investors desire for his investments. Every investor expects to get back his capital on maturity without loss & without delay.

4. Liquidity: - An investment, which is easily saleable, or marketable without loss of money & without loss of time is said to possess liquidity. Some investments like bank deposits, Post office deposit, NSC, NSS etc. are not marketable. Equity shares of companies listed on stock exchanges are easily marketable through the stock exchanges and therefore can be said to have good liquid feature.

RISK INVOLVED IN INVESTING

Every investment has risk and dealing with risk is a normal part of investing. Here risk can be said to be as the chance that an investment would not give the desired outcome to the investor. It is generally said that higher potential returns usually come with higher risk. The various types of investment risk are summarized below -

Interest Rate Risk

Interest rate risk is the possibility that a fixed-rate debt instrument will decline in value as a result of a rise in interest rates. Whenever investors buy securities that offer a fixed rate of return, they are exposing themselves to interest rate risk.

Business Risk

Business risk is the measure of risk associated with a particular security. It is also known as unsystematic risk and refers to the risk associated with a specific issuer of a security. Business risk refers to the possibility that the issuer of a stock or a bond may go bankrupt or be unable to pay the interest or principal in the case of bonds

Credit Risk

This refers to the possibility that a particular bond issuer will not be able to make expected interest rate payments and/or principal repayment. Typically, the higher the credit risk, the higher the interest rate on the bond.

Call Risk

Call risk is specific to bond issues and refers to the possibility that a debt security will be called prior to maturity. Call risk is most prevalent when interest rates are falling, as companies trying to save money will usually redeem bond issues with higher coupons and replace them on the bond market with issues with lower interest rates. In a declining interest rate environment, the investor is usually forced to take on more risk in order to replace the same income stream.

Inflationary Risk

Inflationary Risk is also known as purchasing power risk. It is the chance that the value of an asset or income will be eroded as inflation shrinks the value of a country's currency. Inflationary Risk is the risk that future inflation will cause the purchasing power of cash flow from an investment to decline.

Market Risk

Market risk, also called systematic risk, is a risk that affects all securities in the same manner. In other words, it is caused by some factor that cannot be controlled by diversification.

Liquidity risk

Liquidity is a measure of how easy or hard it is to sell an asset. Liquidity risk refers to the possibility that an investor may not be able to buy or sell an investment as and when desired or in sufficient quantities because opportunities are limited. A good example of liquidity risk is selling real estate.

Currency or exchange rate risk

Currency or exchange rate risk is a form of risk that arises from the change in price of one currency against another. The constant fluctuations in the foreign currency in which an investment is denominated vis-à-vis one's home currency may add risk to the value of a security.

VARIOUS INVESTMENT ALTERNATIVES AVAILABLE TO AN INVESTOR –

There are various number of investment alternative available to an investor for the purse of investment. A brief description on some

of them are as follows -

Fixed Deposit
Fixed deposit is one of the oldest & most common methods of Investing. A fixed deposit is an investment account comprising a single deposit, for a fixed term at a guaranteed fixed rate of interest. It can be used for both short and long term investment purposes. A fixed deposit account allows a person to deposit money for a set period of time, thereby earning a higher rate of interest in return.

Government Securities
Government securities are sovereign securities which are issued by the Reserve Bank of India on behalf of Government of India, in lieu of the Central Government's market borrowing programme. The term Government Securities includes:

- Central Government Securities
- State Government Securities
- Treasury bills

The Central Government borrows funds to finance its 'fiscal deficit'. The market borrowing of the Central Government is raised through the issue of dated securities and 364 days treasury bills either by auction or by floatation of loans. In addition, treasury bills of 91 days are issued for managing the temporary cash mismatches of the Government. These do not form part of the borrowing programme of the Central Government. There are various types of Government securities such as Dated securities, zero coupon bonds, partly paid stocks, floating rate bonds, bonds with call/put option and capital indexed bonds.

Corporate bond
Corporate bonds are nothing but debt instruments issued by a corporation, the holder of which receives interest from the corporation periodically for a fixed period of time and gets back the principal along with the interest due at the end of the maturity period. Corporate bond normally offers a higher rate of interest as compared to fixed deposit or postal saving or similar investments because of the risk element present in it.

Mutual fund
A Mutual fund is a pure intermediary which performs a basic function of buying and selling securities on behalf of its unit holder, which the latter can also perform but not as easily, conveniently economically, and profitably. The investors in the MF are given the share in its total funds which is proportionate to their investments, and which is evidenced by the unit certificates. MFs provide investors continuous supervision and analysis, investment consultancy, judicious investment decisions, and expert, experienced, professional management of portfolio at affordable costs.

Post office deposit
Post office schemes are offered by the Government of India. They are safe, secure and risk-free investment options. The instruments are transferrable to any post office anywhere in India. The various Post office schemes in which money can be invested are Post office monthly income scheme, Post office time deposit scheme, Post office savings account, National saving certificate, Kisan vikas patra.

Equity shares
Equity share is said to be one of the very risky investment avenue. One can start investing in equities by participating in primary markets (applying for IPO's) and also by purchasing securities from secondary markets (stock exchanges). Equity is known as high risk investment as when a sick firm is liquidated or declared bankrupt, equity shareholders lose their entire investment. However investors are ready to take this High risk as investment in good firms will give the investors high returns.

Gold
Of all the precious metals, gold is the most popular as an investment. Gold is a hedge against the dollar and inflation. It has a very low correlation with other asset classes like equity and debt thereby a good asset to diversify the overall portfolio. Gold is considered as the best investment in India, that is the only reason why India is the highest consumer of gold in the world.

Real Estate
Real estate investment involves the commitment of funds to property with an aim to generate income through rental or lease and to achieve capital appreciation. Real estate refers to immovable property, such as land, and everything else that is permanently attached to it, such as buildings. When a person acquires real estate, he also acquires a set of rights, including possession, control and transfer rights. . As compared to owning stocks and bonds, rental real estate requires a significant amount of time and effort to be devoted by the landlord.

Public provident fund
Public provident fund is a very attractive fixed income option for small investors. PPF is a savings-cum-tax-saving instrument, which also serves as a retirement planning tool for those who are not covered by any structured pension plans. The popularity of PPF as an investment avenue has been because of various reasons, seldom found in other savings instruments - high rate of return, compound interest, complete safety, no wealth tax, tax-free interest and tax benefits.

CONCLUSION
A basic principle of investing is that the investment avenue must match the investor's risk profile. For example, a high risk investment avenue would suit a risk-taking investor. Also the investment should aid the investor in achieving his financial goals and objectives. For example, if the investor wishes to save money to buy a car in a stipulated period of time, then his investments alternative selection should help him achieve that predetermined goal.

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