**JAIPURIA INSTITUTE OF MANAGEMENT, INDORE**

**PGDM**

**FIFTH TRIMESTER (Batch 2019-21)**

**END TERM EXAMINATION, JANUARY-2021**

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| Course Name | **Wealth Management** | Course Code | **FIN 503** |
| Max. Time | **2 hours** | Max. Marks | **40** |

**Instructions: Each question carry 8 marks.**

**Q1. Financial Planning isn't just for the Rich**

A lot of people feel that financial planning is only for the rich and it isn’t at the top of mind of many first jobbers. After all, if one does not have a lot of money what is there to plan? But eventually you may want to buy that first house, get married, travel the world or retire early. Where will that money come from if you did not plan? Financial planning does not have to be complicated but neither is it a monthly budget plan. Although a monthly budget is a component of the bigger picture. Start by thinking how you can save. An investor must remember the line, ‘it’s not how much you earn but how much you are safe that matters.’ Then how you can protect that wealth, think of yourself as a wealth making machine hence, insurance – medical, life and general insurance is important – to protect your capability to continue to build wealth. Start thinking and understanding about building wealth via investments be it real estate, mutual funds or shares. What are the keys to financial planning a newbie at work should know? Do not squander away your hard earned money. Do not think you are young hence you have a lot of time to save for your retirement and that dream home. Money does not work that way. It has its own set of rules and if you do not obey it, you will pay for it in double. What are some of the keys to good financial planning?

1. ***Pay Yourself First:*** It basically means when you get your pay, put some aside for yourself immediately. Better yet, siphon it to an account where withdrawing is tough. Almost always you will still have money to take care of other bills when you pay yourself first. This money is for a rainy day, emergency cash and cash for investment opportunities that may crop up.
2. ***Living Expenses****:* You can then start to pay off all your living expenses bills. There are the cell phone, rent, student loan, car loans, utilities bill, etc. to pay off. Of course the grocery bills and transportation costs. I like to keep leisure out of these living expenses because to me these are priorities, if these aren’t taken care of, it can lead to debt accumulation. Especially paying off loan instalments where interest can compound one month after another.
3. ***Save for the Future:*** Under save for the future, lump the desired lifestyle you want for your family in here. It means taking into account what you want for your future. Is it a house, paying for your children’s education, etc.? Financial freedom starts when you know how to manage your money. Think about investments in this category. You do not just save this money in the bank, you use it to invest in order to hedge against inflation and also to grow your money. This is an important part of keys to financial planning as it helps grow the money. Inflation is a money virus that will shrink the value of your money. Use investment as an antidote for this.

4. ***Personal Development***: You need to continually improve yourself. I know at a young age you may not think about this too much. Start this habit early and allocate, even if it is a small sum for personal development. For example, something as simple as reading about managing money and investments. What about work related books to help you improve your work quality? All these go a long way in making you a better person.

5. ***Leisure****:* Of course, you must reward yourself. There is no sense in working so hard for the money but not being able to enjoy it. Use this pool of money in moderation though. Allocate some money for leisure - weekend breaks, movies, or even the yearly traveling.

6. ***Charity****:* You do not exist in this world alone. You need to know you are truly blessed and one way to show gratitude is to contribute the money you have earned. Rich are those who can give, for one who is poor has nothing to give. Of course, for the purpose of this article I am talking about giving money, but you can go beyond that like giving your time and energy. The keys to financial planning aren’t all about investments and saving, it includes fun and taking care of others as well. The earlier you plan the better it will be for you.

**Questions**

1. What are the keys to financial planning a newbie at work should know?

2. What is the importance of personal financial planning?

**Q2. Evaluating Investment Banking and Market Risks**

Understanding and being able to evaluate the investment banking market and its risks is important for all investors. Investment banking helps companies find the capital needed to expand their business, bring new products to the market and grow the economy. The investment banking system is important to the country’s economic well-being and provides a tremendous value for all investors. One element of investment banking involves the proper management of risk. Risks are always present when investing and can never be eliminated. There are techniques that investment bankers use to manage the risks associated with investing and to help investors and the company’s they represent maximize their potential profits.

**Elements of Investment Banking**

Investment banking involves bringing market companies that seek to sell their stock to the public. Investment bankers evaluate a company’s financial information, management team and business to determine how best to introduce the company’s stock to the market and provide the best price for that stock. Investment banking involves both the initial and subsequent offer of a company’s stock. The initial offering, which is known as the initial public offering or IPO, sets the initial pricing for a company and provides it with the capital necessary to meet its business objective. The investment banker, as the underwriter, will maintain an interest in the company’s stock to sell to the public as part of the exchange market.

**Nature and Types of Risk**

The work of the investment banker to properly time the offer of an IPO, or secondary offering, of a company’s stock is based on their evaluation of the market conditions. A company’s stock is less likely to do well when investor’s expectations are lower due to an economic hardship or concerns about inflation. The investment banker studies the economy carefully to determine the best time to offer a company’s stock. Risks associated with investing and bringing a company to market includes market risk, credit risk, inflation or purchasing power risk and regulatory risk. Each of these risks is specific to certain types of companies and is always present. It is the job of investment banker to understand the nature of risk and help companies and investors manage risk properly.

**Methods for Handling Risk**

Risk can be managed through different strategies design to reduce exposure. An investment banker may recommend that a stock not be sold during a certain period when interest rates are high in order to maximize the price that the company’s share can get. Investors use techniques such as diversification and dollar cost averaging as a way to reduce their risk exposure.

**Questions**

1. What is the role of an investment banker in guiding people about investment?

2. What do you understand by the term: Investment Banking? Name few investment banking companies.

**Q3. The Reality of Investment Diversification**

Investment diversification, simply said, is “don’t put all your eggs in one basket.” This is the traditional approach to investing that you’ll see promoted by many financial advisors and popular personal finance magazines and investment books. Here’s the idea behind investment diversification. Suppose you invest $10,000 in five different investments for twenty years. The results are below:

1. $2,000 in a high risk investment becomes worthless

2. $2,000 in a risk level four investment earns 10% and grows to $13,455

3. $2,000 in a risk level three earns 8% and grows to $9,322

4. $2,000in a risk level two earns 6% and grows to $6,414

5. $2,000 in a risk level one investment earns 2% and grows to $2,972

You invested $10,000 which grew to $32,163, which means, on average your investments earned a 6% annualized return. Not bad. Investment diversification is important. I advise you do it. I also advise you understand its limitations. The premise behind choosing to diversify your investments is that if you do it properly, you will earn an average return of let’s say six to seven percent a year. Financial planners will run a retirement plan projection for you using a rate of return based on this assumption.

They often neglect to account for a margin of error. The impact of a margin of error is best explained with this excerpt from the book The Black Swan:

“You would take a different set of clothes on your trip to some remote destination if I told you that the temperature was expected to be seventy degrees Fahrenheit, with an expected error rate of forty degrees than if I told you that my margin of error was only five degrees.” Diversification does help reduce investment risk, but you must remember that the long term results of a diversified set of investments are far from certain. Adding additional investment risk management techniques to diversification can improve the odds that your investments will achieve the results you need them to achieve so you can reach your financial goals.

**Questions**

1. What do you mean by investment diversification? Why is it advisable to diversify your assets?

2. How can an investor diversify his assets?

**Q4. Gold Loans-Personal Loan against Gold: A Financing Option for Short-term Needs**

For Indians, gold is considered as an essential investment from a cultural, emotional and safety perspective. One bought, is a dead investment. It tends to lie in the locker not earning you any money. Why not make use of it in your time of need? You can monetise this idle asset to help you tide over your financial need. So if ever you find yourself in need of money, consider gold loans as an option. Gold loans also known as gold deposits are loans given by banks/ NBFCs by taking gold as a security.

Gold loans are not new to the Indian market. It existed but in the unorganised sector where money lenders used gold as a security for providing loans. Now banks have entered this space in a big way because the market is very large considering the fact that most Indians tend to have sufficient investment in gold. More importantly, with more and more women working in the family, people have become broadminded. So the social stigma that was once attached to taking a loan on gold is gradually being eliminated. Off late, this product has become popular because of the substantial rise in gold prices. The quantum of loan that one can get by giving gold as security has increased tremendously making it an attractive loan proposition. What is the process to be followed to obtain a gold loan? You offer your jewellery to the lender who can be a bank or an NBFC. The lender will evaluate the purity of the jewellery. The charge for evaluation is generally borne by the borrower. Once the evaluation is done, the paper work for the mortgage is done. Banks will ask you to produce personal documents such as Pan Card, address proof among other things. The lender will give you a loan which in most cases can be up to a maximum of 80% of the value of the jewellery. After having repaid the loan, you get your gold back from the lender.

**Features**

1. Secured Loan: Gold loan is essentially borrowings against the security i.e. gold. Thus this loan should be taken only if you’re absolutely sure that you will be able to repay the loan else you may end up losing your gold.

2. Tenure: Gold loans are typically for duration of 3 to 12 months. They are thus best used to fund short term monetary requirements.

3. No end use restrictions: The loan can be taken for any purpose so long as the money is not being used for speculative purposes.

4. Loan amount: In most cases, the maximum loan value is not more than 80% of the value of gold. Most banks deal in relatively higher loan amounts. NBFCs on the other hand, deal in small value loans.

5. Interest Rate: The interest rate charged by banks can be in the range of 11.5% and 15%. Banks usually charge a processing fee while NBFCs may not charge the same. The rate of interest charged by NBFCs is much higher as compared to banks.

6. Repayment: The loan can be foreclosed at any time without any penalty. In case of irregular payment of EMIs, a penal interest of up to 2% is charged by banks.

7. Market risk: The lender retains the exposure to the market risk arising from movements in the market price of gold.

**Advantages**

1. Quick processing: Gold loans require minimum documentation and hence it can be resorted to in times of urgent need. Banks maintain that it takes a few hours to get a gold loan and some NBFCs state that it takes only a few minutes.

2. More attractive than a personal loan: The rate of interest charged on gold loans tends to be much lower than that of a personal loan. Therefore, it may be worthwhile putting your asset to work and thus reducing your cost of loan.

3. Emotional attachment will ensure timely payment: Most families have an emotional attachment to gold and that will make you morally responsible to repay the loan in time so that you can get back the gold that you had placed as a security.

4. Cash flow management: In a typical loan against gold transaction, only interest needs to be paid during the tenure of the loan and the principal amount has to be repaid at the end of the tenure. This allows customers the borrower to manage cash flows better. In times of need of money for a short duration, you can resort to gold loans. Let your asset that you have built over years; be of use to you when you are undergoing a financial strain. Note that you should take a gold loan if and only if you are sure of repaying the loan in time. Else you may end up losing your most treasured asset.

**Questions**

1. How do you view Gold loan as sources of personal finance? Support your explanation with relevant reasons.

2. Name the various banks providing the customers “Loans against Gold or Gold Loans”. Which bank was the first to introduce this service in India?

3. Which finance option will you prefer: Gold Loan or Personal Loan? Give reasons.

**Q5. How much Life Cover do you Need?**

The primary purpose of life insurance is to provide risk cover that offers financial protection to a policyholder’s dependents in the event of the policyholder’s death. One needs to have enough life insurance so that his or her family can continue with their current lifestyle even if the breadwinner passes away. Like every financial decision, life insurance shouldn’t be and needn’t be arbitrary. There is such a thing as ‘the right amount of cover’, which assumes greater significance in light of the fact that there’s a price to pay for buying grossly less or grossly more. If you underinsure, you risk causing financial hardship to your dependents; if you over-insure, you waste money paying for something you don’t need. The amount of insurance you need depends on your personal circumstances, which comprises of many variables. The most important of these is dependents. If you don’t have dependents (say, you are not married and your parents are financially self-sufficient), you don’t need life insurance at all. Likewise, if your spouse is working and can live comfortably without your income, you don’t need cover. However, if the two of you have taken loans, then you need to provide a back-up for those loans. And if you have young children, you will need to provide for expenses to raise them and support their higher education. Therefore, to answer the question of how much cover, answer the question: how much capital does your family need, both in the short-term and in the long-term? The answer can be derived in three steps.

**Step 1: Work out your Expenses**

***Living expenses:*** These include day-to-day expenses such as food and utilities, and nonrecurring expenses your family may have. Your current annual expenses, exclude your own, can be a good indicator. If you have young children, chances are, their expenses will increase with age. Work out their expenses till they become financially independent that period should determine the tenure of your cover.

***Current liabilities:*** This is the principal amount outstanding in your various loans (for example, house, car, personal loans or credit card outstanding).

***Future expenses*:** The major expenses expected in the future like higher education of children and their wedding expenses. Consider the time horizon and the impact of inflation on these expenses.

**Step 2: Determine your assets Salary**

If your spouse is earning, some of the day-to-day expenses can be supported from that salary.

***Current assets:*** Value of investments like mutual funds, shares, real estate, bonds, and post office savings. Don’t include the house you live in, as your family will still need to live in it.

***Other pay-outs:*** Your pension and insurance plans. This includes pension or superannuation plans offered by your employer, employee provident fund and life cover from your existing insurance plans. Many employers provide life cover to their employees through a group insurance plan. Typically, the cover is a multiplier of the base salary. Check whether you are covered by such a plan, and add it to the existing cover.

**Step 3: Calculate your Life Cover** We will consider the example of the Sharma family, their annual expense is 3 lakhs and

Mrs Sharma earns 1.2 lakh a year. That leaves a shortfall of 1.8 lakh. Now, because of inflation, this amount will increase every year. Assuming the cost of living increases by 4 per cent a year and their corpus earns 10 per cent a year (post-tax), the effective rate of return is 6 per cent. In order to earn 1.8 lakh at that rate, the Sharmas will need a capital of 30 lakhs. To this, we add their current liabilities and future expenses. That’s what the sharma’s need to cover for. Next, we work out how much of this they can meet by what they have, namely their current assets and existing life cover. The balance is the additional life cover they need to get. Once you have calculated the life cover, get a life insurance product that suits your need. Term plans are the cheapest and most effective. However, they don’t provide any returns, which is not a bad thing. It is advisable not to mix insurance and investment, as such products are not the most efficient. The one exception to this rule is a children’s plan in which the insurer pays the sum assured in case of the insured parents’ death, as well as continues to pay the future premium to ensure the fund accumulation for children’s education continues as planned by the parent. Lastly, assess your insurance need every three years or when there is a change in your family situation for example, marriage, birth of a child, spouse discontinuing career.

**Questions**

1. “The amount of insurance you need depends on your personal circumstances, which comprises of many variables.” What according to you are the most important factors which an individual should consider before deciding the insurance amount?

2. Discuss the importance of considering “inflation” as a crucial factor while deciding the insurance amount.