

DP08

Retail Financial Services

5 APRIL 2006

1. Time allowed : Three (3) hours
2. Total number of questions : Six (6) questions
3. Number of questions to be answered : Five (5) questions
Part A : Three (3) questions [20 marks each]
Part B : Two (2) questions [20 marks each]
4. Show details of workings, where appropriate. Silent, non-programmable calculators may be used.
5. Begin each answer to a new question on a fresh page.
6. Answer **all** questions in **English**.
7. Blank pages are provided at the end of the question paper for rough work.

PART A

ANSWER ALL THREE (3) QUESTIONS

1. (a) John has a housing loan account with a credit limit of RM1million with Bank A. The loan was under progressive release when the following transactions were recorded:

Date	Item	RM
1 November 2005	Balance brought down	900,000 Dr
1 December 2005	Final drawdown of the balance 10%	100,000 Dr
31 December 2005	Balance carried forward	1,000,000 Dr

Assuming that the interest rate charged was 6.0% per annum, calculate the following:

- (i) Interest payable for October 2005, if there was no drawdown during the month [2]
(ii) Interest payable for November 2005 [2]
(iii) Interest payable for December 2005 [2]
- (b) Mariam maintains a personal overdraft account with a credit limit of RM500,000 with Bank B. The following transactions were recorded for the overdraft facility in October 2005:

Date	Item	RM
1 October 2005	Balance brought down	400,000 Dr
15 October 2005	Withdrawal	100,000 Dr
31 October 2005	Balance carried forward	500,000 Dr

Assuming that the interest rate charged was 7.0% per annum, calculate the following:

- (i) Interest payable for October 2005 [2]
(ii) Commitment fee for October 2005, assuming that the commitment fee charged on the unutilised portion of the overdraft facility is 1.0% per annum [2]
- (c) Ali opened a share margin trading account with Bank C and was granted the following terms based on the securities he had pledged:

Market value of securities	RM400,000
Agreed value of financing @ 70%	RM280,000
Margin of finance	2 times
Pre-set line of credit	RM560,000

Ali has used up the pre-set credit limit to the maximum (RM560,000) when the market value of the pledged securities, including those purchased using the approved margin facility, fell sharply to RM200,000 due to a plunge in the stock market.

To maintain the approved financing margin, Bank C gave him two options:

- Option 1 : Top up the shortfall with additional deposits/cash
Option 2 : Pledge additional securities

Assuming that Ali wants to maintain the approved financing margin, calculate the following:

- (i) The amount of cash required to top up the shortfall [2]

- (ii) The amount of additional securities to be pledged [2]
- (d) Apart from quoted shares, name **three** other types of securities that are acceptable to be pledged to a bank for share margin trading. [3]
- (e) State **three** reasons why unquoted shares are normally not accepted as a security to a bank. [3]
(Total:20 marks)

2. (a) Mohan purchased a passenger car costing RM100,000 and was offered the following hire-purchase terms by Bank Canggih:

Margin of finance	90%
Interest rate	2.5% per annum
Repayment period	9 years

Calculate the following:

- (i) Term charges [2]
- (ii) Monthly instalment payment [3]
- (iii) Annual percentage rate (APR), based on the following formula:

$$\text{APR} = \frac{2NF(300C + NF)}{2N^2F + 300C(N + 1)}$$

Where:

N is the total number of instalments

C is the number of instalments that would be paid in one year if instalments continued to be paid at the same intervals

F is the amount, determined as:

$$F = \frac{100C \times T}{N \times A}$$

Where:

T is the total amount of pre-determined term charges

A is the amount financed [2]

- (iv) Interest on overdue instalment for the first month, assuming that the number of days overdue is 10 days. [2]
- (v) Statutory rebate, assuming that Mohan intends to early settle the hire-purchase after paying 50 instalments, based on the following formula:

$$\text{Statutory rebate} = \frac{RP(RP + 1)}{OP(OP + 1)} \times \text{Term charges}$$

Where:

RP is the remaining period

OP is the original period [3]

- (b) In relation to the Hire-Purchase Act 1967, fill in the blanks with the correct number of days for each of the following:
- (i) Under Section 5(1) of the Hire-Purchase Act 1967, an owner must serve on the hirer and the guarantor a copy each of the hire-purchase agreement within ___ days of making the hire-purchase agreement. [1]
- (ii) The Fourth Schedule notice will be issued and served to the hirer after ___ days upon default of two successive instalments. The owner may repossess the vehicle not earlier than ___ days after the notice has expired. [1]
- (iii) An owner must issue a Fifth Schedule notice to the hirer within ___ days after repossession and serve a notice of auction to the hirer not less than ___ days from the auction date. [1]
- (c) State **five** rights of a hirer under the Hire-Purchase Act 1967. [5]
(Total:20 marks)

3. (a) The following are the Income Statement and the Balance Sheet of B-wax Bhd as at 31 December 2005:

BALANCE SHEET AS AT 31 DECEMBER

Item	2005 (RM'000)	2004 (RM'000)
Non-current assets		
Plant and equipment	2,110	1,296
Goodwill on consolidation	8,709	8,709
Investment in a jointly-controlled entity	250	-
	11,069	10,005
Current assets		
Due from contract customers	5,349	2,614
Trade receivables	18,370	7,453
Other receivables	748	514
Due from related parties	33	25
Tax recoverable	-	165
Cash and cash equivalents	10,312	18,511
	34,812	29,282
Current liabilities		
Due to contract customers	10	522
Trade payables	1,139	951
Other payables	2,082	1,252
Due to related parties	0	19
Tax payable	39	19
	3,270	2,763
Net current assets	31,542	26,519
	42,611	36,524
<i>Financed by:</i>		
Share capital	20,693	20,685
Share premium	9,850	9,821
Retained profits	12,071	6,016
Exchange reserve	(3)	2
	42,611	36,524

INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER

Item	2005 (RM'000)	2004 (RM'000)
Revenue	37,325	21,880
Direct expenses	(24,696)	(11,098)
Gross profit	12,629	10,782
General and administrative expenses	(3,351)	(2,534)
Selling and distribution expenses	(1,855)	(1,566)
Other operating expenses	(1,727)	(1,166)
Other operating income	434	153
Profit before taxation	6,130	5,669
Taxation	(75)	(23)
Net profit for the year	6,055	5,646
Earnings per share (sen)		
- Basic	2.93	3.83
- Diluted	2.89	3.76

Calculate the following for the financial year ended 31 December 2005 for B-wax Bhd:

- (i) Current ratio [1]
 - (ii) Gross profit margin [1]
 - (iii) Net profit margin (after taxation) [1]
 - (iv) Working capital [1]
 - (v) Debtors' days [1]
 - (vi) Creditors' days [1]
 - (vii) Gearing ratio [1]
- (b) Character is one of the most important qualitative factors used by banks when evaluating a loan application.
- State **six** common methods that a bank uses to assess a borrower's character. [3]
- (c) The Government established the National SME Development Council to promote the development and growth of Small- and Medium-sized Enterprises (SMEs) but SMEs still face difficulties in getting financing from financial institutions.
- State **five** reasons why financial institutions are hesitant to provide financial assistance to the SMEs. [5]
- (d) The Government and Bank Negara Malaysia support the growth and development of SMEs in Malaysia through funding allocation to special funds and loan schemes, totalling RM8.9billion in 2004.
- List **five** ways financial institutions can help in financing the SMEs. [5]

(Total:20 marks)

PART B

ANSWER TWO (2) QUESTIONS ONLY

4. (a) ABX has a choice of using either a financial lease or an operating lease to finance the purchase of an injection mould. Bersatu Finance is willing to provide the leasing facility based on the following terms:

Equipment cost	RM100,000
Amount financed	100%
Lease period	5 years
Interest rate	<ul style="list-style-type: none">• 5% per annum on residual value• 4% per annum on amount financed less residual value
Residual value at the end of Year 5	RM20,000

Compute the following:

- (i) Monthly lease rental using a financial lease based on a full pay-out lease. [2]
- (ii) Monthly lease rental using an operating lease based on a non-full pay-out lease. [2]
- (iii) Tax write-down value assuming that the initial allowance is 20% and annual allowance is 10% at the end of Year 5. [4]
- (iv) Lessor's effective rate of return (based on a full pay-out lease), using the following formula:

$$\text{Effective rate of return} = \frac{\text{Rate} * 2 * \text{No. of rentals}}{(\text{No. of rentals} + 1)} \quad [2]$$

- (b) List **five** advantages of leasing over hire-purchase from the perspective of a lessee. [5]
- (c) Banks are investing a significant part of their annual budget providing advanced electronic banking services for their customers. [5]

State **two** main disadvantages from the perspective of the customers and **three** main disadvantages from the perspective of the banks arising from the adoption of a technological approach. [5]

(Total:20 marks)

5. (a) Internet banking has seen an explosive growth and banks are increasing the delivery of financial services through Internet-based systems and payment gateways:
- (i) Briefly describe **four** factors that accounted for the surge in the Internet banking transactions in the recent years. [4]
 - (ii) Briefly describe **four** types of risks faced by banks with the introduction of Internet banking. [6]
- (b) The Government established the National Agricultural Policy (NAP3: 1998-2010) with the objective to transform the agricultural sector into a vibrant growth engine. However, the agricultural sector is affected by high risks as many uncontrollable external factors determine its success and output.
- Explain **five** common types of risks encountered by banks in agricultural financing. [10]
(Total:20 marks)
6. (a) The management of working capital is one of the most important aspects of a firm's overall financial management as it involves a trade-off between profitability and risk.
- (i) Define working capital. [2]
 - (ii) Explain why the management of working capital is important to the borrower as well as the bank. [4]
- (b) In managing a firm's financial structure, one of the key decisions is to determine the most appropriate mix of short- and long-term financing as it affects both the firm's profitability and overall liquidity.
- (i) Explain the main difference between the purpose of a short-term financing and a long-term financing. [2]
 - (ii) List **four** examples of short-term debts and **four** examples of long-term debts that a firm may incur. [4]
- (c) (i) State **three** main objectives of a bank in the provision of Automated Teller Machine (ATM) services to its customers. [3]
- (ii) Apart from the cash dispensing function, name **five** other key functions that can be performed at ATMs. [5]
- (Total:20 marks)

- END OF QUESTION PAPER -

OUTLINE ANSWERS

The comments given in the boxes below indicate the areas of weaknesses the examiners have identified and their advice to future candidates.

PART A

Question 1

- Candidates did not understand the operations and mechanics of share margin operations with regard to the maintenance of the security margin.
- Candidates must have good understanding of all the major types of personal loans and their mechanics/operations to obtain good marks. They should be familiar with the computation of interest payable and able to apply them using simple cases.

1. (a) (i) Interest payable (Oct 2005):
= $\frac{\text{RM}900,000 \times 31 \times 6\%}{365}$
= RM4,586.30
- (ii) Interest payable (Nov 2005):
= $\frac{\text{RM}900,000 \times 30 \times \%}{365}$
= RM4,438.36
- (iii) Interest payable (Dec 2005):
= $\text{RM}1,000,000 \times 1/12 \times 6\%$
= RM5,000
- (b) (i) Interest payable (Oct 2005):
= $\frac{\text{RM}400,000 \times 14 \times 7\%}{365} + \frac{\text{RM}500,000 \times 17 \times 7\%}{365}$
= RM1,073.97 + RM1,630.14
= RM2,704.11
- (ii) Commitment fee (Oct 2005):
x2 = $\text{RM}500,000 \times 31/365 \times 7.00\% = \text{RM}2,972.60$
x1 = RM2,704.11
Commitment fee
= $\frac{(\text{RM}2,972.60 - \text{RM}2,704.11) \times 1\%}{7\%}$
= RM38.36
- (c) (i) Amount of cash top-up:
= $\text{RM}560,000 - 70\% * \text{RM}200,000 = \text{RM}420,000$
- (ii) Amount to securities top-up:
= $\text{RM}560,000/70\% - \text{RM}200,000 \times 70\%$
= $\text{RM}800,000 - \text{RM}140,000 = \text{RM}660,000$
- (d) Three types of securities that are acceptable:
- Landed properties
 - Fixed deposits
 - Unit trust

- (e) Three reasons why unquoted shares are unacceptable:
- Difficult to establish value (not traded)
 - Difficult to find buyer (pre-emption rights). Purchasers may set unreasonable terms.
 - Only equitable mortgage possible. Right to transfer of shares restricted by Articles of Association.

Question 2

- Some candidates were uncertain about the correct number of days required under the HP Act that need to be complied by the owner to protect the interest of the hirer.
- Candidates must have a good understanding of the key aspects of his finance requirements under the HP Act apart from the computational aspects. They should understand how HP works and the implications of non-compliance with the requirement of the HP Act.

2. (a) (i) Term charges:
 $= RM100,000 \times 90\% \times 2.5\% \times 9 \text{ years}$
 $= RM20,250$
- (ii) Monthly instalment payment:
 $= \frac{RM120,250}{9 \times 12}$
 $= RM1,113.43$
- (iii) $F = \frac{100 \times 12 \times 20,250}{108 \times 90,000}$
 $F = 2.5$
- APR:
 $= \frac{2 \times 108 \times 2.5 (300 \times 12 + 108 \times 2.5)}{(2 \times 108 \times 108) \times (2.5 + 300 \times 12 \times 109)}$
 $= 4.64\%$
- (iv) Interest on overdue instalment:
 $= \frac{RM1,020.83 \times 8\% \times 10}{365}$
 $= RM2.24$
- (v) Statutory rebate:
 $= \frac{(108 - 50) (58+1) \times RM20,250}{108 (108+1)}$
 $= RM5,886.47$
- (b) (i) 14 days
- (ii) 14 days, 7 days
- (iii) 21 days, 21 days
- (c) Rights and duties of a hirer (any five of the following):
- Information and statement on the hire-purchase account (S.9).
 - Rights to appropriate hire-purchase instalments to different hire-purchase accounts.
 - Consent from owner to remove goods to another place.
 - Give written notice on early completion.
 - Early termination of hire-purchase agreement by returning goods to owner [S.15(1)].
 - Duty to pay rental even if goods are destroyed.

- Duty to inform owner regarding the possession of control of the goods (its whereabouts) S.37(1) and (2).
- Fraudulent sales or disposal of goods S38. Fine \leq RM10k or 3 years imprisonment or both.

Question 3

Candidates must learn the financial ratios as well as the non-quantitative aspects of SME lendings as it is an important examination topic.

3. (a) (i) Current ratio
 = Current assets/Current liabilities
 = RM34,812,000/RM3,270,000 = 10.65
- (ii) Gross profit margin = RM12,629,000/RM37,325,000 = 33.8
- (iii) Net profit margin (after taxation) = RM6,055,000/RM37,325,000 = 16.2
- (iv) Working capital
 = Current assets – Current liabilities
 = RM34,812,000 – RM3,270,000
 = RM31,542,000
- (v) Debtors' days = RM18,370,000/RM37,325,000 * 365 = 180 days
- (vi) Creditors' days = RM1,139,000/RM37,325,000 * 365 = 11 days
- (vii) Gearing ratio = RM3,270,000/RM42,611,000 = 0.077
- (b) Six common methods used to assess a borrower's character:
- Conduct and status of accounts
 - Conduct bank enquiries
 - Suppliers checking for repayment records
 - Credit checking, litigation and bad cheque returns
 - Check the borrower's competitors
 - Interview the borrower.
- (c) Five key factors why financial institutions are hesitant to provide financing to SMEs:
- Inadequate security/limited collateral
 - Inadequate audited accounts/reliable financial/incomplete records
 - Absence of satisfactory business/track records
 - Reluctance by the borrowers to reveal operations/share information to the bankers for credit assessment
 - Difficulties to fulfil requirement by banker particularly on documents requirements.
- (d) Five ways financial institutions can help in financing SMEs:
- Develop innovative financial package to SMEs
 - Develop in depth industry study on targeted industry groups
 - Package SME loans with special funds at lower rate
 - Road shows and seminars
 - Provide advisory services.

PART B

Question 4

- Candidates could not differentiate the different types of leases.
- None of the candidates understood the implications of leasing with regard to tax depreciation and its tax write-down value.
- Candidates must understand the advantages of leasing over other alternative method of financing assets and be able to illustrate its benefits using different formulas.

4. (a) (i) Financial lease based on full pay-out lease:

$$= \frac{\text{RM}100,000 \times (1 + 0.05 \times 5)}{5 \times 12}$$

$$= \text{RM}2,083.33$$
- (ii) Operating lease based on non-full pay-out lease:

$$= \frac{\text{RM}80,000 + (\text{RM}20,000 \times 5\% \times 5) + (\text{RM}20,000 \times 4\% \times 5)}{5 \times 12}$$

$$= \text{RM}1,483.33$$

(iii)

Year	Cost (RM)	Initial allowance (20%) (RM)	Annual allowance (12%) (RM)	Total depreciation (RM)	Tax write-down value (RM)
1	100,000	20,000	12,000	32,000	68,000
2			8,160	8,160	59,840
3			7,181	7,181	52,659
4			6,319	6,319	46,340
5			5,561	5,561	40,779

- (iv) Effective rate of return (lessor):

$$= \frac{5 \times 2 \times (5 \times 12)}{(5 \times 12) + 1}$$

$$= 9.84\%$$
- (b) Five advantages of leasing over hire-purchase:
- 100% financing
 - Preserves credit worthiness – off-balance sheet treatment for leasing
 - Hedges against risk of technological obsolescence
 - Flexible end of term options (renewal possible)
 - Tax efficient – full tax deductibility on lease payment
- (c) Disadvantages:
- From the perspective of customers:*
- Loss of personal contact with bank (impersonal service)
 - Steep learning curve for older customers not at ease with computers
- From the perspective of banks:*
- Extremely high capital outlays/initial investment
 - Commoditising of products and services
 - High strategic risks involved (selecting the wrong technology, timing)

Question 5

- Instead of stating risks encountered by banks in agricultural financing, some candidates stated the factors required for appraising agricultural projects.
- Candidates must have sound understanding of all the key aspects of agricultural finance as it is an important topic for examination purposes.

5. (a) (i) Four factors for the surge in Internet banking:
- Internet availability 24 x 7
 - Low entry for customer. Existing PC with telephone line and subscription to ISP sufficient
 - Ease of use – friendly, virtual, interactive, ease of use
 - Constraints of brick and mortar/physical presence not relevant. Need only a website to operate and establish market presence.
- (ii) Four types of risks faced by banks in Internet banking:
- Transaction risk – security breaches, unauthorised access, disclosure of confidential information, demand on service and reputation of transactions.
 - Legal risk – on cross border transaction due to legality and enforceability of contracts in foreign countries. Legal infrastructure inadequate.
 - Reputation risk – negative publicity/affect customer trust and confidence.
 - Strategic risks – large investment and resources required for Internet banking projects.
- (b) Common types of risks in agricultural financing (any five of the following):
- Pricing risks – seasonally price fluctuation, product substitute, market accessibility, competition, government actions
 - Natural risks – fire, flood, drought, typhoon
 - Technological risks – new production method and technology
 - Key man reliance risks – reliance on one person who is the main business driver.
 - Risks from actions of third party – government actions, land owners, environmental risks.
 - Production risks – pest, disease and weather.

Question 6

- Most candidates were not able to provide good answers to the question on the management of working capital.
- Candidates failed to differentiate the main purpose between short-term and long-term financing for business.
- Candidates must be well-prepared for questions on simple business finance with regards to SME lending as it is one of the priority sectors in bank lending.

6. (a) (i) Working capital = Current assets – Current liabilities
It determines the liquidity position of the business and whether short-term funding is sufficient to short-term liabilities.
- (ii) For the banker, if the working capital is not sufficient, there is an opportunity to extend additional working capital financing to meet short-term needs.
For the borrower, it could mean longer stock holding period and slower stock or business turnover which may affect sales revenue and profitability.
- (b) (i) Short-term financing is for financing current assets while long-term financing are used for financing both long and short-term assets. However, long-term financing are always financed by long-term debts.

(ii) Example of short-term debts (any four of the following):

- Overdraft
- Term loan < 1 year
- Hire-purchase < 1 year
- Leasing < 1 year
- Trade facilities

Example of long-term debts (any four of the following):

- Term loan > 1 year
- Hire-purchase > 1 year
- Leasing > 1 year
- Owner's equity

(c) (i) Three key objectives of ATMs:

- Reduce queues at banking counters
- Move customers to more efficient and lower cost channels
- 24-hour banking facilities

(ii) Any five of the following key functions of ATMs:

- Balance enquiries
- Funds transfer
- Bill payment
- Cash/cheque deposits
- Passbook update
- Product information
- Statement printing