Dr. Babasaheb Ambedkar Open University
(Established by Government of Gujarat)

BBA
SEMESTER - 5
BBASEC506
PERSONAL FINANCE

Message for the Students

Dr. Babasaheb Ambedkar Open (University is the only state Open University, established by the Government of Gujarat by the Act No. 14 of 1994 passed by the Gujarat State Legislature; in the memory of the creator of Indian Constitution and Bharat Ratna Dr. Babasaheb Ambedkar. We Stand at the seventh position in terms of establishment of the Open Universities in the country. The University provides as many as 54 courses including various Certificate, Diploma, UG, PG as well as Doctoral to strengthen Higher Education across the state.

On the occasion of the birth anniversary of Babasaheb Ambedkar, the Gujarat government secured a quiet place with the latest convenience for University, and created a building with all the modern amenities named ‘Jyotirmay’ Parisar. The Board of Management of the University has greatly contributed to the making of the University and will continue to this by all the means.

Education is the perceived capital investment. Education can contribute more to improving the quality of the people. Here I remember the educational philosophy laid down by Shri Swami Vivekananda:

> ***“We want the education by which the character is formed, strength of mind is Increased, the intellect is expand and by which one can stand on one’s own feet”.***

In order to provide students with qualitative, skill and life oriented education at their threshold. Dr. Babaasaheb Ambedkar Open University is dedicated to this very manifestation of education. The university is incessantly working to provide higher education to the wider mass across the state of Gujarat and prepare them to face day to day challenges and lead their lives with all the capacity for the upliftment of the society in general and the nation in particular.

The university following the core motto ‘स्वाध्यायः परमं तपः does believe in offering

enriched curriculum to the student. The university has come up with lucid material for the better understanding of the students in their concerned subject. With this, the university has widened scope for those students who

are not able to continue with their education in regular/conventional mode. In every subject a dedicated term for Self Learning Material comprising of Programme advisory committee members, content writers and content and language reviewers has been formed to cater the needs of the students.

Matching with the pace of the digital world, the university has its own digital platform Omkar-e to provide education through ICT. Very soon, the University going to offer new online Certificate and Diploma programme on various subjects like Yoga, Naturopathy, and Indian Classical Dance etc. would be available as elective also.

With all these efforts, Dr. Babasaheb Ambedkar Open University is in the process of being core centre of Knowledge and Education and we invite you to join hands to this pious *Yajna* and bring the dreams of Dr. Babasaheb Ambedkar of Harmonious Society come true.

Prof. Ami Upadhyay
Vice Chancellor,
Dr. Babasaheb Ambedkar Open University,
Ahmedabad.

Dr. Babasaheb Ambedkar Open University

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BBASEC506

BBA - SEMESTER - 5

Personal Finance

BLOCK-1

BLOCK-2

BBA SEMESTER-5

Personal Finance

BLOCK: 1

Authors' Name: Prof. (Dr.) Manoj Shah, Professor and Director,

Dr. Babasaheb Ambedkar Open University, Ahmedabad.

Review (Subject): Dr. Shankarsinh Shodha, Associate Professor,
Gujarat University, Ahmedabad.

Review (Language): Dr. Ketan Gediya, Associate Professor & Head,
V.M. Patel College of Management Studies, Ganpat University.

Editor's Name: Prof. (Dr.) Manoj Shah,
Professor and Director,
School of Commerce and Management,
Dr. Babasaheb Ambedkar Open University,
Ahmedabad.

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Deputy Registrar,
Dr. Babasaheb Ambedkar Open University,
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Unit : 1
Introduction to Personal Finance

1.1 Introduction

Personal finance is all about managing money in a proper and smart way in daily life. It includes how a person earns money, spends it, saves it, and plans for future needs. Every individual has to deal with money, whether the income is small or large. Good management of money helps in fulfilling daily needs, avoiding financial problems, and living a comfortable life.

Personal finance is important because it helps in making better decisions about money. Without proper planning, a person may spend more than required and face difficulties later. It teaches how to control expenses, save regularly, and use money wisely. It also helps in preparing for emergencies and future responsibilities like education, buying a house, or retirement. In today's fast-changing world, managing money has become more important than ever. Prices of goods and services are increasing, and unexpected expenses can arise at any time.

Personal finance helps a person stay prepared for such situations and avoid financial stress. It also encourages the habit of planning before spending, which leads to better financial stability. Another important aspect of personal finance is that it helps in building a secure future. By saving and investing regularly, a person can grow their money over time and achieve long-term goals. It also creates a sense of confidence and independence, as a person does not have to depend on others for financial support.

Overall, personal finance is not just about handling money, but about creating a balanced and secure life. It helps a person manage present needs while also preparing for the future, leading to a stable and stress-free lifestyle.

1.2 Meaning and Scope of Personal Finance :

Personal finance refers to the way an individual manages his or her money in daily life. It includes all activities related to earning, spending, saving, and planning the use of money. It helps a person to make proper decisions about financial matters so that income is used wisely and future needs are also taken care of. In simple terms, personal finance is about handling money in such a way that a person can live comfortably today and remain financially secure in the future.

❖ **Definition of Personal Finance :**

"Personal finance is the process of planning and managing an individual's financial resources, including income, expenses, savings, investments, and risk, in order to achieve financial goals."

❖ **Scope of Personal Finance :**

1. Income Management: Income management means understanding how much money a person earns and how it is received from different sources such as salary, business, rent, or side income. Proper income management helps in deciding how much money is available for spending, saving, and investing. It also helps in increasing income by finding additional earning opportunities and using skills effectively.
2. Expense and Budgeting: This involves planning and controlling daily expenses. A budget helps a person decide how much money should be spent on different needs like food, travel, bills, and entertainment. It prevents unnecessary spending and helps in saving money. Example: If a person earns ?20,000 per month, they may decide to spend ?10,000 on household needs, ?5,000 on rent, ?3,000 on other expenses, and save ?2,000. This planned approach avoids overspending.
3. Saving: Saving means keeping aside a part of income for future use instead of spending it all. It provides financial safety during emergencies such as medical issues, job loss, or urgent needs. Regular saving also builds a habit of financial discipline. Example: A person saving ?100 daily will have ?3,000 at the end of the month, which can be used in case of sudden expenses.
4. Investment: Investment refers to using saved money in such a way that it grows over time. It includes options like bank deposits, shares, mutual funds, or other financial instruments. Investment helps in increasing wealth and achieving long-term goals. It is important to choose investments carefully by considering risk and return.
5. Risk Management: Life is uncertain, and financial risks can arise at any time. Risk management means protecting oneself from such risks through tools like insurance. It ensures that a person and their family do not face

financial hardship during unexpected situations like accidents, illness, or loss of income. Example: Taking health insurance can help cover hospital expenses instead of paying a large amount suddenly from savings.

6. Debt Management: Debt management involves proper use of borrowed money such as loans or credit cards. While loans can be useful for important needs, excessive borrowing can create financial pressure. Managing debt means borrowing within limits and repaying on time to avoid interest burden and financial stress. Example: Paying credit card bills on time avoids extra interest and keeps finances under control.

7. Future Financial Planning: This includes planning for long-term goals such as buying a house, children's education, marriage, or retirement. It helps a person stay prepared for future responsibilities and ensures a stable life. Proper planning involves setting clear goals, saving regularly, and investing wisely to achieve those goals without financial difficulty.

1.3 Importance of Personal Finance Planning :

1. Proper Control over Income and Expenses: Personal financial planning helps a person understand how much money is coming in and how it is being spent. It creates discipline in spending and avoids wastage of money. This ensures that important needs are fulfilled first before spending on unnecessary things. If a person plans their monthly budget, they will first pay rent and bills before spending on entertainment.

2. Helps in Achieving Financial Goals: Financial planning helps in setting clear short-term and long-term goals like buying a bike, house, or saving for future needs. It provides a clear path to achieve these goals step by step through saving and investment. Example: If someone wants to buy a phone worth ₹20,000, they can plan to save ₹2,000 per month and achieve the goal in 10 months.

3. Encourages Saving Habit: It develops the habit of saving regularly from income. Instead of spending all earnings, a person learns to keep aside a portion for future use. This habit is very useful for financial stability. Saving even a small amount like ₹50 or ₹100 daily can build a good amount over time.

5. Provides Financial Security in Emergencies: Financial planning prepares a person for unexpected situations like illness, accidents, or sudden expenses. By creating an emergency fund and taking insurance, financial stress can be reduced during difficult times. If a person has saved money for emergencies, they do not need to borrow during a medical emergency.

6. Helps in Better Investment Decisions: With proper planning, a person can choose suitable investment options according to their needs and risk level. It helps in growing money over time and building wealth for the future. Instead of keeping all money idle, a person may invest in fixed deposits or other options to earn returns.

7. Avoids Unnecessary Debt: Financial planning helps in managing loans and credit wisely. It prevents overspending and reduces the need to borrow money. If loans are taken, it ensures proper repayment without burden. Example: Planning expenses properly can help avoid using credit cards for unnecessary purchases.

8. Gives Peace of Mind and Confidence: When money is managed properly, a person feels secure and stress-free. Financial planning removes confusion about money matters and builds confidence in handling future responsibilities. It helps in leading a stable and comfortable life.

9. Improves Financial Discipline: Personal financial planning helps a person develop discipline in handling money. It teaches regular habits like budgeting, saving, and avoiding unnecessary expenses. Over time, this discipline becomes a part of daily life and helps in making better financial decisions.

1.4 Financial Goals: Short-term, Medium-term and Long-term :

Financial goals are the targets a person sets to manage money for present and future needs. These goals give direction to income, spending, saving, and investment. Without clear financial goals, money may be spent without planning, and important needs may not be fulfilled on time. When goals are properly defined, it becomes easier to plan and achieve them step by step. Financial goals are generally divided into three types based on time: short-term, medium-term, and long-term. Each type has its own importance and requires a different level of planning, saving, and investment.

❖ **Short-Term Financial Goals :**

Short-term goals are those which a person wants to achieve in a short period, usually within a few months to 1 year. These goals are small, simple, and require less money. They are mostly related to daily life needs or small wishes. For short-term goals, a person usually depends on regular savings rather than investment because the time period is very short. Proper budgeting and control over expenses are very important to achieve these goals easily.

❖ **Examples :**

⇨ Buying a mobile phone

⇨ Purchasing clothes for festivals

⇨ Paying school or college fees

⇨ Planning a short trip

Short-term goals help in developing saving habits and financial discipline. They also give quick satisfaction as they are achieved in a short time.

❖ **Medium-Term Financial Goals**

Medium-term goals are those which are planned for a period of around 1 to 5 years. These goals are bigger than short-term goals and require more money and better planning. In this case, a person needs to save regularly and may also use simple and safe investment options to grow money. These goals are often related to improving lifestyle, career, or personal development. Proper financial planning and patience are required to achieve them.

❖ **Examples :**

⇨ Buying a bike or a car

⇨ Funding higher education or a professional course

⇨ Starting a small business

⇨ Saving for marriage or family needs

Medium-term goals teach the importance of consistency and planning. They help a person understand how to manage money over a longer period.

❖ **Long-Term Financial Goals :**

Long-term goals are those which take more than 5 years to achieve. These goals are very important and usually require a large amount of money. They need strong planning, regular saving, and proper investment over a long period. In long-term goals, investment plays a very important role because saving alone may not be enough. A person must choose suitable investment options to grow money and beat inflation.

❖ **Examples :**

⇨ Buying a house

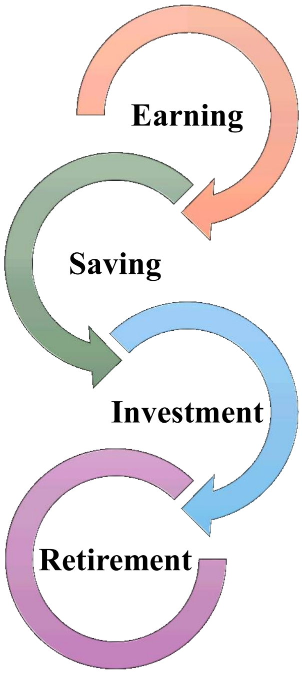
⇨ Planning for retirement

⇨ Children's education and future security

Long-term goals provide financial stability and security for the future. Starting early is very important because it gives more time for money to grow.

1.5 Personal Finance Life Cycle: Earning, Saving, Investing, Retirement :

The personal finance life cycle explains how a person manages money at different stages of life. It shows the journey from earning money to using it wisely for present and future needs. This cycle mainly includes four stages :



earning, saving, investing, and retirement. Each stage is connected with the other, and proper planning in each stage helps in building a secure and comfortable life.

❖ **Earning Stage**

This is the first and most important stage of the financial life cycle. In this stage, a person starts earning money through a job, business, or any other source. It is the foundation of all financial activities because without income, it is not possible to spend, save, or invest.

At this stage, a person should focus on improving skills, gaining experience, and increasing income over time. It is also important to develop good financial habits like budgeting and controlling expenses from the beginning. If money is managed properly from the earning stage, it becomes easier to handle future financial responsibilities.

❖ **Examples :**

A person working in a company earns a monthly salary and uses it for daily needs like rent, food, and travel. If they improve their skills, they may get a higher salary in the future.

❖ **Saving Stage**

After earning, the next important step is saving. In this stage, a person sets aside a part of income for future use. Saving is very important because it provides financial security and helps in handling unexpected situations like medical emergencies or job loss.

At this stage, a person should develop a habit of saving regularly, even if the amount is small. Creating an emergency fund is also important, which can be used during difficult times. Saving also helps in achieving short-term and medium-term goals.

❖ **Example:**

A person saves ?3,000 every month from their salary. Over time, this amount becomes useful for emergencies or planned expenses.

❖ **Investing Stage**

Saving alone is not enough for long-term growth, so the next stage is investing. In this stage, a person uses saved money to earn returns and increase wealth over time. Investment helps in achieving big financial goals and protects money from losing value due to rising prices.

At this stage, a person should choose investment options carefully based on risk, return, and time period. Regular investment and patience are very important for getting good results. The earlier a person starts investing, the more benefits they can get in the future.

❖ **Example :**

A person invests part of their savings in fixed deposits, mutual funds, or other options to earn additional income.

❖ **Retirement Stage**

This is the final stage of the personal finance life cycle. In this stage, a person stops working and does not have a regular source of income. Therefore, the money saved and invested during earlier stages is used to meet daily expenses.

Proper planning during the earning, saving, and investing stages ensures a comfortable and stress-free retirement. A person should plan for retirement from an early stage so that they do not face financial difficulties later in life.

❖ **Example :**

A retired person uses savings, pension, or investment returns to manage their daily living expenses without depending on others.

All these stages are connected like a continuous process. A person earns money, saves a part of it, invests to grow wealth, and finally uses that money during retirement. If any stage is ignored, it may create financial problems in the future.

❖ **Importance of Personal Finance Life Cycle :**

1. Helps in Proper Planning of Money at Every Stage of Life: The life cycle guides a person on how to manage money from earning stage to retirement. It helps in planning income, expenses, savings, and investments at the right time, so that money is used properly throughout life.

2. Ensures Financial Security and Stability: By following the life cycle, a person regularly saves and invests money. This creates a strong financial base and ensures that basic needs and future requirements can be fulfilled without difficulty.

3. Helps in Achieving Both Short-Term and Long-Term Goals: The life cycle helps in balancing present needs and future goals. It allows a person to achieve small goals like buying daily items as well as big goals like buying a house or planning for retirement through proper planning and discipline.

4. Reduces Financial Stress and Uncertainty: When a person follows proper financial planning at each stage, they feel more secure about their future. Savings and investments help in handling emergencies and unexpected situations, which reduces worry and brings peace of mind.

1.6 Role of Financial Discipline :

Financial discipline means using money in a careful and planned way. It helps a person control spending, save regularly, and make better financial decisions. A disciplined approach towards money ensures a stable and stress-free life.

1. Better Control over Spending: Financial discipline helps a person understand the difference between needs and wants. It reduces unnecessary expenses and ensures that money is spent only on important things. This habit prevents wastage and improves financial stability. Example: Instead of buying costly items without thinking, a person plans purchases and avoids overspending.

2. Regular Saving for Future: A disciplined person always saves a part of income before spending. This habit creates a strong financial base and helps in meeting future needs easily. Even small savings done regularly can make a big difference over time.

3. Easy Achievement of Goals: Financial discipline keeps a person focused on their goals. It helps in following a proper plan and avoiding distractions like unnecessary spending. As a result, financial goals can be achieved smoothly and on time. Example: A person saving regularly every month can easily

arrange money for buying a vehicle.

4. Reduced Financial Stress: When money is managed properly, there is less worry about expenses and future needs. Financial discipline brings peace of mind because a person feels prepared for both present and future situations.

5. Protection from Debt Problems: A disciplined approach avoids unnecessary borrowing and helps in managing loans properly. It ensures timely repayment and prevents the burden of heavy interest. Example: A person who spends within their income does not need to depend too much on credit cards or loans.

6. Stronger Financial Future: Financial discipline builds a habit of planning, saving, and investing over time. This leads to financial security and independence. It helps a person live a comfortable life and face challenges with confidence.

1.7 Relationship between Income, Spending, Saving and Investment:

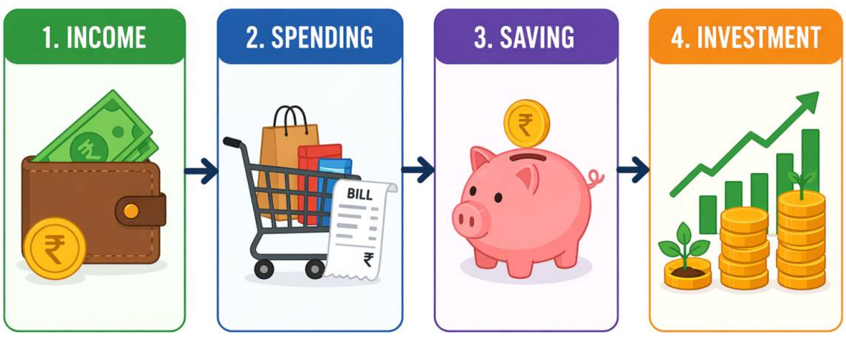
Income, spending, saving, and investment are the four main parts of personal finance. They are not separate; instead, they are closely connected and depend on each other. Together, they form a complete process of managing money. If one part is not handled properly, it directly affects the others. Understanding this relationship helps a person make better financial decisions and maintain a balanced financial life.

1. Income: The Starting Point of All Activities

Income is the money a person earns from a job, business, or other sources. It is the foundation of all financial activities because every decision about spending, saving, and investment depends on income. A higher and stable income makes it easier to manage expenses and save more. However, even with a limited income, proper planning can help in managing money effectively.

❖ **Example :**

If a person earns ₹30,000 per month, all their expenses, savings, and investments will be planned within this amount.



2. **Spending: Use of Income for Daily Needs**

Spending means using income to meet daily needs such as food, rent, bills, education, transport, and other expenses. Spending is necessary, but it should be controlled and planned carefully. If a person spends too much on unnecessary items, there will be very little or no money left for saving and investment. Proper spending means giving priority to needs over wants and avoiding wasteful expenses. Budgeting plays an important role in controlling spending.

❖ **Example :**

If a person spends ₹28,000 out of ₹30,000, only ₹2,000 is left for saving, which may not be enough for future needs.

3. **Saving: The Balance after Spending**

Saving is the portion of income that is not spent. It is the most important step for financial security. Saving helps in handling emergencies, meeting future needs, and achieving short-term goals. A person should always try to save a fixed portion of income regularly. Saving depends on spending habits. If spending is controlled, saving automatically increases. On the other hand, high spending reduces the ability to save.

❖ **Example :**

If a person controls expenses and spends ?20,000 out of ?30,000, they can save ?10,000, which gives better financial security.

4. **Investment: Growth of Savings**

Investment is the use of saved money to earn returns and increase wealth over time. Saving alone is not enough for long-term financial growth because money may lose value due to rising prices. Investment helps money grow and supports long-term goals. A person should choose investment options carefully based on safety, return, and time period. Regular investment helps in building wealth gradually.

❖ **Example :**

If a person invests ?5,000 every month, over time it can grow into a large amount and help in achieving big goals like buying a house.

❖ **Interdependence of All Four Elements**

All four elements are closely connected and influence each other :

⇨ Higher income allows more spending, saving, and investment

⇨ Controlled spending increases saving

⇨ Higher saving leads to better investment opportunities

⇨ Good investments increase wealth and may improve future income

If any one element is not managed properly, the whole financial system gets disturbed. For example, excessive spending reduces saving, and low saving reduces investment.

❖ **Exercise:**

➢ **Answer the following questions in detail.**

1. Explain the meaning, definition and scope of personal finance in simple language.
2. Describe the importance of personal financial planning with suitable examples.
3. Explain financial goals (short-term, medium-term and long-term) with examples.
4. Describe the personal finance life cycle and explain each stage in detail.
5. Explain the role of financial discipline in managing money.
6. Describe the relationship between income, spending, saving and investment in process form.
7. Explain how proper financial planning helps in achieving financial security.

➢ **Write a short note on each of the following :**

1. Importance of saving
2. Budgeting
3. Investment
4. Risk management
5. Financial discipline

❖ **Multiple Choice Questions (MCQs)**

1. Personal finance mainly deals with :

   a) Money management b) Business management

   c) Production d) Marketing

2. Saving means :
   a) Spending money b) Keeping money for future
   c) Borrowing money d) Losing money
3. Which of the following is a short-term goal ?
   a) Retirement planning b) Buying a house
   c) Buying a mobile phone d) Children's education
4. Investment helps in :
   a) Growing money b) Increasing expenses
   c) Reducing income d) Stopping savings
5. Financial discipline means :
   a) Spending more b) Controlling money habits
   c) Avoiding income d) Ignoring planning
6. Which stage comes first in financial life cycle?
   a) Saving b) Investment
   c) Earning d) Retirement
7. Budget helps in :
   a) Increasing expenses b) Avoiding savings
   c) Reducing income d) Controlling expenses
8. Medium-term goals are usually for :
   a) Less than 1 year b) 1 to 5 years
   c) More than 10 years d) Daily needs
9. Insurance is related to :
   a) Saving b) Spending
   c) Risk management d) Investment only
10. Which is the final stage of financial life cycle ?
    a) Saving b) Earning
    c) Investment d) Retirement
11. If spending is high, saving will be :
    a) Low b) High
    c) Same d) Double

12. Personal finance helps in:
    a) Creating confusion
    b) Avoiding income
    c) Increasing debt only
    d) Achieving financial stability
13. Which of the following is the correct order of personal finance process?
    a) Saving ? Income ? Investment ? Spending
    b) Income ? Saving ? Spending ? Investment
    c) Income ? Spending ? Saving ? Investment
    d) Investment ? Saving ? Income ? Spending
14. Saving is important mainly because it :
    a) Increases daily expenses
    b) Helps in future and emergencies
    c) Reduces income
    d) Avoids planning
15. Investment is done to:
    a) Grow money over time
    b) Increase expenses
    c) Keep money idle
    d) Reduce savings

❖ **Answers :**

1. a) Money management
2. b) Keeping money for future
3. c) Buying a mobile phone
4. a) Growing money
5. b) Controlling money habits
6. c) Earning
7. d) Controlling expenses
8. b) 1 to 5 years
9. c) Risk management
10. d) Retirement
11. a) Low
12. d) Achieving financial stability
13. c) Income ? Spending ? Saving ? Investment
14. b) Helps in future and emergencies
15. a) Grow money over time

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Unit : 2
Income Planning and Budgeting

2.1 Introduction

Income planning and budgeting are the foundation of effective personal finance management. Organizing, allocating and monitoring income are essential to ensure the financial needs and goals of Individuals. Income planning and budgeting are vital skills to maintain financial discipline, reduce financial stress and work toward the long-term economic well-being of individuals. In personal finance, this concept helps individuals make informed decisions about spending, saving and investing.

Income planning refers to understanding various sources of income - such as salary, business earnings, or passive income and strategically distributing them to cover essential expenses, discretionary spending, savings and investment.

Budgeting is the process of creating a financial plan that outlines expected income and expenses over a specified period, usually monthly. A well-prepared budget helps individuals to track their cash flow, avoid spending and build financial stability. Additionally, it supports the achievement of short-term and long-term financial goals, such as purchasing assets, funding education, or preparing for retirement.

2.2 Meaning and Sources of Personal Income :

Total earnings received by an individual or household from various sources over a specified period of time are referred to as personal income, which is usually measured monthly or annually. It represents the inflow of money that is available for spending, saving and investing in the context of personal finance. Personal income includes not only salary but also all forms of monetary and non-monetary receipts that contribute to an individual's financial resources. Understanding personal income helps individuals in effective budgeting, financial planning and achieving financial goals.

⇨ According to Irving Fisher, "Personal Income consists of all income received by individuals in the form of money or services."

⇨ According to the Reserve Bank of India, "Personal income includes all earnings and receipts of individuals from productive activities as well as transfer payments within a given period."

⇨ Sources of personal income:

Personal income can be broadly classified into the following categories:

(1) Earned Income :

Money received by an individual through direct effort, work or active involvement in economic activities is referred to as Earned Income. In addition to salaries and wages earned by individuals, it also includes bonuses, commissions and tips. Self-employed individuals earn income through profits from their businesses, while professionals like doctors, lawyers, and freelancers earn their income in the form of fees for their services. Continuous efforts and time investment are essential for this kind of income. It is the most common and primary source of income for most people.

(2) Passive Income :

After initial investment of time, money, or resources, earnings that are generated with minimum ongoing effort are referred to as Passive income. Continuous day-to-day involvement is not required in Passive income. Rent income from property, interest earned from savings accounts or fixed deposits, dividends received from shares and royalties are the common sources of rental income. It plays an important role in personal finance because it diversifies income streams and reduces financial dependence on active work. It enables individuals to build long-term financial stability by providing a steady flow of income even when they are not actively working.

(3) Portfolio Income :

Earnings generated from the investment in financial assets are referred to as Portfolio income. Interest income from bonds or securities and capital gain earned from the sale of stock or mutual funds are included in it. Market performance and investment decisions are the bases of portfolio income. It is associated with long-term wealth creation by making an investment in stock or securities. It also allows individuals to grow their financial resources over time through strategic asset management.

(4) Transfer Income :

Transfer income is related to money received by an individual without providing any goods or services in return. Pensions, scholarships, grants, government benefits, subsidies, gifts and inheritances are included in it. Instead of compensation, it provides support, welfare, or assistance. It plays an important role in personal finance because it helps individuals to meet financial needs, especially during periods such as retirement, education, or financial hardship.

(5) Windfall Income :

Money received unexpectedly or irregularly is included in Windfall income. It is not a planned or consistent source of earnings. Lottery winnings, unexpected bonuses, or insurance claim payouts are included in it. It is not predictable. Thus, it should not be relied upon for regular financial needs. In personal finance, Careful handling and thoughtful decisions are essential for windfall income.

2.3 Types of Income: Active & Passive Income :

In personal finance, understanding types of income is a key part of financial planning and budgeting. As income is the foundation of every budget, it determines how much an individual can spend, save and invest. Income is mainly classified into Active Income and Passive Income.

(1) Active Income :

Money earned through direct effort, time, skills, or physical and mental work is known as active income. It is the most common and primary source of income for individuals. It is the foundation of most people's lives. It ensures daily survival and stability. In active income, a continuously work is essential in order to earn money. Thus, an individual's direct participation and effort are much needed in active income.

❖ **Main types of Active Income :**

(1) Salary

Salary represents a fixed amount paid regularly (usually monthly) by an employer. It is common in full-time jobs such as a teacher, an engineer, or an office worker. In the case of salary, income remains stable regardless of hours worked.

(2) Wages :

In the case of Wages, payment is based on the number of hours worked. It is common in part-time jobs, daily labour or shift-based work. Depending upon hours worked, generally income increases or decreases.

(3) Freelance :

It is earned by completing specific projects or tasks for clients. It is common in fields like graphic design, writing, coding and consulting. It offers flexibility in choosing work, clients and schedule. Income can be irregular and depends on the availability of projects.

(4) Business Income :

Business income is related to the income earned from a business where the owner is actively involved. It requires daily management, decision-making and supervision. For example, the income of shop owners, restaurant operators or small entrepreneurs.

❖ **Characteristics :**

(1) Continuous effort and time commitment are required in Active income.

(2) It is generally stable and predictable, especially in salaried jobs.

(3) A person can only work a fixed number of hours in a day, and has a limited earning capacity.

(4) It is linked to productivity and performance.

(5) It is easier to start compared to passive income, as it does not require large investments.

❖ **Advantages :**

(1) It provides regular and practicable income.

(2) It is easier to start earning.

(3) It provides financial stability.

(4) It helps to build the skills and experience of an individual.

❖ **Limitations :**

(1) It is time-bound, meaning that income stops when a person is not able to work due to illness, retirement, or unemployment.

(2) It may also lead to stress and workload pressure if not balanced properly.

(3) Unless there are job changes, skill upgrades or promotions, active income is frequently slow.

(2) Passive Income: After an initial investment of time, money or skills, money earned with little or no continuous effort is known as Passive income. Instead of depending on daily work, passive income is generated from assets or systems that continue to produce money over time. It enables individuals to earn even when they are not actively working. Thus, it helps individuals to step toward financial independence.

❖ **Main Types of Passive Income :**

(1) Investment Income :

Money earned from financial investment is known as Investment income. The most common sources of passive income include interest from fixed deposits, savings accounts, bonds or returns from mutual funds and stocks.

(2) Dividend Income :

Money received as a share of profits from companies in which individual have invested by buying their shares. When companies earn profits, they distribute dividends to reward their shareholders. Based on the number of shares an individual holds, the individual receives regular dividend payments.

(3) Rental Income :

Rental Income represents money earned by renting out property, such as land, houses, shops, or offices, to tenants. For example, when an individual earns money from monthly rent from a house or shop, it is considered rental income.

(4) Intellectual Income :

Intellectual income is the money earned from original creative work or inventions that are legally protected. It arises when people utilize or buy the rights to an individual's work, such as books, music, or inventions. For Example, book authors earn royalties, musicians earn music royalties and inventors earn patent licensing fees when others use their inventions.

(5) Digital Passive Income :

The money received from online platforms or digital assets that continue to generate revenue over time is known as digital passive income. It requires initial effort, like content creation or website development. For example, income received from YouTube monetization, online courses, blogs with advertisements and an affiliate marketing website.

❖ **Characteristics :**

(1) It requires initial effort, investment or skill.

(2) It does not depend on daily work.

(3) It can grow over time.

(4) Income is not stable; it may vary.

❖ **Advantages :**

(1) When enough passive income sources are built, an individual can cover daily expenses. Thus, individuals move closer to financial independence. It reduces financial stress and increases freedom in life decisions.

(2) Unlike active income, continuous involvement is not required. Passive income keeps generating money even when a person is not working every day.

(3) Even without a proportionate increase in effort, it can grow over time. For example, a popular YouTube channel or Online course can reach more people and make more money without requiring the same level of additional work.

(4) By making investments in assets such as stocks, property, and digital platforms, an individual can create continuous income streams. Over time, these earnings can be reinvested and increase the overall wealth of individuals.

❖ **Limitations :**

(1) For passive income, a significant investment of money, time, or skills is essential in the beginning.

(2) Immediate earnings are not generated in passive income because the investment takes time to grow.

(3) Many passive income streams involve financial risk. For example, the stock market can fluctuate.

(4) To be successful, individuals often need financial literacy or technical knowledge.

(5) It is not a continuous source of income because it is unpredictable or unstable.

2.4 Concept of budgeting :

In personal finance, budgeting is related to the process of planning and managing income and expenses over a specified period. It is usually a monthly. It enables an individual to ensure that their income is used wisely to meet needs, save money and achieve financial goals.

Budget acts like a financial roadmap, which guides an individual about how much they earn, how much they spend and how much they save.

❖ **Objectives of Budgeting :**

(1) Financial Control :

Budgeting enables individuals to control spending habits by setting clear limits for each category of expenses. It helps to identify where money is being spent unnecessarily and encourages disciplined financial behaviour. It makes it easy to track daily, monthly and weekly expenses.

(2) Proper allocation of Income :

It helps to ensure that income is distributed wisely among different financial needs such as necessities, lifestyle expenses and savings. It prioritizes essential expenses such as food, rent and bills and allocates funds for wants like shopping and entertainment. It ensures a fixed portion is set aside for savings and investments.

(3) Achievement of Financial Goals :

Budgeting helps in systematic financial planning to achieve both short-term and long-term goals.

(4) Ensuring a saving habit :

Budgeting encourages individuals to save regularly and consistently. Thus, it creates an emergency fund and supports future financial security.

(5) Avoidance of Debt :

To prevent financial imbalance is one of the key objectives of budgeting. It helps individuals to keep spending within income limits and avoid high-interest debt.

2.5 Importance of budgeting in personal finance :

Budgeting is a fundamental aspect of personal finance that helps to individuals manage their income. The importance of budgeting can be understood through the following points :

(1) Provides Financial Clarity :

It helps to understand the financial situation of an individual by showing total income, expenses and savings. An Individual can know where their money is coming from and where it is being spent. Due to this, it becomes easier to plan finances effectively and avoid confusion or mismanagement of money.

(2) Helps in Controlling Expenses :

Budgeting helps to control the spending of an individual. Individuals can avoid overspending by setting limits for different categories such as food, entertainment, and transportation. It reduces impulsive buying and encourages thoughtful spending, leading to better financial discipline.

(3) Ensures Proper Allocation of Income :

Due to budgeting, the individual ensures that income is distributed properly among essential needs, personal wants and savings. It assists in saving money for leisure activities while prioritizing necessary expenses like food and rent. Not only this, but it also ensures that a portion of income is saved for future use and, maintains a balance in financial management.

(4) Encourages Saving Habit :

By making a fixed part of financial planning, a well-planned budget promotes regular savings for individuals. Budgeting encourages people to save first rather than save what's left over after spending. Due to this habit, it helps in building an emergency fund and securing financial stability over time.

(5) Avoid Debt and Financial Problems :

Budgeting helps individual live within their means. Thus, the need to borrow money is reduced by planning expenses and avoiding overspending. As a result, Individuals can minimize the use of credit cards and loans. This helps in preventing debt and maintaining financial stability.

(6) Improves Financial Discipline :

By encouraging individuals to track their expenses and stick to their plans, budgeting develops financial discipline. It raises awareness of spending patterns and encourages responsible money management.

(7) Prepares for Emergencies :

Budgeting helps in preparation for unforeseen circumstances like medical emergencies or sudden job loss because life is unpredictable. People can manage such circumstances without financial strain by allocating money for savings and emergency funds.

(8) Helps in Monitoring and Evaluation :

By comparing planned expenses with actual spending, budgeting enables individuals to evaluate their financial performance on a regular basis. This makes it easier to identify the areas where money is being saved or overspent. This assessment can be used to make the required changes to enhance financial planning.

2.6 Types of budgets :

Budgeting is an essential part of personal finance. Budgets can be classified based on the relationship between income and expenses. The three main types of budgets are balanced budget, surplus budget and deficit budget.

(1) Balanced Budget :

It refers to the situation where total income is equal to total expenses. There is neither surplus nor deficit in this type of budget. It means that all money earned is used to cover expenses. If a person earns Rs. 40,000 per month and spends exactly Rs. 40,000 on rent, food, transport and other expenses, it is a balanced budget.

❖ **Characteristic :**

(1) Income = Expenses :

Total income is exactly equal to total expenses, which is the most important feature of a balanced budget. It represents that every rupee earned is planned and allocated to different expenses categories such as rent, food, transport and utilities. Thus, no extra money is left at the end of the period. All the financial resources are fully utilized. Thus, it requires careful planning to ensure spending does not exceed income.

(2) No Savings or Extra Funds Left :

Since income equals expenses in a balanced budget, there is no surplus amount available for savings or investment. Thus, all income is spent on current needs and no portion is set aside for future use, nor is an emergency fund is created. It ensures that all immediate needs are met; thus, there is no financial cushion for unexpected situations or future goals.

(3) No Borrowing Required :

As expenses are planned as per income, there is no need to borrow money. Individuals do not rely on loans or credit cards. Thus, there is no interest burden or debt accumulation.

(4) Financial Stability is maintained :

As income and expenses are properly aligned, a balanced budget ensures short-term financial stability. Thus, there is no deficit or shortage of funds and smooth management of daily and monthly expenses. It also reduces the risk of financial problems.

❖ **Advantages :**

(1) There is no need to borrow money or take loans because expenses do not exceed income.

(2) Careful planning and disciplined spending habits are encouraged by a balanced budget.

(3) It ensures that an individual lives within their means and stays out of debt.

(4) It helps individuals in effectively allocating their resources without overspending.

❖ **Limitations :**

(1) There is no extra money left for saving or investing, which affects future financial security.

(2) There are no funds available in the case of unexpected expenses, which can create financial stress.

(3) It becomes very difficult to grow wealth over time without savings or investments.

(4) It ignores future financial goals and only focuses on present needs.

(2) Surplus Budget:

Surplus budget represents the situation where total income is greater than total expenses during a specified period. It means that there is still some amount of money left unspent after spending money on all essential needs (like food, rent and bills) and non-essential wants (like entertainment or shopping). This leftover money is known as surplus. It highlights a positive financial position where an individual is not only able to meet all their expenses comfortably but also has extra funds available.

❖ **Characteristic :**

(1) Income exceeds expenses :

Total income is more than total expenses, which is the main feature of a surplus budget. It indicates that individuals earn more money than they spend within a given period. In a surplus budget, expenses are kept under control and within limits. Thus, there is a positive balance at the end of the budget period.

(2) Extra Funds are available after spending :

A certain amount of money remains unused after covering all essential and non-essential expenses, known as surplus. The surplus or extra money is not wasted; it can be redirected toward productive purposes and it provides flexibility in financial planning.

(3) Promotes saving and investing :

A surplus budget naturally encourages individuals to save and invest regularly. A portion of the surplus can be saved in banks or emergency funds. If it can be invested in assets like stocks, mutual funds, or property, it helps in long-term wealth creation.

(4) No need for borrowing or debt :

There is no need to borrow money since income is sufficient to cover all expenses. It eliminates dependence on loans or credit cards and maintains a debt-free lifestyle.

(5) Reflects strong financial condition :

A surplus budget shows good control over income and expenses. It demonstrates financial discipline and planning.

❖ **Advantages :**

(1) A surplus budget ensures that a portion of income is regularly saved. Thus, it helps build financial security.

(2) A surplus budget also helps to generate more income and grow wealth over time.

(3) It provides a safety cushion for emergencies such as a medical emergency or job loss.

(4) It supports both short-term goals and long-term goals.

(5) Due to surplus budget, anxiety about unexpected expenses is reduced.

❖ **Limitations :**

(1) It requires a strong control over spending habits.

(2) Individuals may sometimes make excessive cuts to required spending.

(3) Money may remain unused and lose value if surplus is not invested properly.

(3) Deficit Budget

A deficit budget represents the financial condition in which an individual's total expenses are greater than their total income over a specified period. It shows that a person is spending more money than they earn, which creates a gap or shortage of funds. Regular income alone is not sufficient to manage this shortage; thus, the individual must rely on external sources to cover the differences.

❖ **Characteristics :**

(1) Expenses are higher than income :

Total expense exceeding total income is the main feature of a deficit budget. This indicates that spending is not aligned with income. It is often caused by poor planning or high living costs.

(2) Shortage of funds occurs :

There is not enough money to cover all financial needs because income is insufficient to meet expenses. In a deficit budget, basic or essential expenses may become difficult to manage. Thus, it creates stress and uncertainty.

(3) Dependence on Loans :

In order to overcome the shortage, individuals often rely on loans from banks or credit cards. Thus, individuals need to borrow money from their friends or family.

(4) Leads to Debt and Financial Obligations :

Regular borrowing results in the accumulation of debt. Loans must be repaid with interest. Thus, it creates a financial burden.

(5) Indicates financial imbalances :

A deficit budget clearly shows a lack of balance between income and expenses. Thus, it reflects poor financial planning or discipline and weakens overall financial difficulties.

❖ **Advantages :**

(1) When borrowing is used for productive purposes such as education, starting a business or skill development, borrowing may be justified, as these can increase future income and improve financial stability.

(2) It allows individuals to meet necessary expenses temporarily.

❖ **Limitations :**

(1) Continuous deficit leads to borrowing, which results in the accumulation of debt.

(2) As borrowing includes interest, it creates financial pressure.

(3) Managing repayments can cause anxiety and instability.

(4) It indicates a lack of financial control and planning.

2.7 Household budget preparation :

Household budget preparation is related to the process of planning, organizing and controlling the income and expenses of a family or household over a specific period, usually a month. Estimating total income of a family and allocating it properly to meet all needs, wants, savings and investments are included in it. It is a financial plan for managing the family's money wisely.

❖ **Steps in Household Budget Preparation :**

(1) Estimating Total Income :

Estimating total income is the first and most important step in household budget preparation. It includes identifying and adding all sources of money that the household receives regularly or occasionally. Income from different sources such as salary, business earnings, rental income and passive income is included. Each of these plays an important role in determining the overall financial capacity of the family. Knowing the exact income helps in planning expenses properly and avoiding overspending.

(2) Listing all expenses :

In this step, all expected household expenses are carefully recorded to understand where money will be spent. Fixed expenses include regular payments like rent, EMI, school fees and variable expenses like groceries, electricity and transport charges, depending on usage and occasional expenses like medical bills, home repairs, or festival celebrations are found out. It helps individuals in planning and spending properly and avoiding unnecessary financial stress.

(3) Categorizing Expenses :

In this step, expenses are divided into needs, wants and savings. Needs include essential expenses like food, housing, utilities; wants include non-essential spending like entertainment, shopping, leisure activities, while savings include the portion of income set aside for future needs and emergencies.

(4) Allocating Income :

The household income is divided among different expense categories in a planned way. Mostly 50% income is allocated to needs, 30% is used for wants and the remaining 20% is reserved for savings and investments.

(5) Setting financial Goals :

In this step, households identify and plan their financial goals for the short term and long term. In long-term goals, buying a house is included, which requires long-term savings and planning, while another important goal is funding children's education or retirement planning to ensure their future security.

(6) Monitoring and Control :

To ensure proper financial management, actual expenses are regularly compared with the budgeted amount. Ensuring that there is no overspending in any category is beneficial. Additionally, it ensures that the planned savings targets are achieved on time.

2.8 Tools for budgeting and expense tracking :

(1) Manual Tools :

(a) Notebook/Diary Method :

In this method, Individuals write down income and expenses manually in a notebook. Income and expenses are recorded daily or monthly in a notebook. This method helps in developing awareness of spending habits. It is suitable for individuals who prefer traditional methods. It does not require technology and is easy to use, but this method can be time-consuming and less accurate for long-term tracking.

(b) Envelope System :

Cash is divided into different envelopes based on expense categories such as food, rent, transport and entertainment. In this method, each envelope has a fixed amount and spending is limited to what is available in each envelope. Once money is finished, no extra spending is allowed in this method. Thus, it controls overspending and encourages discipline in managing cash.

(2) Digital Tools :

(a) Mobile Budgeting Apps :

Mobile budgeting apps are Smartphone applications, such as Money Manager, Wallet and mint are, designed to track income and expenses automatically or manually. Visual tools like charts, graphs, and reports are provided to clearly show spending patterns. It also sends alerts for overspending, making budgeting easy, fast and accurate with real-time updates.

(b) Spreadsheets (Excel/Google Sheets) :

Spreadsheets such as Excel or Google Sheets are widely used digital tools for budgeting and financial planning. According to their income and expenses, users can create a customized budget. Built-in formulas help in automatically calculating totals, savings and balances. This method is flexible, easy to calculate and highly useful for detailed financial analysis and planning.

(3) Banking and Financial Tools :

(a) Online Banking Services :

Online banking services are digital platforms provided by banks to help customers manage their accounts. In real time, they show account balances and spending history. These programs make it simple for customers to keep track of their income and expenses easily.

(b) Credit/Debit Card Statements :

An Individual can monitor their expense trends over a given time period with the use of monthly statements. They offer a detailed record of all purchases and transactions made. Identifying unnecessary expenses and improving budgeting decisions are made possible by this information.

❖ **Answer the following questions in detail :**

(1) What do you mean by income? Explain types of income.

(2) Discuss various types of budgets in detail.

❖ **Write Short Notes on the following :**

(1) Sources of Personal Incomes

(2) Importance of Budgeting in Personal Finance

(3) Concept of Budgeting

(4) Household Budget preparation

(5) Tools for Budgeting and Expense Tracking

❖ **Choose the correct answer from the options given below each of the following statements :**

(1) What is income in personal finance ?

(a) Money received regularly for work or investments

(b) Money spent on goods and services

(c) Only profits from a business

(d) Only salary from the job

(2) From the following, ______ is an example of active income.

(a) Rental Income (b) Salary

(c) Dividends (d) Interest

(3) From the following, _____ is considered passive Income.

(a) Wages (b) Salary

(c) Rental income (d) Overtime pays

(4) What is a budget ?

(a) A plan for managing income and expenses

(b) A record of past expense

(c) A bank statement

(d) A type of Tax

(5) From the following, ______is NOT a benefit of budgeting.

(a) Better control over money

(b) increased unnecessary spending

(c) Reduces financial stress

(d) Helps achieve financial goals

(6) What happens if expenses exceed income ?

(a) Surplus (b) Deficit

(c) profit (d) Investment

(7) From the following, which is the first step in creating a Budget?

(a) Spend Money (b) Invest Money

(c) Borrow Money (d) Track income and expenses

(8) Why is saving important in budgeting ?

(a) To increase expenses

(b) To reduce income

(c) to avoid earning money

(d) To prepare for future needs and emergencies

****

Unit : 3
Saving and Banking

3.1 Introduction

Saving and banking are two basic ideas that help people manage their money in a smart and secure way. In daily life, money comes in through income such as salary, business, or other sources, and it goes out in the form of expenses like food, rent, travel, and entertainment. If all the money is spent without planning, it can create problems in the future. This is where saving becomes important. Saving simply means keeping aside a part of income for future use instead of spending it all at once. It helps in handling emergencies, achieving personal goals, and building financial stability over time.

Banking plays a key role in making saving easy and safe. Instead of keeping money at home, people can deposit their savings in a bank. Banks not only protect money but also help it grow by giving interest. They offer different types of accounts, such as savings accounts for regular deposits and withdrawals, and fixed deposits for earning higher interest over a period of time. With the help of banks, people can also transfer money, pay bills, and access funds whenever needed, making financial life more convenient.

In today's world, banking has become even more simple and accessible due to digital services. People can use mobile apps and internet banking to check balances, transfer money, and make payments anytime and anywhere. This has reduced the need to visit bank branches and has made financial transactions faster and more efficient. Debit cards, ATM services, and online payment systems have become common tools that support day-to-day financial activities.

Saving and banking are closely connected because banks provide a safe place to keep savings and also encourage disciplined financial habits. When people regularly save money in a bank, they develop a habit of planning their expenses and thinking about the future. It also helps in achieving long-term goals like buying a house, starting a business, or funding education. Without proper saving and banking practices, it becomes difficult to manage financial responsibilities effectively.

Understanding saving and banking is essential for making wise financial decisions. These concepts not only help in managing money better but also provide a sense of security and confidence about the future. By developing the habit of saving and using banking services wisely, individuals can create a strong financial foundation and lead a more stable and stress-free life.

3.2 Meaning and Importance of Saving

❖ **Meaning of Saving :**

Saving means keeping aside a part of the money you earn instead of spending all of it immediately. In simple words, it is the habit of setting aside money for future use. People save for many reasons, such as emergencies, future goals, or unexpected expenses. It is not about how much you earn, but how wisely you manage and keep a portion of it safe. Even small amounts saved regularly can grow into a useful fund over time and provide financial support when needed.

❖ **Definition of Saving :**

"Saving is the portion of income that is not spent on current consumption but is kept aside for future use."

❖ **Importance of Saving :**

(1) Helps in Emergency Situations :

Saving acts like a safety net during difficult times such as illness, job loss, or urgent repairs. It reduces stress because you have money available when unexpected situations arise.

(2) Supports Future Goals :

Whether it is buying a house, starting a business, or planning higher education, saving makes it possible to achieve these goals without depending completely on others.

(3) Reduces Dependence on Borrowing :

When you have savings, you do not need to rely on loans or credit for every need. This helps avoid interest payments and debt problems.

(4) Encourages Good Financial Habits :

Saving teaches discipline and better money management. It helps you control unnecessary spending and plan your finances more carefully.

(5) Helps in Wealth Creation :

Savings can be invested to earn returns over time. This allows your money to grow and increases your overall wealth gradually.

(6) Provides Peace of Mind :

Knowing that you have some money saved gives a sense of relief and reduces financial worries, allowing you to focus better on other aspects of life.

3.3 Factors affecting Saving Habits :

Saving habits are not the same for everyone. Some people find it easy to save regularly, while others struggle even if they earn well. This happens because saving depends on many different factors such as income, lifestyle, personal thinking, and economic conditions. A person's priorities, responsibilities, and financial awareness also play an important role in deciding how much they can save. Understanding these factors helps in improving saving habits and making better financial decisions in daily life.

❖ **Level of Income :**

Income is one of the most important factors affecting saving. When a person earns more, it becomes easier to save after meeting basic needs. On the other hand, if income is low, most of the money is spent on daily expenses, leaving very little or no scope for saving.

❖ **Spending Habits :**

The way a person spends money greatly influences saving. People who control unnecessary expenses and avoid impulsive buying are able to save more. In contrast, those who spend freely without planning often struggle to save.

- **Lifestyle Choices :**

  A luxurious lifestyle with high spending on comfort, fashion, and entertainment reduces the ability to save. Simple and balanced living helps in keeping expenses low and increases savings.

- **Family Responsibilities :**

  Family size and responsibilities also affect saving habits. A person supporting a large family or having many dependents may find it difficult to save compared to someone with fewer responsibilities.

- **Financial Awareness :**

  People who understand the importance of saving and have basic financial knowledge are more likely to save regularly. Lack of awareness often leads to poor money management and low savings.

- **Future Goals and Planning :**

  Having clear goals like buying a home, education, or retirement motivates people to save. Without any clear purpose, people may not feel the need to save regularly.

- **Economic Conditions :**

  Factors like inflation, job opportunities, and overall economic stability influence saving. During times of high prices or economic uncertainty, people may find it harder to save.

- **Availability of Banking and Saving Options :**

  Easy access to banks and saving schemes encourages people to save. When financial services are simple and convenient, people are more likely to develop saving habits.

- **Personal Attitude and Discipline :**

  A person's mindset plays a key role. Those who are disciplined and future-oriented usually save more, while careless or short-term thinkers may ignore saving.

- **Social Influence :**

  Friends, family, and society can influence spending and saving behaviour. For example, pressure to maintain a certain lifestyle or follow trends can reduce savings, while a positive environment can encourage better habits.

3.4 Role of Banking in Personal Finance :

Banking plays a very important role in managing money in a safe, organized, and efficient way. It helps individuals handle their daily financial activities like saving, spending, borrowing, and investing without confusion. Instead of keeping cash at home or managing money informally, banks provide a proper system where money can be stored securely and used whenever needed. With the help of banking services, people can plan their finances better, avoid unnecessary risks, and build a stable financial future.

❖ **Safe Keeping of Money :**

Banks provide a secure place to keep money. Instead of the risk of loss or theft at home, money deposited in a bank remains protected and easily accessible whenever required.

❖ **Encourages Saving Habit :**

Bank accounts make it easier to save regularly. When people deposit money in a bank, it creates a habit of setting aside a portion of income, which helps in building financial discipline.

❖ **Easy Payments and Transactions :**

Banking services allow smooth and quick transactions such as transferring money, paying bills, and shopping online. This reduces the need to carry cash and makes daily financial activities more convenient.

❖ **Access to Loans and Credit :**

Banks provide loans and credit facilities for various needs like education, business, or personal use. This helps individuals manage large expenses without facing immediate financial pressure.

❖ **Helps in Financial Planning :**

Banks offer different financial products like savings accounts, fixed deposits, and recurring deposits. These options help individuals plan their finances based on their goals and time period.

❖ **Earns Interest on Savings :**

Money deposited in banks can earn interest over time. This helps savings grow gradually, which supports long-term financial goals.

❖ **Record Keeping and Transparency :**

Banks maintain proper records of all transactions. This helps individuals track their income and expenses easily and manage their budget more effectively.

❖ **Supports Digital and Cashless Economy :**

Modern banking services like mobile banking, internet banking, and digital payments make transactions faster and more efficient. It saves time and provides flexibility in managing money from anywhere.

❖ **Builds Financial Confidence :**

Having access to banking services gives a sense of control over money. It reduces financial stress and helps individuals feel more confident about handling their finances.

❖ **Helps in Investment Opportunities :**

Banks also guide and provide options for investing money in safe and suitable schemes. This helps individuals grow their wealth and secure their future.

3.5 Types of bank accounts :

Banks offer different types of accounts to meet different financial needs. Some accounts are meant for daily use, while others are designed to help in saving and growing money over time. Each account has its own features, benefits, and purpose. Understanding these accounts clearly helps in choosing the right option and managing money in a better and more organized way.

❖ **Saving Account :**

A savings account is the most commonly used account for keeping money safely while earning a small amount of interest. It is mainly designed for individuals who want to save money along with having easy access to it. This account allows deposits and withdrawals as per need, but banks may have certain limits on the number of transactions in a month. It provides facilities like ATM cards, debit cards, mobile banking, and internet banking, which make daily transactions simple and convenient. A savings account also helps in receiving income such as salary, interest, or other payments directly into the bank. It is ideal for managing day-to-day expenses while still maintaining a balance for future use. Overall, it promotes financial discipline by encouraging people to save regularly.

❖ **Current Account :**

A current account is mainly used by business persons, firms, and companies who have to deal with a large number of daily transactions. This account allows unlimited deposits and withdrawals, making it suitable for handling frequent financial activities without restrictions. Unlike a savings account, it usually does not offer any interest on the balance, as its main purpose is smooth and continuous transactions rather than saving. One important feature of a current account is the overdraft facility, which allows the account holder to withdraw more money than what is available in the account, up to a certain limit. This helps in managing short-term financial needs or cash flow issues. It also provides services like cheque payments, fund transfers, and bulk transactions, making it very useful for business operations.

- **Fixed Deposit (FD) :**

  A fixed deposit is a type of account where money is deposited for a fixed period, which can range from a few months to several years. In this account, the money is locked for the chosen time, and in return, the bank offers a higher rate of interest compared to regular savings accounts. It is considered one of the safest investment options because it is not affected by market risks. The interest rate is fixed at the time of deposit, which means the returns are predictable. Although premature withdrawal is allowed in some cases, it may involve a penalty or lower interest. Fixed deposits are suitable for people who want to save money for future needs without taking risks. It is often used for long-term planning and helps in growing savings steadily over time.

- **Recurring Deposit (RD) :**

  A recurring deposit is a type of account that encourages regular saving by allowing a person to deposit a fixed amount every month for a specific period. It is especially useful for those who may not have a large amount to invest at once but want to build savings gradually. The interest rate offered is usually higher than a savings account and is fixed at the time of opening the account. At the end of the maturity period, the total amount deposited along with interest is paid to the account holder. This account promotes financial discipline, as it requires regular monthly contributions. Missing deposits may result in penalties, so it encourages consistency in saving. It is suitable for planning future financial needs in a systematic and organized way.

3.6 Interest Calculation Methods :

When money is deposited in a bank or invested, it earns extra money called interest. This interest is calculated using different methods. The two most common methods are Simple Interest and Compound Interest. Understanding these methods helps in knowing how money grows over time and allows better financial planning.

(A) Simple Interest (SI) :

Simple interest is calculated only on the original amount (called principal). The interest remains the same every year because it is not added back to the principal.

Simple Interest = $\frac{(P \times R \times T)}{100}$

❖ **Where :**

P = Principal (original amount)

R = Rate of interest (per year)

T = Time (in years)

❖ **Calculation :**

Principal (P) = ₹10,000

Rate (R) = 5% per year

Time (T) = 2 years

Simple Interest = (10,000 × 5 × 2) / 100 = ₹1,000

❖ **Total Amount:**

Total = Principal + Interest = 10,000 + 1,000 = ₹11,000

❖ **Explanation :**

In simple interest, the interest for each year remains the same. Here, ₹500 is earned every year (5% of 10,000), so for 2 years, total interest becomes ₹1,000.

(B) Compound Interest (CI) :

Compound interest is calculated on the principal as well as the interest earned in previous periods. This means interest keeps increasing because it is added back to the original amount.

❖ **Amount with Compound Interest** = $P\left(1 + \frac{(R)}{100}\right)$

➢ **Where :**

A = Final Amount

P = Principal

R = Rate of interest

T = Time

➢ **Calculation:**

Principal (P) = ₹10,000

Rate (R) = 5%

Time (T) = 2 years

$A = 10{,}000\ (1 + 5/100)^2$

$A = 10{,}000 \times (1.05)^2$

A = 10,000 × 1.1025 = ₹11,025

- **Compound Interest Earned:**
- **Compound Interest = Amount - Principal**

  = 11,025 - 10,000 = ?1,025

- **Explanation:**

  Year 1: Interest = ₹500 → New amount = ₹10,500

  Year 2: Interest = 5% of ₹10,500 = ₹525

  So, total interest = ₹500 + ₹525 = ₹1,025

3.7 Digital Banking and Modern Banking Servicess for Budgeting and Expense Tracking :

Digital and modern banking have made financial activities faster, easier, and more flexible than ever before. Today, most banking tasks can be done using a mobile phone or computer without visiting a branch. However, to use these services effectively, it is important to understand their key features, benefits, available services, and possible challenges in a clear and practical way.

❖ **Key Features of Digital Banking :**

(1) **24/7 Availability :** Digital banking services are available all the time, even on holidays. This means a person can check their balance, transfer money, or pay bills at any hour without depending on bank working hours. It gives complete freedom and flexibility in managing money.

(2) **Easy Account Access :** Users can access their bank accounts through mobile apps or websites using secure login details. This removes the need to visit a bank branch and makes account handling simple and quick. It also helps in managing finances even while travelling.

(3) **Instant Fund Transfer :** Money can be transferred instantly from one account to another using digital platforms. Whether it is paying a friend or making a business payment, transactions happen within seconds, which is very helpful in urgent situations.

(4) **User-Friendly Interface :** Most banking apps and websites are designed in a simple way so that even people with basic knowledge can use them easily. Clear menus, instructions, and simple steps make the process smooth and less confusing.

(5) **Real-Time Updates :** Every transaction is updated immediately. Users receive instant notifications through SMS or app alerts, which helps in tracking spending, avoiding mistakes, and keeping control over finances.

(6) **High Level of Security :** Digital banking uses security measures like passwords, OTP (One-Time Password), fingerprint, and face recognition to protect accounts. These systems reduce the risk of unauthorized access and make transactions safer when used carefully.

❖ **Advantages of Digital Banking :**

(a) **Saves Time and Effort :** There is no need to stand in queues or travel to the bank. Transactions can be completed in minutes from home or anywhere, which makes banking very convenient.

(b) **Convenience in Daily Life :** People can manage all their financial activities such as bill payments, recharges, shopping, and transfers through one platform. This makes daily life more organized and stress-free.

(c) **Faster Transactions :** Payments and transfers happen quickly compared to traditional banking methods. This is especially useful in emergencies where immediate payment is required.

(d) **Better Financial Control :** Since all transactions are recorded digitally, it becomes easier to track income and expenses. This helps in proper budgeting and better financial planning for the future.

(e) **Reduced Cash Handling :** Digital payments reduce the need to carry cash, which lowers the risk of loss or theft. It also makes transactions cleaner and more secure.

(f) **Environment-Friendly :** Paperless banking reduces the use of paper, which is beneficial for the environment. It also helps in keeping records safely stored in digital form.

(g) **Wide Accessibility :** People in different locations, including remote areas, can access banking services as long as they have internet connectivity. This increases financial inclusion and allows more people to use banking services.

(h) **Easy Record Keeping :** All transactions are automatically recorded and stored in digital form. This makes it easy to check past transactions, download statements, and maintain proper financial records without extra effort.

❖ **Important Modern Banking Services :**

(1) **NEFT, RTGS, and IMPS :** These are electronic fund transfer systems that allow safe and quick transfer of money between bank accounts. NEFT is used for regular transfers, RTGS is used for large-value transactions, and IMPS allows instant transfers at any time.

(2) **UPI Services :** UPI allows instant money transfer using mobile phones with simple IDs. It is widely used for both small and large payments, and it has made digital payments very common in everyday life.

(3) **Mobile and Internet Banking :** These platforms provide full access to banking services like checking balances, transferring funds, and managing accounts online. They make banking possible from home without visiting a branch.

(4) **ATM Services :** ATMs allow cash withdrawal, balance inquiry, and mini statements at any time. They are available in many locations, making access to cash quick and easy.

(5) **Debit and Credit Cards :** These cards are used for making payments both online and offline. Credit cards also provide short-term borrowing, which can be useful during urgent needs.

(6) **Auto Debit and Standing Instructions :** These services automatically pay bills like electricity, insurance, or loan EMI on time. This helps in avoiding late fees and ensures regular payments without manual effort.

(7) **E-Statements and Alerts :** Banks provide digital account statements and instant notifications for every transaction. This improves transparency and helps in keeping track of financial activities easily.

(8) **Online Loan and Investment Services :** Many banks offer loans, fixed deposits, and investment options online. This makes the process faster, easier, and reduces paperwork.

(9) **Contactless Payments :** This service allows payments by simply tapping a card or mobile device on a machine without entering a PIN for small amounts. It makes transactions faster, safer, and more convenient, especially in busy places.

❖ **Challenges of Digital and Modern Banking :**

(a) **Risk of Cyber Fraud :** Online banking can be targeted by hackers or fraudsters. People may receive fake messages, emails, or links that try to steal personal and banking details. If users are not careful, they may lose money. Therefore, it is very important to avoid sharing passwords, OTPs, or clicking on unknown links.

(b) **Dependence on Internet and Technology :** Digital banking requires a stable internet connection and a working device like a smartphone or computer. If there is no internet or the device is not working, banking services cannot be used, which can create problems in urgent situations.

(c) Lack of Digital Knowledge : Some people, especially older individuals or those not familiar with technology, may find it difficult to use digital banking services. This can limit their ability to take full advantage of these modern facilities.

(d) Technical Issues : Sometimes banking apps or servers may not work properly due to maintenance or technical errors. This can delay transactions and create inconvenience for users.

(e) Privacy Concerns : Personal and financial data is stored online, which may create fear about misuse of information. If proper security measures are not followed, there is a risk of data leakage or hacking.

(f) Overdependence on Digital Systems : Relying completely on digital banking can be risky during power cuts, network failures, or system breakdowns. In such situations, people may face difficulty in accessing their money or completing transactions.

❖ **Exercise :**

Answer the following questions in detail.

1. What is saving? Explain its importance in simple words.
2. What factors affect saving habits? Explain in detail.
3. Explain how banks help in managing money in daily life.
4. Describe different types of bank accounts in detail.
5. Explain simple interest and compound interest in detail.
6. What is digital banking? Explain its benefits and problems.

❖ **Write a note on each of the following :**

1. Importance of saving
2. Saving account
3. Fixed deposit
4. UPI and digital payments
5. Important modern banking services
6. Challenges of digital and modern banking

❖ **Choose the correct answer from the options given below each of the following statements :**

(1) **Saving means :**

a) Keeping aside part of income b) Spending all money

c) Borrowing money d) Taking loans

Answer: a) Keeping aside part of income

(2) Saving helps in :

a) Increasing expenses b) Financial security

c) Wasting money d) Reducing income

Answer: b) Financial security

(3) Which account is used for regular use?

a) Fixed deposit b) Recurring deposit

c) Savings account d) Loan account

Answer: c) Savings account

(4) Fixed deposit gives :

a) No safety b) Daily withdrawal

c) High risk d) Higher interest

Answer: d) Higher interest

(5) Recurring deposit is for :

a) One-time saving b) Monthly saving

c) No saving d) Business use

Answer: b) Monthly saving

(6) Compound interest is calculated on :

a) Only principal b) Only rate

c) Principal and interest d) Only time

Answer: c) Principal and interest

(7) UPI is used for :

a) Opening account b) Taking loan

c) Paying tax d) Instant transfer

Answer: d) Instant transfer

(8) One problem of digital banking is :

a) Easy use b) Fast service

c) 24/7 access d) Cyber fraud

Answer: d) Cyber fraud

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Unit : 4
Investment Planning

4.1 Meaning and Objectives of Investment

❖ **Meaning of Investment :**

Investment is not just saving money; it is a planned allocation of funds into assets that can generate income or grow in value over time. The key element of investment is the expectation of future benefits.

❖ **For example: :**

⇨ When you keep money in a savings account, it earns very little interest.

⇨ But when you invest in shares or mutual funds, your money has the potential to grow significantly.

Thus, investment involves three important elements: time, risk, and return. Time refers to the duration for which money is invested, which can be short-term or long-term; generally, longer investment periods provide better opportunities for growth and compounding. Risk means the uncertainty associated with an investment, as there is always a possibility that actual returns may be lower than expected or even result in loss. Different investments carry different levels of risk, such as low risk in bank deposits and high risk in equity shares. Return is the profit or income earned from an investment, which may be in the form of interest, dividends, or capital gains. Therefore, every investment decision requires a proper balance between time, risk, and return to achieve financial goals effectively.

❖ **Objectives of Investment :**

1. Income Generation : Income generation is one of the main objectives of investment. Investors invest their money to earn a regular and stable income in the form of interest, dividends, or rent. This is especially important for people who do not have a regular salary, such as retired individuals. For example, a retired person may invest in bonds or fixed deposits to receive interest regularly, which helps in meeting daily expenses and maintaining a stable lifestyle.

2. Capital Appreciation : Capital appreciation means an increase in the value of an investment over time. Investors aim to grow their invested money by choosing assets that have the potential to increase in price. This objective is usually associated with long-term investments. For example, if a person buys land for ?5 lakh and sells it later for ?10 lakh, the increase in value is known as capital appreciation. It helps in earning profits and increasing overall wealth.

3. Wealth Creation : Wealth creation is a long-term objective of investment. It involves systematic and continuous investment over a period of time to accumulate a large amount of money. Investors use tools like mutual funds, shares, and SIPs to build wealth gradually. For example, investing a fixed amount every month in mutual funds for 15-20 years can result in a substantial corpus due to compounding. This helps in achieving major life goals like buying a house, children's education, or retirement planning.

4. Inflation Protection : Inflation reduces the purchasing power of money over time, meaning that the same amount of money can buy fewer goods and services in the future. One of the key objectives of investment is to

earn returns that are higher than the inflation rate. If the return on investment is lower than inflation, the real value of money decreases. Investments like equity shares and real estate generally provide higher returns and help in protecting wealth from inflation.

5. Financial Security: Investments provide financial security by acting as a safety net during uncertain situations. Life is unpredictable, and emergencies such as medical expenses, accidents, or job loss can arise at any time. Having investments ensures that individuals have sufficient funds to handle such situations without financial stress. It also provides security for future needs like retirement and family responsibilities.

6. Tax Saving: Another important objective of investment is to reduce tax liability. The government provides tax benefits on certain investment options to encourage savings and investments. Investments like Public Provident Fund (PPF), National Savings Certificate (NSC), and Equity Linked Savings Scheme (ELSS) allow deductions under tax laws. This helps investors save money on taxes while also growing their wealth.

7. Retirement Planning: Retirement planning is an important objective of investment, as individuals need financial support after they stop earning a regular income. By investing regularly during their working years, people can build a sufficient fund to maintain their lifestyle after retirement. Long-term investment options like pension schemes, provident funds, and mutual funds are commonly used for this purpose. Proper retirement planning ensures independence and a stress-free life in old age.

8. Liquidity Management: Liquidity refers to the ability to convert investments into cash quickly without significant loss. One objective of investment is to maintain a balance between liquid and non-liquid assets. Investors keep some portion of their money in easily accessible forms like savings accounts or short-term investments to meet urgent financial needs. Proper liquidity management ensures that individuals can handle unexpected expenses without disturbing long-term investments.

9. Achievement of Financial Goals: Investments help individuals achieve specific financial goals in life. These goals may be short-term, medium-term, or long-term, such as buying a car, purchasing a house, funding children's education, or starting a business. By planning and investing systematically, individuals can accumulate the required funds within a specific time period. Thus, investment plays a crucial role in turning financial goals into reality.

4.2 Difference Between Saving and Investment :

Basis	Saving	Investment
Meaning	Saving refers to setting aside a portion of income for future use without taking any significant risk. The main aim is to keep money safe.	Investment refers to using money to purchase financial assets with the objective of earning returns or increasing wealth over time.
Purpose	The primary purpose of saving is safety, liquidity, and meeting short-term needs or emergencies.	The main purpose of investment is wealth creation, capital appreciation, and achieving long-term financial goals.
Time Period	Saving is generally done for short-term needs, such as daily expenses, emergencies, or small purchases.	Investment is usually done for medium to long-term goals like retirement, education, or buying a house.
Risk Level	Saving involves very low or almost no risk, as money is kept in safe places like bank accounts.	Investment involves different levels of risk depending on the type of asset, such as low risk in bonds and high risk in shares.
Return	Returns from savings are low and fixed, such as interest from savings accounts or fixed deposits.	Investments offer higher returns, but they are not always guaranteed and may fluctuate.
Liquidity	Savings are highly liquid, meaning money can be easily accessed at any time without loss.	Investments may have low or moderate liquidity, as some assets cannot be quickly converted into cash without loss.
Growth of Money	Savings do not significantly increase wealth because returns are low and may not beat inflation.	Investments help in growing money over time and can beat inflation, leading to real wealth creation.
Examples	Savings account, cash, fixed deposits. Example: Saving money to buy a phone next year.	Shares, mutual funds, bonds, real estate. Example: Investing in shares for retirement.
Nature	Conservative and safe approach.	Growth-oriented and risk-taking approach.

4.3 Risk and Return Concept :

- **Risk :** Risk refers to the possibility that the actual return from an investment may be different from the expected return, and it may even result in a loss. In simple terms, risk means uncertainty about the future outcome of an investment. Every investment carries some level of risk, depending on the type of asset and market conditions. For example, if an investor buys shares at ₹100 and the price falls to ₹70, the investor incurs a loss of ₹30, which shows that the risk has been realized. Risk can arise due to various factors such as market fluctuations, economic changes, company performance, or unexpected events. Therefore, understanding risk is very important before making any investment decision, as it helps investors choose suitable options based on their risk tolerance.

- **Return :** Return is the profit or income earned from an investment over a period of time. It is the reward that investors receive for taking risk and investing their money. Returns can be in the form of interest (from bonds or deposits), dividends (from shares), or capital gains (increase in value of investment). For example, if an investor buys shares at ₹100 and sells them at ₹150, the profit of ₹50 is considered as return. Higher returns are usually associated with higher risk, while lower returns are linked with safer investments. Therefore, investors aim to maximize returns while managing risk effectively.

- **Relationship Between Risk and Return**

  Risk and return are directly related to each other. Generally, investments that offer higher returns involve higher risk, whereas investments with lower risk provide lower returns. For example, equity shares are high-risk investments but offer the possibility of high returns, while fixed deposits are low-risk investments with stable but lower returns. This relationship is known as the risk-return trade-off, where investors must balance their desire for higher returns with their ability to bear risk. A proper understanding of this concept helps investors make better financial decisions and build a balanced investment portfolio.

4.4 Importance of Risk and Return Concept :

1. Helps in Rational Investment Decision-Making

The concept of risk and return enables investors to make logical and informed decisions rather than emotional or impulsive ones. By understanding how much risk is involved in a particular investment and what return can be expected, investors can compare different investment options and select the most suitable one. It ensures that decisions are based on analysis rather than speculation.

2. **Assists in Balancing Risk and Return (Risk-Return Trade-off)**

   Every investor aims to earn maximum returns with minimum risk. However, higher returns usually come with higher risk. The risk-return concept helps investors find the right balance between these two factors. It prevents them from taking unnecessary risks for unrealistic returns and also from being too conservative, which may limit growth.

3. **Essential for Portfolio Diversification**

   Understanding risk and return is crucial for creating a diversified investment portfolio. Investors can distribute their funds across different asset classes such as equity, debt, gold, and real estate. This reduces the overall risk because poor performance in one investment can be offset by better performance in another, leading to more stable returns.

4. **Helps in Risk Management and Loss Minimization**

   By analysing the level and type of risk involved in investments, investors can take preventive steps to reduce potential losses. For example, they may avoid highly volatile stocks or invest only a small portion in risky assets. This approach helps in protecting capital and ensuring long-term financial stability.

5. **Aligns Investments with Financial Goals**

   Different financial goals require different levels of risk and return. For short-term goals like buying a gadget, low-risk investments are preferred, while long-term goals like retirement can tolerate higher risk for better returns. The concept helps investors match their investment choices with their specific goals and time horizon.

6. **Encourages Long-Term Investment Approach**

   Understanding risk and return motivates investors to adopt a long-term perspective. Short-term market fluctuations may create fear, but knowledge of risk-return relationships helps investors stay invested and benefit from long-term growth and compounding.

7. **Improves Understanding of Market Behaviour**

   The concept helps investors understand how different factors such as economic changes, interest rates, inflation, and market trends affect investment returns. This knowledge allows them to respond wisely during market ups and downs instead of reacting emotionally.

8. Maximizes Efficiency of Investment (Optimal Allocation)

Investors can allocate their funds efficiently by choosing the best combination of assets that provides the highest return for a given level of risk. This is known as optimal portfolio allocation, which helps in maximizing overall returns while controlling risk.

9. Builds Financial Discipline and Awareness

Understanding risk and return makes investors more disciplined and cautious. They become more aware of their financial decisions, avoid unnecessary speculation, and focus on planned and systematic investment strategies.

10. Supports Wealth Creation and Financial Stability

Ultimately, the proper understanding of risk and return leads to better investment planning, which helps in long-term wealth creation and financial stability. It ensures that investors achieve their financial goals while managing uncertainties effectively.

4.5 Types of Risks :

1. Market Risk

Market risk refers to the possibility of loss due to fluctuations in the overall market conditions. The prices of financial assets such as shares, bonds, and mutual funds can change due to factors like economic conditions, political events, inflation, or changes in demand and supply. This type of risk affects almost all investments, especially those in the stock market. For example, during a stock market crash, share prices may fall sharply, leading to losses for investors. Market risk cannot be completely avoided but can be reduced through diversification.

2. Credit Risk

Credit risk arises when the borrower fails to pay interest or repay the principal amount on time. This type of risk is common in fixed-income securities like bonds and debentures, especially corporate bonds. If a company faces financial difficulties or goes bankrupt, it may default on its payments, causing loss to investors. For example, if an investor buys a corporate bond and the company fails to repay, the investor suffers a loss. Therefore, investors should check the credit rating of issuers before investing.

3. Liquidity Risk

Liquidity risk refers to the inability to quickly convert an investment into cash without significant loss in value. Some assets are not easily tradable and may take time to sell. For example, real estate is a highly illiquid investment because selling property may take months or even years. In such situations, investors may be forced to sell at a lower price if they urgently need money. Maintaining a balance between liquid and illiquid assets helps in managing this risk.

4. Inflation Risk

Inflation risk occurs when the returns from an investment are lower than the rate of inflation, resulting in a decrease in the real purchasing power of money. Even if an investment provides a fixed return, rising prices can reduce its actual value. For example, if an investment gives a return of 5% but inflation is 7%, the investor is effectively losing 2% in real terms. This risk is common in fixed-income investments like fixed deposits and bonds. Investments in equities and real estate are often preferred to overcome inflation risk.

5. Interest Rate Risk

Interest rate risk mainly affects fixed-income securities like bonds. It arises due to changes in interest rates in the economy. When interest rates rise, the prices of existing bonds fall because new bonds offer higher returns, making older ones less attractive. Conversely, when interest rates fall, bond prices increase. For example, if an investor holds a bond with a 6% interest rate and market rates rise to 8%, the value of that bond decreases. This risk is important for investors dealing in bonds and debt instruments.

❖ **Risk-Return Relationship**

Investment	**Risk**	**Return**
Savings Account	Very Low	Very Low
Bonds	Low	Moderate
Shares	High	High

4.6 Types of Investments :

A. Equity Shares

Equity shares represent ownership in a company. When an investor buys shares, they become a part-owner of that company and are entitled to a share in its profits. For example, buying shares of a company means owning a small portion of that business. The returns from equity shares come in the form of dividends and capital appreciation when the share price increases. However, equity shares involve a very high level of risk due to market fluctuations, economic changes, and company performance. Despite the risk, they offer the potential for high returns, making them suitable for long-term investors.

B. Bonds and Debentures

Bonds and debentures are fixed-income investment instruments where investors lend money to a company or government for a specific period. In return, they receive regular interest payments and the principal amount at maturity. For example, a government bond may offer 7% annual interest. These investments have features such as fixed income and fixed maturity, making them more stable compared to shares. They are considered less risky and are suitable for conservative or risk-averse investors who prefer steady and predictable returns.

C. Mutual Funds

Mutual funds are investment vehicles where money is collected from multiple investors and managed by professional fund managers. The collected funds are invested in a diversified portfolio of assets such as shares, bonds, and other securities. For example, an investor may invest ?5000 in a mutual fund, and the fund manager allocates it across various investments. Mutual funds are of different types, including equity funds (high risk), debt funds (low risk), and hybrid funds (balanced). They provide diversification, professional management, and are suitable for both beginners and experienced investors.

D. Real Estate

Real estate investment involves purchasing physical property such as land, houses, or commercial buildings. It is considered a tangible asset and is often used for long-term investment purposes. For example, an individual may buy a flat and earn rental income from it. The returns from real estate include regular rental income and capital appreciation as property values increase over time. However, it requires a large initial investment and is less liquid compared to other investment options.

E. Gold and Commodities

Gold and other commodities are traditional forms of investment and are considered safe during times of economic uncertainty. Investors can invest in gold in physical form (jewellery, coins) or digital form such as Gold ETFs and sovereign gold bonds. Gold acts as a hedge against inflation and market volatility. Although it does not provide regular income like interest or dividends, it helps preserve wealth and provides stability to an investment portfolio.

4.7 Investment Avenues in India :

India offers a wide range of investment avenues to suit different types of investors based on their risk tolerance, financial goals, and time horizon. These options range from safe, government-backed schemes to high-risk market-linked investments.

1. **Bank Deposits**

   Bank deposits are one of the safest and most popular investment options in India. These include savings accounts, fixed deposits (FD), and recurring deposits (RD). Investors deposit money with banks and earn a fixed rate of interest over a specific period. For example, a Fixed Deposit provides assured returns and capital safety. These are ideal for conservative investors who prefer low risk and stable income, but returns are generally lower compared to other investments.

2. **Post Office Schemes**

   Post office schemes are government-backed investment options known for their safety and reliability. Popular schemes include Public Provident Fund (PPF), National Savings Certificate (NSC), and Sukanya Samriddhi Yojana. These schemes offer fixed returns, tax benefits, and long-term savings opportunities. For example, PPF has a lock-in period of 15 years and is suitable for long-term wealth creation. These are ideal for risk-averse investors and those looking for tax-saving options.

3. **Stock Market**

   The stock market allows investors to buy and sell shares of companies listed on exchanges. It offers high return potential through capital appreciation and dividends. However, it involves high risk due to price fluctuations and market volatility. Investors need proper knowledge, research, and market understanding to invest successfully. It is suitable for investors with high risk tolerance and a long-term investment horizon.

4. **Mutual Funds**

   Mutual funds pool money from multiple investors and invest in a diversified portfolio of securities such as shares and bonds. They are managed by professional fund managers, making them suitable for beginners. Investors can start with small amounts through Systematic Investment Plans (SIP). Mutual funds offer diversification and flexibility but are subject to market risks. They are suitable for both moderate and long-term investors.

5. **Government Securities**

   Government securities, also known as G-Secs, are issued by the government to raise funds. These include treasury bills and government bonds. They are considered very safe as they are backed by the government, but they offer relatively lower returns. These investments are ideal for conservative investors who prioritize safety over high returns.

6. Insurance Plans

Insurance plans provide financial protection along with investment benefits. Certain plans like Unit Linked Insurance Plans (ULIPs) combine insurance coverage with investment in equity or debt instruments. These plans help in risk coverage and long-term savings. However, they may involve charges and lower returns compared to pure investment options. They are suitable for individuals seeking both protection and investment.

7. Pension Schemes

Pension schemes are designed for long-term retirement planning. One popular example is the National Pension System (NPS), which allows individuals to invest regularly during their working years and receive a pension after retirement. These schemes encourage disciplined savings and provide financial security in old age. They are suitable for long-term investors planning for retirement.

8. Gold Investments

Gold is a traditional and trusted investment option in India. Investors can invest in physical gold (jewellery, coins) or financial instruments like Gold ETFs and sovereign gold bonds. Gold is considered a safe investment during economic uncertainty and acts as a hedge against inflation. It is highly liquid but does not provide regular income.

9. Real Estate

Real estate involves investment in physical property such as land, residential, or commercial buildings. It is a long-term investment that provides returns through rental income and capital appreciation. However, it requires a large initial investment and is less liquid. It is suitable for investors with sufficient capital and a long-term perspective.

4.8 Basics of Portfolio Diversification :

❖ **Meaning :** Portfolio diversification refers to the strategy of spreading investments across different assets to reduce overall risk. Instead of investing all money in a single option, investors allocate funds to multiple investment avenues. This concept is commonly explained by the saying, "Don't put all your eggs in one basket." If one investment performs poorly, others may perform well and balance the loss. Diversification is an essential principle of investment planning for achieving stable and consistent returns.

❖ Why Diversification is Important :

1. Reduces Risk

Diversification helps in minimizing risk by spreading investments across different assets. If one investment suffers a loss, the impact is reduced because other investments may perform better. For example, if stock prices fall, gains from bonds or gold can offset the loss. This reduces the overall risk of the portfolio.

2. Provides Stable Returns

Different types of investments perform differently under various market conditions. While equity may give high returns during economic growth, debt instruments provide stability during uncertain times. By combining different assets, diversification ensures more stable and consistent returns over time.

3. Protects Against Market Changes

Market conditions are constantly changing due to economic, political, and global factors. Diversification protects investors from sudden market fluctuations. For example, when the stock market declines, gold prices often rise, helping to balance the overall portfolio performance.

❖ Types of Diversification

1. Asset Diversification

Asset diversification means investing in different types of assets such as equity, debt, gold, and real estate. Each asset class has different risk and return characteristics. For example, equity offers high returns with high risk, while debt provides stable but lower returns. Combining these assets helps in reducing overall risk and improving portfolio balance.

2. Sector Diversification

Sector diversification involves investing in different industries such as banking, information technology (IT), and pharmaceuticals. This ensures that poor performance in one sector does not significantly affect the entire portfolio. For example, if the banking sector is underperforming, growth in the IT or pharma sector can compensate for losses.

3. Time Diversification

Time diversification refers to investing money at regular intervals over a period of time rather than investing a lump sum at once. This is commonly done through Systematic Investment Plans (SIP) in mutual funds. It helps in reducing the impact of market volatility and averages out the cost of investment.

❖ **Example of a Diversified Portfolio**

Asset Type	Investment Amount
Equity	₹40,000
Bonds	₹30,000
Gold	₹10,000
Real Estate	₹20,000

In this example, the investor has spread funds across multiple assets, reducing risk and ensuring balanced returns.

Advantages such as Lower risk, better stability and Balanced returns

Disadvantages such as May reduce high profits and Requires management.

4.9 Conclusion :

Portfolio diversification is a key strategy in investment planning that helps reduce risk, ensure stable returns, and protect against market fluctuations. A well-diversified portfolio enables investors to achieve their financial goals more effectively and securely.

❖ **Exercise:**

Choose the correct answer from the options given below each of the following statements :

1. **Investment means :**
   A) Spending money for consumption
   B) Putting money to earn future returns
   C) Borrowing money
   D) Saving only in cash

Answer: B

2. **Saving is generally :**
   A) High risk activity
   B) No risk activity
   C) Illegal activity
   D) Only in shares

Answer: B

3. Risk and return are :

A) Independent

B) Unrelated

C) Positively related

D) Always negative

Answer: C

4. Which of the following is an example of equity investment ?

A) Bank deposit

B) Government bond

C) Shares of company

D) Fixed deposit

Answer: C

5. Mutual funds are :

A) Direct investment in gold

B) Pool of money managed by experts

C) Bank loans

D) Insurance plan

Answer : B

❖ **Answer the following questions in details :**

1. Explain the meaning and objectives of investment.
2. Differentiate between saving and investment.
3. Explain the concept of risk and return in investment.
4. Discuss importance of risk and return concept.
5. Explain types of risks in investment.
6. Explain different types of investments.
7. Explain investment avenues in India.

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BBA SEMESTER-5

Personal Finance

BLOCK: 2

Authors' Name: Prof. (Dr.) Manoj Shah, Professor and Director,

Dr. Babasaheb Ambedkar Open University, Ahmedabad.

Review (Subject): Dr. Narayan Baser, Associate Professor,
Pandit Deendayal Energy University, Gandhinagar.

Review (Language): Dr. Ketan Gediya, Associate Professor & Head,
V.M. Patel College of Management Studies, Ganpat University.

Editor's Name: Prof. (Dr.) Manoj Shah,
Professor and Director,
School of Commerce and Management,
Dr. Babasaheb Ambedkar Open University,
Ahmedabad.

Publisher's Name: Dr. Bhavin Trivedi,
Deputy Registrar,
Dr. Babasaheb Ambedkar Open University,
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Gujarat, India.

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Unit : 5
Personal Tax Planning

5.1 Introduction :

Personal Tax Planning is a vital concept in personal finance, as it focuses on managing an individual's income, expenses and investments to minimize tax liability while fully compliant with the law. It is about making smart financial decisions to take advantage of available deductions, exemptions and rebates provided by the government. Personal tax planning helps an individual to structure their finances efficiently in order to reduce tax burden legally. It is a continuous process. Regular review of financial goals, income charges and updates in tax laws is needed for this.

5.2 Meaning of Tax and Tax planning

A compulsory financial charge imposed by the government on individuals and entities to generate revenue for public expenditure is known as a Tax. Revenue collected from this will be utilized to provide essential services such as infrastructure, education, healthcare, defence, and welfare programs. Taxes are mandatory. Generally, it is levied based on income, goods and services, property or transactions.

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❖ **Tax Planning :**

The systematic arrangements of an individual's financial activities to minimize tax liability within the legal framework are known as Tax Planning. Use of available deductions, exemptions, rebates and allowances provided under tax laws is permitted. Rather than evading taxes, reducing the tax burden legally is the Objective of Tax Planning. An Individual can increase their disposable income, improve savings and achieve their financial goals effectively through effective tax planning. As tax planning is a continuous activity, careful evaluation and regular updates of income sources, investment options and applicable tax rules are essential.

5.3 Importance of Tax planning

Through tax planning, individual can manage their income smartly and efficiently while ensuring compliance with legal requirements. By using available deductions, exemptions and benefits under tax laws, individuals can make informed decisions to reduce tax liability. The purpose of tax planning is not related to saving money, but it also contributes to better financial stability, disciplined money management and achievement of long-term financial goals.

(1) Reduction of Tax Liability :

Tax planning is important to reduce the tax liability of an individual. It is mandatory for individual to pay taxes on their income, but the amount payable can differ, which depends on how well one plans their finances. By taking advantage of various provisions such as deductions for investments, insurance premiums, education loans and housing loans, individuals can significantly reduce their taxable income and thereby ultimately it reduces tax liability.

(2) Better Financial Management :

Due to tax planning, individuals tend to organize their income, expenses and investments more systematically and it helps in gaining a clearer understanding of their financial position. As a result, individual can maintain proper financial records, track their spending patterns and make informed decisions. For example, if one tracks his salary, rent, insurance and investments to plan his taxes. Thus, he can understand where his money goes and manage it more efficiently.

(3) Increase in Savings and Investments :

Tax planning is also important to increase savings and investment for the individual. Buying a house, children's education and retirement planning are common purposes for which an individual wants to save money. By tax planning, an individual manages their finances efficiently and is able to allocate money towards these goals. An Individual can align tax-saving investments with long-term objectives and can work towards achieving their goals in a more efficient and timely manner. For example, investing in retirement schemes helps individuals save taxes and build a financial cushion for the future.

(4) Legal Compliance :

As payment of taxes is a legal obligation, failure to do so will result in penalties, fines, or legal actions. Individual enables to understand the rules and regulations related to taxation through proper tax planning. Thus, individual can fulfil their responsibilities accurately and on time. It helps to avoid unnecessary legal complications and reduces the risk of errors while tax filing. As a result, stress could be avoided and the financial security of the individual can increase.

(5) Better Cash Flow Management :

An Individual can spread their tax-saving investments and payments throughout the year with effective tax planning. It leads to smoother cash flow and a reduction in financial stress.

(6) Disciplined financial habits :

Tax planning also promotes disciplined financial habits in individuals. It motivates individuals to plan their finances, make consistent investments and avoid excess spending. It develops habits of consistent savings since many tax-saving instruments need periodic contributions. This discipline results in better financial health and stability. Additionally, it fosters a sense of responsibility for prudent financial management.

(7) Maximizing the benefits of government policies :

In tax planning, by investing money in schemes like Public Provident Fund or National Pension System, individuals save tax while building future security. It encourages savings, insurance, and investment as intended by the government. It helps to align an individual's financial decisions with both tax savings and long-term goals

(8) Risk Management and Financial Security :

Various tax-saving tools, including insurance policies, provide monetary security against unforeseen events such as illness, accidents, or death. An Individual can secure their future and take tax advantages while investing in such instruments. This ensures that they have enough finances to deal with uncertainties.

(9) Overall Financial Awareness :

Due to constant involvement in tax planning, an individual is more aware and up-to-date about the financial concepts, tax laws and investment options, which avoids common financial mistakes and leads to making better financial decisions.

5.4 Types of Taxes :

(1) Direct Taxes :

Direct taxes are taxes paid directly by individuals or organizations/companies to the government. It cannot be shifted to others. Direct Taxes are governed by the Income Tax Act, 1961, but the Income Tax Act, 2025, is the new law replacing the Income Tax Act,1961 from April 2026. Income tax is one of the most important forms of Direct Taxes. By taking advantage of deductions, exemptions and proper financial planning strategies (while ensuring legal compliance), individual can reduce their tax liability.

(2) Indirect Taxes :

These kinds of taxes are collected by intermediaries (such as sellers or service providers) from customers and then paid to the government. The burden of indirect taxes can be shifted from one person to another. Goods and Services

Tax is the main indirect tax in India, which applies to most goods and services. Indirect taxes are paid by individuals while purchasing the product or availing services because it is part of the price. Indirect taxes are generally regressive in nature because they apply equally regardless of income level. Every day's spending and overall cost of living are affected by indirect taxes. Thus, it is very important in personal finance.

5.5 Basics of Income Tax

Income tax is a direct tax charged on the income earned by individuals or entities. In India, it is governed by the Income Tax Act, 1961, which lays down rules for calculation, payment and administration of tax. Now, let us understand basic terminologies related to income tax.

❖ **Income :**

It refers to any money or benefit earned by an individual during a financial year. Various sources of income, such as salary, wages, business profits, rent from property, interest on savings, dividends, and capital gains from the sale of assets, are included in the income. Income may be received in cash or kind. Certain kinds of benefits provided by the employer are also considered in taxable income. Income serves as the basis for budgeting, saving and investment decisions.

❖ **Heads of income :**

Income is divided into five heads, which are as follows :

(1) Income from salary: (wages, pension, gratuity, allowances)

(2) Income from House Property: (rent)

(3) Profits and gains from Business or Profession (income from trade, business, consultancy)

(4) Capital gains (profit from the sale of assets such as shares, Mutual funds, property)

(5) Income from Other Sources (interest amount on savings account or fixed deposits, dividends, or lottery winnings)

❖ **Tax Slabs :**

In India, the tax slab is based on a progressive tax structure, meaning higher income is taxed at higher rates. In order to reflect economic conditions and to ensure fair taxation across income groups, tax slabs are revised by the government from time to time. An Individual can choose between the old tax regime or new tax regime. In the old tax regime, individuals can get the benefit of exemptions and deductions; on the other side new tax regime offers lower tax rates with limited deductions.

- **Old Regime :**

The following is the tax slab for a **Resident individual** who is below 60 years.

Income	Tax Rate
Up to Rs. 2,50,000	Nil
Rs. 2,50,001 to Rs. 5,00,000	5%
Rs. 5,00,001 to Rs. 10,00,000	20%
Above Rs. 10,00,000	30%

The following is the tax slab for **Senior Citizens**, who are between 60 and 80 years

Income	Tax Rate
Up to Rs. 3,00,000	Nil
Rs. 3,00,001 to Rs. 5,00,000	5%
Rs. 5,00,001 to Rs. 10,00,000	20%
Above Rs. 10,00,000	30%

The following is the tax slab for **Super Senior Citizens**, who are above 80 years.

Income	Tax Rate
Up to Rs. 5,00,000	Nil
Rs. 5,00,001 to Rs. 10,00,000	20%
Above Rs. 10,00,000	30%

- **Old Regime :**
- **Health and Education Cess :** An additional 4% tax is levied on the total income tax payable to fund government spending on the health and education sectors.

❖ **Surcharge :** An extra surcharge imposed on an individual whose income exceeds specified high-income limits, increasing the overall tax liability.

➢ **New Regime :**

Under the new tax regime of the Income Tax Act, there is no separate benefit based on age. Thus, the same tax slabs apply to all individuals.

Income	Tax Rate
Up to Rs. 4,00,000	Nil
Rs. 4,00,001 to Rs. 8,00,000	5%
Rs. 8,00,001 to Rs. 12,00,000	10%
Rs. 12,00,001 to Rs. 16,00,000	15%
Rs. 16,00,001 to Rs. 20,00,000	20%
Rs. 20,00,001 to 24,00,000	25%
Above Rs. 24,00,000	30%

⇨ **Health and Education Cess :** 4%

⇨ **Surcharge :** applicable if income > Rs. 50 Lakh

❖ **Previous year and Assessment year :**

➢ **Previous Year :** In simple words, it can be said that the year in which income is earned is known as the Previous Year. For Example, Income earned from 1st April 2025 to 31st March 2026 is the previous year 25-26.

➢ **Assessment Year :** In simple words, it can be said that the year in which income is assessed and taxed is known as the Assessment Year. For example, the income of the Previous year 2025-26 is assessed in the Assessment Year 2026-27.

5.6 Deductions and Exemptions

Deductions and exemptions are important for individuals because they help taxpayers reduce their taxable income and ultimately reduce their tax liability.

❖ **Deduction :** The Amount subtracted from gross total income to arrive at taxable income is known as Deduction.

➢ Under the Income Tax Act, 1961, an individual can claim a wide range of deductions to reduce taxable income. Some common deductions under the Income Tax Act, 1961, are given below:

Section	**Details**
Section 80 C	• Most important deduction: ✓ Public Provident Fund (PPF) ✓ Life insurance Premium (LIC) ✓ Equity Linked Savings Scheme (ELSS) ✓ Tuition Fees ✓ Employee Provident Fund (EPF) • Maximum Deduction: Rs. 1,50,000
Section 80 CCC	• Pension Fund contributions (LIC Pension schemes, etc.) • Preventive health check-ups • Maximum Deduction: Rs. 1,50,000 (Combined with 80C)
Section 80D	• Deduction for Health Insurance Premium • Preventive health check-ups • Available for self, family and parents • Maximum Deduction: Rs. 25,000 (Self and Family) Rs. 25,000 / Rs. 50,000 (parents depending on age)
Section 80DD	• Medical care for disabled dependents • Maximum Deduction: Rs. 75,000 / Rs. 1,25,000
Section 80DDB	• Treatment of specified critical diseases • Maximum Deduction: Rs. 40,000 (non-senior)
Section 80 E	• Deduction on interest for higher education loans • No upper limits • Available for 8 years
Section 80 G	• Deduction for donations to charitable institutions • 50% or 100% deductions (with/without limit)
Section 80TTA/TTB	• Savings account interest • Rs. 10,000 (non-senior citizens) • Senior citizens (80TTB); • Rs. 50,000
Section 80U	• Fixed Deductions for disability (self-dependent)

- Under the old regime, various deductions are allowed, whereas the new regime offers lower tax rates but allows very limited or no deductions.
- Under the Income Tax Act, 2025, most of these deductions are removed or highly restricted, with only a few allowances like the standard deduction and limited employer contributions.

❖ **Exemptions :** There are certain incomes that are fully or partially excluded from tax. These incomes are not considered to calculate the total taxable income.

- The list of exemptions under the Old Tax Regime (Income Tax Act, 1961) is as follows. These are incomes that are fully or partially not taxable.

(A) Salary Related Exemptions :

1. House Rent Allowance (HRA) - Exemption on rent paid based on salary, rent and city rules.
2. Leave Travel Allowance (LTA) - Exemption on travel expenses within India (2 journeys in 4 years)
3. Standard Deduction- Rs. 50,000 for salaried individuals and pensioners.
4. Gratuity - Fully or partially exempt depending on employee type and limits
5. Leave Encashment - Exemption on encashed unused leaves (limits apply for private employees)
6. Transport Allowances - Exemption mainly for different-abled employees
7. Children Education Allowance - Small fixed exemption per child (subject to conditions)
8. Hostel Expenditure Allowance- For children living in a hostel (subject to limit)

(B) Income-Specific Exemptions :

1. Agricultural Income - fully exempt from tax
2. Scholarships for education - fully exempt
3. Interest on PPF - fully exempt

4. Interest on certain government provident funds - Exempt subject to conditions

5. Income from life insurance maturity proceeds - Exempt if conditions are satisfied

(C) Other Exemptions :

1. Capital Gains exemptions - exemptions on reinvestment in property or bonds

2. Foreign allowance - Exempt in specific cases

3. Special allowances for official duties - (Uniform allowance, travel allowance, etc. - only to the extent used)

❖ The list of exemptions available under the New Tax Regime (Income Tax Act, 1961) is as follows:

(A) Salary Related Exemptions :

1. Standard Deduction- Rs. 50,000 for salaried individuals and pensioners

2. Employer Contribution to NPS - Exempt in employer's contribution (within prescribed limits)

3. Gratuity - Fully or partially exempt as per rules and limits

4. Leave Encashment - Exempt as per applicable limits (retirement cases)

5. Commuted Pension - Exemption for certain pension withdrawals

(B) Income-Specific Exemptions :

1. Agricultural Income - fully exempt from tax

2. Scholarships for education - fully exempt

3. Life Insurance maturity proceeds - Exempt if conditions are satisfied (premium limit rules apply)

4. Gifts - certain gifts from relatives or, on occasion, remain exempt

(C) Other Limited Exemption :

1. Retirement benefits - allowed as per existing rules under section 10

❖ **Exemptions: Old Vs New Tax Regime**

Category	Old Tax Regime	New Tax Regime
Standard Deduction	₹ 50,000 (allowed)	₹ 50,000 (allowed)
House Rent Allowance (HRA)	Allowed (partial/fully exempt)	Not Allowed
Leave Travel Allowance (LTA)	Allowed	Not Allowed
Gratuity	Exempt (as per limit)	Exempt (same rules)
Leave Encashment	Exempt (as per limit)	Exempt (same rules)
Transport Allowance (specific cases)	Partially exempt (disabled employees etc.)	Not generally available
Agricultural Income	Fully Exempt	Fully exempt
Scholarships for education	Fully Exempt	Fully exempt
Allowances for official duties	Partially exempt	Not available

5.9 Tax Saving Instruments

Tax savings instruments are financial tools allowed under the Income Tax Act,1961, that help taxpayers reduce taxable income legally. The following are the most effective tax savings instruments under the Old Tax Regime, where exemptions and deductions are widely available.

(1) Instruments under section 80C (Maximum deduction: Rs. 1.5 Lakh)

A) Public Provident Fund (PPF)

One of the most popular tax-saving instruments is the Public Provident Fund (PPF) under section 80C of the Income Tax Act,1961. It is a government-backed savings scheme designed to encourage long-term investment with lower risk. The scheme has a lock-in period of 15 years. Thus, it is suitable for long-term financial goals such as retirement planning. Individuals can invest a minimum of Rs. 500 and up to Rs. 1,50,000 annually, which also qualifies for deduction under section 80C. PPF is considered ideal for risk-averse investors seeking secure wealth accumulation because of its safety, tax efficiency and disciplined long-term nature.

B) Employee's Provident Fund (EPF)

EPF is a government-backed retirement savings scheme that is mandatory for salaried employees working in the organized sector. Under this scheme, both the employee and the employer contribute a fixed percentage of the employee's salary to the fund each month. It ensures disciplined and regular savings over the course of employment. It is a low-risk investment option because the EPF interest rate is set by the government and is generally stable.

C) Equity Linked Savings Scheme (ELSS)

ELSS is a type of mutual fund that primarily invests in equities and offers tax benefits under section 80C, allowing deductions of up to Rs. 1.5 Lakh per year. Among tax-saving mechanisms in India, it has the shortest mandatory lock-in period of three years. ELSS funds have the potential to yield higher returns than traditional options, but they also carry considerable risk due to their market-linked nature. In addition to this, ELSS investments are relatively tax-efficient because long-term capital gains exceeding Rs. 1 Lakh are subject to a 10% tax.

D) Life Insurance Premiums (LIC) :

Up to Rs. 1,50,000 per year deduction is available for life insurance paid for qualified policies under section 80C. It offers both financial protection and tax savings. To be eligible for these tax benefits, the policy must, however, satisfy certain conditions (such as a minimum premium-to-sum assured ratio).

E) National Savings Certificate (NSC) :

A government-backed fixed income instrument, the National Savings Certificate (NSC), is tax -deductible up to Rs. 1.5 lakh annually under section 80C. It is suitable for conservative investors because it provides low risk and assured returns. Although the interest is taxable, it can be reinvested and is deductible in the initial years.

F) 5-Year Tax Saver Fixed Deposit :

Banks offer Tax Saver Fixed Deposits, which are eligible for section 80C tax benefits and have a five-year lock-in term. It is a secure investment choice because it offers both fixed and guaranteed returns. However, the interest earned is taxable based on the investor's income slab.

(G) Sukanya Samriddhi Yojana (SSY)

The Sukanya Samriddhi Yojana is a government scheme that benefits girls and is qualified for a section 80C tax deduction. It has a fully tax-free maturity and one of the highest interest rates among small savings schemes. The account supports long-term financial planning for education and marriage and can be opened by parents or guardians.

(2) Section 80C + 80EE/80EEA (Home Loan Benefits)

In India, Home loan advantages include a number of tax deductions that reduce overall taxable income. Up to Rs. 1,50,000, the principal repayment of a home loan is eligible for deduction under section 80C. Under section 24(b), the interest paid on the loan is separately deductible; the maximum benefit for self-occupied property is Rs. 2,00,000. Depending on the eligibility condition, first-time homebuyers can also be eligible for additional deductions under section 80EE or 80EEA.

(3) Section 80D (Health Insurance)

Under section 80D, a tax deduction is allowed on premiums paid for health insurance covering self, family and parents. Depending upon the age of insured persons, the deduction limit ranges from Rs. 25,000 to Rs. 1,00,000. This encourages people to maintain health coverage while reducing the financial burden of medical care.

(4) Section 80E (Education Loan)

Section 80E provides tax benefits on the interest paid for higher education loans taken for self, spouse, children, or a student for whom the individual is a legal guardian. The amount of interest that can be deducted has no upper limit. The benefit is offered for a maximum of eight years, or until the interest is paid in full, whichever is earlier.

(5) Section 80TTB/80TTA (interest income)

Individuals (except for senior citizens) may deduct up to Rs. 10,000 from interest received from Savings Bank Accounts under section 80TTA. Section 80TTB provides a higher deduction of up to Rs. 50,000 exclusively for senior citizens on interest earned from fixed deposits, savings accounts and recurring deposits. By providing relief on interest income from bank deposits, these provisions aid in lowering taxable income.

(6) Section 24(b) – Home Loan Interest :

Under this section, a deduction of up to Rs. 2,00,000 lakh per year on interest paid on a home loan for a self-occupied house. By allowing borrowers to claim interest as a deduction, it helps reduce taxable income. Thus, this benefit makes home ownership more affordable by reducing the overall tax burden.

5.10 Role of Tax Planning in Wealth Creation

An individual's ability to accumulate and grow wealth over time is strongly affected by Tax planning, which is a vital component of personal finance. It mainly involves analysing one's financial situation and minimizing the tax liability by making use of legal provisions under the Income Tax Act, 1961. Through effective tax planning, individuals can make use of legal provisions to ensure that no extra tax is paid beyond what is required.

(1) Minimizing Disposable Income :

To increase disposable income is one of the primary roles of tax planning. Disposable income means income remaining after payment of taxes. By effective tax planning, an individual can reduce taxable income by claiming various deductions such as section 80C, section 80D, Section 80G, etc. and exemptions. An individual can save their additional income for future needs or invest in financial institutions.

(2) Encouraging Systematic Investment :

In order to get a tax benefit, an individual is motivated to invest their funds in specific financial instruments that offer tax benefits. Many people are motivated to invest their funds in Government-approved schemes that provide deductions. Thus, people tend to develop a habit of disciplined investing. For example, investing money in Public Provident Fund (PPF), Equity Linked Savings Schemes (ELSS), National Pension System (NPS), Life Insurance Policies, etc. Investing money in this kind of investments serve dual purpose, i.e., reduces tax liability and generates returns over time. This creates a structured approach to building wealth rather than relying on random or impulsive investments.

(3) Harnessing the Power of Compounding :

Harnessing the power of compounding is related not only to earning returns on your original investments, but it also includes returns already generated over time. Due to the compounding factor, when an individual saves money and this money is invested on a regular basis, the investor's invested money grows exponentially. Tax planning supports compounding by allowing more money to be invested initially and encourages long-term investments. Compounding is a significant technique for long-term financial growth and wealth creation since it works best with consistent and early investing. If the time period of investment is longer, the growth of investment is greater, as returns keep adding to the principal. For example, investing money in PPF or mutual funds over the years can significantly increase the wealth of an individual.

(4) Providing Financial Security :

Ensuring protection against unexpected risks and maintaining stability for the future are the key components of financial security. Generally, in tax planning, investments are made that provide risk coverage and financial protection. Such as Life insurance, Health Insurance, and Pension Schemes. In addition to the tax benefits, these instruments also safeguard individuals and their families from financial difficulties caused by illness, accidents, or loss of income. Life insurance supports dependents, while Health insurance reduces medical expenses. After working years, retirement plans ensure a steady income. Thus, tax planning helps to ensure peace of mind along with long-term wealth creation.

(5) Legal Compliance and Risk Reduction :

Legal Compliance and risk reduction refer to correctly adhering to tax laws with a view to avoiding penalties and monetary losses. By accurately reporting income, claiming valid deductions, and filing returns on time, effective tax planning ensures that individuals adhere to the rules of the Income Tax Act, 1961. This helps to avoid legal charges, penalties and interest charges. Additionally, it lowers the chances of risk of scrutiny or audits by tax authorities. The Taxpayer may ensure smooth financial transactions by keeping accurate records and being transparent. Thus, legal compliance helps individual to protects individuals from risks along with steady and secure wealth creation over time.

(6) Adapting to changing Tax Policies :

Adapting to changing tax policies refers to the adjustment in the financial and investment decisions in response to updates in tax laws and rules under the Income Tax Act, 1961. An effective tax planning ensures that individuals stay updated and adapt to changes in tax laws and policies. For example, choosing between old and new regimes or shifting investments based on revised benefits requires flexibility. An Individual can minimize tax liability and maximize returns by adapting to these changes. This ensures that financial planning continues to be effective, legal and compliant, ultimately supporting consistent wealth creation.

(7) Supporting Asset Creation :

Use of tax planning to build a long-term asset is referred to as supporting asset creation. The Income Tax Act, 1961 consist of various provisions that encourage individuals to invest in assets by offering tax benefits. Investment in mutual funds, NPS and PPF helps build financial assets while home loans provide deductions on principal and interest that promote real estate ownership. These kinds of incentives are helpful to motivate and convert the savings of individuals into productive investments.

(8) Promoting Financial Discipline :

In tax planning, by following provisions of the Income Tax Act, 1961, individuals plan their income, track expenses and invest regularly to claim deductions and exemptions. This necessitates maintaining records and making timely investments. As a result, people-built habits like budgeting, saving and long-term investing and it improves financial stability and support steady wealth creation while ensuring compliance with tax laws.

(9) Enhancing Overall Financial Efficiency :

Tax planning improves overall financial efficiency by ensuring that income is optimally utilized, investments are strategically selected and the tax burden is minimized. This leads to higher net returns, better financial stability and faster achievement of financial independence.

❖ **Choose the correct answer from the options given below each of the following statements :**

(1) Tax Planning primarily aims at ______.

(a) Avoiding tax illegally

(b) Reducing Tax liability within the legal framework

(c) Eliminating all taxes

(d) Increasing Tax rates

(2) Tax is best defined as which of the following ?

(a) Voluntary Payment to Government

(b) Compulsory Payment to the Government for public services

(c) Loan to Government

(d) Donation to Government

(3) Tax planning means ______.

(a) Hiding income

(b) Not paying Taxes

(c) Structuring income and investments to reduce tax legally

(d) delaying audits

(4) One of the major benefits of tax planning is _____.

(a) increased tax burden

(b) reduced disposable income

(c) Higher savings and investments

(d) Legal penalties

(5) How does tax planning improve financial efficiency ?

(a) Increasing expenses (b) Reducing net returns

(c) Maximizing after-tax income (d) Blocking investments

(6) Taxes are broadly classified into _____.

(a) Direct and Indirect (b) Fixed and Variable

(c) Income and Savings (d) Local and Global

(7) A direct tax is _____.

(a) paid directly by the person on whom it is imposed

(b) paid by one person and borne by another

(c) Shifted to customers

(d) Optional tax

(8) From the following, _____ is an example of direct tax.

(a) GST (b) Custom duty

(c) Sales tax (d) Income tax

(9) Indirect tax is ______.

(a) only for business

(b) Refundable always

(c) paid by consumers through goods and services

(d) paid directly to the government by the income earner

(10) From the following, __________ is an example of Indirect Tax

(a) Income tax (b) Wealth tax

(c) GST (d) None of the above

(11) Income tax is levied on which of the following?

(a) Savings only

(b) Only Salary

(c) only business profit

(d) Total income of a person or entity

(12) From the following, which is a basic principle of income tax?

(a) higher income = lower tax

(b) Higher income = Higher Tax liability

(c) equal tax for all

(d) No tax on income

(13) A deduction in income tax is related to _____.

(a) Added to income

(b) Reduction from taxable income

(c) Extra tax charged

(d) Penalty on income

(14) Exemption refers to _____.

(a) Income included fully in tax

(b) tax penalty

(c) Loan Waiver

(d) income not included in taxable income

(15) From the following, ____ is a common tax savings instrument.

(a) Lottery tickets (b) Cash holdings

(c) ELSS mutual funds (d) Luxury Spending

(16) Tax savings investments mainly aim to _____.

(a) Reduce taxable income and build wealth

(b) Avoid reporting income

(c) Increase expenses

(d) Increase tax liability

(17) One of the key benefits of tax planning in wealth creation is ______.

(a) Lower compounding potential

(b) improved compounding through tax efficiency

(c) reduced income

(d) Higher tax burden

❖ **Briefly Answer the following questions :**

(1) What is Tax ?

(2) What is income ?

(3) What is tax planning?

(4) What do you mean by Direct tax ?

(5) What is indirect tax ?

(6) Give an example of a Direct Tax.

(7) What is the previous year ?

(8) What is the Assessment year ?

(10) What is the maximum limit for deduction under section 80C ?

(11) What is Section 80D of the Income Tax Act ?

(12) What is deduction ?

(13) What is an exemption ?

(14) Give two examples of an exemption.

❖ **Write Short Notes :**

(1) Tax and Tax Planning

(2) Types of Taxes

(3) Deductions and Exemptions

❖ **Answer the following question in detail.**

(1) What is Tax Planning? Explain in detail the importance of Tax Planning.

(2) Discuss the role of Tax Planning in wealth creation.

(3) Discuss various tax savings instruments.

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Unit : 6
Insurance and Risk Management

6.1 Meaning of Risk :

Risk: Risk refers to the possibility of financial loss or uncertainty that arises due to unexpected events in the future. It is an inherent part of human life because the future is always uncertain and unpredictable. In the context of personal finance, risk mainly relates to the chance of losing money, income, or valuable assets. Individuals face different types of risks in their daily lives, such as accidents, illnesses, death, and natural disasters, which can significantly affect their financial stability.

Risk is closely associated with uncertainty, as it is impossible to predict future events with complete accuracy. Even with careful planning, unexpected situations may occur, leading to financial losses. For example, a person who is financially stable today may suddenly face a medical emergency that requires huge expenses. Therefore, risk creates a situation where the actual outcome may differ from what is expected, often resulting in negative consequences.

Another important aspect of risk is that it involves the possibility of loss. This loss may be financial, physical, or related to property. For instance, an accident may result in injury and medical costs, while a fire or flood may damage property and assets. These losses can disturb an individual's financial planning and reduce savings accumulated over time. Thus, understanding risk is essential for making informed financial decisions.

Risk is also unavoidable in nature. No individual can completely eliminate risk from life, as it arises from both controllable and uncontrollable factors. While some risks can be reduced through precautions, others, such as natural disasters, are beyond human control. Hence, instead of avoiding risk completely, individuals should focus on managing it effectively.

6.2 Meaning of Risk Management

Risk management is the process of identifying, analysing, and controlling risks in order to minimize their negative impact. It is a systematic approach that helps individuals and organizations deal with uncertainties in a planned manner. The main objective of risk management is to reduce financial losses and ensure stability in life by preparing for unexpected situations.

The process of risk management begins with the identification of risks. Individuals need to recognize various risks they may face, such as health risks, life risks, or property-related risks. Once risks are identified, the next step is to assess their impact by evaluating the likelihood of occurrence and the potential financial loss. This helps in prioritizing risks and focusing on the most serious ones.

After assessing the risks, appropriate methods are selected to handle them. These methods include avoiding risky activities, reducing the impact through preventive measures, transferring the risk to another party (such as insurance), or accepting the risk if it is minor. Among these methods, insurance is one of the most effective tools, as it provides financial protection against major losses.

Finally, risk management involves implementing the chosen strategies and regularly reviewing them. Since life situations and financial conditions change over time, it is important to update risk management plans accordingly. Proper risk management not only reduces financial uncertainty but also provides peace of mind and ensures long-term financial security for individuals and their families.

6.3 Steps in Risk Management :

1. Identification of Risks

The first step in risk management is to identify all possible risks that an individual may face in life. This involves carefully analysing personal, financial, and environmental situations to recognize potential threats. Risks can be related to health, life, property, income, or investments. Proper identification is very important because unidentified risks cannot be managed. For example, a person should identify risks such as illness, accidents, job loss, or damage to property. This step helps in creating awareness about possible future uncertainties.

2. Measurement (Assessment) of Risks

After identifying risks, the next step is to measure or assess them. This involves evaluating the likelihood of the risk occurring and the extent of financial loss it may cause. Some risks may have a high probability but low impact, while others may be rare but cause severe damage. By measuring risks, individuals can prioritize them and focus more on serious risks. For example, the risk of minor illness may be frequent but less costly, whereas the risk of a major disease may be less frequent but very expensive.

3. Choosing Methods to Handle Risk

Once risks are assessed, appropriate methods are selected to deal with them. There are four main methods of handling risk:

- Avoidance: Avoiding activities that involve high risk.
- Reduction: Taking preventive measures to reduce the impact of risk.
- Transfer: Transferring the risk to another party, mainly through insurance.
- Acceptance: Accepting the risk when the potential loss is small or manageable.

Choosing the right method depends on the nature and severity of the risk. For example, taking health insurance is a way of transferring health-related risk.

4. Implementation of Decisions

After selecting the appropriate methods, the next step is to implement them effectively. This means putting the planned strategies into action. Implementation may include purchasing insurance policies, adopting safety measures, or making financial adjustments. Proper execution is essential because planning alone is not enough. For instance, deciding to buy life insurance is not useful unless the policy is actually purchased and maintained.

5. **Review and Monitoring**

Risk management is a continuous process, so regular review and monitoring are necessary. Over time, an individual's financial situation, responsibilities, and risk exposure may change. Therefore, risk management strategies should be updated accordingly. Reviewing helps in identifying new risks and ensuring that existing measures are still effective. For example, as income increases, a person may need higher insurance coverage to maintain adequate protection.

6.4 Importance of Insurance in Personal Finance

1. **Financial Protection**

Insurance provides strong financial protection against unexpected losses that may arise due to events such as accidents, illness, death, or natural disasters. These events can lead to heavy expenses and may disturb a person's financial stability. Insurance helps in covering these losses by providing compensation, thereby reducing the financial burden. For example, health insurance can cover expensive medical treatments, while property insurance can compensate for damage to assets.

2. **Risk Transfer**

One of the most important functions of insurance is risk transfer. Through insurance, the financial risk faced by an individual is transferred to the insurance company. In return for a fixed premium, the insurer agrees to bear the loss if the uncertain event occurs. This helps individuals avoid bearing large financial losses on their own. For instance, by paying a small premium for life insurance, a person can ensure that their family receives financial support in case of their death.

3. **Peace of Mind**

Insurance provides peace of mind by reducing stress and anxiety about future uncertainties. Knowing that financial support is available in case of emergencies allows individuals to live confidently and focus on their personal and professional life. It creates a sense of security and stability. For example, a person with health insurance feels less worried about sudden medical expenses.

4. Savings and Investment (in Some Policies)

Certain insurance policies, such as endowment plans and whole life policies, not only provide protection but also act as savings and investment tools. These policies encourage regular savings and help individuals build a financial corpus over time. At maturity, the insured receives a lump sum amount, which can be used for future needs like education, marriage, or retirement. Thus, insurance supports long-term financial planning.

5. Supports Family Security

Insurance plays a crucial role in ensuring the financial security of family members, especially dependents. In the absence of the earning member, insurance provides financial support to meet daily expenses, education costs, and other needs. This helps the family maintain their standard of living even in difficult situations. Life insurance, in particular, is essential for protecting the financial future of dependents.

6.5 Types of Insurance

A. Life Insurance

Life insurance is a type of insurance that provides financial protection to the family or dependents of the insured person in case of their death. It ensures that the family members do not face financial difficulties after the loss of the earning member. The insurance company pays a fixed sum of money (sum assured) to the nominee, which helps in maintaining the family's standard of living.

There are different types of life insurance policies. Term insurance is the simplest and most affordable type, where protection is provided for a specific period, and the benefit is paid only if the insured dies during that term. Whole life insurance provides coverage for the entire lifetime of the insured and also includes a savings component. Endowment plans combine insurance with savings, where the policyholder receives a lump sum amount either on maturity or in case of death.

Life insurance is very important in personal finance because it provides income replacement to the family in the absence of the earning member. It also ensures family security, helping dependents meet their daily expenses, education costs, and future needs.

B. Health Insurance

Health insurance is a type of insurance that covers medical and healthcare expenses incurred by the insured person. It provides financial support for costs related to hospitalization, surgeries, medicines, and other treatments. With the rising cost of healthcare services, health insurance has become a necessity for every individual.

Health insurance offers several benefits. It reduces the financial burden caused by sudden medical emergencies and ensures that individuals receive proper treatment without worrying about expenses. It also helps in covering rising healthcare costs, which can otherwise disturb a person's savings and financial planning. By having health insurance, individuals can protect themselves and their families from unexpected medical expenses.

C. General Insurance

General insurance includes all types of insurance other than life insurance. It provides protection against various non-life risks such as damage to property, vehicles, or loss during travel. This type of insurance helps individuals and businesses safeguard their assets and reduce financial losses arising from unforeseen events.

There are several types of general insurance. Motor insurance protects against damage to vehicles and covers third-party liability. Fire insurance provides compensation for losses due to fire accidents. Travel insurance covers risks associated with travel, such as trip cancellation, loss of luggage, or medical emergencies during travel. Property insurance protects buildings and other assets against risks like theft, fire, or natural disasters.

General insurance is important because it helps in protecting valuable assets and ensures financial stability in case of unexpected losses.

6.6 Principles of Insurance

Insurance is based on certain fundamental principles that ensure fairness, transparency, and proper functioning of insurance contracts. These principles protect both the insurer and the insured.

1. Utmost Good Faith

The principle of utmost good faith means that both the insurer and the insured must act honestly and disclose all relevant facts related to the insurance contract. The insured must provide complete and true information about the subject matter, such as health condition, age, occupation, or any existing risks. Similarly, the insurer must clearly explain the terms, conditions, and coverage of the policy.

If any important fact is hidden or misrepresented, the insurance contract may become invalid. For example, if a person hides a serious illness while taking health insurance, the insurer may reject the claim later.

2. Insurable Interest

The principle of insurable interest means that the insured must have a financial or economic interest in the subject matter of insurance. This ensures that the person will suffer a financial loss if the insured event occurs.

For example, a person can insure their own life, house, or vehicle because they have a direct financial interest in them. However, a person cannot insure a stranger's property, as they do not suffer any loss if it is damaged. This principle prevents misuse of insurance for profit-making.

3. Indemnity

The principle of indemnity states that the insured is compensated only to the extent of the actual loss suffered, and not more than that. The purpose of insurance is to restore the financial position of the insured to the condition before the loss occurred, not to allow profit.

This principle mainly applies to general insurance such as fire and property insurance. For example, if a person's property worth ?5 lakh is damaged, the insurer will pay only up to ?5 lakh, even if the insured amount is higher.

4. Subrogation

Subrogation means that after paying the claim, the insurance company gets the legal right to recover the loss from a third party who was responsible for the damage. This prevents the insured from receiving double compensation.

For example, if a person's car is damaged due to another driver's fault, the insurer will first pay the claim to the insured. Later, the insurer can recover the amount from the responsible third party.

5. Contribution

The principle of contribution applies when a person has taken multiple insurance policies for the same risk. In such cases, all insurers share the loss proportionately. This ensures that the insured does not receive more than the actual loss.

For example, if a property is insured with two companies and suffers damage, both insurers will contribute to the compensation based on their share of coverage.

6. Proximate Cause

The principle of proximate cause means that the actual and main cause of the loss must be identified to determine whether the claim is payable. The insurer will only pay if the cause of loss is covered under the policy.

For example, if a fire insurance policy covers fire damage, but the loss is caused by an earthquake (not covered), the claim may be rejected. Therefore, identifying the main cause of loss is very important.

6.7 Insurance Premium and Claims Process

Insurance Premium: Premium is the amount paid by the insured to the insurer for coverage. Factors affecting premium Age, Health condition, Risk level, Policy type. An insurance premium is the amount of money that the insured person pays to the insurance company in return for financial protection or coverage. It is usually paid regularly, such as monthly, quarterly, or annually. The payment of premiums is essential to keep the insurance policy active. In simple terms, it is the cost of transferring risk from the individual to the insurer.

The amount of premium is not the same for everyone; it depends on several important factors. Age is a key factor, as younger individuals generally pay lower premiums compared to older individuals due to lower risk. Health conditions also play a significant role, especially in health and life insurance, where unhealthy individuals may have to pay higher premiums. The risk level associated with the insured person or asset also affects the premium; a higher risk leads to a higher premium. For example, a person working in a dangerous job may pay more. Additionally, the type of policy chosen, including its coverage and duration, influences the premium amount. Policies with higher coverage or additional benefits usually have higher premiums.

Thus, the premium is calculated carefully by insurance companies to balance risk and ensure that they can provide compensation when required. Claims Process: The claims process refers to the procedure through which the insured person requests compensation from the insurance company after a loss has occurred. It is an important part of insurance because it determines how and when the insured receives financial support.

❖ **Factors Affecting Premium**

(a) Age : Age is an important factor in determining the premium. Younger individuals usually pay lower premiums because they are considered less risky, whereas older individuals pay higher premiums due to higher chances of illness or death.

(b) Health Condition: A person's health condition directly affects the premium amount. Healthy individuals are charged lower premiums, while those with existing health issues may have to pay higher premiums, especially in life and health insurance.

(c) Risk Level: The level of risk associated with a person or asset also influences the premium. Higher risk leads to higher premium. For example, people working in hazardous occupations are required to pay more.

(d) Policy Type: The type of insurance policy and the amount of coverage chosen also affect the premium. Policies with higher coverage, longer duration, or additional benefits generally have higher premiums.

❖ **Steps to claim insurance :**

1. Inform the insurance company
2. Submit claim form
3. Provide required documents
4. Verification by insurer
5. Claim settlement

1. Inform the Insurance Company

The first step in the claims process is to inform the insurance company about the loss or incident as soon as possible. Timely intimation is very important to ensure that the claim is not rejected due to delay.

2. Submit Claim Form

After informing the insurer, the insured must fill out and submit the claim form. This form includes important details such as policy number, nature of loss, date, and place of the incident.

3. Provide Required Documents

The insured is required to submit necessary documents to support the claim. These may include medical bills, hospital records, police reports, death certificates, or repair bills, depending on the type of insurance.

4. Verification by Insurer

The insurance company then verifies the claim by checking the documents and investigating the details of the incident. This step ensures that the claim is genuine and falls within the policy coverage.

5. Claim Settlement

Once the verification is complete and the claim is approved, the insurer settles the claim by making the payment. The payment may be made directly, reimbursed, or provided through cashless services, depending on the policy terms.

6.8 Role of Insurance in Financial Security

1. Protects Against Financial Shocks

Insurance acts as a safety net against sudden and unexpected financial losses. Events such as accidents, illness, death, or natural disasters can create heavy financial burdens. Insurance helps in covering these losses, thereby protecting individuals from financial shocks and preventing disruption of their financial stability.

2. Provides Long-Term Security

Insurance offers long-term financial security by ensuring that individuals and their families are protected over a period of time. Life insurance policies, in particular, provide financial support in the future, either in the form of maturity benefits or death benefits. This helps individuals plan for future uncertainties with confidence.

3. Helps in Wealth Protection

Insurance helps in protecting the wealth and assets of an individual. Without insurance, a major loss (like fire, accident, or medical emergency) can wipe out savings and investments. By providing compensation, insurance ensures that accumulated wealth is not significantly affected by unexpected events.

4. Supports Retirement Planning

Certain insurance policies, such as pension plans and endowment policies, help individuals in planning for retirement. These policies provide a steady income or lump sum amount after retirement, ensuring financial independence and stability during old age.

5. Ensures Family Welfare

Insurance plays a crucial role in ensuring the welfare of family members, especially dependents. In case of the death of the earning member, life insurance provides financial support to the family. This helps them meet daily expenses, education costs, and other financial needs, ensuring a secure and stable life.

6.9 Conclusion

Insurance and risk management play a very important role in personal financial planning. Life is full of uncertainties, and individuals face various risks such as health issues, accidents, property loss, and financial instability. Through proper risk management, these uncertainties can be identified, analysed, and controlled effectively. Insurance is an essential part of personal finance. It helps in managing risks, protecting assets, and ensuring financial security for individuals and their families. Insurance premiums and claims process are essential components of an insurance contract. While the premium ensures continuous protection, the claims process provides financial support during unexpected losses, thereby ensuring financial security. Insurance is a key tool for achieving financial security. It not only protects against risks but also supports long-term financial planning, wealth protection, and the overall well-being of individuals and their families. Thus, insurance and risk management together contribute to financial stability, economic security, and better future planning. They are essential components of a strong personal financial system and help individuals lead a stress-free and secure life.

❖ **Exercise**

➢ **Choose the correct answer from the options given below each of the following statements:**

1. Risk means :

A) Guaranteed profit

B) Uncertainty of loss

C) Fixed income

D) No investment

Answer : B

2. Risk management refers to :

A) Avoiding all investment

B) Controlling and reducing risk

C) Increasing only profit

D) Borrowing money

Answer : B

3. **First step of risk management is:**

   A) Risk transfer

   B) Risk identification

   C) Risk avoidance

   D) Risk sharing

   Answer : B

4. **Insurance is mainly used for :**

   A) Profit making

   B) Risk transfer

   C) Tax evasion

   D) Gambling

   Answer : B

5. **Life insurance provides :**

   A) Vehicle protection

   B) Medical treatment only

   C) Financial security after death

   D) Property repair

   Answer : C

6. **Health insurance covers :**

   A) Crop loss

   B) Medical expenses

   C) Stock loss

   D) Theft only

   Answer : B

7. **General insurance includes :**

   A) Only life cover

   B) Only health cover

   C) Property and asset protection

   D) Only savings

   Answer : C

8. **Premium is :**

   A) Insurance claim amount

   B) Money paid for insurance policy

   C) Profit earned

   D) Loan interest

   Answer : B

9. **Claim is:**

   A) Insurance contract

   B) Request for compensation

   C) Premium payment

   D) Risk avoidance

   Answer : B

10. **One principle of insurance is:**

   A) Gambling

   B) Insurable interest

   C) Speculation

   D) Loss avoidance

   Answer : B

11. **Risk can be :**

   A) Only financial

   B) Only personal

   C) Pure and speculative

   D) Only fixed

   Answer : C

12 **Insurance helps in :**

   A) Increasing risk

   B) Financial security

   C) Reducing savings

   D) Increasing uncertainty

   Answer : B

13. Which is NOT a type of insurance ?

A) Life insurance

B) Health insurance

C) General insurance

D) Stock insurance

Answer : D

14. Insurance works on principle of :

A) Profit sharing

B) Large number of people pooling risk

C) Gambling

D) Loan system

Answer : B

15. Risk transfer means :

A) Risk is avoided

B) Risk is shifted to insurer

C) Risk is increased

D) Risk is ignored

Answer : B

❖ **Answer the following questions in detail :**

1. Explain the meaning of risk and discuss different types of risks faced in personal financial life.
2. Define risk management. Explain the meaning and importance of risk management in personal finance.
3. Describe the steps involved in the risk management process in detail.
4. Discuss the importance of insurance in personal financial planning and risk protection.
5. Explain different types of insurance in detail.
6. What are the principles of insurance? Explain each principle with examples.
7. Explain the concept of insurance premium and describe the claim settlement process in detail.
8. Discuss the importance of risk management and insurance in modern financial systems.

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Unit : 7
Credit and Debt Management

7.1 Introduction :

Before understanding credit or debt management, it is necessary to know the meaning of management. Management is the process of planning, organizing, directing, leading, and controlling the resources to achieve goals efficiently and effectively.

Financial planning is an again a management of finance. Financial planning is a comprehensive, step-by-step process of managing income, expenses, savings, and investments to achieve short- and long-term financial goals. The principle of universe says that resources are always scares so as owned financial resources. There come the "credit" and "debt". These are two sides of a coin, for receiver it's a debt and for giver, it's a credit. And if not planned or handled carefully, may lead to insolvency.

Credit plays a necessary role in financial planning. Credit is necessary to facilitate immediate access to goods, services, or capital while delaying payment, acting as a cornerstone for personal financial mobility and economic growth. It enables major purchases (homes, cars), provides a safety net for emergencies, and builds a credit score essential for securing lower interest rates on loans.

Let us first know the meaning of the words debt and credit. How much you owe is debt and how much you can borrow is credit. The most important components of credit include history of on-time payments, types of credit owned, amounts owed and credit utilization. Another thing that goes into a person's credit score is the length of credit history, which means the age of the oldest account on file.

Credit management is the strategic process of granting credit to customers, setting payment terms, and monitoring collections to ensure timely payment and minimize financial risk. It involves assessing customer creditworthiness, defining credit policies, and managing accounts receivable to protect cash flow and improve company profitability. Credit management refers to everything directly related to approving, monitoring and recovering customers' payments.

The term credit derived from Latin word **"Credo",** which means **"I Believe". Nelso** defines credit management is the practices followed by organization to manage the sales they make on credit. Credit management in the terms of strategies is used by one to collect and have a control on credit payments from the borrowers. Financial management means procurements of funds and its optimum utilization. And credit management is a part of financial management as it is related to procurement of funds.

Credit was originated with the civilization of Assyria, Egypt and Babylon way back 3000 years. Identified or recognized it from the Europe and its growth of credit. Those days, agents used to look after such credit transaction and for the purpose, the contract called Cambium Contract was created with all necessary details of the credit transaction.

7.2 Meaning of Credit and Debt:

Credit is a financial agreement where a borrower receives money, goods, or services immediately but promises to repay the lender at a later date, usually with interest. Credit is an agreement between a lender and a borrower that allows the borrower to obtain funds, goods or services now and repay them later. Credit makes it possible to borrow money now, and repay it over a period of time. Interest, fees and charges may apply to anything you borrow. Credit is a relationship between a borrower and a lender. The borrower borrows money from the lender. The borrower pays back the money at a later date. Credit is a contractual agreement in which a borrower receives something of value immediately and agrees to pay for it later, usually with interest.

Something, especially money, that is owed to someone else, or the state of owing something: pay off a debt He managed to pay off his debts in two years. The meaning of DEBT is something owed: obligation. Debt is an obligation that requires one party, the debtor, to pay money borrowed or otherwise withheld from another party, the creditor. Debt is something that is owed, such as money, goods, or services · Debt is money you owe a person or a business. It's when you've borrowed money you'll need to pay back. Debt refers to money borrowed by one party from another with the promise of repayment, usually with interest. Debt is a financial obligation that must be repaid. The noun debt refers to an obligation to pay for or do something.

7.2.1. Definition Of Credit :

- **Prof. Thomas :** "The term credit is now applied to that belief in a man's probability and solvency which will permit of his being entrusted with something of value belonging to another whether that something consists, of money, goods, services or even credit itself as and when one may entrust the use of his good name and reputation".
- **Prof. Kinley :** "By credit, we mean the power which one person has to induce another to put economic goods at his deposal for a time on promise or future payment. Credit is thus an attribute of power of the borrower".

7.2.2. Definition Of Debt :

The expression 'financial debt' is defined under section 5(8) of the Code as a debt along with interest, if any, which is disbursed against the consideration for the time value of money and includes-

- money borrowed against the payment of interest;
- any amount raised by acceptance under any acceptance credit facility or its de-materialized equivalent;
- any amount raised pursuant to any note purchase facility or the issue of bonds, notes, debentures, loan stock or any similar instrument;

- ⇨ the amount of any liability in respect of any lease or hire purchase contract which is deemed as a finance or capital lease under the Indian Accounting Standards or such other accounting standards as may be prescribed;
- ⇨ receivables sold or discounted other than any receivables sold on non-recourse basis.

7.3 Characteristics of Credit

- ➢ **Trust/Confidence :** The basis of credit, where the lender believes the borrower will repay.
- ➢ **Creditor-Debtor Relationship :** A formal, bi-partite contract linking two parties.
- ➢ **Deferred Payment :** Goods or funds are transferred immediately, but repayment happens in the future.
- ➢ **Interest/Cost :** A fee is charged for using the funds, often with a fixed or floating interest rate.
- ➢ **Risk :** The possibility that the borrower defaults on the payment.

7.4 Characteristics of Debt

- ➢ **Fixed Repayment Schedule :** Debt involves a predetermined schedule, often with regular payments covering both principal and interest, allowing for predictability.
- ➢ **Obligation to Repay :** Debt must be repaid by a specified date, and failure to do so can lead to legal action or bankruptcy.
- ➢ **Interest Expense :** Lenders charge interest, which is the cost of borrowing and is often tax-deductible for businesses.
- ➢ **No Ownership Dilution :** Debt holders do not get a stake in the company; control remains with the owners.
- ➢ **Creditor's Claim/Security :** Secured debt is backed by collateral, allowing lenders to seize assets if the borrower defaults.
- ➢ **Maturity Date :** The date by which the borrower must pay back the full loan amount.

7.5 WHAT IS LOAN ?

When a sum of money is borrowed from a bank, financial institution, lender, or friend and there is an agreement to repay it over time with interest, it is referred to as a loan. Loans allow individuals or businesses to meet their financial needs without using their savings upfront. Different types of loans are tailored to suit various needs, such as personal, home, education, and business. A loan has three components - principal or the borrowed amount, interest rate and tenure or duration for which the loan is availed.

❖ **IMPORTANT TERMS :**

- Principal : This is the original amount of money you borrow from the bank.
- Interest : This is the extra money you pay to the bank for borrowing the principal. It is usually a percentage of the principal.
- Tenure : This refers to the total period over which you need to repay the loan. It could be months or many years.
- EMI (Equated Monthly Instalment) : This is the fixed amount of money you pay back to the bank every month. It includes both a part of the principal and the interest.
- Collateral/Security : This is an asset, like a house or gold, that you promise to the bank as a guarantee for a 'secured' loan. If you cannot repay, the bank can use this asset.
- Credit Score : This is a number that shows how good you are at managing and repaying borrowed money. A higher score usually means banks trust you more and are more likely to lend to you.
- Eligibility : These are the conditions you must meet to qualify for a loan, such as your age, income, and type of employment.

7.6 Advantages of Loan

- **Availability of tenure :** The loan is not repayable on demand and so available for the term of the loan - generally three to ten years - unless you breach the loan conditions.
- **Attached with asset :** Loans can be tied to the lifetime of the equipment or other assets you're borrowing the money to pay for.
- **Flexibility for capital repayment :** At the beginning of the term of the loan, you may be able to negotiate a repayment holiday, meaning that you only pay interest for a certain amount of time while repayments on the capital are frozen.
- **No profit sharing :** While you must pay interest on your loan, you do not have to give the lender a percentage of your profits or a share in your company.
- **Fixed ROI :** Interest rates may be fixed for the term so you will know the level of repayments throughout the life of the loan.

7.7 Disadvantages of Loan

- **Terms and conditions :** Larger loans will have certain terms and conditions or covenants that you must adhere to, such as the provision of quarterly management information.
- **No flexibility :** Loans are not very flexible - you could be paying interest on funds you're not using.
- **Trouble in repayment :** You could have trouble making monthly repayments if your customers don't pay Risk of asset: you promptly, causing cashflow problems.
- **In some cases :** loans are secured against the assets of the business or your personal possessions, e.g. your home. The interest rates for secured loans may be lower than for unsecured ones, but your assets or home could be at risk if you cannot make the repayments.
- **Early repayment charges :** There may be a charge if you want to repay the loan before the end of the loan term, particularly if the interest rate on the loan is fixed.

7.8 Classifications of Loans

- **Secured Loans :** Backed by collateral (e.g., house, car, gold), making them lower risk for lenders and offering lower interest rates. Examples: Mortgage loans, auto loans, gold loans.
- **Unsecured Loans :** Not backed by collateral, relying instead on credit scores and income. These typically have higher interest rates. Examples: Personal loans, student loans, credit card loans.

7.9 TYPES OF LOAN :

A) Based on the Security Provided

- **Secured Loans**

  These loans require the borrower to provide collateral for the money being borrowed. If the borrower cannot repay the loan, the bank can utilise the given collateral to recover the pending payment. The interest rate for such loans is much lower than that of unsecured loans.

- **Unsecured Loans**

  Unsecured loans do not require collateral for loan disbursement. The bank analyses the borrower's past relationship with the bank, the credit score, and other factors to determine whether the loan should be given. The interest rate for such loans can be higher, as there is no way to recover the loan amount if the borrower fails to pay off the loan.

B) Based on the Purpose

- **Education Loan :** Education loans are financial aid that borrowers can use to pursue education. The loan is only valid when the course is an undergraduate degree, a postgraduate degree, or any other diploma/ certification course from a reputed institution/university. You must have the admission pass provided by the institution to get the financing.
- **Personal Loan :** You can go for a personal loan whenever there is a liquidity issue. A personal loan can range from repaying an old debt, going on vacation, funding for the downpayment of a house/car, and medical emergency to purchasing big-ticket furniture or gadgets.
- **Vehicle Loan :** Vehicle loans finance the purchase of two-wheeler and four-wheeler vehicles. They can be used to purchase both new and second-hand four-wheelers. The lender determines the loan amount based on the vehicle's on-road price. You may need to make a down payment, as these loans rarely offer 100% financing. The lender retains ownership of the vehicle until the loan is fully repaid.
- **Home Loan :** Home loans provide funds to purchase a house or flat, construct a house, renovate/repair an existing house, or purchase a plot for the construction of a house or flat. The lender will hold the property until the rightful owner has completed their repayments.
- **Business Loan :** Business loans are made to fund business-related needs, such as working capital, expansion, equipment purchases, or operational costs. The amount sanctioned depends on the business's financials and the applicant's credit profile.
- **Top-up Loan :** Top-up loans are offered in addition to an existing home or personal loan. These loans do not require additional documentation and are processed faster than fresh loans. The top-up amount can be used for any personal or professional purpose.

C) Based on the Pledged Assets

- **Gold Loan :** Many financiers and lenders offer cash when the borrower pledges physical gold, such as jewellery or gold bars/coins. The lender weighs the gold and calculates the amount offered based on several checks of purity and other factors. The money can be used for any purpose. The loan must be repaid in monthly instalments so that it can be cleared by the end of the tenure and the gold can be taken back to the borrower's custody. If the borrower fails to repay on time, the lender reserves the right to take over the gold to recover the losses.

- **Loan Against Assets :** Like pledging gold, individuals and businesses pledge property, insurance policies, FD certificates, mutual funds, shares, bonds, and other assets to borrow money. Based on the value of the pledged assets, the lender will offer a loan with some margin. The borrower needs to make repayments on time so that they can get custody of the pledged assets at the end of the tenure. Failing to do so, the lender can sell the assets to recover the defaulted money.
- **Loan Against Property :** This type of loan is taken by pledging residential or commercial property. The loan amount sanctioned is usually a percentage of the property's market value. These loans are ideal for long-term needs such as higher education, business expansion or significant medical expenses.

D) Types of Loans for Businesses

Businesses, from small shops to large companies, also need money to grow and operate. Banks provide various loans tailored for business needs:

- **Working Capital Loans :** Businesses need money for their everyday operations, like paying salaries, buying raw materials, or managing inventory. Working capital loans help businesses cover these short-term expenses, ensuring they have enough cash flow to keep running smoothly.
- **Term Loans :** Term loans are provided for specific, larger investments that a business plans to make. This could be for buying new machinery, expanding a factory, or investing in new technology. These loans are repaid over a fixed period, usually with regular instalments.
- **Project Finance :** For very large and complex projects, such as building a new power plant or a major infrastructure project, banks offer project finance. This type of loan is often shared by several banks and is carefully planned around the expected income from the project itself.
- **Business Overdraft :** An overdraft facility allows a business to withdraw more money from its current account than it actually has. It is a flexible way for businesses to manage short-term cash needs, up to a pre-approved limit. Interest is only charged on the amount that is overdrawn.

7.10 Consumer Credit and Consumer Finance

Consumer credit, or consumer debt, is personal debt taken on to purchase goods and services. Although any type of personal loan could be labelled consumer credit, the term is more often used to describe unsecured debt of smaller amounts.

Consumer credit allows consumers to get an advance on income to buy products and services. In emergencies, like a car breakdown, consumer credit can provide necessary funds. Credit cards are a commonly accepted form of payment, so using this type of revolving credit can be convenient. Banks and financial institutions, department stores, and many other businesses offer consumer credit. Many credit cards also provide rewards such as cash back or travel points. Consumer credit use reflects the portion of a family or individual's spending that goes to goods and services that depreciate quickly. It includes necessities such as food and discretionary purchases such as cosmetics or dry-cleaning services.

A credit card is one type of consumer credit in finance, but a mortgage is not considered consumer credit because it is backed with the property as collateral. Two main types of consumer credit include instalment credit, which involves fixed payments over a set period, and revolving credit, which involves borrowing up to a credit limit.

- Consumer credit is personal debt used to buy goods and services without collateral.
- There are two main types of consumer credit: instalment credit and revolving credit.
- Instalment credit is paid in equal monthly payments over a set period.
- Revolving credit allows repeated borrowing up to a credit limit, often at higher interest rates.
- Responsible use of consumer credit can enhance purchasing power and build credit history, but can lead to debt if mismanaged.

7.11 Management of Loan Responsibility

- **Repay on Time :** Always make your EMI payments by the due date. This is the most important part of responsible borrowing. Late payments can lead to extra charges and damage your credit score.
- **Understand Terms :** Make sure you fully understand all the rules and conditions of your loan agreement before you sign it. Ask the bank if anything is unclear.
- **Avoid Over-Borrowing :** Only borrow what you truly need and what you are sure you can comfortably repay. Taking on too many loans can lead to financial difficulties.
- **Maintain a Good Credit Score :** By repaying your loans on time, you build a good credit score. This will make it easier for you to get loans in the future, often with better interest rates.
- **Communicate with Your Bank :** If you ever face difficulties in making your payments, contact your bank immediately. They might be able to offer solutions or advice.

7.12 Interest Rate

An interest rate is a percentage charged on the loan amount that one has borrowed. It is imposed by the lender over the principal loan amount. Rate of interest is nothing but the cost of borrowing for the borrower and reward of saving for the lender. There are various factors influences rate of interest.

7.13 Credit Score

A credit score is a number that shows how well you manage and pay back money you have borrowed. A good score usually means banks trust you more.

7.14 Evaluation of Credit

Prior advancing credit to anybody it becomes essential to go for the credit analysis to prove the credit decision prudent. Credit worthiness of the applicant will decide the smooth repayment of the loan and its interest on time. To make the credit safe and profitable, banks always opt for credit evaluation of the applicant. There are various methods of evaluation of credit. Gathering credit information, credit analysis and then the credit decision are the three steps of credit evaluation. The banks through its credit department collects the credit related information about the applicant with the help of various resources. Interviews of the applicant, financial statement analysis, credit report of credit rating agencies, banks statements or reports are more probable forms of credit information of the applicant.

7.15 Credit analysis (credit worthiness of applicants) :

After gathering the credit information, banker analyses it to evaluate the creditworthiness of the borrower. This is known as Credit Analysis. It involves the credit investigation of a potential customer to determine the degree of risk in the loan. The creditworthiness of the applicant calls for a detailed investigation of the 5 “C” of credit -

- Character,
- Capacity,
- Capital,
- Collateral and
- Conditions.
- **Character :** The "character? means the reputation of the prospective borrower. This includes certain moral and mental qualities of integrity, fairness, responsibility, trust worthiness, industry, etc. The honesty and integrity of the borrowers is of primary importance. So, credit character should be judged on the basis of applicant's performance in bad times

- **Capacity :** It is the management ability factor. It indicates the ability of the potential borrower to repay the debt. It also shows the borrower's ability to utilize the loan effectively and profitably.
- **Capital :** Capital refers to the general financial position of the potential borrower's firm. It indicates the ability to generate funds continuously over time. Capital means investment represents the faith in the concern, its product and nature. Bank should also determine the amount of immediate liabilities that are due. For the true estimate, market value of assets should be considered rather than book value.
- **Collateral :** Collateral means assets offered as a pledge against the loan. It serves as cushion at the time of insufficiency of giving a reasonable assurance of repayment of the loan.
- **Conditions :** It refers to the economic and business conditions of the country and position of particular business cycle, which affect the borrower's ability to earn and repay the debt. This is beyond the control of the borrower. Sometimes borrower may have a high credit character, potential ability to produce income but the condition may not be in favour. For the proper evaluation, bank should have eyesight on the economic condition too. For this, they have to rate the borrowers in different categories like excellent, well and poor.

Both the formal and non-formal tools combined would lead to perfection in credit appraisal and ward of increasing default tendency in credit. There are number of tools and techniques developed to evaluate the creditworthiness of the borrower like, ratio analysis, cash flow projections, fund flow statement, credit scoring etc.

Effective credit and debt management is the cornerstone of long-term financial health, transforming potential liabilities into tools for growth. The core of success lies in a proactive, disciplined approach: distinguishing between good and bad debt, maintaining high creditworthiness through timely payments, and managing cash flow to minimize interest costs. Ultimately, whether for individuals or businesses, mastering debt ensures stability, preserves liquidity, and provides the freedom to pursue financial goals. For those overwhelmed, exploring debt management plans through reputable credit counselling services is a recommended step toward regaining control.

❖ Exercise

➢ MCQs Fill In The Blanks

1. ___________________ is the strategic process of granting credit to customers, setting payment terms, and monitoring collections to ensure timely payment and minimize financial risk. (Credit management)

2. ________________ is an agreement between a lender and a borrower that allows the borrower to obtain funds, goods or services now and repay them later. (Credit)
3. ______________ is a relationship between a borrower and a lender. (Credit)
4. __________________ means assets offered as a pledge against the loan. (Collateral)
5. __________________ means assets offered as a pledge against the loan. (Collateral)
6. _________________ is the management ability factor. It indicates the ability of the potential borrower to repay the debt. (Capacity)
7. The _________________ means the reputation of the prospective borrower. (character)
8. A __________________ is a number that shows how well you manage and pay back money you have borrowed. (credit score)
9. An _________________ is a percentage charged on the loan amount that one has borrowed. (interest rate)
10. ___________________ allows consumers to get an advance on income to buy products and services. (Consumer credit)

❖ **Answer The Following Questions :**

1. Briefly explain the meaning of credit and debt.
2. Define credit and explain its characteristics.
3. Define debt and explain its characteristics.
4. What is loan? Explain the important terms related to loan.
5. Define loan and explain its advantages and disadvantages.
6. Define loan and explain its classification.
7. Explain the types of loan briefly.
8. Explain the types of loan for business purposes.
9. Write a note on management of loan responsibility.
10. Write a note on credit analysis.

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Unit : 8
Retirement and Wealth Planning

8.1 Introduction :

Retirement is when someone decides to stop working and end their professional career. Retirement, fundamentally, is when you leave the workforce behind. After working whole life to earn money, a time comes when rest from the daily work routine becomes necessary. Retirement is a life stage when you decide to leave work and live off a pension or savings without any active work or income source. The standard age to retire in India is 60 years. However, one may retire early or extend their work life according to physical and mental health, financial planning, and personal preferences.

Retirement in India is the phase of life where an individual ceases active employment, typically between the ages of 58 and 60. The retirement age varies across different sectors and is determined by job type, government policies, and organizational rules.

Retirement planning is the process of preparing finances today in order to ensure a secure and comfortable life after stop working. It involves estimating future expenditures, considering the impact of inflation and building a mix of savings and investments that will generate a steady income in the course of retirement years.

Retirement planning in India assists in creating a retirement corpus that ensures financial independence, meeting post-retirement goals and protecting from financial worries in old age.

With a steady income source, one can resolve most problems and post-retirement challenges in the future, including healthcare costs and lifestyle expenses. A person doesn't need to depend on your kids and government schemes to live a comfortable and confident life. Simultaneously, he or she can achieve his or her long-term financial goals and leave a legacy for your kids.

Retirement planning is the process of preparing your finances today so that you can meet your dreams and goals independently by the time you retire and live a comfortable life afterwards. It involves setting goals by assessing the current financial situation, measuring future expenses, and creating a strategy to build a sufficient corpus. The primary objective of planning is to maintain a similar living standard after retirement with financial security and independence.

A retirement plan is a financial strategy tailored to assist in building a corpus that supports after your active working years. It is essentially a way to ensure that your lifestyle and financial requirements are taken good care of when regular income from work stops.

You can maintain a confident and enjoyable life even after retirement if you plan for it well. At the right time helps you reap benefits and impacts lifestyle significantly. The National Pension System (NPS) offers ample returns and pensions to achieve your retirement goals and handle emergencies without depending on others. With a wide range of benefits such as lump sum withdrawal at retirement, regular pension for life, tax benefits, etc. Retirement planning is not just about saving funds; it is, in fact, associated with building financial security, stability and mental peace for your future. Here are the reasons why it matters.

8.2 Need for Retirement Planning :

❖ **Plan for Uncertain Economic Conditions :**

The economy might change in ways that are not expected. Recessions, inflation or instability in the job market can impact savings as well as investments. For instance, in the course of COVID-19, many witnessed income disruptions while their expenses continued. A prudent retirement plan comes across as a safety net. This makes sure that even if the economy shifts, your future lifestyle remains secure.

- **Lower Dependence on Social Security or Government Schemes :**

  While schemes such as EPF, pensions or other government allowances endow great support, they might not be adequate to cover all post-retirement expenditures. For example, the month-on-month pension from EPF might fall short of mitigating rising healthcare or lifestyle costs. By building own retirement corpus, gain more control, flexibility and great confidence that needs will be met.

- **Enable Wealth Transfer and Legacy Planning**

  Retirement planning is not just about mitigating needs; it is even about securing the future of your family. Through estate planning tools such as wills, trusts and beneficiary designations, can ensure wealth is passed on in a smooth manner to chosen heirs. Early planning prevents disputes, safeguards assets and permits to decide how and when wealth must be transferred.

- **Take Advantage of Retirement-Specific Tax Benefits**

  Investing in retirement plans also brings tax benefits. Contributions as per Section 80C, Section 80CCC and Section 80CCD (1) (of up to ?1.5 lakh). In addition, Section 80CCD(1B) (an additional ?50,000 for NPS) can lower taxable income. Using such benefits early not just lowers your tax liability but also assists your corpus in growing faster through the long-term compounding effect.

- **Achieve Peace of Mind and Financial Confidence**

  Perhaps the greatest importance of retirement planning lies in the emotional security it provides. Knowing that future is funded reduces stress and allows to make better life decisions. For example, a couple who began planning in their 30s can now travel, pursue hobbies, and support their children without financial worry, proving that peace of mind is the real return on investment.

- **Achieve Goals**

  When retired from work, one would like to travel to new places, pick up a hobby, or start a venture. One may also need money to send child abroad for higher studies or host their wedding. With efficient planning, one can achieve these goals.

- **Better Quality of Life:**

  A person would not want to compromise lifestyle after retirement. After retirement, pension should be sufficient to cover them.

- **Address Healthcare and Lifestyle Needs:**

  Instead of depending on others in case of medical emergencies and other lifestyle needs, a retirement plan builds an emergency fund that keeps prepared for expenses related to sudden events.

8.3 Benefits of Retirement Planning :

- **Make Money for future needs :**

  Creating a diverse financial portfolio that includes smart pension planning means that will be in charge of financial future. Money that one invests will gather returns ensuring that will have a lucrative package available when one actually need it for the predetermined purpose in the life.

- **Tax Benefits**

  The retirement planning process also boasts several tax benefits and rebates, depending on the type of policy you choose. This makes a retirement plan an effective way to plan and secure future funds.

- **Better Health with Reduced Financial Worries**

  With an effective retirement or pension plan in place, one can easily reduce the stress you might ordinarily experience regarding future financial situation. Not having to worry about money means that one doesn't have to endure the stress that goes along with it.

- **Reducing the Burden on Your Children and/or Family**

  Having the right type of retirement planning in place reduces the financial burden on children, spouse and family. This is because they won't have to stress about covering income to ensure one is taken care of. This is especially beneficial if children are still at college or just started working by the time you retire.

- **Make Better Financial Decisions in the Present**

  Setting a few retirement goals in place when one is younger and will ensure that can make appropriate financial decisions to accommodate current and future needs. One will also be more likely to choose the right policy for the goals.

8.4 Reasons to have Retirement Planning :

- **Retiring Early :** Crafting a retirement plan empowers individuals to save and invest strategically, offering the possibility of an early retirement if desired.
- **Extended Life Expectancy :** A well-structured retirement plan becomes crucial to increasing life expectancy as it provides financial security throughout an extended retirement period.
- **Addressing Healthcare Costs :** Retirement planning becomes a shield against the rising tide of medical expenses in old age, ensuring that healthcare needs are adequately covered.

- **Achieving Retirement Aspirations :** A retirement plan serves as a roadmap to fulfilling post-retirement goals, enabling individuals to maintain their desired lifestyle.
- **Financial Security Maintenance :** By delivering a steady income stream, a retirement plan acts as a cornerstone for maintaining financial stability during retirement.
- **Vital for Self-Employed Individuals :** Recognizing the unique challenges of self-employed individuals, retirement planning becomes crucial as they may lack access to employer-sponsored plans.
- **Integral to Estate Planning :** A retirement plan seamlessly integrates into a comprehensive estate plan, ensuring the orderly distribution of assets according to individual wishes.
- **Peace of Mind Assurance :** Retirement planning instils peace of mind, offering the assurance that a well-structured financial future is in place.
- **Health and Stress Reduction :** Reduced stress stemming from financial planning contributes to better health outcomes, highlighting the holistic benefits of retirement planning.
- **Tax Minimization :** A retirement plan plays a pivotal role in minimizing taxes, a significant factor that can impact retirement income substantially.
- **Encourages Better Investments :** Retirement planning fosters the development of superior investment strategies, potentially leading to higher returns on investments.
- **Boosts Retirement Savings :** Consistent and effective saving, facilitated by a retirement plan, becomes essential for building a comfortable retirement fund.
- **Enhances Retirement Income :** A well-executed retirement plan has the potential to increase retirement income, ensuring a more comfortable lifestyle in retirement.
- **Empowers with Financial Control :** Retirement planning provides individuals with greater control over their financial future, enabling informed decision-making throughout their retirement journey.

8.5 Steps of Retirement Planning :

1. **Understanding Current Standing :** Before diving into retirement planning, conduct a thorough evaluation of your current financial situation. Assess your income, expenses, savings, investments, and debts. This comprehensive review provides a clear snapshot of your financial standing and serves as the foundation for formulating effective retirement strategies.

2. **Anticipating Future Financial Needs :** Estimate your retirement expenses by considering factors such as living costs, inflation, potential lifestyle changes, and healthcare expenditures. This step helps you determine the financial requirements for maintaining your desired lifestyle during retirement, offering a realistic foundation for your retirement savings goals.

3. **Defining Your Financial Milestones :** Based on the estimated expenses, establish a clear retirement savings goal. This target reflects the total amount required to secure your retirement. It guides you in calculating monthly savings contributions, providing a tangible roadmap to achieve your financial objectives during retirement.

4. **Leveraging Employer-Sponsored Plans :** Take full advantage of employer-sponsored retirement plans, such as 401(k)s or 403(b)s, by maximizing your contributions. If your employer offers matching contributions, ensure you contribute enough to benefit from the match. Additionally, consider supplementing your savings with an Individual Retirement Account (IRA) for added financial security.

5. **Building a Diversified Portfolio :** Invest wisely by selecting a diversified mix of assets aligned with your risk tolerance and time horizon. Stocks, bonds, and mutual funds should be chosen thoughtfully. Collaborating with a financial advisor can aid in crafting a personalized investment strategy tailored to your unique retirement goals.

6. **Creating a Retirement Budget :** Develop a retirement budget that incorporates estimated expenses and retirement income. This budget acts as a guiding framework, ensuring you stay on track and avoid outliving your savings. Regularly revisiting and adjusting the budget is crucial for adapting to changing financial landscapes.

7. **Securing Your Well-Being :** Include healthcare costs in your retirement plan, covering aspects like Medicare premiums, copayments, and out-of-pocket expenses. Exploring options like Health Savings Accounts (HSAs) or long-term care insurance can offer additional financial protection in this regard.

8. **Staying Agile for Financial Success :** Regularly review your retirement plan, preferably annually, to verify alignment with your goals. Adjustments may be necessary based on changes in your financial situation, evolving expenses, or fluctuations in investment performance. This proactive approach ensures your plan remains dynamic and responsive.

9. **Strategic Social Security Planning :** Devise a plan for Social Security by determining the optimal time to start receiving benefits. Delaying benefits can result in higher monthly payments, offering a potential advantage if longevity is expected.

10. **Exploring Diverse Retirement Income Streams :** Consider supplementary sources of retirement income, such as rental property, part-time employment, or passive income streams. Diversifying your income sources enhances financial stability and flexibility during retirement.

8.6 Important Things for Retirement Planning :

1. **Early and Consistent Savings :** Initiate retirement savings at the earliest opportunity, maintaining a consistent habit. Commencing early allows for substantial fund growth, securing a more robust retirement corpus over time.

2. **Retirement Clarity :** Comprehend your retirement spending prerequisites, targeting a savings goal of 70 to 90 percent of preretirement income for post-retirement financial stability. Strategic planning and well-defined financial objectives are pivotal for a confident retirement.

3. **Contribution to Retirement Plans :** Maximize benefits from employer-offered retirement plans like 401(k), leveraging contributions, tax advantages, and compound interest to significantly enhance your retirement savings.

4. **Investment Wisdom :** Acquire a foundational understanding of investment principles, ensuring a diversified portfolio to effectively manage risk. Tailoring investments based on age and financial goals enhances the potential for improved returns.

5. **Avoiding Premature Withdrawals :** Exercise caution against premature withdrawals from retirement savings to safeguard principal, interest, and tax benefits. Opt for leaving savings invested or consider strategic rollovers during job transitions.

6. **Informed Investment Management :** Regularly monitor investments, incorporating plans to counteract inflation's impact. A clear understanding of inflation's effects on purchasing power and informed investment decisions are integral to long-term financial security in retirement.

8.7 Retirement Plan Options :

1. **National Pension System** :

   The NPS is a voluntary, defined contribution retirement savings scheme regulated by PFRDA. It is designed to enable the subscribers to make optimum decisions regarding their future through systematic savings during their working life.

2. Public Provident Fund :

This is a popular long term investment option which offers safety with attractive interest rate and returns that are fully exempted from Tax. Investors can invest minimum 500 to maximum₹1,50,000 in one financial year.

3. Senior Citizen Savings Scheme (SCSS)

A government scheme which is an apt choice of investment for those over 60 years of age. SCSS is available through many banks and post offices across India. An individual can invest a maximum amount of ₹ 15 lakh, individually or jointly in an SCSS account.

4. Pradhan Mantri Vaya Vandana Yojana

The aim of the scheme is to give senior citizens a form of regular pension. The scheme can be purchased from LIC in offline as well as in online mode. The scheme can be purchased by paying lump sum amount ranging from 1.5 lakh to maximum 15 lakh for monthly pension.

5. Reverse Mortgage

Reverse mortgage is a relatively new way of financing against real estate. A reverse mortgage enables a senior citizen to receive a regular stream of income from a lender (bank or a financial institution) against the mortgage of his/her home. The borrower (i.e. the individual pledging the property) continues to own the property and is allowed to reside in the property, till the end of his/her life and receives a periodic payment on it. Upon the death, the house goes to the lender.

8.8 Wealth Creation and Wealth Preservation :

Wealth creation is the active process of growing your net worth through high-yield investments and calculated risks, while wealth preservation is the defensive strategy of protecting those accumulated assets from market crashes, inflation, and taxes. Ultimately, creation builds the fortress, and preservation defends it. Wealth creation is about accumulating assets over many years, whereas wealth preservation is about protecting those assets once you have them. As one financial advisor explains, 'Wealth creation is about accumulation', involving growth-oriented investments (like equities and startups) with a long-term horizon. By contrast, wealth preservation focuses on security: 'protecting what you have accumulated and asking 'how long can this last?'. In other words, wealth creation aims to grow net worth aggressively, while preservation aims to lock in and extend your net worth. Wealth creation has a different, and sometimes, the opposite connotation of risk when compared to wealth preservation. Creation focuses on building wealth before a major life event, like retirement, occurs. Preservation focuses on safeguarding what you've already accumulated so it lasts a lifetime or can be passed down to future generations.

The ideal financial journey involves both phases. You start in the wealth creation mode to build a meaningful financial base. As you approach retirement or acquire significant assets, you gradually reallocate parts of your portfolio into wealth preservation to lock in your gains and ensure steady income. Maintaining a healthy balance protects your nest egg against catastrophic market downturns while still outpacing inflation. A balanced portfolio maintains enough growth to outpace inflation and build wealth, while also holding safe assets for stability. In practice, that means mixing equities with bonds, cash, or other low-risk assets to cushion against downturns.

A balanced portfolio invests in both stocks and bonds to reduce potential volatility, aiming for income and moderate growth. This "balanced" approach lets an investor tolerate normal market ups and downs, knowing the portfolio is designed to preserve capital as well as grow it.

8.9 Wealth Creation :

Wealth creation is the strategic process of accumulating and multiplying assets over time. It goes beyond just earning and saving money, involving disciplined investing, asset allocation, and leveraging compound growth to build long-term financial independence. Wealth creation is the process of investing in different asset classes where the investments will help in fulfilling key needs. These investments should also be self-contained that can generate a stable source of income, helping one to fulfil their aspirations.

The wealth creation process will be most effective if started early. Starting investments during the early stages of life will give a head start for achieving goals. It also helps in generating higher growth in the long term. This is due to the power of compounding. Power of compounding is a concept that will help in building a considerable corpus in the future. The concept of compounding revolves around reinvesting the returns back into the fund to earn higher growth. Therefore, the longer one stays invested, the higher will be the gain in wealth.

Wealth creation process always starts with setting financial goals. Then these goals have to be classified based on the time period. For example, goals that an investor wants to achieve in the next few years will be short term goals. Similarly, there can be medium term goals and long-term goals.

Short term goals are the ones that one wants to achieve in the next 1-3 years. Medium term goals are the goals that one wants to achieve in the next 3-5 years. And any goal beyond five years is considered as long term goals.

8.9.1. Importance of Wealth Creation :

Wealth creation is a process of investing in multiple asset classes that eventually help in meeting one's livelihood needs. Therefore, wealth creation as an investment strategy plays a significant role.

- **Regular income**

  Investments into good assets will help in generating alternate sources of income. For example, investments in equities, mutual funds or debt instruments will help in generating income through interest or dividends. Therefore, during retirement, these investments will be an additional source of income that will help one in retiring peacefully and have financial independence. Also, in times of emergencies or health crisis, these investments will help in addressing the contingencies.

- **Retirement planning**

  The benefits of investments are realized to a greater extent during post-retirement years. Having a separate retirement fund will help investors in leading a stress free and healthy retirement. Retirement is the time where one's savings or investments do the work for them. To create one such fund, it is important to start early and invest regularly.

- **Goal based investing**

  Goal based investing is the best way to measure one's financial success. All of us have goals and dreams about the future. Prioritizing and achieving one goal at a time will give the utmost satisfaction. To do so, one should list down all the goals along with timelines and start investing towards them. Starting small and early will help in wealth creation.

  Wealth creation is simple and easy when done right. Discipline and commitment to investing is the key to create wealth. Starting early in the career will help in multiplying returns by taking advantage of the power of compounding. With various investment opportunities available in the market, it is essential to pick the right one that helps in wealth creation. Moreover, wealth creation aligned with life goals or financial goals, will help investors stay motivated.

8.10 Wealth Preservation

Wealth preservation is the process of safeguarding existing assets against risks like inflation, market volatility, taxes, and legal liabilities. While wealth creation focuses on aggressive growth, preservation prioritizes capital protection and financial security so your assets can support your lifestyle or be passed to future generations. Wealth preservation is defined as a set of strategies and financial practices that are executed to protect and maintain the wealth and assets of an individual or family over time. In practice, this can include risk mitigation from market volatility, inflation, legal claims, and so on. Wealth preservation is usually a part of a larger financial plan aimed at increasing wealth.

8.10.1. Important Things to Keep in Mind for Wealth Preservation :

- Preservation is concerned with more than growing wealth, and also involves understanding how to avoid big losses through balanced investments.
- Alternative methods including real estate, private equity, and offshore investments are also smart for wealth preservation.

Wealth Preservation refers to strategies and practices aimed at safeguarding an individual's or family's assets from risks such as market fluctuations, taxation, or legal challenges. It ensures the long-term security of wealth for future generations while maintaining financial stability in the present.

8.10.2. Key Elements of Wealth Creation :

- **Asset Protection :** Shielding assets from creditors, lawsuits, or political instability through mechanisms such as trusts, foundations, or offshore structures.
- **Tax Efficiency :** Minimizing tax liabilities by taking advantage of favourable tax regimes, such as Gibraltar's low corporate tax rates and tax-exempt statuses for specific individuals and entities.
- **Estate Planning :** Using tools like wills, trusts, and life insurance to ensure a smooth transfer of wealth to heirs while reducing potential disputes and tax burdens.

8.11 Financial Independence

Financial independence is the capacity to maintain a standard of living and achieve financial objectives without the help or support of others. It is attained when a person has amassed enough money, property, and passive income to pay their bills and maintain their preferred standard of living. Individuals who achieve financial independence have freedom, flexibility, and control over their financial decisions, enabling them to pursue their objectives and lead independent lives.

Financial independence can be attained through careful budgeting, methodical saving, and astute investing. It entails laying a strong financial foundation by controlling expenses, creating a budget, and paying down debt. Many people aim to build a diversified investment portfolio that produces passive income, such as stocks, bonds, real estate, or businesses.

8.11.1. Benefits of Financial Independence :

- Financially independent individuals can decide according to their values and goals without being constrained by financial obligations. It enables them to follow their passions, take chances, and make choices consistent with their long-term goals.
- Financial stress and anxiety can be greatly diminished by achieving financial independence. One feels secure and at ease knowing they have the money to care for their needs and handle unforeseen expenses.
- Planning for retirement is closely related to financial independence. It enables people to build enough savings and investments to support their preferred retirement lifestyle, ensuring a cozy and secure future.
- Financial independence enables people to take advantage of potential opportunities, such as starting a business, investing in businesses, or returning to school. It creates opportunities for both professional and personal growth.
- Dependence on others for financial support is reduced when one is financially independent. It encourages independence and allows people to choose according to their needs and goals.
- Planning for the future is a necessary part of achieving financial

independence. Wealth creation is one of the main objectives of saving and investing and building a secure financial future. Wealth creation is not limited to creating financial assets but can also be translated into creating social well-being and contributing to the betterment of society through philanthropic means. Wealth creation is an ongoing process that needs careful planning and understanding of how money multiplies and increases over time.

❖ **Exercise**

➢ **Fill in the blanks in the following statements :**

1. ______________ is when someone decides to stop working and end their professional career. (Retirement)
2. __________________ is the process of preparing finances today in order to ensure a secure and comfortable life after stop working. (Retirement planning)
3. (NPS) stands for __________________ (The National Pension System)
4. _______________is a financial strategy tailored to assist in building a corpus that supports after your active working years. (A retirement plan)
5. _______________ is not just about mitigating needs; it is even about securing the future of your family. (Retirement planning)
6. (SCSS) stands for ________________ (Senior Citizen Savings Scheme)
7. ________________ is about accumulating assets over many years, whereas wealth preservation is about protecting those assets once you have them. (Wealth creation)
8. A ______________________ invests in both stocks and bonds to reduce potential volatility, aiming for income and moderate growth. (balanced portfolio)
9. _______________ is the strategic process of accumulating and multiplying assets over time. (Wealth creation)
10. ______________ process always starts with setting financial goals. (Wealth creation)
11. __________________ are the ones that one wants to achieve in the next 1-3 years. (Short term goals)
12. And any goal beyond five years is considered as_________________ . (long term goals)

❖ **Answer the following questions in detail :**

1. What is retirement planning? Explain its importance.
2. Explain in detail the benefits of retirement planning
3. Explain the reasons to have retirement planning in detail.
4. Explain in detail the steps of retirement planning
5. Explain the important things of retirement planning in detail.
6. Write a detailed note on retirement plan options.
7. What is wealth creation? Explain its importance.
8. What is wealth preservation and explain the important things to be kept in mind for wealth preservation.
9. What is financial independence? Explain its importance.

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સ્વાધ્યાયઃ પરમં તપઃ
સ્વાધ્યાયઃ પરમં તપઃ

શિક્ષણ, સંસ્કૃતિ, સદ્ભાવ, દિવ્યબોધનું ધામ
ડૉ. બાબાસાહેબ આંબેડકર ઓપન યુનિવર્સિટી નામ;
સૌને સૌની પાંખ મળે, ને સૌને સૌનું આભ,
દશે દિશામાં સ્મિત વહે હો દશે દિશે શુભ-લાભ.

અભણ રહી અજ્ઞાનના શાને, અંધકારને પીવો ?
કહે બુદ્ધ આંબેડકર કહે, તું થા તારો દીવો;
શારદીય અજવાળા પહોંચ્યાં ગુર્જર ગામે ગામ
ધ્રુવ તારકની જેમ ઝળહળે એકલવ્યની શાન.

સરસ્વતીના મયૂર તમારે ફળિયે આવી ગહેકે
અંધકારને હડસેલીને ઉજાસના ફૂલ મહેંકે;
બંધન નહીં કો સ્થાન સમયના જવું ન ઘરથી દૂર
ઘર આવી મા હરે શારદા દૈન્ય તિમિરના પૂર.

સંસ્કારોની સુગંધ મહેંકે, મન મંદિરને ધામે
સુખની ટપાલ પહોંચે સૌને પોતાને સરનામે;
સમાજ કેરે દરિયે હાંકી શિક્ષણ કેરું વહાણ,
આવો કરીયે આપણ સૌ
ભવ્ય રાષ્ટ્ર નિર્માણ...
દિવ્ય રાષ્ટ્ર નિર્માણ...
ભવ્ય રાષ્ટ્ર નિર્માણ

DR. BABASAHEB AMBEDKAR OPEN UNIVERSITY
(Established by Government of Gujarat)
'Jyotirmay' Parisar,
Sarkhej-Gandhinagar Highway, Chharodi, Ahmedabad-382 481
Website : www.baou.edu.in