MEANING OF INVESTMENT

Investment is an activity that is engaged in by people who have savings i.e investments are made from savings , or in other words people invest their savings but all savings are not investment.

Investment may be defined as a commitment of funds made in the expectations of some positive rate of return , expectation of returns is an essential element of an investment.

SCOPE OF INVESTMENT MANAGEMENT

The business of investment has several facets, the employment of professional fund managers, research (of individual assets and asset classes), dealing, settlement, marketing, internal auditing, and the preparation of reports for clients. The largest financial fund managers are firms that exhibit all the complexity their size demands. Apart from the people who bring in the money (marketers) and the people who direct investment (the fund managers), there are compliance staff (to ensure accord with legislative and regulatory constraints), internal auditors of various kinds (to examine internal systems and controls), financial controllers (to account for the institutions' own money and costs), computer experts, and "back office" employees (to track and record transactions and fund valuations for up to thousands of clients per institution).

FINANCIAL AND ECONOMIC MEANING OF INVESTMENT

In the financial sense investment is the commitment of a person’s fund to derive future income in the form of income . dividend premium , pension benefit , or appreciation , in the value of their capital example :- purchasing of shares , debentures , post office saving certificates , insurance policies are all investments in the financial sense such investment generates financial assets.

IN THE ECONOMIC SENSE

Investment means the net addition to the economy's capital stock which consists of goods and services , that are used in the production of other goods and services . example :- new constructions of plants and machines , inventories and etc .

DIFFERENCE B/W INVESTMENT AND SPECULATION

Differences between investment and speculation

1. Investment: Investment is rationally based on the knowledge of past share price behaviour. From such knowledge, it is possible to compute the probability of future return.

- A common method of investment analysis is to study the past range of PER or DY of a particular share or a class of shares.
- From this study of its past price range, we can predict the likelihood of its price being out of this range in the future.
- By comparing its current price with the expected future price range (future price = future PER x future earnings) we know whether the current price is too high or too low and take the necessary action accordingly.

Speculation: Speculation is purely based on the HOPE that the future price will be higher rather than on anything tangible.

2. Investment: Investment requires an investor to do some work before hand and decisions are made based on known facts and figure.

- Such work typically may consist of estimating future level of Earnings Per Share and computing the past range of the PER.
- By multiplying the future EPS with the likely PER, we have an estimate of the future level of price.
- If the present price is very low compared with the future price, we buy and vice versa.

Speculation: Speculation is usually based on wild rumours and unsubstantiated hearsays which cannot be checked for accuracy. Undoubtely, speculation is a lot easier than investment but one tends to reap what one sows.

3. Investment: Investment is made for the **long term (i.e. two years or more)**based on the idea that one is much more certain when one is trying to predict the cumulative results of many daily movement. Once invests with the knowledge that over the long run, the real investors will always make a gain.

Speculation: Speculation is usually for the **short run (i.e three months or less**unless one is caught whence a speculator is then forced to become an investor), based on the idea that certain events may result in a rise in price (bonus, rights, takeovers, and others).

4. Investment: Over a long period of time, true investment **tends to produce a positive result.** Based on many years of research in the US and Europe, Long Term Investment consistently produced much higher return than fixed deposit or the inflation rate. The Malaysian experience has mirrored the Western experience.

Speculation: Since speculation is not based on anything concrete, its result is not at all predictable. Speculation can occasionally produce very high gains just as it can produce very high losses. Over a long period of time, speculation is most unlikely to produce better return than true investment.

5. Investment: True investors can **sleep soundly at night** since they have a fairly good idea of the possible extent of their loss and gain before hand. Besides, since they are investing for the long term, they can **forget about short term movements and ignore the market most of the time.**

Speculation: Speculation is likely to lead to many sleepless nights and anxious days since its result is so uncertain. The speculator will have to be always on the alert to take the necessary quick action to catch the right moment.

DIFFERENCE B/W INVESTMENT & GAMBLING

Gambling vs Investing

Gambling and Investing have few things in common. These activities both involved money and is considered as a commercial activity. There are many ways how entrepreneur spend their money to earn more. But taking a closer look to these two activities involving money, there are differences that needs clarification for us to be able to use these two terms in the right way. For sure, there are great differences between gambling and investing and, if we can classify those, we can identify what is gambling and investing specifically.

Gambling

Gambling is considered to be a major international commercial activity wherein most of these activities are illegal. Illegal gambling is heavily controlled or banned in many jurisdictions in local and national. Aside from illegal gambling, there are also activities that are legal such as wagering money in a game without certain outcome, just an intent to win additional money. Gambling is commonly found in casinos where you can earn money in playing different types of games like table games, electronic games and sports betting.

Investing

On the other hand, investing is also a commercial activity, wherein investors put money into something but not gaming, with the hope of a regular profit. The activities involve purchasing of financial instruments or other assets to gain profitable returns.

Investing is almost the same with gambling, but the only good thing in investing is that, you can see a profit from the money you invested regularly.

Difference between gambling and investing

Whether it is gambling or investing, an entrepreneur spend money in different ways wishing to earn more money. In one way or the other, both are ways to earn more money to sustain daily needs. The only thing is that, in gambling you are enjoying playing game while you earn and in investing, you are serious enough or shall we say you are a business minded person in spending the money.

In brief:

1. Gambling and investing are both ways of making their money profitable.
2. Gambling in general is a recreational activity than an activity to find extra income.
3. Gambling is done in a way of leisure like playing games while investing makes your money grow in a professional way and helps you become mature enough in business.
4. Gambling is commonly found in casinos where you can earn money in playing different types of games like table games, electronic games and sports betting while investing is found in establishments like banks and business offices or any small business.
5. In gambling you are not sure if you earn more money unless you win the game while investing assures you regular profit if you manage the business in the right way.
6. The risk of losing money is very high in gambling whereas in investing there are tools to forecast the return.

7. When gambling goes beyond the recreational level and becomes uncontrollable or addictive it can create pathological gambling disorder in a person that affects the important aspects of the gambler's life.

IMPORTANCE OF INVESTMENT

Every branch of knowledge has its own contributions that made a turning point in the historical lanes of human beings. In mechanics it is wheel, in science it is fire. In political science it is vote and in economics it is money. Money is the queen among all these fundamental discoveries. Money is anything that is generally acceptable as a means of exchange and that at the same time act a store of value. So there is no question in the fact that money is important and money does matter.

Until the middle part of twentieth century, the whole economic system was run on the basis of classical economic principles associated with the names of Adam Smith, David Ricardo, T R Malthus, J B Say, Alfred Marshall etc. their economic doctrines enjoyed wide spread authority during the late eighteenth and nineteenth century. According to them, money acts as a medium of exchange. It means that money has only one function that is transaction. But after the Great depression of 1930's, an intellectual giant John Maynard Keynes, a favorite student of Alfred Marshall in Cambridge University came with a new set of thoughts and ideas. He published a book named 'General Theory of Employment, Interest and Money' in 1936. it has created a great revolution in economic history and became a landmark in modern economic thinking. In this theory Keynes examined the sore of value function of money along with transaction function. According to him demand for money arises due to three motives. They are transaction motive, precautionary motive and speculative motive.

1. Transaction motive

It refers to the demand for money for the current transaction of the people. People hold cash in order to bridge the interval between receipt of income and the expenditure. This amount will depend upon the interval at which income is received. The businessmen and entrepreneurs also will keep a portion of their resource in ready cash to meet the current needs. Keynes calls this as business motive. The amount hold in liquid form will depend upon the business turnover. Transaction demand for money is independent of rate of interest and it will remain constant at a particular level of income.

2. Precautionary motive

It refers to the desire of the public to hold cash balances for meeting unforeseen or unpredictable contingencies such as unemployment, sickness, accidents etc. The amount of money hold under this motive will depend on the nature of individuals' income.

3. Speculative motive

It refers to the desire to hold one's resources in liquid form in order to take advantage in market movements regarding future changes in price and rate of interest. There is an inverse relation between rate of interest and people's tendency to spend money.

Precautionary and speculative motive induce people to save money. When people save, banks will lend this amount to businessmen for investment. Thus there is a very close relationship between savings and investment. While we understand the importance of savings and investment in one's life it is very essential to understand the interconnection between them.

Savings refers to that part of income which is not consumed. On the other hand by the term investment we mean an addition to the stock of physical capital. Savings and investment are two crucial economic variables by which we can measure a person's physical quality of life and standard of living. Everyone can agree that saving money as early as possible will help one and his family to achieve more stable life than someone who has no savings. Long term habit of saving money is a way of protecting someone from natural adversity that comes in his life.

According to Warren Buffet, world's second richest person, if a person has to become a millionaire at the age of 65, then he has to save $10 per day if he is at the age of 25. If he has 35 year old, he must save $22 in a day. If he is at the age of 45, his savings requirement is $55 per day. If he wait until the age of 55, he has to save $182 per day. He assumes the saved amount of money generate 8% returns per year. This example shows the importance of savings in one's life. The importance of savings may be analyzed on the basis of the reasons by which people are induced to save.

1. To meet unexpected expenditure in life: According to a modern monetarist Milton Friedman, people's current income has two components namely permanent and transitory component. Transitory component refers to the amount of income generated accidentally and unanticipated. It may be positive or negative. If it is negative people's current income will decrease and they will become unable to meet their needs. At this time savings plays a crucial role in compensating this adverse situation and rescue them from borrowing.

2. Savings act as an inducement for investment: If a person has considerable savings, he will have a feeling that he is able to meet some unexpected expenditure and to face moderate risk. This feeling induces him to make investments. Savings can provide an excellent source for future business ventures as capital. It also allows for exploring sleeping talents and other interests that may increase one's income.

3. Makes a felling of rationality: Every normal human beings are rational in behavior. It means that they try to maximize their satisfaction with minimum spending. It induces them to save a part of their income.

4. Children's education: One of the most important things a person can do is to educate his children. In today's world education is very essential and so expensive. Therefore savings is very important on the side of education also. Quality based education will provide a great sense of accomplishment and peace of mind foe a person.

5. Achieve a feeling of self reliance: A habit of savings give people the ability to enjoy independence and power to do things.

6. Security of the family: Even though in the process of income determination, we take income of an individual over his entire life span, death is an accidental fact. Everyone fears death. So they are always aware of the stability and security of their family. It forces them to save a portion of their income.

Savings and investment are mutually interconnected economic variables. When we examine the importance of savings, it is very essential to understand what is the role of investment in one's life. Keynes's psychological law of consumption shows that income is not equal to expenditure and it makes a gap between income and consumption. It can be filled in by additional investment only. If additional investment does not take place, income and employment will inevitably fall.

According to classicals, level of investment depends on the rate of interest only. But Keynes has introduced some dynamic variables such as expectation and Marginal Efficiency of Capital. Marginal Efficiency of Capital (MEC) is the expected returns fro additional unit of investment. An investor will decide to invest only if the expected profit is higher than the rate of interest he has to pay. According to Keynes, out of these determinants of investment, MEC is of crucial importance. Keynes has assumed that rate of interest changes quickly and remains more or less constant. Then if MEC is higher than rate of interest, investment will be higher and vise versa. Fluctuations in the investment are due to fluctuations in the MEC. Profit is essential to induce businessmen to take risk. The probable risks are from competition and business cycles. Great the risk, higher will be the level of profit which the entrepreneur will expect. An entrepreneur is not influenced by current rate of profit but the expected rate of profit.

In modern times people prefer to invest in human capital than non human assets. It is because they have convinced that man power is the richest asset. Benjamin Franklin says “an investment in knowledge always pays the best interest”. According to Census Bureau, the agency responsible for taking the census, provide demographic information in United States, people with a bachelor’s degree earn on average nearly twice as much as people with only a high school diploma. College may be expensive but it is one of the best investments we can make. We have to invest in man power that turn the dreams we have into realities. Only an educated society can transform the world. Only a person with confidence, competence, responsibility and honesty can become a good businessman or investor. Everyday thousands of people become unemployed by working under untruthful entrepreneurs. Good investors create the backbone of the society.

In order to achieve higher growth in savings and investment, banking system has a important role to play. Banking institutions have been playing a vital role in economic development of different countries of the world. An efficient and diversified banking system is must for promoting savings and canalizing them into investment and helps to achieve a faster rate in economic growth. Thus the good health of an economy is reflected in the good health of its banking system. In modern economies banks are considered to be the dealers of money as well as leaders of development.

FACTORS FAVOURABLE FOR INVESTMENT

Capital investment decisions are not governed by one or two factors, because the investment problem is not simply one of replacing old equipment by a new one, but is concerned with replacing an existing process in a system with another process which makes the entire system more effective. We discuss below some of the relevant factors that affects investment decisions:

(i) Management Outlook: lf the management is progressive and has an aggressively marketing and growth outlook, it will encourage innovation and favor capital proposals which ensure better productivity on quality or both. In some industries where the product being manufactured is a simple standardized one, innovation is difficult and management would be extremely cost conscious. In contrast, in industries such as chemicals and electronics, a firm cannot survive, if it follows a policy of 'make-do' with its existing equipment. The management has to be progressive and innovation must be encouraged in such cases.

(ii) Competitor's Strategy: Competitors' strategy regarding capital investment exerts significant influence on the investment decision of a company. If competitors continue to install more equipment and succeed in turning out better products, the existence of the company not following suit would be seriously threatened. This reaction to a rival's policy regarding capital investment often forces decision on a company'

(iii) Opportunities created by technological change: Technological changes create new equipment which may represent a major change in process, so that there emerges the need for re-evaluation of existing capital equipment in a company. Some changes may justify new investments. Sometimes the old equipment which has to be replaced by new equipment as a result of technical innovation may be downgraded to some other applications, A proper evaluation of this aspect is necessary, but is often not given due consideration. In this connection, we may note that the cost of new equipment is a major factor in investment decisions. However the management should think in terms of incremental cost, not the full accounting cost of the new equipment because cost of new equipment is partly offset by the salvage value of the replaced equipment. In such analysis an index called the disposal ratio becomes relevant.

Disposal ratio = (Salvage value, Alternative use value) / Installed cost

(iv) Market forecast: Both short and long run market forecasts are influential factors in capital investment decisions. In order to participate in long-run forecast for market potential critical decisions on capital investment have to be taken.

(v) Fiscal Incentives: Tax concessions either on new investment incomes or investment allowance allowed on new investment decisions, the method for allowing depreciation deduction allowance also influence new investment decisions.

(vi) Cash flow Budget: The analysis of cash-flow budget which shows the flow of funds into and out of the company may affect capital investment decision in two ways. 'First, the analysis may indicate that a company may acquire necessary cash to purchase the equipment not immediately but after say, one year, or it may show that the purchase of capital assets now may generate the demand for major capital additions after two years and such expenditure might clash with anticipated other expenditures which cannot be postponed. Secondly, the cash flow budget shows the timing of cash flows for alternative investments and thus helps management in selecting the desired investment project.

(vii) Non-economic factors: new equipment may make the workshop a pleasant place and permit more socializing on the job. The effect would be reduced absenteeism and increased productivity. It may be difficult to evaluate the benefits in monetary terms and as such we call this as non-economic factor. Let us take one more example. Suppose the installation of a new machine ensures greater safety in operation. It is difficult to measure the resulting monetary saving through avoidance of an unknown number of injuries. Even then, these factors give tangible results and do influence investment decisions.

INVESTMENT PROCESS

The Investment Process: How to Begin

Just what is the stock market, and how do you begin investing in it? These are important questions, and many people are unclear about the answers. Understanding how stocks and bonds are traded, what an index is, and where to open a brokerage account will help you begin the investment process armed with your most valuable asset: knowledge.

The Stock Market
The stock market is the general term for the organized trading of stocks, and a stock exchange is a market for buying and selling stocks. The New York Stock Exchange is the largest stock exchange in the in the world. The National Association of Securities Dealers (NASDAQ) is also an important exchange.

Stock prices are determined by supply and demand – by sellers and buyers willing to buy or sell at a certain price. As demand goes up, the price rises, and when demand goes down, the price follows suit.

Indexes
An index takes a sample of stocks and uses it to measure the market as a whole or by a specific industry. Three of the most common indexes are:

- *The Dow Jones Industrial Average (DJIA).* The DJIA is comprised of 30 blue chip (well-established, financially sound companies) stocks.
- *The S&P 500.* This index is owned by Standard & Poor's, and consists of 500 stocks chosen for such factors as market size, liquidity (the ability to convert an asset into cash quickly and penalty-free), and industry types.
- *The Wilshire 5000.* This index tracks the performance of most publicly traded, U.S.-headquartered stocks available on the major exchanges.

As an investor, you can look to indexes to gauge how the stock market is doing. For example, if you hear reports that the DJIA is up, the larger companies are doing well, and so too should your stocks if you are invested in them. Following an index can help you make educated investment decisions.

Brokerage Accounts
So how do you actually begin? All you need is to open a brokerage account at a financial institution or brokerage house. As soon as you open your account, you can begin to buy and sell stocks and bonds – a process called trading. You can make trades with the assistance of a broker, over the phone, or online via the financial institution’s website. Whether you do it on your own or with help, you will be charged a fee for each trade you make.

Where you choose to open your account depends on how much assistance you need or want, and if you are willing to pay for it. You can open a brokerage account at:

- *Your financial institution.* Many credit unions and banks sell investment products, and they may even have financial planners on staff who can provide guidance.
- *A traditional brokerage house.* These companies provide a wide range of services. They staff professional money managers who can help you with very specific investment advice (for a fee). Traditional brokerage houses tend to have higher commissions than other options.
- *A discount brokerage house.* If you want to invest without professional assistance, a discount broker may be the right company for you. You will be charged for making trades, but it will be considerably less than if you had an expert assist you. Commissions are even less if the company is Internet-based.

Research Before You Buy
Even if you trust your broker or advisor completely, it is important to do your own research before you purchase any security. After all, it is your money on the line – win or lose, the person or company who sells you the investment product earns a commission. Remember too, to have realistic expectations. Don't take "hot" stock tips that promise a huge payout, particularly if you hear about it through an anonymous email!

The best place to begin your research is the Internet. Visit the company's website and read all about it – including a history of its stock price, financial position, breaking news about products or services, and management. Whether you are buying stocks or bonds, it is important to know what you are getting into.

Investing is an exciting, and most often worthwhile venture. Will all of your investments pay off the way you want them to? Of course not. Even professionals lose money. Expect setbacks and keep learning – you'll be on the road to riches before you know it.

END OF 1ST UNIT