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# A Study on Factors Affecting Investment Decision Making in the Context of Portfolio Management

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**Abstract**

**In a broad sense, investment is allocating resources into something with the expectation of gain, usually over a longer term. A portfolio refers to a collection of assets or investment instruments depending on the investor's income, budget and convenient time frame. Portfolio management refers to the selection of securities and their continuous shifting in the portfolio for optimizing the return and maximizing the wealth of an investor by analyzing the strengths, weaknesses, opportunities, and challenges for performing a wide range of activities related to a portfolio. It helps in making selection of various tradeoffs. Investing in portfolio rather than in individual asset gains attraction because of its 'risk reduction and performance optimization' capability. In order to design an outstanding portfolio, the investor needs to take vital decisions which can influence the very performance of the portfolio. The present study light up the influential factors which can affect the decisions taken in the context of a portfolio and tries to emphasis the dire need of having an investment portfolio.**

**Keywords: investment, portfolio, influential, investor, factors, need, decision**

## 1.0 Introduction to Investment and Portfolio Management

Investment is allocating resources into something with the expectation that it will generate income or the value of which will appreciate in future and ultimately will fetch a profit. It is believed that the word 'investment' originates from the Latin word '*vestis*, meaning garment, and refers to the act of putting things such as money or other claims to resources into others' pockets. From the perspective of ICFAI, investment is "sacrificing something now for the prospect of gaining something later". In its broad sense, an investment is a sacrifice of current money or other resources for future benefits. It involves the dedication of resources which have been saved or put away from current utilization in the hope that some benefits will accumulate in future. So, in this regard, the term investment is defined by Fuller and Farrell as "postponed consumption".

The term 'investment' is used differently in economics and in finance. In finance, investment is allocating resources into something with the expectation of gain, usually over a longer term. In the words of economists "investment is the net additions to the economy's capital stock which consists of goods and services that are used in the production of other goods and services".

A portfolio refers to a collection of assets or investment tools such as stocks, shares, mutual funds, bonds, and cash and so on depending on the investor's income, budget and convenient time frame. Portfolio management refers to the selection of securities and their continuous shifting in the portfolio for optimizing the return and maximizing the wealth of an investor. It also refers to the science of analyzing the strengths, weaknesses, opportunities, and challenges for performing a wide range of activities related to one's portfolio for maximizing the return at a given risk. It helps in making a selection of debt vs. equity, growth vs. safety, and various other tradeoffs. It aims at managing various investments of individuals to earn the maximum profits within the stipulated time frame. In this regard, it can be said that portfolio management is the art of selecting the right investment policy for the individuals in terms of minimum risk and maximum return.

**1.1 Importance of Portfolio Investment**

A portfolio investment is a liberal or passive investment of securities in a portfolio, and it is made with the expectation of earning a return. This expected return is directly correlated with the investment's expected risk. Investment through portfolio is separate from direct investment, which involves taking a substantial stake in a target company in its true sense. Portfolio investments can cover a wide range of asset classes. The composition of investments in a portfolio depends on a number of factors such as the investor's risk tolerance, investment horizon and amount invested, etc. Investing in portfolio rather than in individual asset gains attraction because of its 'risk reduction and performance optimization' capability. In order to design an outstanding portfolio, the investor needs to take vital decisions which can influence the very performance of the portfolio. The present study light up the influential factors which can affect the decisions taken in the context of a portfolio and tries to emphasis the dire need of having an investment portfolio.

**1.2 Objectives of the Study**

1. To identify the prominent factors which affect the portfolio decision making
2. To emphasis the need of having a portfolio of assets.

**1.3 Methodology**

The study aims at providing some insights about the prominent factors affecting the vital decisions taken in the context of an investment portfolio. It emphasizes the need for maintenance of an investment portfolio rather than deploying disposable income in one or two investment avenues. The study is descriptive in nature. All the relevant information are collected using books, articles, websites, and few interviews with experts in the field of portfolio investment.

**1.4 Types of Portfolio Management**

Portfolio Management is further of the following types:

1.4.1 Active Portfolio Management: In an active portfolio management service, the portfolio managers are actively involved in transacting securities to ensure highest profits to individuals.

1.4.2 Passive Portfolio Management: In a passive portfolio management, the portfolio manager deals with a fixed portfolio designed to match the current market scenario.

1.4.3 Discretionary Portfolio Management Services: In Discretionary portfolio management services, an individual authorizes a portfolio manager to take care of his financial needs on his behalf. The individual issues money to the portfolio manager who in turn takes care of all his investment needs, paperwork, documentation, filing and so on. In discretionary portfolio management, the portfolio manager has full rights to take decisions on his client's behalf.

1.4.4 Non-Discretionary Portfolio Management Services: In non-discretionary portfolio management services, the portfolio manager can merely advise the client what is good and bad for him but the client reserves full right to take his own decisions.

**1.5 Prominent tasks in Portfolio Management**

- Taking decisions about investment mix and policy
- Matching investments to objectives
- Asset allocation for individuals and institutions
- Balancing risk against performance

**1.6 Objectives of Portfolio Investment**

The objectives of portfolio management are the following.

1.6.1 Risk Reduction through Diversification: To reduce the risk of loss of capital or income, investing in various types of securities and over a wide range of industries, i.e., diversification is useful.

1.6.2 Safety of Principal: It is another aim of portfolio investment to keep the capital or principal amount intact, in terms of value and in terms of purchasing power. The capital or the principal amount invested should not erode, either in value or in terms of purchasing power. By earning the return, principal amount will not erode in nominal terms, by earning returns at a rate not lesser than the inflation rate; the principal amount will be intact in present value terms.

1.6.3 Stability of Income: To facilitate a more accurate and systematic re-investment of income and to ensure growth and stability in returns portfolio investment are of much help.

1.6.4 Capital Growth: To enable attainment of capital growth by reinvesting in growth securities a portfolio is a must.

1.6.5 Marketability: It will be the dream of every investor to have an easily marketable investment portfolio so that the investor is able to take advantage of attractive opportunities in the market.

1.6.6 Liquidity: Some investors prefer that the portfolio should be such that whenever they need their money, they may get the same.

1.6.7 Maintaining the Purchasing Power: Inflation usually eats the value of money, i.e., purchasing power. Hence, one object of the portfolio is that it must ensure the maintenance of the purchasing power of the investor intact by providing the ex-ante return in addition to normal return.

1.6.8 Tax Savings: Commonly investments offer some tax benefits like reduction in the amount of total income, etc. For that one has to effectively plan for and reduce the tax burden on income, by executing his investment portfolio.

**1.7 Basic Principles of Portfolio Management**

There are two basic principles of Portfolio Management. They are:

1.7.1 Effective Investment Planning: Effective investment planning is made by taking into account the following.

1.7.1.1 Fiscal, financial and monetary policies of the Government, and the Reserve Bank of India.

1.7.1.2 Industrial and economic environment and its impact on industry prospects in terms of prospective technological changes, competition in the market, capacity utilization by the industry and demand prospects, etc.

1.7.2 Constant Review of investment: The Portfolio Manager should review the investment in securities on a continuous basis, to identify more profitable avenues for selling and purchasing the investment. This review requires analysis of the following.

1.7.2.1 Assessment of quality of management of the Companies in which investment has already been made or is proposed to be made.

1.7.2.2 Financial and trend analysis of Financial Statements of Companies to identify sound Companies with optimum capital structure and better performance and to disinvest the holding of those Companies whose performance is not satisfactory.

1.7.2.3 Analysis of Securities Market and its trend.

The above analysis will help the portfolio manager to arrive at a conclusion as to whether the securities already in possession should be disinvested and new securities be purchased. If so, the timing for investment or disinvestment is also revealed.

**1.8 Factors Affecting Investment Decisions**

A portfolio refers to a collection of assets or investment tools such as stocks, shares, mutual funds, bonds, and cash and so on depending on the investor's income, budget and convenient time frame. Having an investment portfolio is the dream of majority of investors. In the background of portfolio investment every investor assumes a handful of constraints or influential factors on the occasion of investment decision making. In this juncture of the study, an attempt to list out the factors which can put significant weight on the selection of investment is made. Based on the review, the following are the crucial criteria for the investment decision making in the purview of portfolio.

1.8.1 Types of Securities: In the design phase of a portfolio every investor has to face ambiguities regarding the type of securities to be included in the portfolio. To decide upon this he needs to understand his nature as an investor or the group of investors he belongs to. The groups may be of risk takers or lovers, risk averters, and risk neutrals.

1.8.2 Proportion of Investment: The investor has to decide upon the extent of leverage employed by the portfolio. A judicious mix of assets will bring optimum return at a given level of risk.

1.8.3 Identification of Industry: The identification of industries with potential for growth has to be done for the diversification of the portfolio. This also helps to earn optimum return on investment.

1.8.4 Identification of Company: The Company to which the investible funds are to be deployed is selected after analyzing the fundamentals such as quantitative and qualitative factors by using appropriate tools.

1.8.5 Objectives of Portfolio: Before making an investment decision wise investors carefully observe the objectives of portfolio. If the portfolio is to have safe and steady returns then securities with low-risk would be selected. In case of portfolios which are floated for high returns, then risk investments which carry a very high rate of return will be selected.

1.8.6 Timing of purchase: As far as the success of portfolio investment is concerned, the timing of purchase is crucial. More succinctly, the acquisition price of asset to be included in the portfolio depends entirely on the timing decision. If a person wishes to make any gains, he should buy when the shares are selling at a low price and sell when they are at a high price.

1.8.7 Risk Tolerance: Risk refers to the volatility in return of portfolio. The amount of risk the investor is willing to take on is an extremely important factor. While some investors to become more risk-averse with the passing of time, the conservative investor remain risk-averse over his life-cycle. The aggressive investor generally dares to take risk throughout his life-span as he loves to be a risk taker. If an investor is risk averse and he takes too much risk, he usually panic when confronted with unexpected losses and abandon the investment plans mid-stream and suffers huge losses.

## 1.9 Conclusion

This paper attempts to pinpoint the prominent factors which affect the portfolio decision making and emphasizes the dire need of having a portfolio of assets rather than individual asset. The study was descriptive in nature. Full-fledged support has been given from the part of the study to the argument of having a mix of assets in the form of investment portfolio based on the risk reduction and performance optimization capability of the portfolio. The study has identified a number of factors such as risk tolerance, timing, type and proportion of assets, portfolio objectives, industry and company identification, etc. which can influence the decisions taken with regard to the investment portfolio.

## 1.10 Limitations

The present study suffers from the limitation that it is not often practical to consider all factors in the process of portfolio decision making. The attitudes of majority investors are beyond the purview of a study. Empirical validation of the influential factors is necessary for investor education regarding portfolio investment.

## 1.11 Implications

A study about the influential factors without considering risk class of the investor is somehow dangerous. In practice, no investor can be persuaded to have a portfolio of assets rather than investing in a single investment avenue.

## 1.12 Scope for Further Research

Different authors have tried to shed light on the need of having a portfolio of assets rather than an asset. In addition, some have tried to explain the impact of considering a single influential factor in the portfolio decision making in place of a handful of constraints.

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