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Internal Assessment Test - III

Sub:	**BANKING AND FINANCIAL SERVICES**							Code:	**18MBAFM301**
Date:	**16-11-2019**	Duration:	90 mins	Max Marks:	50	Sem:	III	Branch:	MBA

		Marks	OBE CO	OBE RBT
	Part A -Answer Any Two Full Questions (20*02=40 Marks)			
1(a)	Define NBFCs.	[03]	CO1	L1
(b)	Explain Overview and types of NBFCs in India.	[07]	CO1	L2
(c)	Discuss different types of leasing.	[10]	CO4	L2
2(a)	Define Venture Capital.	[03]	CO3	L1
(b)	Explain the types and stages in venture capital.	[07]	CO3	L2
(c)	Describe various steps followed by credit rating agencies in rating process.	[10]	CO2	L2
3(a)	Define mutual funds.	[03]	CO3	L1
(b)	Discuss various types of mutual funds.	[07]	CO3	L2
(c)	The following data are furnished by ABC Leasing Ltd. Investment cost Rs.500 lakh, primary lease term 5 years, estimated residual value after the primary period Nil and pre-tax required rate of return 24%. Calculate annual lease rentals under the following rental structures: a) Equated b) Stepped (an annual increase of 15%) c) Ballooned (annual rental of Rs.80 lakh for years 1 – 4) and d) Deferred (2 years deferment period).	[10]	CO4	L3
	Part B - Compulsory (01*10=10marks)			
4 (a)	Alfa Ltd. is thinking of installing computers. Decide whether the computers are to be purchased outright (through 14% borrowing) or to be acquired on lease basis. The company is in the 50% tax bracket. The other data available are: **Purchase of computers**: Purchase price Rs.20,00,000 Annual maintenance (to be paid in advance) Rs.50,000 per year Expected economic useful life 6 years Depreciation (for tax purposes) SLM Salvage value Rs.2,00,000 Payment of loan: 6 year-end equal installments of Rs.5,14,271 **Leasing of computers:** Lease charges (to be paid in advance): Rs.4,50,000 Maintenance expenses to be borne by lessor	[10]	CO4	L3

Course Outcomes		PO1	PO2	PO3	PO4	PO5
CO1:	The Student will be acquainted to various Banking and Non-Banking financial services in India.		1a,b			
CO2:	The Student will understand the activities of Merchant Banking and Credit Rating.		2c			
CO3:	The Student will be equipped to understand micro financing and other financial services in India.		2a,b 3a,b			
CO4:	The Student will understand how to evaluate and compare leasing & hire purchase.		1c, 3c, 4a			

Cognitive level	KEYWORDS
L1	list, define, tell, describe, recite, recall, identify, show, label, tabulate, quote, name, who, when, where, etc.
L2	describe, explain, paraphrase, restate, associate, contrast, summarize, differentiate interpret, discuss
L3	calculate, predict, apply, solve, illustrate, use, demonstrate, determine, model, experiment, show, examine, modify
L4	classify, outline, break down, categorize, analyze, diagram, illustrate, infer, select
L5	grade, test, measure, defend, recommend, convince, select, judge, support, conclude, argue, justify, compare, summarize, evaluate
L6	design, formulate, build, invent, create, compose, generate, derive, modify, develop, integrate

PO1–*Theoretical Knowledge; PO2–Effective Communication Skills; PO3–Leadership Qualities; PO4 –Sustained Research Orientation; PO5 –Self-Sustaining Entrepreneurship*

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Answer Key/Solutions
Internal Assessment Test 3– Nov 2019

Sub:	**BANKING AND FINANCIAL SERVICES**					**Code:**	**18MBAFM301**
Date:	16-11- 2019	Duration: 90 mins	Max Marks: 50	**Sem:**	**III**	**Branch:**	**MBA**

Note: Part A - Answer Any Two Full Questions (20*02=40 Marks)
Part B - Compulsory (01*10= 10marks)

Part	**Question #**		**Description**	**Marks Distribution**		**Max Marks**
	1	a	**Define NBFCs.**	A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property. A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in installments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company).	3	20 M
		b	**Explain Overview and types of NBFCs in India.**	**Basic Category of NBFC** NBFC's are broadly classified in – a. Terms of liabilities in Deposit and Non- Deposit Accepting NBFCs b. Size and Systematically important and other Non-Depositing Holding Companies c. Kind of activity of the company Hence, there are ten different types of NBFCs companies that are discussed below – **1. Asset Finance Company** It is a financial institution that facilitates the service of financing the various assets for individuals and the businesses which include machinery, heavy industrial equipment, production and farming equipment and large power generators. The income arising from there from should not less be than the 60% of its total assets. UTI AMC, ICICI AMC, BIRLA SUN LIFE AMC are few examples of asset management company. **2. Investment Company** It is a financial institution whose principal business is the acquisition of securities. In a simple term, these companies take money from the public which invested in various securities and financial products. Thereafter, company deducts its operational cost from the earned profit and later distribute to shareholders. Bajaj Alliance General Insurance Company, IDFC, HDFC mutual fund are examples of some Investment company. **3. Loan Company** Loan Company as its name states is a financial	7	

				institution which offers loan for various purposes other than of the AMC which also includes the Housing Finance Firms. LIC finance ltd, PNB Housing Finance Firm, HDFC are some examples of the Loan companies. **4. Infrastructure Finance Company** It is a Non- Banking Finance Company – a. That deploys three- fourth of its total assets in infrastructure loans b. That has a minimum Net Owned Fund of 300crores c. That has minimum 'A' credit rating or equivalent d. CRAR of 15% Few examples are GMR infrastructure ltd, Hindustan Construction Company. **5. Systematically Important Core Investment Company** It is a Non- Banking Finance Company – a. That deploys 90% of its total assets in the form of investment in shares, stocks, debt or loan group company. b. Out of 90%, 60% should be invested in equity shares or those which compulsorily converted later in equity shares. c. Does not carry any activity referred in section 45(c) or 45(f) of RBI act 1934. d. That accepts public funds **6. Infrastructure Debt Fund** IDFs raise resources through bonds for long-term infrastructure projects. The bonds are issued in multiple currencies to ensure that have they had a five –year maturity for investors. **7. Microfinance Company** People in the urban, semi-urban or rural area of India need financial help to start their business and fulfill other requirements but they are hesitant to seek the help from banks because of the formalities which need to fulfill to get the required money. Now, here the microfinance company come out, they provide financial help to these underprivileged people. Bandhan Financial Service Ltd, Ujjivan Financial service are few examples. **8. NBFC (Factor)** These types of NBFCs in India are low. These companies usually buy loans at a much discounted rate from lenders and after that, they adjust repayment table of the debtor to ensure facile settlement adding small profit. **9. Mortgage Company** It is a financial institution where - • At least 90% of the business turnover is of mortgage guarantee or • At least 90% of the gross income is from mortgage guarantee business or • Net owned Fund is 100 crores **10. Non- operative Financial Holding Company** It is a separate category of NBFCs which is wholly owned Non-operative financial holding company permitted to set up or hold the bank as well as another financial service with the permission of RBI under applicable regulatory prescription.		
		c	**Discuss different types of leasing.**	**1. Financial Lease** Financial leasing is a contract involving payment over a longer period. It is a long-term lease and the lessee will be paying much more than the cost of the property or equipment to the lessor in the form of lease charges. It is irrevocable. In this type of leasing the lessee has to bear all	10	

costs and the lessor does not render any service.

2. Operating Lease

In an operating lease, the lessee uses the asset for a specific period. The lessor bears the risk of obsolescence and incidental risks. There is an option to either party to terminate the lease after giving notice. In this type of leasing

- lessor bears all expenses
- lessor will not be able to realize the full cost of the asset
- specialized services are provided by the lessor.

This kind of lease is preferred where the equipment is likely to suffer obsolescence.

3. Leveraged and non-leveraged leases

In leveraged and non-leveraged leases, the value of the asset leased may be of a huge amount which may not be possible for the lessor to finance. So, the lessor involves one more financier who will have charge over the leased asset.

4. Conveyance type lease

In Conveyance type lease, the lease will be for a long-period with a clear intention of conveying the ownership of title on the lessee.

5. Sale and leaseback

In a sale and leaseback, a company owning the asset sells it to the lessor. The lessor pays immediately for the asset but leases the asset to the seller. Thus, the seller of the asset becomes the lessee. The asset remains with the seller who is a lessee but the ownership is with the lessor who is the buyer. This arrangement is done so that the selling company obtains finance for running the business along with with the asset.

6. Full and non pay-out lease

A full pay-out lease is one in which the lessor recovers the full value of the leased asset by way of leasing. In case of a non pay-out lease, the lessor leases out the same asset over and over again.

7. Specialized service lease

The lessor or the owner of the asset is a specialist of the asset which he is leasing out. He not only leases out but also gives specialized personal service to the lessee. Examples are electronic goods, automobiles, air-conditioners, etc.

8. Net and non-net lease

In non-net lease, the lessor is in charge of maintenance insurance and other incidental expenses. In a net lease, the lessor is not concerned with the above maintenance expenditure. The lessor confines only to financial service.

9. Sales aid lease

In case, the lessor enters into any tie up arrangement with manufacturer for the marketing, it is called sales aid lease.

10. Cross border lease

Lease across national frontiers are called cross border lease, Shipping, air service, etc., will come under this category.

11. Tax oriented lease

Where the lease is not a loan on security but qualifies as a lease, it will be considered a tax oriented lease.

12. Import Lease

In an Import lease, the company providing equipment for lease may be located in a foreign country but the lessor and the lessee may belong to the same country. The equipment is more or less imported.

13. International lease

Here, the parties to the lease transactions may belong

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<tr><td rowspan="2"></td><td rowspan="2">2</td><td>a</td><td>Define Venture Capital.</td><td>It is a private or institutional investment made into early-stage / start-up companies (new ventures). As defined, ventures involve risk (having uncertain outcome) in the expectation of a sizeable gain. Venture Capital is money invested in businesses that are small; or exist only as an initiative, but have huge potential to grow. The people who invest this money are called venture capitalists (VCs). The venture capital investment is made when a venture capitalist buys shares of such a company and becomes a financial partner in the business.

Venture Capital investment is also referred to risk capital or patient risk capital, as it includes the risk of losing the money if the venture doesn’t succeed and takes medium to long term period for the investments to fructify.</td><td>3</td><td rowspan="2">20 M</td></tr>
<tr><td>b</td><td>Explain the types and stages in venture capital.</td><td>Types of Venture Capital funding
The various types of venture capital are classified as per their applications at various stages of a business. The three principal types of venture capital are early stage financing, expansion financing and acquisition/buyout financing.
The venture capital funding procedure gets complete in six stages of financing corresponding to the periods of a company’s development
• Seed money: Low level financing for proving and fructifying a new idea
• Start-up: New firms needing funds for expenses related with marketing and product development
• First-Round: Manufacturing and early sales funding
• Second-Round: Operational capital given for early stage companies which are selling products, but not returning a profit
• Third-Round: Also known as Mezzanine financing, this is the money for expanding a newly beneficial company
• Fourth-Round: Also called bridge financing, 4th round is proposed for financing the "going public" process
A) Early Stage Financing:
Early stage financing has three sub divisions seed financing, start up financing and first stage financing.
• Seed financing is defined as a small amount that an entrepreneur receives for the purpose of being eligible for a start up loan.
• Start up financing is given to companies for the purpose of finishing the development of products and services.
• First Stage financing: Companies that have spent all their starting capital and need finance for beginning business activities at the full-scale are the major beneficiaries of the First Stage Financing.
B) Expansion Financing:
Expansion financing may be categorized into second-stage financing, bridge financing and third stage financing or mezzanine financing.
Second-stage financing is provided to companies for the</td><td>7</td></tr>
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purpose of beginning their expansion. It is also known as mezzanine financing. It is provided for the purpose of assisting a particular company to expand in a major way. Bridge financing may be provided as a short term interest only finance option as well as a form of monetary assistance to companies that employ the Initial Public Offers as a major business strategy.

C) Acquisition or Buyout Financing:

Acquisition or buyout financing is categorized into acquisition finance and management or leveraged buyout financing. Acquisition financing assists a company to acquire certain parts or an entire company. Management or leveraged buyout financing helps a particular management group to obtain a particular product of another company.

Stages in Venture Capital

Stage 1: Seed capital

The descriptor “seed” is appropriate here, since it suggests money that will fuel a startup’s growth down the road. At this point, the leaders of a startup may not have any commercially available product yet and are instead most likely focused on convincing investors why their ideas are worthy of VC support.

Seed funding rounds are typically small and are channeled toward research and development of an initial product. The money may also be used for conducting market research or expanding the team. There are seed accelerators out there, like Y Combinator, that accept applicants, provide seed capital and offer an opportunity to demo a solution to major investors.

Stage 2: Startup capital

This stage is similar to the seed stage. With initial market analysis conducted and business plans in place, companies look to begin marketing and advertising the product and acquiring customers.

Organizations at this stage likely have at least a sample product available. VC funding may be diverted to acquiring more management personnel, fine-tuning the product/service or conducting additional research.

Stage 3: Early stage/first stage/second stage capital

Though sometimes called “first stage,” this stage only comes after the seed and startup ones in most cases. Funding received at this stage will often go toward manufacturing and production facilities, sales and more marketing.

The amount invested here may be significantly higher than during prior stages. At this point, the company may also be moving toward profitability as it pushes its products and advertisements to a wider audience.

Stage 4: Expansion stage/second stage/third stage capital

Growth is often exponential by this stage. Accordingly, VC funding serves as more fuel for the fire, enabling expansion to additional markets (e.g., other cities or countries) and diversification and differentiation of product lines.

With a commercially available product, a startup at this stage should be taking in ample revenue, if not profit. Many companies that get expansion funding have been in business for two to three years.

Stage 5: Mezzanine/bridge/pre-public stage

After reaching this juncture, the company may be looking to go public, given that its products and services have found suitable traction. Funds received here can be used for activities such as:

- Mergers and acquisitions
- Price reductions/other measures to drive out

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<td>competitors
• Financing the steps toward an initial public offering</td>
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<td>Describe various steps followed by credit rating agencies in rating process.</td>
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Steps Involved in Credit Rating
Step 1 • Request from issuer and analysis
Step 2 • Rating Committee
Step 3 • Communication to management and appeal
Step 4 • Pronouncement of Rating
Step 5 • Monitoring of the Assigned Rating
Step 6 • Rating Watch
Step 7 • Rating Coverage
Step 8 • Rating Scores
Steps involved in Credit Rating

Request from issuer and analysis: The first step to credit rating is that the enterprise applies to the rating agency for the rating of a particular instrument. Thereafter, an expert team interacts with the firm's those charged with governance and acquires relevant data. Factors which are considered includes:

Historical performance
Financial Policies
Business Risk profile
Competitive Position, etc.

Rating Committee: Based on the information gathered and evaluation performance, the presentation of the report is made by the expert's team to the Rating Committee, in which the issuer is not permitted to take part.
Communication to management and appeal: The decision of the rating is shared with the issuer and if he/she does not agree with the decision, then an opportunity of being heard is given. The issuer is required to provide material information, so as to appeal against the decision. The decision is reviewed by the committee, but that does not make any change in the ratings.
Pronouncement of the rating: When the issuer agrees to the rating decision, the agency make a public announcement, of the rating.
Monitoring of the assigned rating: The agency which rates the issue, overlooks the performance of the issuer and the business environment in which it operates.
Rating Watch: On the basis of continuous critical observation undertaken by the rating agency, it may place a rated security on Rating Watch.
Rating Coverage: Credit Ratings are not confined to particular debt instruments, but also covers public utilities, transport, infrastructure, energy projects, Special Purpose Vehicles etc
Rating Scores: Rating scores are given by the credit rating agencies like CRISIL, ICRA, CARE, FITCH.

Credit Rating is of great help, not just in investors protection but to the entire industry, as it directly mobilizes savings of the individuals.
CAMEL Model
CAMEL rating expands to:
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				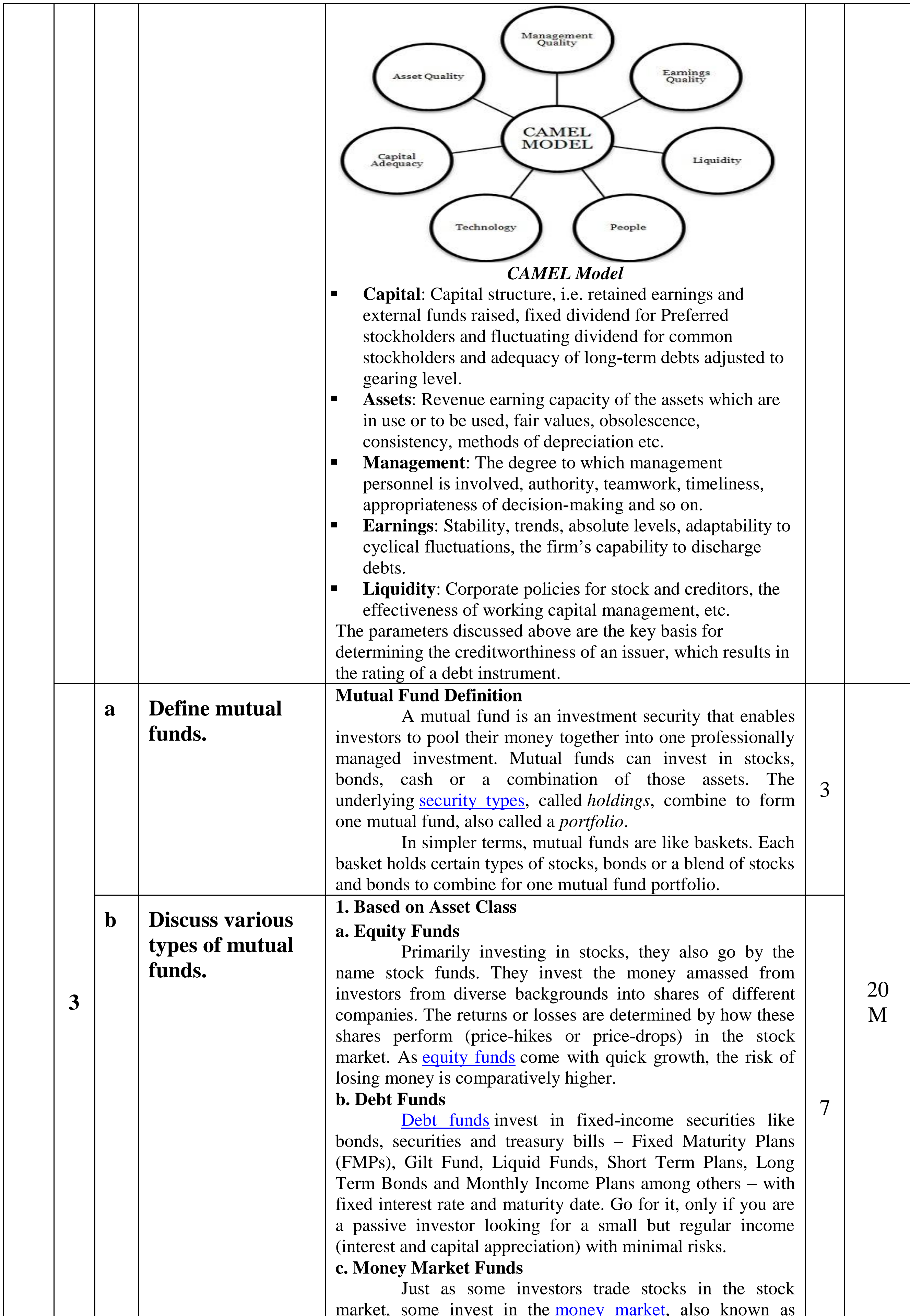 ***CAMEL Model*** ▪ **Capital**: Capital structure, i.e. retained earnings and external funds raised, fixed dividend for Preferred stockholders and fluctuating dividend for common stockholders and adequacy of long-term debts adjusted to gearing level. ▪ **Assets**: Revenue earning capacity of the assets which are in use or to be used, fair values, obsolescence, consistency, methods of depreciation etc. ▪ **Management**: The degree to which management personnel is involved, authority, teamwork, timeliness, appropriateness of decision-making and so on. ▪ **Earnings**: Stability, trends, absolute levels, adaptability to cyclical fluctuations, the firm's capability to discharge debts. ▪ **Liquidity**: Corporate policies for stock and creditors, the effectiveness of working capital management, etc. The parameters discussed above are the key basis for determining the creditworthiness of an issuer, which results in the rating of a debt instrument.		
	3	**a**	**Define mutual funds.**	**Mutual Fund Definition** A mutual fund is an investment security that enables investors to pool their money together into one professionally managed investment. Mutual funds can invest in stocks, bonds, cash or a combination of those assets. The underlying security types, called *holdings*, combine to form one mutual fund, also called a *portfolio*. In simpler terms, mutual funds are like baskets. Each basket holds certain types of stocks, bonds or a blend of stocks and bonds to combine for one mutual fund portfolio.	3	20 M
		b	**Discuss various types of mutual funds.**	**1. Based on Asset Class** **a. Equity Funds** Primarily investing in stocks, they also go by the name stock funds. They invest the money amassed from investors from diverse backgrounds into shares of different companies. The returns or losses are determined by how these shares perform (price-hikes or price-drops) in the stock market. As equity funds come with quick growth, the risk of losing money is comparatively higher. **b. Debt Funds** Debt funds invest in fixed-income securities like bonds, securities and treasury bills – Fixed Maturity Plans (FMPs), Gilt Fund, Liquid Funds, Short Term Plans, Long Term Bonds and Monthly Income Plans among others – with fixed interest rate and maturity date. Go for it, only if you are a passive investor looking for a small but regular income (interest and capital appreciation) with minimal risks. **c. Money Market Funds** Just as some investors trade stocks in the stock market, some invest in the money market, also known as	7	

capital market or cash market. The government, banks or corporations usually run it by issuing money market securities like bonds, T-bills, dated securities and certificates of deposits, among others. The fund manager invests your money and disburses regular dividends to you in return. If you opt for a short-term plan (13 months max), the risk is relatively less.

d. Hybrid Funds

Hybrid Funds (Balanced Funds) is an optimum mix of bonds and stocks, thereby bridging the gap between equity funds and debt funds. The ratio can be variable or fixed. In short, it takes the best of two mutual funds by distributing, say, 60% of assets in stocks and the rest in bonds or vice versa. This is suitable for investors willing to take more risks for 'debt plus returns' benefit rather than sticking to lower but steady income schemes.

2. Based on Structure

Mutual funds can be categorized based on different attributes (like risk profile, asset class, etc.). Structural classification – open-ended funds, close-ended funds, and interval funds – is broad in nature and the difference depends on how flexible is the purchase and sales of individual mutual fund units.

a. Open-Ended Funds

These funds don't have any constraints in a period or a number of units – an investor can trade funds at their convenience and exit when they like at the current NAV (Net Asset Value). This is why the unit capital continually changes with new entries and exits. An open-ended fund may also decide to stop taking in new investors if they do not want to (or cannot manage significant funds).

b. Closed-Ended Funds

Here, the unit capital to invest is fixed beforehand, and hence, they cannot sell a more than a pre-agreed number of units. Some funds also come with an NFO period; wherein there is a deadline to buy units. It has a specific maturity tenure, and fund managers are open to any fund size, however large. SEBI mandates investors to be given either repurchase option or listing on stock exchanges to exit the scheme.

c. Interval Funds

This has traits of both open-ended and closed-ended funds. Interval funds can be purchased or exited only at specific intervals (decided by the fund house) and are closed the rest of the time. No transactions will be permitted for at least 2 years. This is suitable for those who want to save a lump sum for an immediate goal (3-12 months).

3. Based on Investment Goals

a. Growth Funds

Growth funds usually allocate a considerable portion in shares and growth sectors, suitable for investors (mostly Millennials) who have a surplus of idle money to be distributed in riskier plans (albeit with possibly high returns) or are positive about the scheme.

b. Income Funds

This belongs to the family of debt mutual funds that distribute their money in a mix of bonds, certificate of deposits and securities among others. Helmed by skilled fund managers who keep the portfolio in tandem with the rate fluctuations without compromising on the portfolio's creditworthiness, Income Funds have historically earned investors better returns than deposits and are best suited for risk-averse individuals from a 2-3 years perspective.

c. Liquid Funds

Like Income Funds, this too belongs to the debt fund category as they invest in debt instruments and money market with a tenure of up to 91 days. The maximum sum allowed to invest is Rs 10 lakhs. One feature that differentiates Liquid Funds from other debt funds is how the Net Asset Value is calculated – NAV of liquid funds are calculated for 365 days (including Sundays) while for others, only business days are calculated.

d. Tax-Saving Funds

ELSS or Equity Linked Saving Scheme is gaining popularity as it serves investors the double benefit of building wealth as well as save on taxes – all in the lowest lock-in period of only 3 years. Investing predominantly in equity (and related products), it has been known to earn you non-taxed returns from 14-16%. This is best-suited for long-term and salaried investors.

e. Aggressive Growth Funds

Slightly on the riskier side when choosing where to invest in, the Aggressive Growth Fund is designed to make steep monetary gains. Though susceptible to market volatility, you may select one as per the beta (the tool to gauge the fund's movement in comparison with the market). Example, if the market shows a beta of 1, an aggressive growth fund will reflect a higher beta, say, 1.10 or above.

f. Capital Protection Funds

If protecting your principal is your priority, Capital Protection Funds can serve the purpose while earning relatively smaller returns (12% at best). The fund manager invests a portion of your money in bonds or CDs and the rest in equities. You will not incur any loss. However, you need a least 3 years (closed-ended) to safeguard your money, and the returns are taxable.

g. Fixed Maturity Funds

Investors choose as the FY ends to take advantage of triple indexation, thereby bringing down tax burden. If uncomfortable with the debt market trends and related risks, Fixed Maturity Plans (FMP) – investing in bonds, securities, money market etc. – present a great opportunity. As a close-ended plan, FMP functions on a fixed maturity period, which could range from 1 month to 5 years (like FDs). The Fund Manager makes sure to put the money in an investment with the same tenure, to reap accrual interest at the time of FMP maturity.

h. Pension Funds

Putting away a portion of your income in a chosen Pension Fund to accrue over a long period to secure you and your family's financial future after retiring from regular employment – it can take care of most contingencies (like a medical emergency or children's wedding). Relying solely on savings to get through your golden years is not recommended as savings (no matter how big) get used up. EPF is an example, but there are many lucrative schemes offered by banks, insurance firms etc.

4. Based on Risk

a. Very Low-Risk Funds

Liquid Funds and Ultra Short-term Funds (1 month to 1 year) are not risky at all, and understandably their returns are low (6% at best). Investors choose this to fulfill their short-term financial goals and to keep their money safe until then.

b. Low-Risk Funds

In the event of rupee depreciation or unexpected

national crisis, investors are unsure about investing in riskier funds. In such cases, fund managers recommend putting money in either one or a combination of liquid, ultra short-term or arbitrage funds. Returns could be 6-8%, but the investors are free to switch when valuations become more stable.

c. Medium-risk Funds

Here, the risk factor is of medium level as the fund manager invests a portion in debt and the rest in equity funds. The NAV is not that volatile, and the average returns could be 9-12%.

d. High-risk Funds

Suitable for investors with no risk aversion and aiming for huge returns in the form of interest and dividends, High-risk Mutual Funds need active fund management. Regular performance reviews are mandatory as they are susceptible to market volatility. You can expect 15% returns, though most high-risk funds generally provide 20% returns (and up to 30% at best).

5. Specialized Mutual Funds

a. Sector Funds

Investing solely in one specific sector, theme-based mutual funds. As these funds invest only in specific sectors with only a few stocks, the risk factor is on the higher side. One must be constantly aware of the various sector-related trends, and in case of any decline, exit immediately. However, sector funds also deliver great returns. Some areas of banking, IT and pharma have witnessed huge and consistent growth in the recent past and are predicted to be promising in future as well.

b. Index Funds

Suited best for passive investors, index funds put money in an index. A fund manager does not manage it. An index fund identifies stocks and their corresponding ratio in the market index and put the money in similar proportion in similar stocks. Even if they cannot outdo the market (which is the reason why they are not popular in India), they play it safe by mimicking the index performance.

c. Funds of Funds

A diversified mutual fund investment portfolio offers a slew of benefits, and 'Funds of Funds' aka multi-manager mutual funds are made to exploit this to the tilt – by putting their money in diverse fund categories. In short, buying one fund that invests in many funds rather than investing in several achieves diversification as well as saves on costs.

c The following data are furnished by ABC Leasing Ltd. Investment cost Rs.500 lakh, primary lease term 5 years, estimated residual value after the primary period Nil and pre-tax required rate of return 24%. Calculate annual

Computation of Lease Rentals (10)

a. Lease Rental (Equated) = Rs.500/ $PVIFA_{(24\%,5\ years)}$
= Rs.500 / 2.7454
= **Rs.182.14 lakh**

b. If LR are stepped at 15%

Years	LR	PVIF @ 24%	PV of LR	LR	L = 500 Lakh/3.4881 = 143.34
1	L (1) = L	0.8065	0.8065 L	143.34	
2	L $(1.15)^1$ = 1.15 L	0.6504	0.7480 L	164.84	
3	L	0.524	0.6937	189.5	

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<td>lease rentals under the following rental structures: Equated b) Stepped (an annual increase of 15%) c) Ballooned (annual rental of Rs.80 lakh for years 1 – 4) and d) Deferred (2 years deferment period).</td>
<td>
<table>
<tr><td></td><td>$(1.15)^2$ = 1.3225 L</td><td>5</td><td>L</td><td>7</td><td></td></tr>
<tr><td>4</td><td>L $(1.15)^3$ = 1.5209 L</td><td>0.4230</td><td>0.6433 L</td><td>218.01</td><td></td></tr>
<tr><td>5</td><td>L $(1.15)^4$ = 1.749 L</td><td>0.3411</td><td>0.5966 L</td><td>250.70</td><td></td></tr>
<tr><td></td><td></td><td></td><td>3.4881 L</td><td></td><td></td></tr>
</table>
c. 80 x $PVIFA_{(24,4)}$ + LR_5 x $PVIF_{(24,5)}$ = Rs.500 lakh
80 x 2.4043 + 0.34111 LR_5 = 500 lakh
192.34 + 0.34111 LR_5 = 500 lakh
$LR_5 = \frac{500 - 192.34}{0.34111}$ = Rs.901.94 lakh

d. LR x $PVIF_{(24,3)}$ + LR x $PVIF_{(24,4)}$ + LR x $PVIF_{(24,5)}$ = 500 Lakh
0.52449LR + 0.42297LR + 0.34111LR = 500 lakh
1.28857 LR = 500 lakh
LR = Rs.500 lakh/1.28857 = Rs.388 lakh
</td>
<td></td>
<td></td>
</tr>
<tr>
<td>B</td>
<td>4</td>
<td>a)</td>
<td>Alfa Ltd. is thinking of installing computers. Decide whether the computers are to be purchased outright (through 14% borrowing) or to be acquired on lease basis. The company is in the 50% tax bracket. The other data available are:
Purchase of computers:
Purchase price Rs.20,00,000
Annual maintenance (to be paid in advance) Rs.50,000 per year</td>
<td>
<table>
<tr><td>Cost of Leasing:
PV of Lease Rental
[LR + ($PVIFA_{(7\%, 5Y)}$ x LR); 4,50,000 + (4.1002 x 4,50,000)]
Less: PV of tax shield on Lease Rental
[$PVIFA_{(7\%, 6Y)}$ x LR x t; 4.7665 x 4,50,000 x 0.50]</td><td>
22,95,090

-
10,72,463</td></tr>
<tr><td>Cost of Leasing</td><td>12,22,627</td></tr>
</table>

<table>
<tr><td>Cost of Buying
PV of Loan installments
[$PVIFA_{(7\%, 6Y)}$ x LI; 4.7665 x 5,14,271]
PV of maintenance cost
[MC + $PVIFA_{(7\%, 5Y)}$ x MC; 50,000 + 4.1002 x 50,000]
PV of tax shield on MC
[$PVIFA_{(7\%, 6Y)}$ x MC x t; 4.7665 x 50,000 x 0.50]
Less: PV of tax shield on interest (WN – 1)
Less: PV of tax shield on Deprecation
[$PVIFA_{(7\%, 6Y)}$ x depreciation x t; 4.7665 x 3,00,000 x 0.50]
Less: PV of salvage value
[$PVIF_{(7\%, 6Y)}$ x SV; 0.6663 x 2,00,000]</td><td>
24,51,273

2,55,010

-1,19,163

-
4,51,416
-
7,14,975
-
1,33,260</td></tr>
<tr><td>Cost of Buying</td><td>12,87,469</td></tr>
</table>

Working Notes:
1. PV of tax shield on interest = $PVIF_{(r, n)}$ x Interest x t; 0.6663 [2,80,000 x 0.9346 + 2,47,202 x 0.8734 + 2,098,12 x 0.8163 + 1,671,88 x 0.7629 + 1,18,596 x 0.7130 + 62,828 x 0.6663] x 0.50 = 4,51,416
2. Debt Amortisation Schedule
</td>
<td>10</td>
<td>10 M</td>
</tr>
</table>

Expected economic useful life 6 years

Depreciation (for tax purposes) SLM

Salvage value Rs.2,00,000

Payment of loan: 6 year-end equal installments of Rs.5,14,271

Leasing of computers:

Lease charges (to be paid in advance): Rs.4,50,000

Maintenance expenses to be borne by lessor

Years	Loan Instl.	Loan O/S	Interest @ 14%	principal
1	5,14,271	20,00,000	2,80,000	2,34,271
2	5,14,271	17,65,729	2,47,202	2,67,069
3	5,14,271	14,98,660	2,09,812	3,04,459
4	5,14,271	11,94,201	1,67,188	3,47,083
5	5,14,271	8,47,118	1,18,597	3,95,674
6	5,14,271	4,51,443	62,827	4,51,444

Comment: Computers should be acquired on lease basis because it has savings of Rs.64,822 (11,51,622 – 10,86,800).

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