



## UNIT-1

### INVESTMENT SETTING

#### 1.2 FINANCIAL AND ECONOMIC MEANING OF INVESTMENT

The meaning of "investment" can shift slightly depending on whether you're looking at it from a financial or economic perspective. Here's a breakdown of both:

##### **Financial Meaning of Investment:**

In the financial world, an investment typically refers to:

- Allocating capital (money) with the expectation of generating future income or capital appreciation. This can involve various assets like stocks, bonds, real estate, commodities, or even alternative investments like private equity or hedge funds.
- Sacrificing current consumption for potential future gain. You spend money now with the hope of it growing or generating returns over time.
- Accepting a certain level of risk in exchange for potential reward. No investment is guaranteed, and there's always the possibility of losing some or all of your invested capital.

##### **Economic Meaning of Investment:**

From an economic perspective, investment takes a broader view:

- The creation of new physical capital stock used to produce more goods and services in the future. This includes physical assets like machinery, buildings, and infrastructure, as well as intangible assets like research and development or human capital (through education and training).
- Expanding the productive capacity of an economy. By investing, society can produce more goods and services overall, leading to economic growth and potentially higher living standards.
- Driving innovation and technological advancement. Investments in research and development can lead to new technologies and processes, further boosting economic growth and productivity.

##### **Key Similarities:**

- Both emphasize the allocation of resources for future benefit.
- Both acknowledge the presence of risk.
- Both contribute to economic growth and development (though in different ways).



## Key Differences:

- Financial investment focuses on individual financial gain through various assets.
- Economic investment focuses on the broader impact on the economy's productive capacity and growth.
- Financial investment includes intangible assets like stocks and bonds, while economic investment emphasizes physical capital formation.

## EXAMPLE:

### Financial Investment

You invest \$10,000 in a mutual fund that holds a diversified portfolio of stocks. You hope the value of the stocks will increase over time, potentially generating capital appreciation (your \$10,000 becomes more valuable) or dividend income (you receive regular payments from the companies held in the fund). This is a financial investment because it's your individual money, you seek financial gain, and the impact on the broader economy is indirect.

### Economic Investment

A government decides to invest \$1 billion in building a new high-speed railway. This creates jobs in construction and related industries, stimulates economic activity in the regions connected by the railway, and potentially opens up new business opportunities. This is an economic investment because it focuses on creating physical capital (the railway), directly impacts the productive capacity of the economy, and benefits society as a whole.