Investments and Investment Attractiveness LECTURE COURSES

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CHAPTER 1. Investments and Investment Activities

LECTURE 1. INCLUDES:

The concept of investment and essence of economic
Classification of Investments
Investment demand

LECTURE 2. INCLUDES:

Investment Strategy
Investment activity/ Management of investments

THE CONCEPT OF INVESTMENT AND ESSENCE OF ECONOMIC

In difficult and multylateral economic process of modern world, effective capital investment or so called investment presents an acute problem of intercommunication in internal and external markets for states, financial institutes, industrial complexes etc.

Investment (investire) –is a Latin word and stands for getting benefit.

Investment is so broad notion, that it can be defined variously. In different parts of economic sciences and in different fields of practical activities concept of investment has its special features.

Investments in macro economy are defined as part of whole expenses, which consists of expenses on new means of production, investments in new dwellings, on increasing of commercial stocks and etc. So, investment represents a part of gross domestic products, which does not apply in current period and provides increasing of capital.

Investments in micro economy and Theory of Production are defined as a process of creating new capital, which includes production facilities as well as human resources.

In the Finance Theory investments means procurement of the financial or real assets (current cost that envisage benefiting in the future). In other words, investment is determined by change of the current price with the future undefined price.

Economic nature of investments are conditioned by defining regularities of expanded reproduction process and is an additional use of part of public products in order to increase the quality and quantity of all elements of productive powers.

Main source of investments is an accumulation fund or part of national accumulated income, which is directed to fund raising of different factors of production, which is applied as amortization charge itself for renewing of obsolete means of production. The structure of funds, which affects on tempo of expansion of reproduction and investments processes, is formed by constituent parts of all investments.

Subtract the total volume of investments (X) to amortization charges (Y) is net investments (Z), which represents updated production equipment and funds to investment in newly created industrial funds. Also, it is possible to create macro economic proportions.

1. $Z<0$ or $Y>X$, which leads to productive potential impairment, production and service volume reduction, worsening economic conditions;

2. $Z=0$ or $X=Y$. In this case there is no economic growth

3. $Z>0$ or $X>Y$ Revenue growth at the expense of economic growth is provided. Revenue growth rates are higher than investment growth rates.

CLASSIFICATION OF INVESTMENTS

Any service or product creation process (essentials, food products, office equipment, communication service, medical service, utility service, enterprise space, industrial buildings, heavy equipment, technological lines and etc). Production means, which are used in certain moment of time, are united by the concept of capital. The definition of the concept of capital, as well as investments is depended on the context. Generally, equity can be defined as price, which is invested in this or that object. There is inviolable relationship between capital and investment, where the capital is a stock variable and investments are flow variable (As in a famous example - the volume of water in the reservoir and stream of tap water).

Enactment a new manufacture is impossible without a new capital, as well as manufacturing process requires expenditure for capital recovery and update, which is connected to physical amortization or moral aging of means of production. Any expenditure which are connected to recovery and update of existing capital or creation of new capita, are real investments.

Real investments are expenditures on material objects or service, which are used in a certain moment of time and are benefits for the owner. Investments can belong not only expenditures, which are connected to manufacturing, but expenditures connected to construction, buying etc.

In any case, funds are necessary for investing. Own, attracted and borrowed funds can be used for real investing. As a rule, this kind of funds are characterized by certain obligations with certain benefits after some time. Resources together with the obligations can be considered as investments, but benefit in this case is incentive for investor.

Economic nature of investments will be clearly revealed at the time of its classification. The basis of classification is different characteristics, which are used:

- Types of investment
- Objects for allocation of funds
- Type of participation in investing
- Regional characteristic
- Investment period
- Investment volume
- Ownership form
- Participation form for investor
- The degree of risk
- Forms of reproduction

Getting to know each of them briefly.

1. Investments are accepted to be grouped:

- Money funds, the target bank deposits, shares and other commercial papaers;
- Movable and immovable property;
- Property rights, copyright and other intellectual values;
- The right to use (rights to use resources, buildings, land, water, facilities, equipments, technological lines and other property rights);
- Other values.

2. Investments can be defined as follows in connection with funds allocation into objects

- Real investments or funds allocation as material (facilities, machinery/equipment, buildings) and as non-material (licenses, know-how, scientific-technical, medical-technical documents, design and construction activities, patents, software development tools) assets;
- Financial investments or funds allocation in different financial instruments, such as the target bank deposits, deposits, commercial papers.

3. Investments are divided into the following types in the process of investing

- Direct – means direct participation of investor in selecting of investment property and funds allocation. In addition, an investor is directly involved in every phase of investing cycle, among them in investing process, design, construction of investing object and manufacturing of final products.
- Indirect - is implemented by different types of financial intermediaries (companies, banks, funds etc), which accumulate and allocate financial funds most effectively according to their opinion. Such intermediaries participate in investees object management and distribute income among their clients. Investing in securities which is managed as total is called portfolio investments.

4. Investments are considered in regional aspects:

- Domestic investments – current investments inside the state.
- Fund allocation of foreign international governmental organizations, international NGOs, foreign individuals and entities of other countries.
- Foreign investments – funds allocation in investing objects exist outside the county (property acquisition, acquisition of rights, acquisition of securities and etc.).

5. According to the period investments are as follows:

- Short-term investments – funds invested for a period of one year (ÖÑØàØÒÐìÔÚÜØÔ certificates, short-term deposit accounts and etc.).
- Long-term investments – funds invested over a period of one year (mostly, long-term investments are invested in principal funds)

6. Investments are accepted to be divided:

- The total investment – the volume of investments invested in the company in certain period of time
- Net investment - reduced total investments because of amortization charges.

7. According to ownership forms investments can be divided:

- State ownership form, NGOs, citizens' personal funds.
- State investments – different levels of budget scholarships, state agencies and enterprises scholarship

8. Investor participation forms mean:

- Non-movable and movable property acquisition as a direct ownership by adopting, also by adopting of stocks, bonds and other securities;
- The acquisition of concessions and other property rights to the use of natural resource, land.

9. According to the degree of risks investments are divided as follows:

- Risk-free investments. For example, in some countries short-term investments in state bonds are considered risk-free. In this case, given incomes defines safe starting point, which is used at the time of deposit ratio, as investment risk starting.
- Risky investments. The degree of risk and un-

certainty, which is connected to investments, depend on factors such as time, allocation object and etc. Possible miscalculation of degree of hazard depends on market reaction after investments, changes of results of manufacture activity. Risk evaluation criteria:

- The possibility of losing the entire amount of calculated and expected profit. The risk is acceptable.

- The possibility of losing not only profit, but calculated and possible income. The risk is critical.

- The possibility of losing all assets, investors bankruptcy. The risk is catastrophic.

- Investments, invested in upcoming technologies, know-how and in newly established businesses, in the companies working in new fieldss, are called venture and they are high-risk investments.

10. Reproduction may be made in one of the following forms:

- Technical rearmament – complex of measures directed to improving of technical-economic level of manufactures or their parts.
- Reconstruction of existing manufactures – completely or partially. The aim of change of the morally obsolete machinery and equipment change of the manufacture can be improving of product volume and quality, as well as output of new products.
- Expansion of existing manufacture – building or expansion of an additional factory complexes, facilities in order to increase the isolation of the manufacture.
- Construction-setup of new manufactures, buildings, facilities on new areas.

INVESTMENT DEMAND

As an example, consider an investment demand of a company or a manufacture. An investment demand from a company is a key but not the only factor in the demand of the resources. Any company, which updates or creates capital, has an investment demand in order to get benefits. According to one of the assumptions of economic theory the main aim of the company is revenue maximization. In order to achieve this goal, the company strives to use different factors of manufacturing maximally, optimal interdependent and interrelated set of capital is among them. When allocated funds can compensate initial costs and get extra profit, there is a need of investing from the company, creating new capital or improving the existing one. In other words, the motivation of investing derives from non-optimal ration of production means. The profits mentioned above can be defined with percent from investment costs, which we will call profitability of investments.

If we designate:

P - Profitability,

I – Volume of Investments,

G – The Profit Growth

Then P=G-I/I

Profitability of investments can be different according to types of company activities. Despite this, there is a general regularities investment volume increases with decreasing profitability of investments. For example, if the company has a variety of opportunities for funds investing (which differ with profitability and other characteristics), then it will be used for funding projects with high profit during profit maximization , but along with the increase in the volume of investments, there will be less profitable projects. The law of decreasing profitability of investments is a general economic law – "The marginal productivity decreases of manufacturing factors". The curve mentioned above is characterized according to the profit of investment activities of the company and defines its investment demands.

The company will use its own or attracted funds. Expenses is a price, which is necessary to use attracted funds to be paid at the market - „Market rate of interest". If a company uses attracted funds, the percent will take the form of a percentage of funds used for expenditures. If own funds are used, the interest rate is an alternative expenditure for other participants at the market due to the lost salaries.

The company's decision about the volume of investments is determined by profitability of its investment programs on the one hand and on the other hand by market interest rate. The company will try to increase the volume of investments until their profitability equal to the market rate of interest.

All investment demands can be divided into three groups according:

- Direct investments;
- Related investments;
- Scientific-research elaborations

Direct investments are necessary for investment projects to be executed. They include investments in principal and working funds. Investments in principal funds include:

- Construction-reconstruction of buildings and facilities, acquisition or issue of new machinery (includes expenditures of transportation, installation, setup and access)
- Modernization of existing installations
- Technologies which provide operation of installations

Investments in working funds include:

- Supplies of new basic and auxiliary materials
- Supplies of additional basic and auxiliary materials
- Stocks of finished products

- Increase in debtors' account

Mostly investments in nonmaterial assets are associated with exchange-acquisition of patents, licenses, new technologies, trade marks.

Related investments are allocation of funds in objects which are territorially and directly associated with mentioned objects:

- Allocation is such objects which are not directly connected to normal expluatation. (electrical supply communication, water supply, sewage, access roads etc)
- Nonindustrial character installations, for example in environment, social infranstructure and etc

Scientific-research elaborations:

1. Material funds – office equipment, computer hardware, equipment, machinery and etc.
2. Working assets necessary for scientific-research institutes, the design bureaus, higher educational institutions which are performing company duties in order to provide current activities.

The total volume of investment is determined with direct investments, related investments and scientific-research elaborations.

INVESTMENT STRATEGY

The strategy of investment institutes (investment funds, investors, banks, insurance companies, investment companies, pension funds, investment indermediaries and etc.) , is formulated by a special document, which is usually called an investment policy statement.

An investment policy statement, as minimum, consists of following parts:

- The organization's goals
- The structure of an investment portfolio and investment activities
- Estimated profitability of the main segment of the market
- The strategy of investment activities
- Revenue structure, efficiency assessment and reporting
- Planned horizon

The organization's goals. Strategic goal can be guaranteed minimum investment to ensure profitability, a certain percent over the inflation. An investment policy statement can also include obligations of excessive profitability of formed investment portfolio based on determined stock indices. In case of setting several goals of investment strategy, as a rule, they are ranked according to different deliberate priorities.

An investment policy statement can include limitations according to **investment portfolio**. As an example, obligation - An investment of determined minimum percent in the highest degree of winning commitment (securities); Limitations on different segmen of the market according to the investments;

Limitations on investments in securities of one emitent.

Judgment declaring about indicators of **profitability**, risk of the **main segment of the market.** Judgments about future levels of inflation, which are used as basis of evaluation of investment efficiency and decision making.

Investment activity strategy. For example, finding incompletely evaluated securities for increasing investment fund to ensure possible maximum growth of investment portfolio value.

It is necessary to exactly define the reporting obligations before investors in an investment policy statement, also to conduct periodic audits by an independent company.

Planned Horizon is a period of time, on which determined investment strategy is focused. planned horizon is a main basis of optimization of investment decisions.

The investment strategy is the basis for the objectives and activities of the financial institutions. In order to determine objectives and activities, it is necessary to define best investment decisions to achieve the established goals. Mainly investment decisions are derived from investment market, planned horizon, obligations undertaken etc. On the whole, investment activities are executed by:

- Strategic investors - as a rule, they aim to capture control stake or biggest part of authorized capital of competing or different .

-Institutional investors – financial intermediaries (companies, banks, funds etc), who allocate and accumulate investments of different investors.

- Portfolio investors – create investment portfolio, so invest investments in the assets of different company, in securities and so on. Portfolio investors defend themselves from risks with investment portfolios, which may occur in the case of allocating investments in identical assets of one company. At the same time, accumulating funds of different investors allows to get bigger investment portfolio according to the price of financial assets, which increases investment opportunities significantly.

INVESTMENT ACTIVITY/ MANAGEMENT OF INVESTMENTS

Activities of institutional investors can be characterized as an investment process, which consists of interrelated and interdependent tasks:

- Establishment of investment strategy;

- Investment analysis (market analysis, market segment analysis, securities analysis and etc);
- Formation of investment portfolio;
- Investment portfolio management;
- Investment performance measurement.

The principles of investment decisions are divided into two main categories: active and passive. Passive approach is based on estimated meaning of relativity of financial market efficiency. The main goal of passive method is to ensure investment portfolio profitability as a minimum on the average market levcel. Passive investing is to be used for risk reduction and mitigation methods (Future contracts according to indexes, using risk-free investments, maximum approaching an investment portfolio up to one of the index portfolios).

Active methods of investment management mainly means identification and prediction of financial assets incompletely and incorrectly evaluated.

The period between investment allocation and receiving revenues is called as an investment latency. the magnitude and duration of the latency depends on investment process and form. There are three forms of investment process: linear, parallel and interval investments.

In linear investing investment profit is received at the end of investment process.

In parallel investing investment profit is formed along with the investment process.

In interval investing there is certain period between the end of the process and the receive of the investment profit.

In some cases, the subjects of investment activities occupy functions of several subjects of investment activities, which is regulated by mutual contracts.

A number of features define investment activities of the company. Investment activity of the company is an objective process which has its own characteristic patterns emerging logic. Investment activity plays an important role in agricultural activity of the company, as the nature of investments is denial of current requirements in order to gain profit in the future. The company's investment process begins with defining of investment strategy. In this case, investment strategy is long-term complex of objectives and most effective ways to achieve them. Defining of investment strategy depends on: the company's life cycle stage; development strategy, the company's investment attractiveness; internal and external market conditions of investment resources. The company's investment activity should be oriented on long-term objectives and effective selection of investment programmes and projects to be sold. Investment strategy is formed in the framework of the overall strategy of economic development and is based on deep analysis of investment market and its segments.

According to Porter, there are five main factors that determine how attractive company's business or industry is:

- Payback;
- Ability to deliver;
- Market access opportunities;
- Substitutes
- Competition

Competition forces are called as drivers of value or benefit. The company must take into consideration competition forces mentioned above to determine which areas of the business have to increase to be invested, which areas of the business have to decrease to be invested and how to increase profitability of different areas of the business.

„Payback" is one of the determining factors of competitiveness – the more providers are available for buyers, the less profitable production is.

"Ability to deliver" – is one of the determining factors of the company's ability to determine low selling expences, the more the alternative sources of the resources for delivery are, the more profitable the production is.

„Market access opportunities" determines difficulty / simplicity of penetration of competitors into the market. The easier market penetration is, the less profitable the production is and vice versa.

„Substitutes" is one of determining factors of level of competition. The competition if this type exists in the same areas of several different production.

According to Porter, an idea of creating "predominant value" is related to in which field the company prefers to develop its activities and how to gain a competitive advantage in the selected field. According to Porter, there are main following strategic approaches, from which one should be selected; otherwise a variety of approaches may lead the company to uncertainty of the goal.

- Full production differentiation; the aim is to differentiate all kinds of products according to their specification and to provide additional benefits for the buyers. Products for partial differentiation; the company makes a certain kind of product differentiation.
- The full value of the benefits; the company aims to create "predominant value" with minimizing all expences of production.
- Value advantage; the company chooses one of the products or some of them and maximize production cost efficiency.

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