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Meaning of Investment

Production can increase only when the real capital of the economy is expanded, more and more plants, machines, equipment's etc., are created or acquired. The use of a country's resources to produce, create or acquire such capital goods is called investment. To provide means for this investment, the country has to save a part of its income.

Definition of investment

Narrow sense - *"Formation of capital implies that society uses its present production not only for the satisfaction of its consumption but also uses a part of it on capital goods that is acquiring plants and machines, transport facilities or other production equipments"* - Nurkse

Broad sense - *"Human capital formation is the process of increasing knowledge, skill and the capacities of all people of the country."* -F. H. Harbison

In short Capital formation means an increase in the stock of physical and human capital.

Importance of Capital Formation

Capital is an essential fountain of National wealth. It is the chief instrument for increasing production and productivity. The functions and significance of capital and capital formation can be put as under :

- **Productivity and Growth :** Prof. Kuznets accepts that capital formation is a necessary condition for augmenting productivity and growth. Capital plays a multifaceted role in raising productivity. Firstly, by adding to the stock of capital an economy is in a better position to enjoy the advantages of large scale production and increased specialization. Secondly capital accumulation is necessary to equip a growing population with the tools and implement of production.
- **Provision of subsistence :** Capital provides with the means of subsistence that is food, clothing and shelter to labour during the process of production. Nowadays production has been a complex, lengthy and time consuming process. The goods produced by the workers take some time to reach the hands of the consumers. But the workers have to subsist during this. The wages are thus paid to them out of capital formed.
- **Technological development :** capital helps in technological development countries which have abundance of natural resources, Adequate skilled manpower and adequate capital can develop their technology.
- **Provision of raw materials :** A part of the capital is used to buy raw materials for producing finished goods.
- **Advertisement :** in order to increase the sale of commodities the producers undertake advertisement and publicize their products . All this involves expenditure which is met out of capital formed.
- **Research and development :** In order to meet the cut throat competition, the producers devote large sums to find better machines, new techniques of production and new raw materials. Therefore capital

is an essential factor for research and development of new production techniques etc.

- Creation of capital for overheads : Capital for overheads has a great significance for economic development. It includes roads, means of transport and communication, power houses etc. Without developing these infrastructure facilities economic development is not possible. So capital for overheads is very important for increasing the facilities for increasing output.
- Increase in employment : Population in the underdeveloped country increases very rapidly. In order to increase production capacity and employment opportunities, capital is required.
- Formation of human capital : The expenditure incurred on health, education, social services and social welfare, is the expenditure for formation of human capital. But the formation of human capital is possible only through increase in the rate of capital formation.

DETERMINANTS OF INVESTMENT

Investment plays an important role in capital formation. Following are the determinants of investment:

- **Interest Rate:** When the rate of interest is higher people make more savings and investments. In other words, rate of interest is a reward for parting with liquidity. On the other hand with a fall in the rate of interest, investment will decrease because people will prefer to spend more rather they will either save.
- **Government Policies :** Government policies directly affect the investment pattern of the people of a country. If the government makes liberal policies it will lead to more investment. On the other hand if the government imposes high taxes nobody will be ready to make investment.
- **Technological Advancement :** New innovations and technological advancement encourage higher investment. Because new innovation and technology upgradation result into minimum per unit cost as a result profit increases. This profitability attracts more investment.
- **Present Capital Stock :** If the present capital stock is quite enough no investors will go to invest more. On the contrary the capital stock presently is low it will include investment opportunities.
- **Maintenance and Operation Cost :** If maintenance and operation costs are high, no one is ready to make more investment. On the contrary lower maintenance and operation costs encourage investors to invest in future.
- **Competition in the Market. :** In case of less competition or monopoly investment will be high. On the contrary if competition is high, fear and risk takes place and investment will become less.

- Population Growth : Growth of population directly affects investment. When population increases, demand for goods and services also increases. That's why new and more investments take place.
- Degree of Liquidity : Need of cash also affects the level of investment. Higher liquidity preference discourages investment habits. On the contrary, the need for less cash facilitates greater investments.
- Territorial Expansion : With the development of new territories new investment will take place. Because, there will be requirements for infrastructure development.

Causes of low rate of capital formation

The low rate of capital formation in underdeveloped countries like India has been the result of the interaction of various economic, social and cultural factors that have been opening in these countries for centuries together. some of the important factors are as follows :

- Poverty and low level of income
- failure of public sector
- low productivity
- rapid increase in population
- lack of investment incentives
- lack of skilled entrepreneurs
- demonstration effect
- high taxation levels
- unequal distribution of income and wealth
- lack of infrastructural facilities

Measures to Raise The Rate of Capital Formation

- Production should be increased in all spheres through simultaneous development of agriculture, trade, industry, transport, banking, insurance, etc.
- Steps should be taken to improve the distribution of income and wealth in the country
- Drive for increasing Small savings should be intensified and for this purpose, attractive rates of interest should be offered. Special institutions to mobilize small savings should be created.
- There must be a control to check population growth.
- Government must adopt the proper taxation policy so that it may encourage the households to save to the optimum.
- All the essential facilities should be provided to the industries by the Government to encourage capital formation.
- Industrial management should be improved by suitable amendments in the Company Law. This would minimize the number of company failures.
- The rule of law should be firmly established and the safety of life and property be guaranteed.

- The working of stock exchange should be improved. They should be purged of speculative trading activities.

Other measures

- Controlling the wastage and can specious conspicuous of the people and the corporate sector .
- Utilizing the saving potential in disguised unemployment as a source of capital formation through various government schemes.
- Introducing austerity Measures to reduce the volume of government expenditure.
- Making systematic efforts to increase if export and to curtail non essential imports
- Controlling the inflationary pressure so as to raise capacity to save of the people in general.

Questions

Short :

1. Define investment?
2. Explain any four determinants of investment.

Long:

1. What do you mean by investment and explain the importance of investment in India.
2. Discuss the cause of low rate of capital formation and suggest measures to increase them.

Keywords:

1. Subsistence
2. Liquidity
3. Capital stock
4. Accumulation

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THANKS

