TIME VALUE OF MONEY

Time Value of Money

– By Prof. *Simply* Simple™

TIME VALUE OF MONEY

- Some people put their money in a bank account; some make investments in stocks and bonds.
- Different people follow different strategies to keep their money on the move.
- All of them consciously or unconsciously realize time is the biggest enemy of idle money.
- So, the concept of time value of money always influences our decision about what we intend to do with our money.

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- **But what makes a rupee in our hands today worth more than a rupee tomorrow?**

- **What is so different about currencies made of paper that the value of the same amount of money diminishes with time?**

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Well…

- **You need not be a philosopher to understand the concept of time value of money.**
- **A Rs. 100 note today in our pocket is worth more than a Rs. 100 note that we may get after five years. All of us intuitively know that.**
- **But let’s try to understand what actually makes the present value of money worth more than the value of the same amount of money after five years.**

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Remember…

- **Money is just another name for new opportunities.**
- **The money that you have now can open the doors for many opportunities. Different uses of money may have different advantages.**
- **Some of these opportunities may look very small but some of them might really put you on the fastest track to the future.**

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Here's a new term for you to know!

- **If you invest your money now, you would earn a return which would make your money grow in the next five years.**
- **But the problem is you can choose only one of the many equally advantageous opportunities. All of us try to use our money for the best possible opportunity.**
- **The advantage that we forego by not putting our money in another possible opportunity is what is called the Opportunity Cost of Money.**

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For example…

- **So, if you are investing your money in a 10-year bond that pays you 10% interest, then you are foregoing an opportunity of putting the same money in a 10-year term deposit that pays you 8% interest.**

- **In this case, your actual advantage is only the 2 percentage points more interest that you earn on your investment in bonds.**

- **But always remember that different opportunities have different risks. Investment in bonds may be riskier than investment in term deposits.**

- **So you should always compare the risk-adjusted return to find out whether you are gaining or losing in making a particular use of money.**

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It is better to eat your breakfast before inflation eats your money!

- **Today you can buy four pastries for Rs100, but maybe after five years you would be able to buy only two.**

- **So you have to think - if I give you an option of either taking four pastries today or two pastries after five years, which option would you choose?**

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How can you use the concept of time value of money to make intelligent decisions about your money?

- **The first thing you must keep in mind is that you should never keep your present money idle.**
- **Money has to grow with time. Invest it in stocks or bonds so that the return is good enough to at least preserve its present value.**
- **And still better, take the mutual funds route to take advantage of professional fund management services.**

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To Sum Up

- If you invest Rs. 1 lakh now, what should its worth be after 30 years if you are earning 10% return per annum compounded annually?
- For your knowledge, let me tell you that Rs. 1 lakh would be worth Rs. 17.45 lakh after 30 years.
- The concept of time value of money says that the value of money at present is worth more than the same amount of money in the future.
- By making appropriate investment decisions, we can make money grow with the passage of time.

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Hope you have now understood

the concept of Time Value of Money

Thinking of Investment

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