Individual Investment Planning In Current Global Business Scenario

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Abstract:
Individual investment planning involves planning the investments in a pragmatic manner giving due
emphasis on to the current global business scenario that is fast changing and hence, more risky. The
paper brings focus on to the basics of investing in the current economic environment which has opened
its doors to new global dimensions at times which are tough; ever changing and unstructured. These
are the times when expectations are high and results are difficult to achieve because of turbulent
economic conditions and global dependencies.

Key words:
Investment, Investment planning, Global business scenario, Risk-return trade-off, Portfolio, Smart
investor, Investment avenues, Optimal portfolio, Efficient frontier, Performance evaluation.

Introduction
Investment means sacrifice of current consumption for future return. It indicates a trade-off between
present and future consumption. Investment always seeks returns for reasons such as:

- Risk involved
- Sacrifice of present consumption
- Time value of money
- Inflation
- And, simply because someone is parting ways with its hard earned money

Therefore, everyone seeks return from the investment they make. But the question arises, which
avenues will yield more returns i.e. where to invest money? There are many investment options
available to an investor such as stocks, real estate, bank and post office schemes etc. These investment
avenues can be further scrutinized so as to construct a portfolio of investments for an investor. Here
comes in the picture, the role of investment planning.

Investment Planning
Investment planning means identifying investment strategies to suit an investor’s risk appetite and
financial goals. It involves a judicious mix of intelligence and decision making ability on the part of an
individual investment planner. Investment planning becomes essential if the objective is to maximize
the returns with the limited resources and within a limited time frame. Investment planning helps an
investor in:

- Identifying the financial goals
- Choosing appropriate investment options
- Reaching risk-return trade-off
- Generating current income
- Enhancing wealth for future
- Strengthening the portfolio
- Maintaining liquidity
- Save on taxes
In today’s scenario, where market means a global business market which is governed more by speculators and financial institutional investors than by market forces, need of the hour is not to be an investor but a smart investor. Today, a smart investor at one hand must be aware of the:

- fundamentals of investing, and,
- the technical aspects involved thereof

And on the other hand, must also know:

- self risk appetite (conservative, balanced or aggressive), and,
- goals for making investment and asset allocation

The awareness of these factors along with the global market comprehensions will in-turn lead an individual investor to plan for his investments yielding him long term returns.

**Investment Planning Process**

Investment planning involves a series of activities eventually leading to achievement of the financial goal of the investor with limited resources and in the specified time frame. Investment planning process is indeed a circular process i.e. it never ends. The reason is goals of an individual may change over the period of time, time frame for which investment is made could differ as well, risk appetite of an investor may increase once the investor feels confident, an investor may want to get indulged in avenues untouched before, process of evaluation may also change and most importantly market conditions may also change. Therefore, it is a never ending process. The steps involved in investment planning process are as follows:

**Step 1: Identifying the financial goals**

Financial goals are indeed individual reasons for making investments. These reasons may differ for investors as they move from being single to getting married and having family, as they move towards stability in professional life, as they move towards later part of their life i.e. nearing retirement. In all, financial goals differ from individual to individual and from one point of time to another. Financial goals that individual investors may yearn for could be some of these stated below:

- Current living expenses
- Financial security
- Asset accumulation (automobile, house etc.)
- Wealth generation
- Children’s future (education, marriage etc.)
- Retirement
- Medical care

The first step for an individual investor is not only to identify and choose financial goals for self but also to understand the implications of choosing the goals. The goals must be:

- Specific
- Achievable
- Quantifiable
- Realistic
- Time bound
- Actionable
- In adherence to the investment planning criterion

**Step 2: Determining the time horizon for investment**

As an investor is through with the identification of investment/financial goals, next step requires an investor to specify the time frame for which the investment is to be made. Financial goals must be identified in sync with the time horizon so that the funds are available at the time they are required. Investment time horizon can be divided into three categories, viz. short term, medium term and long term.
Short term investments are made for a time horizon of up to a year. The investors opting for such investments generally have high and early liquidity needs. The individuals making investments for very short term say a few days or a month without much understanding of the fundamentals are indeed known as speculators.

Medium term investments are made for a time horizon of one year to five years. The investors opting for such investments generally have moderate liquidity needs.

Long term investments are made for time period of more than five years. The investors opting for such investments generally have low current liquidity needs. The investors generally prefer financial and real assets over a long period.

Step 3: Understanding risk appetite
The investors’ attitude towards undertaking risk varies largely based on factors such as age, education, marital status, income requirements, risk appetite and past experiences. In the light of these factors, an investor could be categorized as a risk taker, a risk neutral or risk averter.

Risk taker is an investor willing to take high risk on investments so as to obtain high returns. These investors prefer to invest more in equities as these are comparatively more risky, and, as the nomenclature have it, high risk, high return.

Risk neutral is an investor willing to take moderate risk. These investors prefer to invest more in mutual funds, bonds, equities of fundamentally strong companies, etc. These investors try to balance their risk and return more judiciously than the other two types of investors.

Risk averter is an investor who takes only minimal risk. These investors prefer to invest in fixed income securities that are less risky.

Step 4: Determining investment strategy
The investor’s financial goals and risk appetite would eventually lead to determining an investment strategy suitable for him. The risk-return perception of an investor could apprehend him to choose a strategy appropriate for him. The strategies adopted could be Conservative, Moderate and Aggressive.

Conservative strategy is for those investors who are investing for short period of time i.e. less than a year and are risk averters. Therefore, the return they get is also comparatively low. Their major objectives for investment are liquidity and safety. They do not invest in equities rather they tend to invest their funds in fixed income securities that are rather secured but yield less returns.

Moderate Strategy is adopted by the investors who are investing for medium period of time i.e. one to five years and are risk neutrals. They seek moderate returns from their investments. Their major objectives for investment are earning income and some growth. They tend to invest in mutual funds, bonds, equities of fundamentally strong companies, etc. that are comparatively secured and yield moderate returns.

Aggressive Strategy is adopted by the investors who are investing for long period of time i.e. more than five years and are risk takers. They seek high returns from their investments. Their major objective for investment is capital growth. They tend to invest in equities that are risky but yield high returns.

Step 5: Identifying investment avenues
Investment avenues are the different options available to investors to invest their funds and earn returns out of these options. Investment avenues can be broadly divided into five categories viz. Securities (Stock Market), Deposits, Postal schemes, Insurance and Real assets.

Securities include:
- Equity Shares
- Preference Shares
- Debentures Bonds
- Government Securities
- Money Market Securities
Deposits:
- Bank Deposits
- NBFC Deposits

Postal Savings:
- National Savings Certificate
- Kisan Vikas Patra
- Post Office Monthly Income Scheme
- Senior Citizen Scheme
- Public Provident Fund

Insurance Plans:
- Endowment Policy
- Life Insurance Policy
- Children’s Insurance Policy
- Unit Linked Insurance Plan

Mutual Funds

Real Assets:
- Real Estate
- Precious Metals

Step 6: Determining investment mix/portfolio
The risk appetite and investment strategy hence determined would lead an investor to choose the investment mix for self from among the options available. Constraints of the investors should be analyzed first. It is within the given framework of constraints that financial goals are formulated. Then based on these goals, the securities are selected. An investor must find his optimal portfolio on the efficient frontier so as to either maximize the return or minimize the risk. Determination of investment mix involves construction of a portfolio that is diversified enough to be comparatively secure but at the same time yield returns.

Step 7: Evaluating the portfolio
Investment evaluation, commonly known as portfolio evaluation, is the process of measuring and comparing the actual returns earned on an investment/portfolio with the estimated returns for a benchmark portfolio. There are several measures suggested for evaluation of investment/portfolio performance. These are as under:

1. **Sharpe’s Performance Index/ Ratio:** It is a reward to variability ratio. This ratio measures the risk premium of the portfolio in terms of its total risk. The risk in this ratio is indicated by standard deviation. The larger the index value, the better the portfolio has performed.

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   \text{Sharpe Index} = \frac{\text{Portfolio average return} - \text{Risk free rate of return}}{\text{Standard deviation of the portfolio return}}
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2. **Treynor’s Performance Index/ Ratio:** It is a reward to risk ratio. This ratio measures the risk premium of the portfolio in terms of its systematic risk given by beta (\(\beta\)) of the portfolio.
3. **Jensen’s Performance Index/ Ratio:** It is based on differential returns. The Jensen’s ratio is based on the difference between the actual return of a portfolio and required return of a portfolio in view of the risk of the portfolio.

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\text{Jensen's Performance Index} = \text{Portfolio average return} - \text{Risk free rate of return} \\
\text{Beta coefficient of the portfolio}
\]

**Step 8: Revising the portfolio**

Portfolio revision refers to the periodic changes made in the investments/portfolio on the basis of the portfolio evaluation, individual’s financial goals and global market scenario. It involves addition or deletion of investment options to the portfolio or changing the proportion of funds in the investment options of the existing portfolio. Revision of portfolio becomes necessary because of the following reasons:

- Change in the investment goals
- Change in the risk appetite
- Change in returns of the securities
- Increase or decrease in the funds available for investment
- Changes in global market scenario

**Current global market scenario**

An understanding of the current market scenario is very important as it helps to figure out which stage of the business cycle does the economy falls in. Currently a lot of macroeconomic factors such as exchange rate, producer price index, consumer price index, money supply etc. suggest that there is a little downside in the market. The issues faced by the market today are paramount. First, the world economy is struggling with post crisis adjustments. Second, factors like stricter norms, undervalued currency, current political scenario, inflation and GDP numbers and global compatibility issues have all made the market even more sensitive.

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