"PORTFOLIO MANAGEMENT IN INDIA- AN ANALYSIS''

Vibha Lamba,
Research Scholar,
Department of Accountancy and Business Statistics,
University of Rajasthan, Jaipur, Rajasthan, India.

ABSTRACT

Investing in equities requires time, knowledge and constant monitoring of the market. For those who need an expert to help to manage their investments, portfolio management service (PMS) comes as an answer. The business of portfolio management has never been an easy one. Juggling the limited choices at hand with the twin requirements of adequate safety and size able returns is a task fraught with complexities. Given the unpredictable nature of the market it requires solid experience and strong research to make the right decision. In the end it boils down to make the right move in the right direction at the right time. That's where the expert comes in. The term portfolio management in common practice refers to selection of securities and their continuous shifting in a way that the holder gets maximum returns at minimum possible risk.

Portfolio management services are merchant banking activities recognized by SEBI and these activities can be rendered by SEBI authorized portfolio managers or discretionary portfolio managers. A portfolio manager by the virtue of his knowledge, background and experience helps his clients to make investment in profitable avenues.

The purpose of present study is to analyse the scope and importance of portfolio management in India. This paper also focuses on the types and steps of portfolio management which a portfolio manager should take to provide maximum returns and minimum risk to his clients for their investments.

Keywords: Portfolio Management, Portfolio Manager, SEBI, Risk, Returns.

Introduction

Portfolio management in common parlance refers to the selection of securities and their continuous shifting in the portfolio to optimize returns to suit the objectives of an investor. This however requires financial expertise in selecting the right mix of securities in changing market conditions to get the best out of the stock market.

In India, as well as in a number of western countries, portfolio management service has assumed the role of a specialized service now a days and a number of professional merchant bankers compete aggressively to provide the best to high net worth clients, who have little time to manage their investments. The idea is catching on with the boom in the capital market and an increasing number of people are inclined to make profits out of their hard-earned savings. Portfolio management service is one of the merchant banking activities recognized by Securities and Exchange Board of India (SEBI). The service can be rendered either by merchant bankers or portfolio managers or discretionary portfolio manager as define in clause (e) and (f) of Rule 2 of Securities and Exchange Board of India (Portfolio Managers) Rules, 1993 and their functioning are guided by the SEBI. According to the definitions as contained in the above clauses, a portfolio manager means any person who is pursuant to contract or arrangement with a client, advises or directs or undertakes on behalf of the client (whether as a discretionary portfolio manager or otherwise) the management or administration of a portfolio of securities or the funds of the client, as the case may be. A merchant banker acting as a Portfolio Manager shall also be bound by the rules and regulations as applicable to the portfolio manager.

Realizing the importance of portfolio management services, the SEBI has laid down certain guidelines for the proper and professional conduct of portfolio management services. As per guidelines only recognized merchant bankers registered with SEBI are authorized to offer these services. Portfolio management or investment helps investors in effective and efficient management of their investment to achieve this goal. The rapid growth of capital markets in India has opened up new investment avenues for investors. The stock markets have become attractive investment options for the common man. But the need is to be able to effectively and efficiently manage investments in order to keep maximum returns with minimum risk.

Portfolio is a collection of asset. The asset may be physical or¬ financial like Shares Bonds, Debentures, and Preference Shares etc. The individual investor or a fund manager would not like to¬ put all his money in the shares of one company, for that would amount to great risk.

Main objective is to maximize portfolio return and at the same time minimizing the portfolio risk by diversification. Portfolio management is the management of various financial assets, which comprise the portfolio.

According to Securities and Exchange Board of India (Portfolio manager) Rules, 1993; “portfolio” means the total holding of securities belonging to any person; Designing portfolios to suit investor requirement often involves making several projections regarding the future, based on the current information. When the actual situation is at variance from the projections portfolio composition needs to be changed. One of the key inputs in portfolio building is the risk bearing ability of the investor.

Portfolio management can be having institutional, for example, Unit Trust, Mutual Funds, Pension Provident and Insurance Funds, Investment Companies and non-Investment Companies. Over time, other industry sectors have adapted and applied these ideas to other types of "investments," including the following: Application portfolio management: This refers to the practice of managing an entire group or major subset of software applications within a portfolio. Organizations regard these applications as investments because they require development (or acquisition) costs and incur continuing maintenance costs. Also, organizations must constantly make financial decisions about new and existing software applications, including whether to invest in modifying them, whether to buy additional applications, and when to "sell" -- that is, retire -- an obsolete software application. Product portfolio management: Businesses group major products that they develop and sell into (logical) portfolios, organized by major line-of-business or business segment. Such portfolios require ongoing management decisions about what new products to develop (to diversify investments and investment risk) and what existing products to transform or retire (i.e., spin off or divest).

Methods of Portfolio Management

Portfolio Management is used to select a portfolio of new product development projects to achieve the following goals:

• Maximize the profitability or value of the portfolio
• Provide balance
• Support the strategy of the enterprise Portfolio

Management is the responsibility of the senior management team of an organization or business unit. This team, which might be called the Product Committee, meets regularly to manage the product pipeline and make decisions about the product portfolio. Often, this is the same group that conducts the stage-gate reviews in the organization. A logical starting point is to create a product strategy - markets, customers, products, strategy approach, competitive emphasis, etc. The second step is to understand the budget or resources available to balance the portfolio against. Third, each project must be assessed for profitability (rewards), investment requirements (resources), risks, and other appropriate factors. The weighting of the goals in making decisions about products varies from company. But organizations must balance these goals: risk vs. profitability, new products vs. improvements, strategy fit vs. reward, market vs. product line, long-term vs. short-term. Several types of techniques have been used to support the portfolio management process:

a) Heuristic models
b) Scoring techniques
c) Visual or mapping techniques

The earliest Portfolio Management techniques optimized projects profitability or financial returns using heuristic or mathematical models. However, this approach paid little attention to balance or aligning the portfolio to the organizations strategy.

Scoring techniques weight and score criteria to take into account investment requirements, profitability, risk and strategic alignment. The shortcoming with this approach can be an over emphasis on financial measures and an inability to optimize the mix of projects. Mapping techniques use graphical presentation to visualize a portfolios balance. These are typically presented in the form of a two-dimensional graph that shows the trade-offs or balance between two factors such as risks vs. profitability, marketplace fit vs. product line coverage, financial return vs. probability of success, etc.

The recommended approach is to start with the overall business plan that should define the planned level of R&D investment, resources (e.g., headcount, etc.), and related sales expected from new products. With multiple business units, product lines or types of development, we recommend a strategic allocation process based on the business plan. This strategic allocation should apportion the planned R&D investment into business units, product lines, markets, geographic areas, etc. It may also breakdown the R&D investment into types of development, eg. technology development, platform development, new products, and upgrades

enhancements, line extensions, etc. Once this is done, then a portfolio listing can be developed including the relevant portfolio data. We favor use of the development productivity index (DPI) or scores from the scoring method. The development productivity index is calculated as follows: (Net Present Value x Probability of Success) Development Cost Remaining. It factors the NPV by the probability of both technical and commercial success. By dividing this result by the development cost remaining, it places more weight on projects nearer completion and with lower uncommitted costs. The scoring method uses a set of criteria (potentially different for each stage of the project) as a basis for scoring or evaluating each project.

Investment Portfolio Management and portfolio theory

Portfolio theory is an investment approach developed by University of Chicago economist Harry M. Markowitz (1927) who won a Nobel Prize in economics in 1990.Portfolio theory allows investors to estimate both the expected risks and returns, as measured statistically, for their investment portfolios. Markowitz described how to combine assets into efficiently diversified portfolios. It was his position that a portfolios risk could be reduced and the expected rate of return could be improved if investments having dissimilar price movements were combined. In other words, Markowitz explained how to best assemble a diversified portfolio and proved that such a portfolio would likely do well.

There are two types of Portfolio Strategies:

A. Passive Portfolio Strategy: A strategy that involves minimal expectation input, and instead relies on diversification to match the performance of some market index.

B. Active Portfolio Strategy: A strategy that uses available information and forecasting techniques to seek a better performance than a portfolio that is simply diversified broadly

Objectives of Portfolio Management

The basic objective of Portfolio Management is to maximize yield and minimize risk. The other objectives are as follows:

a) Stability of Income: An investor considers stability of income from his investment. He also considers the stability of purchasing power of income.

b) Capital Growth: Capital appreciation has become an important investment principle. Investors seek growth stocks which provide a very large capital appreciation by way of rights, bonus and appreciation in the market price of a share.

c) Liquidity: An investment is a liquid asset. It can be converted into cash with the help of a stock exchange. Investment should be liquid as well as marketable. The portfolio should contain a planned proportion of high-grade and readily salable investment.

d) Safety: safety means protection for investment against loss under reasonably variations. In order to provide safety, a careful review of economic and industry trends is necessary. In other words, errors in portfolio are unavoidable and it requires extensive diversification.

e) Tax Incentives: Investors try to minimize their tax liabilities from the investments. The portfolio manager has to keep a list of such investment avenues along with the return risk, profile, tax implications, yields and other returns

There are three goals of portfolio management:

1. Maximize the value of the portfolio
2. Seek balance in the portfolio
3. Keep portfolio projects strategically aligned

It provides a set of portfolio management tools to help achieve these goals. With multiple business units, product lines or types of development, we recommend a strategic allocation process based on the business plan. The Master Project Schedule provides a summary of all-active as well as proposed projects and classifies them by status (active, proposed, on-hold) and by business unit/product line to align projects with the strategic allocation.

Functions of Portfolio Management

The basic purpose of portfolio management is to maximize yield and minimize risk. Every investor is risk averse. In order to diversify the risk by investing into various securities following functions are required to be performed. The functions undertaken by the portfolio management are as follows:

1. To frame the investment strategy and select an investment mix to achieve the desired investment objective;
2. To provide a balanced portfolio which not only can hedge against the inflation but can also optimize returns with the associated degree of risk;
3. To make timely buying and selling of securities;
4. To maximize the after-tax return by investing in various taxes saving investment instruments.

Steps in portfolio management

1) Identification of the objectives:

The starting point in this process is to determine the characteristics of the various investments and then matching them with the individuals need and preferences. All the personal investing is designed in order to achieve certain objectives.

These objectives may be tangible such as buying a car, house etc. and intangible objectives such as social status, security etc. Similarly, these objectives may be classified as financial or personal objectives. Financial objectives are safety, profitability and liquidity. Personal or individual objectives may be related to personal characteristics of individuals such as family commitments, status, depends, educational requirements, income, consumption and provision for retirement etc.

2) Formulation of Portfolio Strategy:

The aspect of Portfolio Management is the most important element of proper portfolio investment and speculation. While planning, a careful review should be conducted about the financial situation and current capital market conditions. This will suggest a set of investment and speculation policies to be followed. The statement of investment policies includes the portfolio objectives, strategies and constraints. Portfolio strategy means plan or policy to be followed while investing in different types of assets. There are different investment strategies. They require changes as time passes, investor's wealth changes, security price change, investor's knowledge expands. Therefore, the optional strategic asset allocation also changes. The strategic asset allocation policy would call for broad diversification through an indexed holding of virtually all securities in the asset class.

3) Selection of Asset mix:

The most important decision in portfolio management is selection of asset mix. It means spreading out portfolio investment into different asset classes like bonds, stocks, mutual funds etc. In other words selection of asset mix means investing in different kinds of assets and reduces risk and volatility and maximizes returns in investment portfolio. Selection of asset mix refers to the percentage to the invested in various security classes. The security classes are simply the type of securities as under: a. money market instrument b. fixed income security c. equity shares d. real estate investment e. international securities.

Once the objective of the portfolio is determined the securities to be included in the portfolio must be selected. Normally the portfolio is selected from a list of high-quality bonds that the portfolio manager has at hand. The portfolio manager has to decide the goals before selecting the common stock. The goal may be to achieve pure growth, growth with some income or income only. Once the goal has been selected, the portfolio manager can select the common stocks.

4) Portfolio Execution:

The process of portfolio management involves a logical set of steps common to any decision, plan, implementation and monitor. Applying this process to actual portfolios can be complex. Therefore, in the execution stage, three decisions need to be made, if the percentage holdings of various asset classes are currently different from desired holdings. The portfolio than, should be rebalanced. If the statement of investment policy requires pure investment strategy, this is only thing, which is done in the execution stage. However, many portfolio managers engage in the speculative transactions in the belief that such transactions will generate excess risk-adjusted returns. Such speculative transactions are usually classified as timing or selection decisions. Timing decisions over or under weight various asset classes, industries or economic sectors from the strategic asset allocation. Such timing decisions are known as tactical asset allocation and selection decision deals with securities within a given asset class, industry group or economic sector. The investor has to begin with periodically adjusting the asset mix to the desired mix, which is known as strategic asset allocation. Then the investor or portfolio manager can make any tactical asset allocation or security selection decision.

5) Portfolio Revision:

Portfolio management would be an incomplete exercise without periodic review. The portfolio, which is once selected, has to be continuously reviewed over a period of time and if necessary revised depending on the objectives of investor. Thus, portfolio revision means changing the asset allocation of a portfolio. Investment portfolio management involves maintaining proper combination of securities, which comprise the investor's portfolio in a manner that they give maximum return with minimum risk. For this purpose, investor should have continuous review and scrutiny of his investment portfolio. Whenever adverse conditions develop, he can dispose of the securities, which are not worth. However, the frequency of review depends upon the size of the portfolio, the sum involved, the kind of securities held and the time available to the investor. The review should include a careful

examination of investment objectives, targets for portfolio performance, actual results obtained and analysis of reason for variations. The review should be followed by suitable and timely action. There are techniques of portfolio revision. Investors buy stock according to their objectives and return-risk framework. These fluctuations may be related to economic activity or due to other factors. Ideally investors should buy when prices are low and sell when prices rise to levels higher than their normal fluctuations. The investor should decide how often the portfolio should be revised. If revision occurs to often, transaction and analysis costs may be high.

6) Portfolio Performance evaluation:

Portfolio management involves maintaining a proper combination of securities, which comprise the investor’s portfolio in a manner that they give maximum return with minimum risk. The investor should have continues review and scrutiny of his investment portfolio. These rates of return should be based on the market value of the assets of the fund.

Complete evaluation of the portfolio performance must include examining a measure of the degree of risk taken by the fund. A portfolio manager, by evaluating his own performance can identify sources of strength or weakness. It can be viewed as a feedback and control mechanism that can make the investment management process more effective. Good performance in the past might have resulted from good luck, in which case such performance may not be expected to continue in the future. On the other hand, poor performance in the past might have been result of bad luck. Therefore, the first task in performance evaluation is to determine whether past performance was good or poor. Then the second task is to determine whether such performance was due to skill or luck. Good performance in the past may have resulted from the actions of a highly skilled portfolio manager. The performance of portfolio should be measured periodically, preferably once in a month or a quarter. The performance of an individual stock should be compared with the overall performance of the market.

Importance of Portfolio Management

Individuals will benefits immensely by taking portfolio management services for the following reason: -

a) Whatever may be the status of the capital market; over the long period capital markets have given an excellent return when compared to other forms of investment. The return from bank deposits, units etc., is much less than from stock market.

b) The Indian stock markets are very complicated. Though there are thousands of companies that are listed only a few hundred, which have the necessary liquidity. It is impossible for any individual wishing to invest and sit down and analyses all these intricacies of the market unless he does nothing else.

c) Even if an investor is able to visualize the market, it is difficult to investor to trade in all the major exchanges of India, look after his deliveries and payments. This is further complicated by the volatile nature of our markets, which demands constant reshuffling of portfolio.

In the past one-decade, significant changes have taken place in the investment climate in India. d) Portfolio management is becoming a rapidly growing area serving a broad array of investors- both individual and institutional-with investment portfolios ranging in asset size from thousands to cores of rupees.

e) It is becoming important because of Emergence of institutional investing on behalf of individuals. A number of financial institutions, mutual funds, and other agencies are undertaking the task of investing money of small investors, on their behalf. Growth in the number and the size of invisible funds- a large part of household savings is being directed towards financial assets.

f) Increased market volatility- risk and return parameters of financial assets are continuously changing because of frequent changes in governments industrial and fiscal policies, economic uncertainty and instability.

g) Professionalization of the field and increase use of analytical methods (e.g. quantitative techniques) in the investment decision-making, and

h) Larger direct and indirect costs of errors or shortfalls in meeting portfolio objectives- increased competition and greater scrutiny by investors.

Prospects of Portfolio management in India

⇒ At present, there are a very few agencies which render this type of services in an organized and professional way.

⇒ However, their share in the total volume is very small.

⇒ There is no constraint on the demand for this type of financial service as every entity would be saving and investing and interested in optimizing the rate of return.

⇒ The size of capital market is increasing.

⇒ There is an increase in the number of stock exchanges.

⇒ New instruments are being introduced in the capital market.

⇒ The equity cult is spreading in the interiors and rural areas.

⇒ The percentage of investment of the household savings is bound to go up.

⇒ It is conservatively estimated that during the eighth plan resources to the tune of over Rs.50000crore will be mobilized through the stock market.

i) ⇒ India today has 20 million investors, as compared to 2 million in 1980

Conclusion

Risk and return go hand in hand, these are the two sides of the investment coin. So, risk is to be managed properly and in a systematic manner for the profitability and overall development of a business organisation.

In the present study, it has been analysed that every business operates in different types of risks, but it can manage these risks in a strategic manner by maintaining a conservative financial profile and by following prudent business and risk management practices. So, each and every business should design 'Internal Control System' by making structured policy with pre defined authorities and responsibilities for safeguarding of its against loss. It has also been analysed that Portfolio management is a very crucial aspect because it facilitates maximum returns and minimum risk.

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