GL BAJAJ
Institute of Management & Research
Approved by A.I.C.T.E., Ministry of HRD, Govt. of India
Plot No. 2, Knowledge Park-III, Greater Noida (U.P.) – 201306

Roll No…………

POST GRADUATE DIPLOMA IN MANAGEMENT (2017-19)
End TERM EXAMINATION (TERM-V)

Subject Name: **Management of Banking and Financial Services**	**Time: 02.00 hours**
Subject Code: **PGF-03**	**Max Marks: 45**

Note:

1. Writing anything except Roll Number on question paper will be deemed as an act of indulging in unfair means and action shall be taken as per rules.

2. All questions are compulsory in Section A, B & and C. Section A carries 2 Case Studies of 10 marks each, Section B carries 2 questions of 7.5 marks each and Section C carries 5 questions 2 marks each.

SECTION - A $\quad$ 10×02 = 20 Marks

Q. 1: Case Study: Mutual funds: How to choose between growth and dividend

Choosing between hundreds of schemes is a difficult task for most mutual fund investors. For newbie investors, another dilemma is whether to go for the growth or the dividend option. While you don't stand to gain or lose significantly with either alternative, there are some aspects that need to be considered to make the correct decision. Let us first examine how one differs from the other.

The alternatives

There are three choices for the mutual fund investor: growth, dividend payout and dividend reinvestment. Under the payout option, profits made by the mutual fund scheme are given to investors at periodic intervals and are not reinvested in the fund. Such dividends are not guaranteed. The fund may dole out these in one year but may not offer anything the next year; it is entirely at the discretion of the fund. The amount of dividend paid may also vary. Contrary to what some people perceive to be an added benefit, the dividend from a mutual fund is actually cut from the net asset value (NAV). So, the NAV will fall to the extent of dividend paid and the dividend distribution tax (DDT), if any. Suppose, a fund with a face value per unit of Rs 10 is trading at an NAV of Rs 40, and it declares dividend of 30%, which means investors, will earn Rs 3 per unit. If, subsequently, you choose to sell your holdings, you will get only Rs 37 per unit as the NAV of the scheme will have fallen from Rs 40 to Rs 37.

Under the growth option, gains made by the scheme are ploughed back into it; no dividends are paid out. This gain is reflected in the NAV of the scheme, which rises over time. While in dividend option investors make money from the dividends as well as the appreciation in the NAV of the scheme (which is lower than the growth scheme), growth investors make money by selling the scheme at a higher NAV at a later date.

Under the reinvestment option, any dividend paid out by the fund is automatically ploughed back into the same scheme. This means that you buy additional units in the scheme from the dividend amount at the prevailing NAV (ex-dividend) of the scheme. As is the case with dividend payout, NAV of the scheme will fall subsequent to payment of dividend, even if the same is reinvested into the scheme. So, the NAV of a dividend payout and dividend reinvestment scheme is the same.

Tax implications

On the whole, returns are almost the same for either type of investor. Where the two differ significantly is in the tax incidence. This also varies according to the choice of fund (equity or debt), holding period (long term or short term) and nature of income (dividend or capital gains).

Currently, dividends from both equity and debt funds are tax-free in the hands of the investor. But for debt funds, such dividends incur DDT (29.12% including cess). This is cut from the NAV of the fund, which means investors pay for it indirectly. However, those who have invested in the growth option of a debt scheme will not have to bear this tax. Here's how taxation affects different categories of investors.

Debt short-term (less than 3 year)

If you redeem your debt fund within three year, the short-term capital gains tax will be added to your income and taxed at the applicable rate. For someone in the 10% slab, growth would be favourable as DDT would be higher at 29.12 %. On the other hand, dividend is beneficial for those in the 30% tax bracket as DDT would be lower than the capital gains tax rate.

Debt long-term (more than 3 year)

If you intend to hold your debt funds for more than three years, the growth option would be more beneficial. This is because long-term capital gains in debt funds are eligible for inflation indexation benefits. With the current high inflation, your long-term capital gains tax liability of 20% on net gains (arrived at after deducting inflation rate from the gross gains) will be lower than the dividend distribution tax of 29.12 %.

Equity short-term (less than 1 year)

If you sell your equity fund within a year, you will have to pay a 15% capital gains tax. As dividends from equity funds attract a DDT of 11.6% , such investors can opt for the dividend option instead.

Equity long-term (more than 1 year)

Currently, long-term capital gains from equity funds are taxed at 10%. This makes the growth option more favourable.

Other considerations

Investors will have to consider the above tax implications while choosing between dividend and growth. The choice will also vary between individuals, depending upon their needs and goals. If an investor wants to earn income at various intervals to fund expenses, dividend payout could be the right choice.

Questions:

a) Mr. Ram's annual salary is Rs 15 lakh. His age is 35 years. Which type of fund would be suitable for him? Explain.
b) Ms Rashmi's annual salary is Rs 3 lakh. Which type of fund would be suitable for her? Explain.
c) On what basis would you differentiate between growth fund and dividend payout option? Explain. Identify the changes that took place in the recent financial budget in relation to DDT and capital gain of debt fund.

Q. 2: Case Study:

Under an advance factoring arrangement ICICI Bank has agreed to advance a sum of Rs 18 lakh against the receivables purchased from ABC Ltd. The factoring agreement provides for an advance payment of 75% of the value of factored receivables and for guaranteed payment after three months from the date of purchasing the receivables. The Advance carries a rate of interest of 15% per annum compounded quarterly and the factoring commission is 2% of the value of the receivables. Both the interest and commission are collected upfront.

a) Compute the amount actually made to ABC Ltd.

b) Calculate the effective cost of funds made available to ABC Ltd.

Assume that the interest is collected in arrear and the commission is collected in advance. Calculate the effective cost of funds made available to ABC Ltd.

SECTION - B **7.5×02 = 15 Marks**

Q.3: Alibaba, founded by Chinese entrepreneur Jack Ma in his apartment, has garnered huge investor interest and appears set to exceed Visa Inc's $19.7 billion IPO in 2008, the biggest US initial offering to date. Explain the reasons why companies go for Initial Public Offer (IPO).

Q.4: How does Bancassurance help banks and insurance companies?

SECTION - C **02×05 = 10 Marks**

Q.5 (A): Why do banks invest in securities, even though loans typically generate a higher return?
Q.5 (B): What is Net Interest Margin? Why it is closely monitored by bank?
Q.5 (C): In the year 2008, USA observed one of the biggest financial crises in the recent history. The free markets with fewer regulations were major causes of the problems identified by the markets observers. Do you agree? What were the other major causes of the crises?
Q.5 (D) what are the likely reasons for weak bank performance in recent times?
Q.5 (E) Explain why mutual funds are attractive to small investors? How can mutual funds generate returns to their share investors?