Our Motto
MONEY MUST GROW

CA Aaditya Jain
With Sunrise You Rise

CA,MBA(FINANCE),RESEARCH ANALYST,
INVESTMENT ADVISOR L-1 & L-2,NCFM,B.COM,M.COM
AWARDED AS NSE CERTIFIED MARKET PROFESSIONAL
AND MASTER OF FINANCIAL ANALYSIS

The Best CA/CMA Final
SFM
WITH PRACTICAL STOCK MARKET KNOWLEDGE
THEORY JULY 2021

राह की धूप मेरे काम आई छांव होती तो सो गाया होता.

Are You Ready
To Learn & Earn?

CA, MBA (FINANCE), RESEARCH ANALYST,
INVESTMENT ADVISOR L-1 & L-2, NCFM, B.COM, M.COM
AWARDED AS NSE CERTIFIED MARKET PROFESSIONAL
AND MASTER OF FINANCIAL ANALYSIS
ORDER NOW
CA & CMA BOOKS

- FINAL SFM
- INTER FM & ECO
- ELECTIVE PAPER RISK MANAGEMENT
- ELECTIVE PAPER FSCM

BEST MATERIAL TO SCORE 100% MARKS

By ditya Jain

100 OUT OF 100 MARKS IN SFM

The Institute of Chartered Accountants of India
Examination Results, Nov 2017

THANKS TO AADITYA JAIN SIR, I SCORED 100 OUT OF 100 MARKS IN SFM WITH ALL INDIA RANK 3 YOU ARE NO. 1 SFM FACULTY OF INDIA, PLZ CHECK MY RESULT AT NRO-0329834; ROLL NO.-426168; ITS A TRIBUTE TO YOUR TEACHING

<table>
<thead>
<tr>
<th>Roll Number</th>
<th>Name</th>
<th>Group I</th>
<th>Group II</th>
</tr>
</thead>
<tbody>
<tr>
<td>426168</td>
<td>AADITYA MITTAL</td>
<td>Financial Reporting</td>
<td>Advanced Management Accounting</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Strategic Financial Management</td>
<td>Information Systems Control and Audit</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Advanced Auditing and Professional Ethics</td>
<td>Direct Tax Laws</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Corporate and Allied Laws</td>
<td>Indirect Tax Laws</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Total</td>
<td>Total</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Result</td>
<td>Result</td>
</tr>
<tr>
<td></td>
<td></td>
<td>052</td>
<td>083</td>
</tr>
<tr>
<td></td>
<td></td>
<td>100</td>
<td>059</td>
</tr>
<tr>
<td></td>
<td></td>
<td>059</td>
<td>073</td>
</tr>
<tr>
<td></td>
<td></td>
<td>057</td>
<td>072</td>
</tr>
<tr>
<td></td>
<td></td>
<td>278</td>
<td>287</td>
</tr>
<tr>
<td></td>
<td></td>
<td>PASS</td>
<td>PASS</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Total</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>565</td>
<td></td>
</tr>
</tbody>
</table>

Mail Us At pendriveclassbyaj@gmail.com
**Benefits With Aaditya Jain Test Series**

1. Improved Time Management skills.
4. Enhanced memory retention.
5. Preparation Strategy Review and Improvement

**India’s No.1**

Faculty has now launched TEST SERIES for ALL SUBJECTS after mind-blowing results of classes.

- **Aditya Mittal** (100 Marks in SFM)
- **Anmol Gupta** (98 Marks in SFM)
- **Sarthak Agarwal** (97 Marks in SFM)
- **Vibhor Agarwal** (97 Marks in SFM)
- **Kanika Goel** (96 Marks in SFM)
- **Mohit Gupta** (94 Marks in SFM)

And Many More........

**CA. Aaditya Jain.**

☎️ 9911442626
Aaditya Jain Class Test Series
Overwhelming Reviews

"I was very speculative of the subject before availing test series from Aaditya Jain sir. But after doing first test series, I found myself at complete ease. I felt motivated towards achieving my goal." - Abhishek Mishra.

"I never saw such type of teacher, knowledge, experience, style. He explains every concept very well and connects with the stock market and examples." - Pooja Gupta.

"Aaditya Jain Sir is Gem. I took the test series and it made me realize my true potential. Any student can easily benefit from this." - Harish Jothi.

"Sir you give very practical knowledge and also start from base so understanding of concepts being easy. And specifically thanks for helping with test series." -}

Compliment Received by Aaditya Jain Sir’s Students

You are the best teacher I have ever studied with. Who continuously updates us everyday. No teacher in CA final even response to our questions asked even near to exams time but you are exceptionally excellent.

Hello Sir,
Sir today I completed your CA Final RM Classes... sir thank you so much for all your efforts and for the way you teach...
Next level ki feelings aa rhi h sir schme aap best the best teacher ho world k.... Sir main RM self k_Name veeli th but job aapse li M ki classes or complete hui tab rast pasi ki paise tu l baar lgenge 10,000 RM k lye bhi but aapse classees krke jo practical knowledge or jo motivation milti h that’s important so I took your RM Classes and aai gary k saath boi rhi hu mja aagya sir aapse padke... thanks a lot Sir
Sir meri notebook k kuch pages apko send kar rhi hu

India’s No.1 Finance Faculty
CA Aaditya Jain

For Class details mail at- pendriveclassbyaj@gmail.com
INDEX

PAST YEARS
1. FINANCIAL POLICY AND CORPORATE STRATEGY 06-09
2. SECURITY ANALYSIS 09-18
3. SECURITIZATION 18-22
4. STARTUP FINANCE 22-28
5. RISK MANAGEMENT 29-31
6. INTERNATIONAL FINANCIAL MANAGEMENT 31-33
7. MUTUAL FUND 33-36
8. MERGERS, ACQUISITIONS AND CORPORATE RESTRUCTURING 36-37
9. DERIVATIVES ANALYSIS AND VALUATION 37-39
10. PORTFOLIO MANAGEMENT 39
11. INTEREST RATE RISK MANAGEMENT 40
12. CORPORATE VALUATION 40
13. VALUATION OF SECURITY 40-41
APPENDIX 41-43

PAST YEARS/RTP/MTP

MAY 2018 EXAM THEORY QUESTION
QUESTION NO.1 Explain the Interface of Financial Policy and Strategic Management? (4 Marks) (Chapter 1)
QUESTION NO.2 Write a short note on Embedded Derivative? (5 Marks) (Chapter 9)
QUESTION NO.3 Interpret the CAPM and state its assumption? (4 Marks) (Chapter 10)
QUESTION NO.4 Explain the Advantages of bringing VC in the company? (4 Marks) (Chapter 4)
QUESTION NO.5 What are the BENEFITS OF SECURITIZATION From the angle of originator & From the angle of investor? (4 Marks) (Chapter 3)
QUESTION NO.6 What are the steps in MECHANISM OF SECURITIZATION? (4 Marks) (Chapter 3)

NOV 2018 EXAM THEORY QUESTION
QUESTION NO.1 Write a short note on Angel Investor? (4 Marks) (Chapter 4)
QUESTION NO.2 Who are the Primary Participants IN SECURITIZATION? (4 Marks) (Chapter 3)
QUESTION NO.3 How different stakeholders view Financial Risk? (4 Marks) (Chapter 5)

MAY 2019 EXAM THEORY QUESTION
QUESTION NO.1 List the main applications of Value At Risk(VAR) (4 Marks) (Chapter 5)
QUESTION NO.2 Briefly explain the steps involved in Mechanism of Securitization. (4 Marks) (Chapter 3)
QUESTION NO.3 Explain briefly the sources for funding a Start-up. (4 Marks) (Chapter 4)

NOV 2019 EXAM THEORY QUESTION
QUESTION NO.1 State briefly the characteristics of venture capital financing. (4 Marks) (Chapter 4)
QUESTION NO.2 Identify the benefits of securitization from the angle of originator. (4 Marks) (Chapter 3)
QUESTION NO.3 What is start-up to avail the benefits of govt scheme? (4 Marks) (Chapter 4)
QUESTION NO.4 Discuss briefly the key decisions which falls within the scope of financial strategy. (4 Marks) (Chapter 1)
QUESTION NO.5 State the main problems faced in securitization in India. (4 Marks) (Chapter 3)
QUESTION NO.6 List the main objectives of International cash management. (4 Marks) (Chapter 6)
**NOV 2020 EXAM THEORY QUESTION-CIRCLE 1**

**QUESTION NO.1** Peer to Peer lending and crowd funding are same and traditional methods of funding. Do you agree? Justify your stand. *(Chapter 4)*

**QUESTION NO.2** An individual attempts to found and build a company from personal finances or from the operating revenues of the new company. What this method is called? Discuss any two methods. *(Chapter 4)*

**QUESTION NO.3** Side pocketing enhances the value of the Mutual fund. Do you agree? Briefly explain the process of side pocketting. *(Chapter 7)*

**QUESTION NO.4** In an efficient market, technical analysis may not work perfectly. However with imperfection, inefficiencies and irrationalities which characteristics the real world, technical analysis may be helpful. Critically analyse the statement. *(Chapter 2)*

**QUESTION NO.5** Distinguish between Pass through certificates and Pay through Certificates. *(Chapter 4)*

**QUESTION NO.6** Differentiate between Economic Value Added and Market Value Added.

**NOV 2020 EXAM THEORY QUESTION-CIRCLE 2**

**QUESTION NO.1** As a financial strategist you will depend on certain key financial decisions. Discuss. *(Chapter 1)*

**QUESTION NO.2** “The process of securitisation can be viewed as process of creation of additional financial product of securities in the market backed by collaterals.” What are the other feature? Describe. *(Chapter 3)*

**QUESTION NO.3** Venture Capital Funding passes through various stages. Discuss. *(Chapter 4)*

**QUESTION NO.4** Non-bank Financial Sources are becoming popular to finance Start-ups. Discuss. *(Chapter 4)*

**QUESTION NO.5** Participants are required for the success of the securitisation process. Discuss their roles. *(Chapter 3)*

**QUESTION NO.6** Risks are inherent and integral part of the market. Discuss. *(Chapter 5)*

**RTP MAY 2018**

**QUESTION NO.1** DISTINGUISH Primary participants and secondary participants in securitization. *(Chapter 3)*

**QUESTION NO.2** DESCRIBE Value at Risk and its application. *(Chapter 5)*

**QUESTION NO.3** EXPLAIN the concept of Bootstrapping and describe the various methods of bootstrapping used by start ups. *(Chapter 4)*

**RTP NOV 2018**

**QUESTION NO.1** DESCRIBE the various parameters to identity the currency risk. *(Chapter 5)*

**QUESTION NO.2** EXPLAIN the challenges to Efficient Market Theory. *(Chapter 2)*

**QUESTION NO.3** EXPLAIN Startup India Initiative. *(Chapter 4)*

**RTP MAY 2019**

**QUESTION NO.1** EXPLAIN the concept of side pocketing in mutual funds. *(Chapter 7)*

**QUESTION NO.2** EXPLAIN cash settlement and physical settlement in derivatives contracts and their relative advantages and disadvantages. *(Chapter 9)*

**QUESTION NO.3** EXPLAIN Co-location/ Proximity Hosting ? *(Chapter 9)*

**QUESTION NO.4** DESCRIBE the factors affecting Industry Analysis. *(Chapter 2)*

**RTP NOV 2019**

**QUESTION No.1** Briefly explain the concept of Exchange Traded Fund. *(Chapter 7)*

**QUESTION No.2** Briefly discuss the concept of Purchasing Power Parity. *(Chapter 6)*

**QUESTION No.3** Explain the reasons of Reverse Stock Split. *(Chapter 8)*

**QUESTION No.4** Explain benefits of Securitization from the point of view of originator. *(Chapter 3)*
QUESTION No. 5 Explain briefly the parameters to identify the currency risk.  
(Chapter 5)

QUESTION No. 6 Compare and contrast start-ups and entrepreneurship. Describe the priorities and challenges which start-ups in India are facing.  
(Chapter 4)

RTP MAY 2020

QUESTION NO.1 How financial goals can be balanced vis-a-vis sustainable growth?  
(Chapter 1)
QUESTION NO.2 What is value at risk? Identify its main features.  
(Chapter 5)
QUESTION NO.3 Explain the factors affecting economic analysis.  
(Chapter 2)
QUESTION NO.4 Discuss briefly the steps in securitization mechanism.  
(Chapter 3)
QUESTION NO.5 What are some of the innovative ways to finance a start-up?  
(Chapter 4)
QUESTION NO.6 What is the difference between management Buyout and leveraged Buyout? State the purpose of a leveraged buyout with the help of an example.  
(Chapter 8)

RTP NOV 2020

QUESTION NO.1: Explain key decisions that fall within the scope of financial strategy.  
(Chapter 1)
QUESTION NO.2: What is Financial Risk? How it can be evaluated from point of views.  
(Chapter 5)
QUESTION NO.3: Explain various “Market Indicators”.  
(Chapter 2)
QUESTION NO.4: Discuss briefly the problems faced in the growth of Securitization of Instruments in Indian context.  
(Chapter 3)
QUESTION NO.5: Explain the methods in which a Start-up firm can bootstrap.  
(Chapter 4)
QUESTION NO.6: Explain the difference between Forward and Future Contract.  
(Chapter 6)

RTP MAY 2021

QUESTION NO.1: Explain the traits that an organisation should have to make itself financially sustainable.  
(Chapter 1)
QUESTION NO.2: Describe the salient features of Foreign Currency Convertible Bonds.  
(Chapter 6)
QUESTION NO.3: Explain how an organization interested in making investment in foreign country can assess Country Risk and mitigate this risk.  
(Chapter 5)
QUESTION NO.4: ‘Venture Capital Financing is a unique way of financing Start-up’. Discuss.  
(Chapter 4)
QUESTION NO.5: Explain the Secondary Participants involved in the process of Securitization of Instruments.  
(Chapter 3)
QUESTION NO.6: Explain how Cash flow-based approach of valuation is different from Income based approach and also explain briefly the steps involved in this approach.  
(Chapter 12)

TEST SERIES: MARCH, 2018

QUESTION NO.1 Compare and contrast startups and entrepreneurship. Describe the priorities and challenges which startups in India are facing.  
(Chapter 4)
QUESTION NO.2 Explain Financial Risk from the point of view of Stakeholder, Company & Government.  
(Chapter 5)
QUESTION NO.3 Explain Dow Jones theory.  
(Chapter 2)
QUESTION NO.4 Describe various securitization instruments.  
(Chapter 3)

TEST SERIES: APRIL, 2018

QUESTION NO.1 Compare and contrast startups and entrepreneurship. Describe the priorities and challenges which startups in India are facing.  
(Chapter 4)
QUESTION NO.2 Explain any four features of Value at Risk (VAR).  
(Chapter 5)
QUESTION NO.3 Explain Random Walk theory.  
(Chapter 2)
QUESTION NO.4 Describe the various problems faced in Securitization.  
(Chapter 3)
TEST SERIES: AUGUST, 2018

QUESTION NO.1 Explain Balancing Financial vis-à-vis Sustainable Growth. (Chapter 1)
QUESTION NO.2 Discuss the types of Commodity Swaps. (Chapter 9)
QUESTION NO.3 Explain Asset Allocation Strategies. (Chapter 10)
QUESTION NO.4 Explain various stages of Venture Capital Funding. (Chapter 4)
QUESTION NO.5 Explain the features of Value-at-Risk (VaR). (Chapter 5)
QUESTION NO.6 Discuss briefly the primary participants in the process of Securitization. (Chapter 3)
QUESTION NO.7 Explain the features of ‘Securitization’. (Chapter 3)

TEST SERIES: OCTOBER, 2018

QUESTION NO.1 EXPLAIN Dow Jones theory. (Chapter 2)
QUESTION NO.2 "The Financial Risk can be viewed from different perspective". Explain this statement. (Chapter 5)
QUESTION NO.3 DIFFERENTIATE between PTS and PTC. (Chapter 3)
QUESTION NO.4 EXPLAIN securitisation in India. (Chapter 3)
QUESTION NO.5 DESCRIBE the term Pitch Presentation in context of Start-up Business? (Chapter 4)

TEST SERIES: MARCH, 2019

QUESTION NO.1 Describe the concept of of ‘Evaluation of Technical Analysis'. (Chapter 2)
QUESTION NO.2 Explain the pricing of the securitized Instruments. (Chapter 3)
QUESTION NO.3 Describe the concept of ‘Stripped Securities.’ (Chapter 3)

TEST SERIES: OCT, 2019

QUESTION NO.1 Compare and contrast start-ups and entrepreneurship. Describe the priorities and challenges which start-ups in India are facing. (Chapter 4)
QUESTION NO.2 Describe the problems faced in the growth of Securitization of instruments in Indian Context. (Chapter 3)
QUESTION NO.3 Mention the various techniques used in economic analysis. (Chapter 2)
QUESTION NO.4 Discuss briefly the key decisions falling within the scope of financial strategy. (Chapter 1)
QUESTION NO.5 Briefly explain how Angel Investors finance the Startups. (Chapter 4)
QUESTION NO.6 Briefly explain Counter party risk and the various techniques to manage this risk. (Chapter 5)
Or Explain some of the parameters to identify the currency risk. (Chapter 5)

TEST SERIES: MAY, 2020

QUESTION NO.1 Explain the basic documents that are required to make up Financial Presentations during Pitch Presentation. (Chapter 4)
QUESTION NO.2 Describe the problems faced in the growth of Securitization of instruments especially in Indian context. (Chapter 3)
QUESTION NO.3 Mention the various challenges to the Efficient Market Theory. (Chapter 2)
QUESTION NO.4 Explain how Financial Risk can be viewed from different viewpoints. (Chapter 5)
QUESTION NO.5 Explain advantages of bringing Venture Capital in the company. (Chapter 4)
QUESTION NO.6 What do you mean by the term ‘Cheapest to Deliver’ in context of Interest Rate Futures? (Chapter 11)
QUESTION NO.7 Explain complexities involved in International Capital Budgeting. (Chapter 6)

TEST PAPER OCTOBER 2020
QUESTION NO.1 Explain the problems that are faced in International Capital Budgeting Decision and how these can be overcome. (Chapter 6)

QUESTION NO.2 "Sustainable growth is important to enterprise long-term development". Explain this statement in context of planning healthy corporate growth. (Chapter 1)

QUESTION NO.3 Explain various Asset Allocation Strategies. (Chapter 10)

QUESTION NO.4 Explain the various problems that are faced in growth of Securitization of Instruments in Indian context. (Chapter 3)

QUESTION NO.5 Explain various Market Indicators. (Chapter 2)

QUESTION NO.6 Explain the term Angel Investor. (Chapter 4)

QUESTION NO.7 Examine briefly the various innovative methods of funding the Startups. (Chapter 4)

TEST SERIES: MARCH, 2021

QUESTION NO.1: Explain the specific steps that make an organisation sustainable. (Chapter 1)

QUESTION NO.2: Reconcile differences between Carve-out and Spin Off. (Chapter 8)

QUESTION NO.3: Identify how different stakeholders view the financial risk? (Chapter 5)

QUESTION NO.4: Explain Angel Investors. (Chapter 4)

QUESTION NO.5: Discuss about the Primary Participants in the process of Securitization. (Chapter 3)

QUESTION NO.6: What is a startup to avail the benefits of government scheme? (Chapter 4)

QUESTION NO.7: Explain the different methods for evaluating the performance of a mutual fund. (Chapter 7)

TEST SERIES: APRIL, 2021

QUESTION NO.1: The idea of Quant Fund is stock-picking free from human intervention. Discuss. (Chapter 7)

QUESTION NO.2: Explain key decisions falling within the scope of Financial Strategy. (Chapter 1)

QUESTION NO.3: Explain the strategy of Portfolio rebalancing under which the value of a portfolio shall not be below a specified value in normal market conditions. (Chapter 10)

QUESTION NO.4: Distinguish between Pass Through Certificates (PTCs) and Pay Through Securities (PTSs). (Chapter 3)

QUESTION NO.5: Modified Duration is a proxy not an accurate measure of change in price of a Bond due to change interest rate. Discuss. (Chapter 13)

QUESTION NO.6: Explain the term Business Model with help of an example. (Chapter 4)

QUESTION NO.7: Explain the methods in which a Startup firm can bootstrap. (Chapter 4)

“There are three important things to remember about education. The first one is motivation, the second is motivation, and the third is motivation.” —AADITYA JAIN

Always find inner strength not to be superior than others, but to fight your biggest enemy, the doubts within yourself. Never let your doubts & fears hold you enslaved — instead conquer them — by working to build your strengths — instead of focusing on your weaknesses and you will achieve things which once seem impossible. If you hear a voice within you which says you can’t do it, still do it and that voice will be silenced. Don’t let others tell you what you can’t do or let their limitations become yours. Your only & truest limitations are those you set upon yourself!_ Positive Thinking Positive Life??
1. **FINANCIAL POLICY AND CORPORATE STRATEGY**

**QUESTION NO.1** Explain the Functions of Strategic Financial Management? OR The investment and financial decisions functions involve many functions. Explain?

- The **investment and financial decisions** functions involve the following functions: (a) Continual search for **best investment opportunities**; (b) Selection of the **best profitable opportunities**; (c) Determination of **optimal mix of funds** for the opportunities; (d) Establishment of **systems for internal controls**; and (e) Analysis of results for future decision-making.

**QUESTION NO.2** What are key decisions falling within the scope of financial strategy? OR As a financial strategist you will depend on certain key financial decisions. Discuss.

1. **Financing decisions**: These decisions deal with the mode of financing or **mix of equity capital and debt capital**.
2. **Investment decisions**: These decisions involve the **profitable utilization of firm’s funds** especially in long-term projects (capital projects). The projects are evaluated in relation to their expected return and risk.
3. **Dividend decisions**: These decisions determine the division of earnings between **payments to shareholders** and reinvestment in the company.
4. **Portfolio decisions**: A portfolio decision refers to a **collection of investment tools** such as stocks, shares, mutual funds, bonds, cash and so on depending on the investor’s income, budget and convenient time frame.

**QUESTION NO.3** Explain the different levels of enterprise strategy? OR Enumerate ‘Strategy’ at different levels of hierarchy.

(a) **Corporate Level Strategy**: Corporate level strategy fundamentally is concerned with **selection of businesses** in which a company should compete. Corporate level strategy should be able to **answer three basic questions**: Suitability: **Whether the strategy would work** for the accomplishment of common objective of the company. Feasibility: **Determines the kind and number of resources required** to formulate and implement the strategy. Acceptability: It is concerned with the **stakeholder’s satisfaction**.

(b) **Business Unit Level Strategy**: At the business unit level, the strategic **issues are about both practical coordination of operating units** and about developing and sustaining a **competitive advantage** for the products and services that are produced.

(c) **Functional Level Strategy**: The functional level is **the level of the operating divisions and departments**. The strategic issues at this level are related to functional business processes and value chain. Functional level strategies in R&D, operations, manufacturing, marketing, finance, and human resources involve the development and coordination of resources through which business unit level strategies can be executed effectively and efficiently. Functional units of an organization are involved in higher level strategies by providing input to the business unit level and corporate level strategy, such as providing information on customer feedback or on resources and capabilities on which the higher level strategies can be based. Once the higher-level strategy is developed, the functional units translate them into discrete action plans that each department or division must accomplish for the strategy to succeed.

Among the different functional activities viz production, marketing, finance, human resources and research and development, **finance assumes highest importance** during the top down and bottom up interaction of planning. Corporate strategy deals with deployment of resources and financial strategy is mainly concerned with mobilization and effective utilization of money, the most critical resource that a business firm likes to have under its command.

**QUESTION NO.4** There are 3 major components of Financial planning. What are they?

- There are **3 major components of Financial planning**:
QUESTION NO.5 Explain briefly, how financial policy is linked to strategic management?

- The success of any business is measured in financial terms. Maximising value to the shareholders is the ultimate objective. For this to happen, at every stage of its operations including policy-making, the firm should be taking strategic steps with value-maximization objective. This is the basis of financial policy being linked to strategic management.
- The linkage can be clearly seen in respect of many business decisions. For example:
  (i) Manner of raising capital as source of finance and capital structure are the most important dimensions of strategic plan.
  (ii) Cut-off rate (opportunity cost of capital) for acceptance of investment decisions.
  (iii) Investment and fund allocation is another important dimension of interface of strategic management and financial policy.
  (iv) Foreign Exchange exposure and risk management.
  (v) Liquidity management.
  (vi) A dividend policy decision deals with the extent of earnings to be distributed and a close interface is needed to frame the policy so that the policy should be beneficial for all.
  (vii) Issue of bonus share is another dimension involving the strategic decision.

Thus from above discussions it can be said that the financial policy of a company cannot be worked out in isolation to other functional policies. It has a wider appeal and closer link with the overall organizational performance and direction of growth.

QUESTION NO.6 Write a short note on Balancing Financial Goals vis-à-vis Sustainable Growth? (May 2014)

- The concept of sustainable growth can be helpful for planning healthy corporate growth. This concept forces managers to consider the financial consequences of sales increases and to set sales growth goals that are consistent with the operating and financial policies of the firm. Often, a conflict can arise if growth objectives are not consistent with the value of the organization’s sustainable growth. Question concerning right distribution of resources may take a difficult shape if we take into consideration the rightness not for the current stakeholders but for the future stakeholders also.
- To take an illustration, let us refer to fuel industry where resources are limited in quantity and a judicial use of resources is needed to cater to the need of the future customers along with the need of the present customers. One may have noticed the save fuel campaign, a demarketing campaign that deviates from the usual approach of sales growth strategy and preaches for conservation of fuel for their use across generation. This is an example of stable growth strategy adopted by the oil industry as a whole under resource constraints and the long run objective of survival over years.
- Incremental growth strategy, profit strategy and pause strategy are other variants of stable growth strategy.
- Sustainable growth is important to enterprise long-term development. Too fast or too slow growth will go against enterprise growth and development, so it should play important role in enterprise development, adopt suitable financial policy initiative to make sure enterprise growth speed close to sustainable growth ratio and have sustainable healthy development.
- The sustainable growth rate (SGR), concept by Robert C. Higgins, of a firm is the maximum rate of growth in sales that can be achieved, given the firm’s profitability, asset utilization, and desired dividend payout and debt (financial leverage) ratios. The sustainable growth rate is a measure of how much a firm can grow without borrowing more money. After the firm has passed this rate, it must borrow funds from another source to facilitate growth. Variables typically include the net profit margin on new and existing revenues; the asset turnover ratio, which is the ratio of sales revenues to total assets; the assets to beginning of period equity ratio; and the retention ratio, which is defined as the fraction of earnings retained in the business.

\[
SGR = ROE \times (1 - \text{Dividend payment ratio})
\]

Sustainable growth models assume that the business wants to:

1. maintain a target capital structure without issuing new equity;
2. maintain a target dividend payment ratio; and
3. increase sales as rapidly as market conditions allow.

Since the asset to beginning of period equity ratio is constant and the firm’s only source of new equity is retained earnings, sales and assets cannot grow any faster than the retained earnings plus the additional debt.
that the retained earnings can support. The sustainable growth rate is consistent with the observed evidence that most corporations are reluctant to issue new equity. If, however, the firm is willing to issue additional equity, there is in principle no financial constraint on its growth rate.

**QUESTION NO.7** What makes an organization sustainable? State the specific steps? [Refer Q.6] OR Explain the specific steps that make an organisation sustainable.

- The concept of sustainable growth can be helpful for planning ... future stakeholders also.
- Sustainable growth is important to enterprise long-term development ........ healthy development.
- Sustainable growth models assume that the business wants to: (1)(2)(3)
- Since the asset to beginning of period equity ratio .......... no financial constraint on its growth rate.

**To be financially sustainable, an organisation must:**

(i) have more than one source of income; (ii) have more than one way of generating income; (iii) do strategic, action and financial planning regularly; (iv) have adequate financial systems; (v) have a good public image; (vi) be clear about its values (value clarity); and (vii) have financial autonomy.

**What makes an organisation sustainable?** In order to be sustainable, an organisation must:

(i) Have a clear strategic direction; (ii) Be able to scan its environment or context to identify opportunities for its work; (iii) Be able to attract, manage and retain competent staff; (iv) Have an adequate administrative and financial infrastructure; (v) Be able to demonstrate its effectiveness and impact in order to leverage further resources; and [vi] Get community support for, and involvement in its work.

**QUESTION NO.8** Explain the traits that an organisation should have to make itself financially sustainable

**To be financially sustainable, an organization must have following traits:** [Refer Q.7]

(i) have more than one source of income...... (vii) have financial autonomy.....Refer previous solution

**QUESTION NO.9** “Sustainable growth is important to enterprise long-term development”. Explain this statement in context of planning healthy corporate growth. [Refer Q.6]

- Sustainable growth is important to enterprise long-term development .... healthy development.
- The sustainable growth rate (SGR), concept by Robert C.... SGR = ROE x (1 - Dividend payment ratio)
- Sustainable growth models assume that the business wants to: (1)(2)(3)

**QUESTION NO.10** Explain the Interface of Financial Policy and Strategic Management?

The interface of strategic management and financial policy will be clearly understood if we appreciate the fact that the starting point of an organization is money and the end point of that organization is also money. No organization can run an existing business and promote a new expansion project without a suitable internally mobilized financial base or both internally and externally mobilized financial base.

**Sources of finance and capital structure are the most important dimensions of a strategic plan.** The generation of funds may arise out of ownership capital and or borrowed capital. A company may issue equity shares and / or preference shares for mobilizing ownership capital.

- Along with the mobilization of funds, policy makers should decide on the capital structure to indicate the desired mix of equity capital and debt capital. There are some norms for debt equity ratio. However this ratio in its ideal form varies from industry to industry. It also depends on the planning mode of the organization under study.

**Another important dimension of strategic management and financial policy interface is the investment and fund allocation decisions.** A planner has to frame policies for regulating investments in fixed assets and for restraining of current assets. Investment proposals mooted by different business units may be addition of a new product, increasing the level of operation of an existing product and cost reduction and efficient utilization of resources through a new approach and or closer monitoring of the different critical activities.

Now, given these three types of proposals a planner should evaluate each one of them by making within group
comparison in the light of capital budgeting exercise.

- **Dividend policy** is yet another area for making financial policy decisions affecting the strategic performance of the company. A close interface is needed to frame the policy to be beneficial for all. Dividend policy decision deals with the extent of earnings to be distributed as dividend and the extent of earnings to be retained for future expansion scheme of the firm.

- It may be noted from the above discussions that financial policy of a company **cannot be worked out in isolation of other functional policies.** It has a wider appeal and closer link with the overall organizational performance and direction of growth. These policies being related to external awareness about the firm, specially the awareness of the investors about the firm, in respect of its internal performance. There is always a process of evaluation active in the minds of the current and future stake holders of the company. As a result preference and patronage for the company depends significantly on the financial policy framework. And hence attention of the corporate planners must be drawn while framing the financial policies not at a later stage but during the stage of corporate planning itself.

### 2. SECURITY ANALYSIS

**QUESTION NO. 1 What is Fundamental Analysis?**

- **Fundamental Analysis** is based on the premise that "All securities can be valued by calculating the present value of their future cash flows".

**QUESTION NO.2 What are the Key Variables Of Fundamental Analysis?**

The key variables that an investor must monitor in order to carry out his fundamental analysis are:

1. Economy Analysis
2. Industry Analysis
3. Firm/Company Analysis

**1. Economy Analysis:**

- **Factors Affecting Economic Analysis:** Some of the economy wide factors are discussed as under:
  - (a) **Growth Rates of National Income and Related Measures:** The estimated growth rate of the economy is important for the industrial sector, and and also for the returns, investors can expect from investment in shares.
  - (b) **Growth Rates of Industrial Sector:** This can be further broken down into growth rates of various industries or groups of industries if required. The growth rates in various industries are estimated based on the estimated demand for its products.
  - (c) **Inflation:** Inflation is measured in terms of either wholesale prices (the Wholesale Price Index or WPI) or retail prices (Consumer Price Index or CPI). The demand in some industries, particularly the consumer products industries, is significantly influenced by the inflation rate. Therefore, firms in these industries make continuous assessment about inflation rates likely to prevail in the near future so as to fine-tune their pricing, distribution and promotion policies to the anticipated impact of inflation on demand for their products.
  - (d) **Monsoon:** Because of the strong forward and backward linkages*, monsoon is of great concern to investors in the stock market too.

**Some of the techniques used for economic analysis are:**

- (a) **Anticipatory Surveys:** They help investors to form an opinion about the future state of the economy. It incorporates expert opinion on construction activities, expenditure on plant and machinery, levels of inventory all having a definite bearing on economic activities. Also future spending habits of consumers are taken into account.

- (b) **Barometer/Indicator* Approach:** Various indicators are used to find out how the economy shall perform in the future. The indicators have been classified as under:
  - (i) **Leading Indicators:** They lead the economic activity in terms of their outcome. They relate to the time series data* of the variables that reach high/low points in advance of economic activity.
  - (ii) **Roughly Coincidental Indicators:** They reach their peaks(high) and troughs(low) at approximately the same time in the economy.
(iii) **Lagging Indicators:** They are time series data of variables that lag behind in their consequences vis-à-vis the economy. They reach their turning points after the economy has reached its own already.

(c) **Economic Model Building Approach:** In this approach, a precise and clear relationship between dependent and independent variables is determined. The steps used are as follows: (i) Estimate Total Income by (ii) Estimating levels of various components of Total Income (iii) and calculate Forecasted GNP (iv) **Comparison:** Comparison is then made of total GNP thus arrived with that from an independent agency and then the overall forecast is tested for consistency.

2. **Industry Analysis:**

Factors Affecting Industry Analysis:

(a) **Product Life-Cycle:** An industry usually exhibits high profitability in the initial and growth stages, medium but steady profitability in the maturity stage and a sharp decline in profitability in the last stage of growth.

(b) **Demand Supply Gap:** Excess supply reduces the profitability of the industry because of the decline in the unit price realization, while insufficient supply tends to improve the profitability because of higher unit price realization.

(c) **Barriers to Entry:** Some of these barriers are related to the product and the technology of production, while other barriers are created by existing firms in the industry.

(d) **Government Attitude:** The attitude of the government towards an industry is a crucial determinant of its prospects.

(e) **State of Competition in the Industry:** Factors to be noted are firms with leadership capability and the nature of competition.

(f) **Cost Conditions and Profitability:** Profitability depends on the state of competition in the industry, cost control measures adopted by its units and growth in demand for its products.

(g) **Technology and Research:** They play a vital role in the growth and survival of a particular industry.

Some of the techniques used for Industry Analysis are:

(a) Regression Analysis (b) Input-Output Analysis

3. **Firm/Company Analysis:**

Factors Affecting Company Analysis:

(a) **Net Worth and Book Value:** Net Worth is sum of equity share capital, and free reserves less intangible assets and any carry forward of losses. The total net worth divided by the number of shares is known as book value of a share.

(b) **Sources and Uses of Funds:** The identification of sources and uses of funds is known as Funds Flow Analysis. One of the major uses of funds flow analysis is to find out whether the firm has used short term sources of funds to finance long-term investments.

(c) **Cross-Sectional and Time Series Analysis:** One of the main purposes of examining financial statements is to compare two firms, compare a firm against some benchmark figures for its industry and to analyse the performance of a firm over time. The techniques that are used to do such proper comparative analysis are: common-sized statement, and financial ratio analysis.

(d) **Size and Ranking:** A rough idea regarding the size and ranking of the company within the economy, in general, and the industry, in particular, would help the investment manager in assessing the risk associated with the company.

(e) **Growth Record:** The following three growth indicators may be particularly looked into:

(a) Price earnings ratio, (b) Percentage growth rate of earnings per annum, (c) Percentage growth rate of net block.

(f) **Financial Analysis:** From the investment point of view, the most important figures are earnings per share, price earning ratios, yield, book value and the intrinsic value of the share.

(g) **Quality of Management:** This is an intangible factor. Yet it has a very important bearing on the value of the shares. Every investment manager knows that the shares of certain business houses command a higher premium than those of similar companies managed by other business houses. This is because of the quality of management.

(h) **Location and Labour-Management Relations:** The locations of the company's manufacturing facilities determines its economic viability which depends on the availability of crucial inputs like power, skilled labour and raw-materials, etc.
(i) **Pattern of Existing Stock Holding**: An analysis of the pattern of existing stock holdings of the company would also be relevant. This would show the stake of various parties in the company.

(j) **Marketability of the Shares**: Another important consideration for an investment manager is the marketability of the shares of the company.

Some of the techniques used for company analysis are:

(a) Correlation & Regression Analysis  
(b) Trend Analysis  
(c) Decision Tree Analysis

**QUESTION NO.3 What is Technical Analysis, Its Assumption & its Principles?**

- **Meaning**: It is a method of share price movements based on a study of price graphs or charts.

- **Assumptions**: Technical Analysis is based on the following assumptions:
  (i) The market value of stock is actually depending on the supply and demand for a stock.
  (ii) The supply and demand is actually governed by several factors. For instance, recent initiatives taken by the Government to reduce the Non-Performing Assets (NPA) burden of banks may actually increase the demand for banking stocks.
  (iii) Stock prices generally move in trends which continue for a substantial period of time. Therefore, if there is a bull market going on, there is every possibility that there will soon be a substantial correction which will provide an opportunity to the investors to buy shares at that time.
  (iv) Technical analysis relies upon chart analysis which shows the past trends in stock prices rather than the information in the financial statements like balance sheet or profit and loss account.

- **Principles of Technical Analysis**: Technical analysis is based on the following three principals:
  (a) The Market Discounts Everything: Technical analysts generally have the view that a company’s share price includes everything including the fundamentals of a company.
  (b) Price Moves in Trends: Technical analysts believe that prices move in trends. In other words, a stock price is more likely to continue a past trend than move in a different direction.
  (c) History Tends to Repeat Itself: Technical analysts believe that history tends to repeat itself.

**QUESTION NO.4 Explain the Elliot Wave Theory of technical analysis?**

- **Inspired by the Dow Theory** and by observations found throughout nature, Ralph Elliot formulated Elliot Wave Theory in 1934. This theory was based on analysis of 75 years stock price movements and charts. From his studies, he defined price movements in terms of waves. As per this theory wave is a movement of the market price from one change in the direction to the next change in the same direction. These waves are resulted from buying and selling impulses emerging from the demand and supply pressures on the market. Depending on the demand and supply pressures, waves are generated in the prices. Accordingly, this theory was named Elliot Wave Theory. As per this theory, waves can be classified into two parts:-
  (i) Impulsive patterns  
  (ii) Corrective patterns

- **Impulsive Patterns**-(Basic Waves) - In this pattern there will be 3 or 5 waves in a given direction (going upward or downward). These waves shall move in the direction of the basic movement. This movement can indicate bull phase or bear phase.

- **Corrective Patterns**-(Reaction Waves) - These waves are against the basic direction of the basic movement. Correction involves fall in case of bull market and rise in case of bear market. As shown in the following diagram waves 1, 3 and 5 are basic movements, which are separated or corrected by wave 2 & 4, termed as corrective movements.

- **Complete Cycle**: One complete cycle consists of waves made up of two distinct phases, bullish and bearish.
QUESTION NO.5 What is the Dow Jones Theory?

The Dow Theory is one of the oldest and most famous technical theories. It was originated by Charles Dow, the founder of Dow Jones Company in late nineteenth century. It is a helpful tool for determining the relative strength of the stock market. It can also be used as a barometer of business. The Dow Theory is based upon the movements of two indices, constructed by Charles Dow, Dow Jones Industrial Average (DJIA) and Dow Jones Transportation Average (DJTA). These averages reflect the aggregate impact of all kinds of information on the market. The movements of the market are divided into three classifications, all going at the same time; the primary movement, the secondary movement, and the daily fluctuations.

The primary movement is the main trend of the market, which lasts from one year to 36 months or longer. This trend is commonly called bear or bull market. The secondary movement of the market is shorter in duration than the primary movement, and is opposite in direction. It lasts from two weeks to a month or more. The daily fluctuations are day-to-day movements. These fluctuations are not part of the Dow Theory interpretation of the stock market. However, daily movements must be carefully studied, along with primary and secondary movements, as they go to make up the longer movement in the market.

Thus, the Dow Theory’s purpose is to determine where the market is and where is it going. The theory, in practice, states that if successively high and the successive lows are higher, then the market trend is up and a bullish market exists. Contrarily, if the successive highs and successive lows are lower, then the direction of the market is down and a bearish market exists.

Charles Dow proposed that the primary uptrend would have three moves up, the first one being caused by accumulation of shares by the far-sighted, knowledgeable investors, the second move would be caused by the arrival of the first reports of good earnings by corporations, and the last move up would be caused by widespread report of financial well-being of corporations. The third stage would also see rampant speculation in the market. Towards the end of the third stage, the far-sighted investors, realizing that the high earnings levels may not be sustained, would start selling, starting the first move down of a downtrend, and as the non-sustainability of high earnings is confirmed, the second move down would be initiated and then the third move down would result from distress selling in the market.

QUESTION NO.6 Explain the Random Walk Theory?

This theory states that the behaviour of stock market prices is unpredictable and that there is no relationship between the present prices of the shares and their future prices. Proponents of this theory argue that stock market prices are independent. A British statistician, M. G. Kendell, found that changes in security prices behave nearly as if they are generated by a suitably designed roulette wheel* for which each outcome is statistically independent of the past history. In the layman’s language it may be said that prices on the stock exchange behave exactly the way a drunk would behave while walking in a blind lane, i.e., up and down, with an unsteady way going in any direction he likes, bending on the side once and on the other side the second time. The supporters of this theory put out a simple argument. It follows that:

(i) Prices of shares in stock market can never be predicted. (ii) The reason is that the price trends are not the result of any underlying factors, but that they represent a statistical expression of past data. (iii) There may be periodical ups or downs in share prices, but no connection can be established between two successive peaks (high price of stocks) and troughs (low price of stocks).

QUESTION NO.7 Explain Support and resistance level with diagram?

When the index/price goes down from a peak, the peak becomes the resistance level. When the index/price
rebounds after reaching a trough (bottom) subsequently, the lowest value reached becomes the support level. The price is then expected to move between these two levels. Whenever the price approaches the resistance level, there is a selling pressure while whenever the price approaches the support level, there is a buying pressure.

QUESTION NO.8 Write a short note on Evaluation Of Technical Analysis? OR In an efficient market, technical analysis may not work perfectly. However with imperfection, inefficiencies and irrationalities which characterize the real world, technical analysis may be helpful. Critically analyse the statement.

Yes, this statement is correct.

Arguments for technical analysis:
(a) Under influence of crowd psychology*, trend persist for some time. Tools of technical analysis help in identifying these trends early and help in investment decision making. (b) Shift in demand and supply are gradual rather than instantaneous. Technical analysis helps in detecting this shift rather early and hence provides clues to future price movements. (c) Fundamental information about a company is observed and absorb by the market over a period of time. Hence price movement tends to continue more or less in same direction till the information is fully assimilated in the stock price.

Arguments against technical analysis:
(a) Most technical analysts are not able to offer a convincing explanation for the tools employed by them. (b) Empirical evidence in support of random walk hypothesis cast its shadow over the usefulness of technical analysis. (c) By the time an up trend and down trend may have been signalled by technical analysis it may already have taken place. (d) Ultimately technical analysis must be self defeating proposition. With more and more people employing it, the value of such analysis tends to decline.

QUESTION NO.9 Explain the different levels or forms of Efficient Market Theory?
(i) Weak form efficiency - Price reflect all information found in the record of past prices and volumes.
(ii) Semi - Strong efficiency - Price reflect not only all information found in the record of past prices and volumes but also all other publicly available information.
(iii) Strong form efficiency - Price reflect all available information public as well as private.

QUESTION NO.10 Explain the Misconception about Efficient Market Hypothesis (EMH) Theory?
- Efficient Market Theory implies that market prices factor in all available information and as such it is not possible for any investor to earn consistent long term returns from market operations.
- Although price tends to fluctuate they cannot reflect fair value. This is because the future is uncertain. The market springs surprises continually and as prices reflect the surprises they fluctuate.
- Inability of institutional portfolio managers to achieve superior investment performance implies that they lack competence in an efficient market. It is not possible to achieve superior investment performance since market efficiency exists due to portfolio managers doing this job well in a competitive setting.
- The random movement of stock prices suggests that stock market is irrational. Randomness and irrationality are two different things, if investors are rational and competitive, price changes are bound to be random.

QUESTION NO.11 Explain the different challenges to Efficient Market Theory?
(a) Limited information processing capabilities- Human information processing capabilities are sharply limited.
(b) **Irrational Behaviour** - Most of the times investors behaviour shows irrationality between market prices and intrinsic values.

(c) **Monopolistic Influence** - A market is regarded as highly competitive. No single buyer or seller is supposed to have undue influence over prices. In practice, powerful institutions and big operators have great influence over the market. The monopolistic power enjoyed by them diminishes the competitiveness of the market.

**QUESTION NO.12** Explain various “Market Indicators”.

The various market indicators are as follows:

(i) **Breadth Index**: ❖ It is an index that covers all securities traded. ❖ It is computed by dividing the net advances or declines in the market by the number of issues traded. ❖ The breadth index either supports or contradicts the movement of the Dow Jones Averages. ❖ If it supports the movement of the Dow Jones Averages, this is considered sign of technical strength and if it does not support the averages, it is a sign of technical weakness i.e. a sign that the market will move in a direction opposite to the Dow Jones Averages. ❖ The breadth index is an addition to the Dow Theory and the movement of the Dow Jones Averages.

(ii) **Volume of Transactions**: ❖ The volume of shares traded in the market provides useful clues on how the market would behave in the near future. ❖ A rising index/price with increasing volume would signal buy behaviour because the situation reflects an unsatisfied demand in the market. ❖ Similarly, a falling market with increasing volume signals a bear market and the prices would be expected to fall further. ❖ A rising market with dwindling volume indicates a bull market while a falling market with dwindling volume indicates a bear market. ❖ Thus, the volume concept is best used with another market indicator, such as the Dow Theory.

(iii) **Confidence Index**: ❖ It is supposed to reveal how willing the investors are to take a chance in the market. ❖ It is the ratio of high-grade bond yields to low-grade bond yields. ❖ It is used by market analysts as a method of trading or timing the purchase and sale of stock, and also, as a forecasting device to determine the turning points of the market. ❖ A rising confidence index is expected to precede a rising stock market, and a fall in the index is expected to precede a drop in stock prices. ❖ A fall in the confidence index represents the fact that low-grade bond yields are rising faster or falling more slowly than high grade yields. ❖ The confidence index is usually, but not always, a leading indicator of the market. ❖ Therefore, it should be used in conjunction with other market indicators.

(iv) **Relative Strength Analysis**: ❖ The relative strength concept suggests that the prices of some securities rise relatively faster in a bull market or decline more slowly in a bear market than other securities i.e. some securities exhibit relative strength. ❖ Investors will earn higher returns by investing in securities which have demonstrated relative strength in the past because the relative strength of a security tends to remain undiminished over time. ❖ Relative strength can be measured in several ways. ❖ Calculating rates of return and classifying those securities with historically high average returns as securities with high relative strength is one of them. ❖ Even ratios like security relative to its industry and security relative to the entire market can also be used to detect relative strength in a security or an industry.

(v) **Odd-Lot Theory**: ❖ This theory is a contrary - pinion theory. ❖ It assumes that the average person is usually wrong and that a wise course of action is to pursue strategies contrary to popular opinion. ❖ The odd-lot theory is used primarily to predict tops in bull markets, but also to predict reversals in individual securities.

**QUESTION NO.13** Explain the different Charting Techniques?

❖ Broadly technical analysts use four types of charts for analyzing data. They are as follows:

![Chart Image]
(i) **Line Chart:** In a line chart, lines are used to connect successive day’s prices. The closing price for each period is plotted as a point. These points are joined by a line to form the chart. The period may be a day, a week or a month. [Diagram in previous page]

(ii) **Bar Chart:** In a bar chart, a vertical line (bar) represents the lowest to the highest price. The left and right horizontal lines on each price bar represent the open and closing prices. For example, the prices of share of A Ltd. for 6 days are as follows:

<table>
<thead>
<tr>
<th>Days</th>
<th>Opening Price (₹)</th>
<th>High Price (₹)</th>
<th>Low Price (₹)</th>
<th>Closing Price (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>01-Jan</td>
<td>58</td>
<td>72</td>
<td>52</td>
<td>68</td>
</tr>
<tr>
<td>02-Jan</td>
<td>71</td>
<td>73</td>
<td>58</td>
<td>64.30</td>
</tr>
<tr>
<td>03-Jan</td>
<td>66</td>
<td>67</td>
<td>56</td>
<td>57</td>
</tr>
<tr>
<td>04-Jan</td>
<td>58.50</td>
<td>75.50</td>
<td>55</td>
<td>72</td>
</tr>
<tr>
<td>05-Jan</td>
<td>73.50</td>
<td>75</td>
<td>58</td>
<td>71</td>
</tr>
<tr>
<td>06-Jan</td>
<td>74.50</td>
<td>76</td>
<td>55</td>
<td>74.50</td>
</tr>
</tbody>
</table>

The above-mentioned prices shall be depicted in Bar Chart as follows:

(iii) **Japanese Candlestick Chart:** Like Bar chart this chart also shows the same information i.e. Opening, Closing, Highest and Lowest prices of any stock on any day but this chart more visualizes the trend as change in the opening and closing prices is indicated by the color of the candlestick. While Black candlestick indicates closing price is lower than the opening price the white candlestick indicates its opposite i.e. closing price is higher than the opening price. Another possibility of no change in opening and closing prices or very near is shown by ‘Doji Candlestick’. Thus, a white Candlestick indicates a Bullish trend and a black Candlestick indicates a bearish trend. The lowest and highest prices are indicated by vertical bar and opening and closing prices are shown in the form of rectangular (as per above-mentioned color scheme) placed in between this bar. In case of Doji Candlestick it is indicated by a simple bar.

Continuing the above example of A Ltd. the prices of share of A Ltd. as per Candlestick chart is shown below:
(iv) **Point and Figure Chart:**

Point and Figure charts are more complex than line or bar charts. They are used to detect reversals in a trend. For plotting a point and figure chart, we have to first decide the box size and the reversal criterion. The box size is the value of each box on the chart, for example each box could be Re.1, Rs.2 or Rs.0.50. The smaller the box size, the more sensitive would the chart be to price change. The reversal criterion is the number of boxes required to be retraced to record prices in the next column in the opposite direction. A Point and Figure (P&F) chart is made up of multiple columns of X’s that represent increases in a security’s price and O’s that represent decreases in price. A column of X’s is always followed by a column of O’s, and vice-versa. Two things which needs to be decided before drawing P&F Chart are (i) Box Size (ii) Reversal amount. In the graph below we took Box Size 1 and reversal amount 3.

<table>
<thead>
<tr>
<th>Period</th>
<th>Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>24</td>
</tr>
<tr>
<td>2</td>
<td>26</td>
</tr>
<tr>
<td>3</td>
<td>27</td>
</tr>
<tr>
<td>4</td>
<td>26</td>
</tr>
<tr>
<td>5</td>
<td>28</td>
</tr>
<tr>
<td>6</td>
<td>27</td>
</tr>
<tr>
<td>7</td>
<td>26</td>
</tr>
<tr>
<td>8</td>
<td>25</td>
</tr>
<tr>
<td>9</td>
<td>26</td>
</tr>
<tr>
<td>10</td>
<td>23</td>
</tr>
</tbody>
</table>

**QUESTION NO.14 Explain few Interpreting Price Patterns?**

There are numerous price patterns documented by technical analysts but only a few and important of them have been discussed here:

(a)**Channel:** A series of uniformly changing tops and bottoms gives rise to a channel formation. A downward sloping channel would indicate declining prices and an upward sloping channel would imply rising prices.

(b)**Wedge:** A wedge is formed when the tops (resistance levels) and bottoms (support levels) change in opposite direction (that is, if the tops, are decreasing then the bottoms are increasing and vice versa), or when they are changing in the same direction at different rates over time.
(c) Head and Shoulders: It is a distorted drawing of a human form, with a large lump (for head) in the middle of two smaller humps (for shoulders). This is perhaps the single most important pattern to indicate a reversal of price trend. The neckline of the pattern is formed by joining points where the head and the shoulders meet. The price movement after the formation of the second shoulder is crucial. If the price goes below the neckline, then a drop in price is indicated, with the drop expected to be equal to the distance between the top of the head and the neckline.

(Head and Shoulders Image)

(i) Head and Shoulder Top Pattern: This has a left shoulder, a head and a right shoulder. Such formation represents bearish development. If the price falls below the neck line (line drawn tangentially to the left and right shoulders) a price decline is expected. Hence it’s a signal to sell.

(ii) Inverse Head and Shoulder Pattern: As the name indicates this formation, it is an inverse of head and shoulder top formation. Hence it reflects a bullish development. The price rise to above the neck line suggests price rise is imminent and a signal to purchase.

(Head and Shoulder Patterns Images)

(d) Triangle or Coil Formation: This formation represents a pattern of uncertainty and is difficult to predict which way the price will break out.

(e) Flags and Pennants Form: This form signifies a phase after which the previous price trend is likely to continue.
(f) **Double Top Form:** This form represents a bearish development, signals that price is expected to fall.

(g) **Double Bottom Form:** This form represents bullish development signaling price is expected to rise.

**DOUBLE TOP  DOUBLE BOTTOM**

(h) **Gap:** A gap is the difference between the opening price on a trading day and the closing price of the previous trading day. The wider the gap the stronger the signal for a continuation of the observed trend. On a rising market, if the opening price is considerably higher than the previous closing price, it indicates that investors are willing to pay a much higher price to acquire the scrip. Similarly, a gap in a falling market is an indicator of extreme selling pressure.

### 3. SECURITIZATION

**QUESTION NO.1** What are the Features of Securitization? OR “The process of securitisation can be viewed as process of creation of additional financial product of securities in the market backed by collaterals.” What are the other feature? Describe.

(i) **Creation of Financial Instruments** - The process of Securitization can be viewed as process of creation of additional financial product of securities in market backed by collaterals.

(ii) **Bundling and Unbundling** - When all the assets are combined in one pool it is bundling and when these are broken into instruments of fixed denomination it is unbundling.

(iii) **Tool of Risk Management** - In case of assets are securitized on non-recourse* basis, then securitization process acts as risk management as the risk of default is shifted.

(iv) **Structured Finance** - In the process of securitization, financial instruments are tailor structured to meet the risk return trade profile of investor, and hence, these securitized instruments are considered as best examples of structured finance.

(v) **Trenching*** - Portfolio of different receivable or loan or asset are split into several parts based on risk and return they carry called ‘Trench’. Each Trench carries a different level of risk and return.

(vi) **Homogeneity*** - Under each trench the securities are issued of homogenous nature and even meant for small investors who can afford to invest in small amounts.

**QUESTION NO.2** What are the BENEFITS OF SECURITIZATION ?

(i) **From the angle of originator**

(ii) **Off - Balance Sheet Financing:** When loan/receivables are securitized it release a portion of capital tied up in these assets resulting in off Balance Sheet financing leading to improved liquidity position which helps expanding the business of the company.

(iii) **More specialization in main business:** By transferring the assets, the entity could concentrate more on core business as servicing of loan is transferred to SPV(Special Purpose Vehicle). Further, in case of non-recourse* arrangement even the burden of default is shifted.

(iv) **Helps to improve financial ratios:** Especially in case of Financial Institutions and Banks, it helps to manage
Capital -To-Weighted Asset Ratio effectively.

(iv) **Reduced borrowing Cost:** Securitized papers are rated and due to credit enhancement these securities can be issued at reduced rate of debts and hence the originator earns a spread*, resulting in reduced cost of borrowings.

From the angle of investor

1. **Diversification of Risk:** Purchase of securities backed by different types of assets provides the diversification of portfolio resulting in reduction of risk.

2. **Regulatory requirement:** Acquisition of asset backed belonging to a particular industry say micro industry helps banks (which can also act as an Investor) to meet regulatory requirement of investment of fund in industry specific.

3. **Protection against default:** In case of recourse* arrangement if there is any default by any third party then originator will be responsible and there can be insurance arrangement for compensation for any such default.

**QUESTION NO.3** Who are the PARTICIPANTS IN SECURITIZATION? OR DISTINGUISH between: Primary participants and secondary participants in securitization? OR Participants are required for the success of the securitisation process. Discuss their roles OR Explain the Secondary Participants involved in the process of Securitization of Instruments. OR Discuss about the Primary Participants in the process of Securitization.

**Solution:**

Broadly, the participants in the process of securitization can be divided into two categories; one is Primary Participant and the other is Secondary Participant.

Primary Participants: Primary Participants are main parties to this process. The primary participants in the process of securitization are as follows:

(a) **Originator:** It is the initiator of deal or can be termed as securitizer. It is an entity which sells the assets lying in its books and receives the funds generated through the sale of such assets. The originator transfers both legal as well as beneficial interest to the Special Purpose Vehicle.

(b) **Special Purpose Vehicle:** Also, called SPV is created for the purpose of executing the deal. Since issuer originator transfers all rights in assets to SPV, it holds the legal title of these assets. It is created especially for the purpose of securitization only and normally could be in form of a company, a firm, a society or a trust. The main objective of creating SPV is to remove the asset from the Balance Sheet of Originator. Further, it also issues the securities to the investors.

(c) **The Investors:** Investors are the buyers of securitized papers which may be an individual, an institutional investor such as mutual funds, provident funds, insurance companies, mutual funds, Financial Institutions etc.

Secondary Participants: Besides the primary participants, other parties involved into the securitization process are as follows:

(a) **Obligor:** Actually they are the main source of the whole securitization process. They are the parties who owe money to the firm and are assets in the Balance Sheet of Originator.

(b) **Rating Agency:** Rating agency assesses the following: (i) Strength of the Cash Flow. (ii) Mechanism to ensure timely payment of interest and principle repayment. (iii) Credit quality of securities. (iv) Liquidity support. (v) Strength of legal framework.

(c) **Receiving and Paying agent (RPA):** Also, called Servicer or Administrator, it collects the payment due from obligor and passes it to SPV. It also follow up with defaulting borrower and if required initiate appropriate legal action against them. Generally, an originator or its affiliates acts as servicer.

(d) **Agent or Trustee:** Trustees are appointed to oversee that all parties to the deal perform in the true spirit of terms of agreement. Normally, it takes care of interest of investors who acquires the securities.

(e) **Credit Enhancer:** Since investors in securitized instruments are directly exposed to performance of the loan, they seek additional comfort in the form of credit enhancement. Originator itself or a third party say a bank may provide this additional context called Credit Enhancer.

(f) **Structurer:** It brings together the originator, investors, credit enhancers and other parties to the deal of securitization. It ensures that deal meets all legal, regulatory, accounting and tax laws requirements.
QUESTION NO.4 What are the steps /MECHANISM OF SECURITIZATION?

1. **Creation of Pool of Assets:** The process of securitization begins with creation of pool of assets by segregation of assets backed by similar type of mortgages in terms of interest rate, risk, maturity and concentration units.

2. **Transfer to SPV:** Once assets have been pooled, they are transferred to Special Purpose Vehicle (SPV) especially created for this purpose.

3. **Sale of Securitized Papers:** SPV designs the instruments based on nature of interest, risk, tenure etc. based on pool of assets. These instruments can be Pass Through Security or Pay Through Certificates. [PTS & PTC will be explained later]

4. **Administration of assets:** The administration of assets where originator collects principal and interest from underlying assets and transfer it to SPV, which acts as a conduit.

5. **Recourse* to Originator:** Performance of securitized papers depends on the performance of underlying assets and unless specified in case of default they go back to originator from SPV.

6. **Repayment of funds:** SPV will repay the funds in form of interest and principal that arises from the assets pooled.

7. **Credit Rating to Instruments:** Sometimes before the sale of securitized instruments credit rating can be done to assess the risk of the issuer.

QUESTION NO.5 What are the main PROBLEMS IN SECURITIZATION especially in Indian context?

1. **Stamp Duty:** Stamp Duty is one of the obstacles in India. Under Transfer of Property Act, 1882, a mortgage debt stamp duty which even goes up to 12% in some states of India and this impedes the growth of securitization in India. It should be noted that since pass through certificate does not evidence any debt only able to receivable, they are exempted from stamp duty. Moreover, in India, recognizing the special nature of securitized instruments in some states has reduced the stamp duty on them.

2. **Taxation:** Taxation is another area of concern in India. In the absence of any specific provision relating to securitized instruments in Income Tax Act, expert’s opinion differ a lot. Some are of opinion that SPV as a trustee is liable to be taxed in a representative capacity then other are of view that instead of SPV, investors will be taxed on their share of income. Clarity is also required on the issues of capital gain implications on passing payments to the investors.

3. **Accounting:** Accounting and reporting of securitized assets in the books of originator is another area of concern. Although securitization is slated to an off-balance sheet instrument but in true sense receivables are removed from originator’s balance sheet. Problem arises especially when assets are transferred without recourse*.

4. **Lack of standardization:** Every originator follows own format for documentation and administration, hence lack of standardization is another obstacle in growth of securitization.

5. **Inadequate Debt Market:** Lack of existence of a well-developed debt market in India is another obstacle that hinders the growth of secondary market of securitized or asset-backed securities.

6. **Ineffective Foreclosure* laws:** Foreclosure laws are not supportive to lending institutions and this makes securitized instruments especially mortgaged backed securities less attractive as lenders face difficulty in transfer of property in event of default by the borrower.

QUESTION NO.6 What are the SECURITIZATION INSTRUMENTS?

1. **Pass Through Certificates (PTCs):**
   - As the title suggests, originator (seller of the assets) transfers the entire receipt of cash in form of interest or principal repayment from the assets sold. Thus, these securities represent direct claim of the investors on all the assets that have been securitized through SPV. Since all cash flows are transferred, the investors carry proportional beneficial interest in the asset held in the trust by SPV. It should be noted that since it is a direct route, any prepayment of principal is also proportionately distributed among the securities holders. Further, due to these characteristics, on completion of securitization by the final payment of assets, all the securities are terminated simultaneously. Skewness* of cash flows occurs in early stage if principals are repaid before the...
scheduled time.

2. Pay Through Security (PTS)

As mentioned earlier, since in PTCs all cash flows are passed to the performance of the securitized assets. To overcome this limitation there is another structure i.e. PTS. In PTS, SPV can issue debt securities backed by the assets and hence it can restructure different tranches from varying maturities of receivables. In other words, this structure permits desynchronization of servicing of securities issued from cash flow generating from the asset. Further, this structure also permits the SPV to reinvest surplus funds for short term as per their requirement. Since, in Pass Through Certificates, all cash flow are immediately passed, In PTS in case of early retirement of receivables, cash can be used for short term yield. This structure also provides the freedom to issue several debt trances with varying maturities.

3. Stripped Securities

Stripped Securities are created by dividing the cash flows associated with underlying securities into two new securities. Those two securities are as follows:

(i) Interest Only (IO) Securities
(ii) Principle Only (PO) Securities

As each investor receives a combination of principal and interest, it can be stripped into two portion of Interest and Principle. Accordingly, the holder of IO securities receives only interest while PO security holder receives only principal. Being highly volatile in nature these securities are less preferred by investors. In case yield to maturity(interest) in market rises, PO price tends to fall as borrower prefers to postpone the payment of principal amount. Reason is simple if they pay early they will have to borrow money at high rate of interest. Hence they prefer to postpone their principal payment. Whereas if interest rate in market falls, PO price tends to rise as the borrower tends to repay the loans fast as they prefer to borrow fresh at lower rate of interest. In contrast, value of IO's securities increases when interest rate goes up in the market as more interest is collected on borrowings. As borrower will pay interest on time as they know that they are paying less interest than prevailing rate. Whereas if interest rate in market falls, the borrower tends to repay the loans fast rather than interest. And due to prepayments of principals, IO's tends to fall. Thus, from the above, it is clear that it is mainly perception of investors that determines the prices of IOs and POs.

QUESTION NO.7 Distinguish between Pass Through Certificates (PTCs) and Pay Through Securities (PTSs)

The difference between Pass Through Certificates (PTCs) and Pay Through Securities (PTSs) are as follows:

Pass Through Certificates (PTCs)
- The originator (seller of the assets) transfers the entire receipt of cash in form of interest or principal repayment from the assets sold. Thus, the investors carry proportional beneficial interest in the asset held in the trust by SPV.
- PTCs are self-amortizing assets because it is a direct route of prepayment of principal which is proportionately distributed among the securities holders. Due to these characteristics on completion of securitization by the final payment of assets, all the securities are terminated simultaneously. Further it also carries uncertainty in repayment of principal.
- Since whatever cash is received is simply passed through there are hardly any surplus fund is left for short term investment.

Pay Through Securities (PTSs)
- In PTS, SPV debt securities backed by the assets and hence it can restructure different tranches from varying maturities of receivables.
- This structure permits desynchronization of servicing of securities issued from cash flow generating from the asset which are used as collateral. Accordingly these subject to less uncertainty regarding the pre-payment of principal.
- This structure permits the SPV to reinvest surplus funds for short term as per their requirement.
QUESTION NO.8 How PRICING OF THE SECURITIZED INSTRUMENTS are done? OR Explain the pricing of the securitized Instruments?

- Pricing of securitized instruments in an important aspect of securitization. While pricing the instruments, it is important that it should be acceptable to both originators as well as to the investors. **On the same basis pricing of securities can be divided into following two categories:**

  - **From Originator’s Angle:** From originator’s point of view, the instruments can be priced at a rate at which originator has to incur an outflow and if that outflow can be amortized over a period of time then it should match the amount raised through securitization.
  - **From Investor’s Angle:** From an investor’s angle security price can be determined by discounting best estimate of expected future cash flows using rate of yield to maturity (Kd) of a security of comparable security with respect to credit quality and average life of the securities. This yield can also be estimated by referring the yield curve available for marketable securities, though some adjustments is needed on account of spread* points, because of credit quality of the securitized instruments.

QUESTION NO.9 Write a short note on SECURITIZATION IN INDIA ?

- It is the **Citi Bank** who pioneered the concept of securitization in India by bundling of auto loans in securitized instruments. Thereafter many organizations securitized their receivables. Although started with securitization of **auto loans** it moved to other types of receivables such as sales tax deferrals, aircraft receivable etc. In order to encourage securitization, the Government has come out with Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002, to tackle menace of Non Performing Assets (NPAs) without approaching to Court. With growing sophistication of financial products in Indian Capital Market, **securitization has occupied an important place.** As mentioned above, though, initially started with auto loan receivables, it has become an important **source of funding for micro finance companies and NBFCs** and even now a days commercial mortgage backed securities are also emerging. The important highlight of the scenario of securitization in Indian Market is that it is dominated by a few players e.g. **ICICI Bank, HDFC Bank, NHB etc.** As per a report of CRISIL, securitization transactions in India scored to the **highest level of approximately Rs. 70000 crores, in Financial Year 2016. (Business Line, 15th June, 2016).** In order to further enhance the investor base in securitized debts, **SEBI allowed FPIs (Foreign Portfolio Investment) to invest in securitized debt of unlisted companies upto a certain limit.**

**4. STARTUP FINANCE**

QUESTION NO.1 What are the INNOVATIVE WAYS TO FINANCE A STARTUP? OR Explain some of the sources for funding a start-up? OR Examine briefly the various innovative methods of funding the Startups. Non-bank Financial Sources are becoming popular to finance Start-ups. Discuss.

- Here are some of the innovative sources for funding a Startup:
  
  (i) **Personal financing.** It may not seem to be innovative but you may be surprised to note that most budding entrepreneurs never thought of saving any money to start a business. This is important because most of the investors will not put money into a deal if they see that you have not contributed any money from your personal sources.
  
  (ii) **Personal credit lines.** One qualifies for personal credit line based on one’s personal credit efforts. Credit cards are a good example of this. However, banks are very cautious while granting personal credit lines. They provide this facility only when the business has enough cash flow to repay the line of credit.
  
  (iii) **Family and friends.** These are the people who generally believe in you, without even thinking that your idea works or not. However, the loan obligations to friends and relatives should always be in writing as a promissory note or otherwise.
  
  (iv) **Peer-to-peer lending.** In this process group of people come together and lend money to each other. Peer to peer lending has been there for many years. Many small and ethnic business groups having similar faith or
interest generally support each other in their start up endeavors.

(v) **Crowdfunding.** Crowdfunding is the use of small amounts of capital from a large number of individuals to finance a new business initiative. Crowdfunding makes use of the easy accessibility of vast networks of people through social media and crowdfunding websites to bring investors and entrepreneurs together.

(vi) **Microloans.** Microloans are small loans that are given by individuals at a lower interest to a new business ventures. These loans can be issued by a single individual or aggregated across a number of individuals who each contribute a portion of the total amount.

(vii) **Vendor financing.** Vendor financing is the form of financing in which a company lends money to one of its customers so that he can buy products from the company itself. Vendor financing also takes place when many manufacturers and distributors are convinced to defer payment until the goods are sold. This means extending the payment terms to a longer period for e.g. 30 days payment period can be extended to 45 days or 60 days. However, this depends on one's credit worthiness and payment of more money.

(viii) **Purchase order financing.** The most common scaling problem faced by startups is the inability to find a large new order. The reason is that they don't have the necessary cash to produce and deliver the product. Purchase order financing companies often advance the required funds directly to the supplier. This allows the transaction to complete and profit to flow up to the new business.

(ix) **Factoring accounts receivables.** In this method, a facility is given to the seller who has sold the good on credit to fund his receivables till the amount is fully received. So, when the goods are sold on credit, and the credit period (i.e. the date upto which payment shall be made) is for example 6 months, factor will pay most of the sold amount up front and rest of the amount later. Therefore, in this way, a startup can meet his day to day expenses.

**QUESTION NO.2 What is PITCH PRESENTATION?**

- Pitch deck presentation is a short and brief presentation (not more than 20 minutes) to investors explaining about the prospects of the company and why they should invest into the startup business.

**Here, some of the methods have been highlighted below as how to approach a pitch presentation:**

(i) **Introduction:** To start with, first step is to give a brief account of yourself i.e. who are you? What are you doing?

(ii) **Team:** The next step is to introduce the audience the people behind the scenes.

(iii) **Problem:** Further, the promoter should be able to explain the problem he is going to solve.

(iv) **Solution:** It is very important to describe in the pitch presentation as to how the company is planning to solve the problem.

(v) **Marketing/Sales:** The market size of the product must be communicated to the investors. This can include profiles of target customers, but one should be prepared to answer questions about how the promoter is planning to attract the customers.

(vi) **Projections or Milestones:** Financial projections include three basic documents that make up a business’s financial statements. (i) Income statement (ii) Cash flow statement (iii) Balance sheet

(vii) **Competition:** Every business organization has competition even if the product or service offered is new and unique. It is necessary to highlight in the pitch presentation as to how the products or services are different from their competitors.

(viii) **Business Model:** The term business model is a wide term denoting core aspects of a business including purpose, business process, target customers, offerings, strategies, infrastructure, organizational structures, sourcing, trading practices, and operational processes and policies including culture.

(ix) **Financing:** If a startup business firm has raised money, it is preferable to talk about how much money has already been raised, who invested money into the business and what they did about it.

**QUESTION NO.3 What are the MODES OF FINANCING FOR STARTUPS?**

(i) **Bootstrapping:** (ii) **Angel Investors:** (iii) Venture Capital Funds
**QUESTION NO.4** EXPLAIN the concept of Bootstrapping and describe the various methods of bootstrapping used by start ups. OR Explain the methods in which a Startup firm can bootstrap. OR An individual attempts to found and build a company from personal finances or from the operating revenues of the new company. What this method is called? Discuss any two methods.

When an individual attempts to found and build a company from personal finances or from the operating revenues of the new company, **it is called Boot Strapping.**

A common mistake made by most founders is that they make unnecessary expenses towards marketing, offices and equipment they cannot really afford. So, it is true that more money at the inception of a business leads to complacency and wasteful expenditure. On the other hand, investment by startups from their own savings leads to cautious approach. It **curbs wasteful expenditures** and enable the promoter to be on their toes all the time.

**Here are some of the methods in which a startup firm can bootstrap:**

(i) **Trade Credit**

When a person is starting his business, **suppliers are reluctant to give trade credit.** They will insist on payment of their goods supplied either by cash or by credit card. However, a way out in this situation is to prepare a well-crafted financial plan. The next step is to pay a visit to the supplier’s office. If the business organization is small, the owner can be directly contacted. On the other hand, if it is a big firm, the Chief Financial Officer can be contacted and convinced about the financial plan.

**Communication skills are important here.** The financial plan has to be shown. The owner or the financial officer has to be explained about the business and the need to get the first order on credit in order to launch the venture. The owner or financial officer may give half the order on credit and balance on delivery. The trick here is to get the goods shipped and sell them before paying to them. One can also borrow to pay for the good sold. But there is interest cost also. So trade credit is one of the most important ways to reduce the amount of working capital one needs. This is especially true in retail operations.

When you **visit your supplier to set up your order** during your startup period, ask to speak directly to the owner of the business if it’s a small company. If it’s a larger business, ask to speak to the chief financial officer or any other person who approves credit. Introduce yourself. Show the officer the financial plan that you have prepared. Tell the owner or financial officer about your business, and explain that you need to get your first orders on credit in order to launch your venture.

The owner or financial officer may give half the order on credit, with the balance due upon delivery. Of course, the trick here is to get the goods shipped, and sell them before one has to pay for them. One could borrow money to pay for the inventory, but you have to pay interest on that money. So trade credit is one of the most important ways to reduce the amount of working capital one needs. This is especially true in retail operations.

(ii) **Factoring**

This is a **financing method where accounts receivable of a business organization is sold** to a commercial finance company to raise capital. The factor then got hold of the accounts receivable of a business organization and assumes the task of collecting the receivables as well as doing what would’ve been the paperwork. Factoring can be performed on a non-notification basis. It means customers may not be told that their accounts have been sold.

However, there are **merits and demerits to factoring.** The process of factoring may actually reduce costs for a business organization. It can actually reduce costs associated with maintaining accounts receivable such as bookkeeping, collections and credit verifications. If comparison can be made between these costs and fee payable to the factor, in many cases it has been observed that it even proved fruitful to utilize this financing method.

In addition to reducing internal costs of a business, **factoring also frees up money that would otherwise be tied to receivables.** This is especially true for businesses that sell to other businesses or to government; there are often long delays in payment that this would offset. This money can be used to generate profit through other avenues of the company. Factoring can be a very useful tool for raising money and keeping cash flowing.

(iii) **Leasing**

Another popular method of bootstrapping is **to take the equipment on lease rather than purchasing it.** It will...
reduce the capital cost and also help lessee (person who take the asset on lease) to claim tax exemption. So, it is better to take a photocopy machine, an automobile or a van on lease to avoid paying out lump sum money which is not at all feasible for a startup organization.

Further, if you are able to shop around and get the best kind of leasing arrangement when you’re starting up a new business, it’s much better to lease. It’s better, for example, to lease a photocopier, rather than pay $3,000 for it; or lease your automobile or van to avoid paying out $8,000 or more.

There are advantages for both the startup businessman using the property or equipment (i.e. the lessee) and the owner of that property or equipment (i.e. the lessor.) The lessor enjoys tax benefits in the form of depreciation on the fixed asset leased and may gain from capital appreciation on the property, as well as making a profit from the lease. The lessee benefits by making smaller payments retain the ability to walk away from the equipment at the end of the lease term. The lessee may also claim tax benefit in the form of lease rentals paid by him.

**QUESTION NO.5** Write a short note on Angel Investor?

Angel investors invest in small startups or entrepreneurs. Often, angel investors are among an entrepreneur’s family and friends. The capital angel investors provide may be a one-time investment to help the business grow or an ongoing injection of money to support and carry the company through its difficult early stages.

Angel investors provide more favorable terms compared to other lenders, since they usually invest in the entrepreneur starting the business rather than the viability of the business. Angel investors are focused on helping startups take their first steps, rather than the possible profit they may get from the business. Essentially, angel investors are the opposite of venture capitalists.

Angel investors are also called informal investors, angel funders, private investors, seed investors or business angels. These are affluent (rich) individuals who inject capital for startups in exchange for ownership equity or convertible debt. Some angel investors invest through crowdfunding platforms online or build angel investor networks to pool in capital.

Angel investors typically use their own money, unlike venture capitalists who take care of pooled money from many other investors and place them in a strategically managed fund. Though angel investors usually represent individuals, the entity that actually provides the fund may be a limited liability company, a business, a trust or an investment fund, among many other kinds of vehicles.

Angel investors who seed startups that fail during their early stages can lose their investments completely. This is why professional angel investors look for opportunities for a defined exit strategy, acquisitions or initial public offerings (IPOs).

**QUESTION NO.6** Write a short note on Venture Capital Funds?

**Meaning:** Venture capital funds are investment funds that manage the money of investors who seek to invest in startup and small- to medium-sized enterprises with strong growth potential. These investments are generally characterized as high-risk/high-return opportunities.

**Structure of Venture Capital Fund in India**

Three main types of fund structure exist: one for domestic funds and two for offshore ones:

(a) Domestic Funds: Domestic Funds raises funds domestically. They are usually structured as: (i) a domestic vehicle for the pooling of funds from the investor, (ii) a separate investment adviser that carries those duties of asset manager. Domestic Vehicle may be a trust and a company. India, unlike most developed countries does not recognize a limited partnership. Trust form is considered best due to its operational flexibility.

(b) Offshore Funds: Two common alternatives available to offshore investors are: the “offshore structure” and the “unified structure”. Offshore structure: Under this structure, an investment vehicle having jurisdiction outside India is created. It can be an LLC or an LP. It makes investments directly into Indian portfolio companies. Typically, the assets are managed by an offshore manager, while the investment advisor in India carries out the due diligence and identifies deals.
Unified Structure: When **domestic investors** are expected to participate in the fund, a unified structure is used. **Overseas investors** pool their assets in an offshore vehicle that invests in a **locally managed trust**, whereas **domestic investors** directly contribute to the trust. This structure is devised to make the **local portfolio investments**.

Investors in venture capital funds are:

Formation of venture capital are

---

**Characteristics of Venture Capital Financing:**

(i) **Long time horizon:** The fund would invest with a long time horizon in mind. Minimum period of investment would be 3 years and maximum period can be 10 years.

(ii) **Lack of liquidity:** When VC invests, it takes into account the liquidity factor. It assumes that there would be less liquidity on the equity it gets. They adjust this liquidity premium against the price and required return.

(iii) **High Risk:** VC would not hesitate to take risk. It works on principle of high risk and high return. So, high risk would not eliminate the investment choice for a venture capital.

(iv) **Equity Participation:** Most of the time, VC would be investing in the form of equity of a company. This would help the VC participate in the management and help the company grow. Besides, a lot of board decisions can be supervised by the VC if they participate in the equity of a company.

**Advantages of bringing VC in the company:**

1. It injects **long-term equity finance** which provides a **solid capital base** for future growth.
2. The venture capitalist is a business partner, **sharing both the risks and rewards**. Venture capitalists are rewarded with business success and capital gain.
3. The venture capitalist is able to **provide practical advice and assistance** to the company based on past experience with other companies which were in similar situations.
4. The venture capitalist also **has a network of contacts** in many areas that can add value to the company.
5. The venture capitalist may be **capable of providing additional rounds of funding** should it be required to finance growth.
6. Venture capitalists are experienced in the process of **preparing a company for an initial public offering (IPO)** of its shares onto the stock exchanges or overseas stock exchange such as NASDAQ.
7. They can also facilitate a trade sale*.

**Stages of funding for VC:** or Venture Capital Funding passes through various stages. Discuss.

1. **Seed Money**: Low level financing **needed to prove a new idea**.
2. **Startup**: Early stage firms that need funding for expenses associated with **marketing & product development**.
3. **First-Round**: Early **sales and manufacturing funds**.
4. **Second-Round**: **Working capital** for early stage companies that are selling product, but not yet turning in a profit.
5. **Third Round**: Also called Mezzanine financing, this is **expansion money** for a newly profitable company.
6. **Fourth-Round**: Also called bridge financing, it is intended to finance the **“going public”** process.

Risk in each stage is different. **An indicative Risk matrix is given below:**

<table>
<thead>
<tr>
<th>Financial Stage</th>
<th>Period (Funds locked in years)</th>
<th>Risk Perception</th>
</tr>
</thead>
<tbody>
<tr>
<td>Seed Money</td>
<td>7-10</td>
<td>Extreme</td>
</tr>
<tr>
<td>Start Up</td>
<td>5-9</td>
<td>Very High</td>
</tr>
</tbody>
</table>
QUESTION NO.7 ‘Venture Capital Financing is a unique way of financing Startup’. Discuss.
Yes, Venture Capital Financing is unique manner of financing a Startup as it possesses the following characteristics:
(i) Long time horizon: .... (iv) Equity Participation: Refer previous solution

QUESTION NO.8 What are the steps of Venture capital Investment?
(1) Deal Origination: VC operates directly or through intermediaries. Mainly many practicing Chartered Accountants would work as intermediary and through them VC gets the deal. Before sourcing the deal, the VC would inform the intermediary or its employees about the following
(a) Sector focus (b) Stages of business focus (c) Promoter focus (d) Turnover focus
(2) Screening: Once the deal is sourced the same would be sent for screening by the VC.
(3) Due Diligence: Once the decision is taken to proceed further, the VC would now carry out due diligence. This is mainly the process by which the VC would try to verify the accuracy of the documents taken.
(4) Deal Structuring: The deal is structured in such a way that both parties win.
(5) Post Investment Activity: The company has to adhere to certain guidelines like strong MIS (Management Information System), strong budgeting system, strong corporate governance and other restrictions of the VC and periodically keep the VC updated about certain milestones.
(6) Exit plan: At the time of investing, the VC would ask the promoter or company to spell out in detail the exit plan. Mainly, exit happens in two ways:
(a) One way is ‘sell to third party(ies)’. This sale can be in the form of IPO or Private Placement to other VCs.
(b) The second way to exit is that promoter would give a buy back commitment at a pre agreed rate (generally between IRR of 18% to 25%). In case the exit is not happening in the form of IPO or third party sell, the promoter would buy back. In many deals, the promoter buyback is the first refusal method adopted i.e. the promoter would get the first right of buyback.

QUESTION NO.9 Compare and contrast startups and entrepreneurship. Describe the priorities and challenges which startups in India are facing?
Differences between a startup and entrepreneurship:
(i) Start up is a part of entrepreneurship. Entrepreneurship is a broader concept and it includes a startup firm.
(ii) The main aim of startup is to build a concern, conceptualize the idea which it has developed into a reality and build a product or service. On the other hand, the major objective of an already established entrepreneurship concern is to attain opportunities with regard to the resources they currently control.
(iii) A startup generally does not have a major financial motive whereas an established entrepreneurship concern mainly operates on financial motive.

Priorities and challenges which startups in India are facing: The priority is on bringing more and more smaller firms into existence. So, the focus is on need based, instead of opportunity based entrepreneurship. Moreover, the trend is to encourage self-employment rather than large, scalable concerns. The main challenge with the startup firms is getting the right talent. And, scarcity of skilled workforce can hinder the chances of a startup organization's growth and development. Further, startups had to comply with numerous regulations which escalates it’s cost. It leads to further delaying the chances of a breakeven or even earning some amount of profit.

QUESTION NO.10 EXPLAIN Startup India Initiative? OR What is a startup to avail the benefits of government scheme? OR What is a startup to avail the benefits of government scheme?
Start-up India scheme was initiated by the Government of India on 16th of January, 2016. As per GSR Notification 127 (E) dated 19th February 2019, an entity shall be considered as a Start-up:

(i) **Upto a period of ten years** from the date of incorporation/ registration, if it is incorporated as a private limited company (as defined in the Companies Act, 2013) or registered as a partnership firm (registered under section 59 of the Partnership Act, 1932) or a limited liability partnership (under the Limited Liability Partnership Act, 2008) in India.

(ii) **Turnover of the entity** for any of the financial years since incorporation / registration has not exceeded one hundred crore rupees.

(iii) **Entity is working towards innovation**, development or improvement of products or processes or services, or if it is a scalable business model with a high potential of employment generation or wealth creation. **Provided** that an entity formed by splitting up or reconstruction of an existing business shall not be considered a 'Start-up'.

**QUESTION NO.11** Peer – to – Peer Lending and Crowd funding are same and traditional methods of funding. Do you agree? Justify your stand.

- No, I do not agree with the given statement because while peer-to-peer lending is in existence for many years the crowd funding is contemporary source of finance for Start-up finance.
- Further in peer-to-peer lending a group of people come together and lend money to each other. Many small and ethnic business groups having similar faith or interest generally support each other in their start-up endeavors.
- On the other hand, Crowdfunding is the use of small amounts of capital from a large number of individuals to finance a new business initiative. Crowdfunding makes use of the easy accessibility of vast networks of people through social media and crowdfunding websites to bring investors and entrepreneurs together.

**QUESTION NO.12** Explain the term Business Model with help of an example.

- The term **business model** is a wide term denoting core aspects of a business including purpose, business process, target customers, offerings, strategies, infrastructure, organizational structures, sourcing, trading practices, and operational processes and policies including culture.
- Further, as per Investopedia, a **business model** is the way in which a company generates revenue and makes a profit from company operations. Analysts use the term gross profit as a way to compare the efficiency and effectiveness of a firm's business model. Gross profit is calculated by subtracting the cost of goods sold from revenues.
- A **business model can be illustrated with the help of an example**. There are two companies – company A and company B. Both the companies are engaged in the business of renting movies. Prior to the advent of internet both the companies rent movies physically. Both the companies made Rs. 5,00,000 as revenues. Cost of goods sold was Rs. 400000. So, the companies made Rs. 100000 as gross profit. After the introduction of internet, company A started to offer movies online instead of renting or selling it physically. This change affected the business model of company A positively. Revenue is still Rs. 500000. But the significant part is that cost of goods sold is now Rs. 200000 only. This is because online sales lead to significant reduction of storage and distribution costs. So, the gross profit increases from 20% to 60%.
- Therefore, Company A isn't making more in sales, but it figured out a way to revolutionize its business model, which greatly reduces costs. Managers at company A have an additional 40% more in margin to play with that of managers at company B. Managers at company B have little room for error and they have to tread carefully.
- Every investor wants to get his money back, so it’s important to tell them in a pitch presentation as to how they should plan on generating revenue. **It is better to show the investors a list of the various revenue streams for a business model** and the timeline for each of them. Further, how to price the product and what does the competitor charge for the same or similar product shall also be highlighted. It is also beneficial to discuss the lifetime value of the customer and what should be the strategy to keep him glued to their product.
5. RISK MANAGEMENT

QUESTION NO.1 Explain how many TYPES OF RISK IS FACED BY AN ORGANIZATION?

**Strategic Risk:** Strategic risk is a risk in which a company’s strategy becomes less effective and it struggles to achieve its goal.

**Compliance Risk:** Every business needs to comply with rules and regulations. For example with the advent of Companies Act, 2013, and continuous updating of SEBI guidelines, each business organization has to comply with plethora of rules, regulations and guidelines.

**Operational Risk:** This type of risk relates to internal risk. It also relates to **failure on the part of the company to cope with day to day operational problems.** Operational risk relates to 'people' as well as 'process'.

**Financial Risk:** Financial Risk is referred as the unexpected changes in financial conditions such as prices, exchange rate, Credit rating, and interest rate etc. Broadly **Financial Risk can be divided into following categories:**

1. **Counter Party Risk:** This risk occurs due to non-honoring of obligations by the counter party which can be failure to deliver the goods for the payment already made or vice-versa or repayment of borrowings and interest etc. Thus, this risk also covers the credit risk i.e. default by the counter party.

2. **Political Risk:** Generally this type of risk is faced by an overseas investors, as the adverse action by the government of host country* may lead to huge loses. This can be on any of the following form:
   - (i) Confiscation or destruction of overseas properties.
   - (ii) Rationing of remittance to home country.
   - (iii) Restriction on conversion of local currency of host country* into foreign currency.
   - (iv) Restriction as borrowings.
   - (v) Invalidation of Patents
   - (vi) Price control of products

3. **Interest Rate Risk:** This risk occurs due to change in interest rate resulting in change in asset and liabilities. This risk is more important for banking companies as their balance sheet’s items are more interest sensitive and their base of earning is spread* between borrowing and lending rates.
   - As we know that the interest rates are two types i.e. fixed and floating. The risk in both of these types is inherent. If any company has borrowed money at floating rate then the risk is rise in interest rate. If any company has borrowed money at fixed rate then the risk is fall in interest rate.

4. **Currency Risk:** This risk mainly affects the organization dealing with foreign exchange as their cash flows changes with the movement in the currency exchange rates. This risk can be affected by cash flow adversely or favorably. For example, if rupee depreciates or dollar appreciates, exporter will stand to gain. If rupee appreciates or dollar depreciates, importer will gain. The best case we can quote Infosys (Exporter) and Indian Oil Corporation Ltd. (Importer).

5. **Liquidity Risk:** Broadly liquidity risk can be defined as inability of organization to meet it liabilities whenever they become due. This risk mainly arises when organization is unable to generate adequate cash or there may be some mismatch in period of cash flow generation. This type of risk is more prevalent in banking business where there may be mismatch in maturities and receiving fresh deposits pattern.

QUESTION NO.2 What is Financial Risk? How it can be evaluated from point of views. OR EVALUATE financial risk from different point of views(STAKEHOLDERS)? or Identify how different stakeholders view the financial risk?

Financial Risk is referred as the unexpected changes in financial conditions such as prices, exchange rate, Credit rating, and interest rate etc. Though political risk is not a financial risk in direct sense but same can be included as any unexpected political change in any foreign country may lead to country risk which may ultimately result in financial loss.

The financial risk can be evaluated from different point of views as follows:

(a) From shareholder’s point of view: Major stakeholders of a business are equity shareholders and they view financial gearing i.e. ratio of debt in capital structure of company as risk since in event of winding up of a company they will be least prioritized. Even for a lender, existing gearing is also a risk since company having high gearing faces more risk in default of
payment of interest and principal repayment.

(b) From Company’s point of view: From company’s point of view if a company borrows excessively or lend to someone who defaults, then it can be forced to go into liquidation.

(c) From Government’s point of view: From Government’s point of view, the financial risk can be viewed as failure of any bank (like Lehman Brothers*), and downgrading of any financial institution leading to spread of distrust among society at large. Even this risk also includes willful defaulters*. This can also be extended to sovereign debt crisis*.

QUESTION NO.3 WHAT IS VALUE-AT-RISK (VAR)?

VAR is a measure of risk of investment. Given the normal market condition in a set of period, say, one day it estimates how much an investment might lose. This investment can be a portfolio, capital investment or foreign exchange etc.

VAR answers two basic questions -(i) What is worst case scenario? (ii) What will be loss?

It was first applied in 1992 in New York Stock Exchange, entered the financial world in 1990s and become world’s most widely used measure of financial risk.

Features of VAR

(i) Components of Calculations: VAR calculation is based on following three components: (a) Time Period (b) Confidence Level - Generally 95% and 99% (c) Loss in percentage or in amount

(ii) Statistical Method: It is a type of statistical tool based on Standard Deviation.

(iii) Time Horizon: VAR can be applied for different time horizons say one day, one week, one month and so on.

(iv) Probability: Assuming the values are normally attributed, probability of maximum loss can be predicted.

(v) Control Risk: Risk can be controlled by setting limits for maximum loss.

(vi) Z Score: Z Score indicates how many standard Deviations is away from Mean value of a population. When it is multiplied with Standard Deviation it provides VAR.

Application of VAR:

(a) To measure the maximum possible loss on any portfolio or a trading position. (b) As a benchmark for performance measurement of any operation or trading. (c) To fix limits for individuals dealing in front office of a treasury department. (d) To enable the management to decide the trading strategies. (e) As a tool for Asset and Liability Management especially in banks.

QUESTION NO.4 Write a short note on appropriate methods for identification and management of counterparty risk? OR Briefly explain Counter party risk and the various techniques to manage this risk?

The various hints that may provide counter party risk are as follows: (a) Failure to obtain necessary resources to complete the project or transaction undertaken. (b) Any regulatory restrictions from the Government. (c) Hostile action of foreign government. (d) Let down by third party. (e) Have become insolvent.

The various techniques to manage this type of risk are as follows: (1) Carrying out Due Diligence before dealing with any third party. (2) Do not over commit to a single entity or group or connected entities. (3) Know your exposure limits. (4) Review the limits and procedure for credit approval regularly. (5) Rapid action in the event of any likelihood of defaults. (6) Use of performance guarantee, insurance or other instruments.

QUESTION NO.5 How should company assess political risk and how this risk can be identified? OR Explain how an organization interested in making investment in foreign country can assess Country Risk and mitigate this risk.

Organisation can assess country risk: (1) By referring political ranking published by different business magazines. (2) By evaluating country’s macro-economic conditions. (3) By analyzing the popularity of current government and assess their stability. (4) By taking advises from the embassies of the home country in the host countries.

Further, following techniques can be used to mitigate(minimize) this risk. (i) Local sourcing of raw materials and labour. (ii) Entering into joint ventures (iii) Local financing (iv) Prior negotiations
QUESTION NO.6 How Interest Rate Risk can be identified?
Generally, interest rate risk is mainly identified from the following:
2. Any action by Government such as demonetization etc.
3. Economic Growth.
4. Release of Industrial Data.
5. Investment by foreign investors.
6. Stock market changes.

QUESTION NO.7 How Currency Risk can be identified? Or explain briefly the parameters to identify the currency risk?
Some of the parameters to identify the currency risk are as follows:
1. Government Action: The government action of any country has a visual impact in its currency. For example, the UK Govt's decision to divorce from European Union, i.e., Brexit brought the pound to its lowest since 1980's.
2. Nominal Interest Rate: As per interest rate parity (IRP), the currency exchange rate depends on the nominal interest of that country.
3. Inflation Rate: As per Purchasing Power Parity theory, inflation rate impacts the value of currency.
4. Natural Calamities: Any natural calamity can have a negative impact.
5. War, Coup, Rebellion etc.: All these actions can have far-reaching impact on currency's exchange rates.
6. Change of Government: The change of government and its attitude towards foreign investment also helps to identify the currency risk.

QUESTION NO.8 Risks are inherent and integral part of the market. Discuss.
Yes, Risk is an integral part of market and this is a type of systematic risk that affects prices of any particular share move up or down consistently for some time periods in line with other shares in the market. A general rise in share prices is referred to as a bullish trend, whereas a general fall in share prices is referred to as a bearish trend. In other words, the share market moves between the bullish phase and the bearish phase. The market movements can be easily seen in the movement of share price indices such as the BSE Sensitive Index, BSE National Index, NSE Index etc.

6. INTERNATIONAL FINANCIAL MANAGEMENT

QUESTION NO.1 List the main objectives of International Cash Management?
The main objectives of an effective system of international cash management are: (1) To minimise currency exposure risk. (2) To minimise overall cash requirements of the company as a whole without disturbing smooth operations of the subsidiary or its affiliate. (3) To minimise transaction costs. (4) To minimise country's political risk. (5) To take advantage of economies of scale as well as reap benefits of superior knowledge.

QUESTION NO.2 Briefly discuss the concept of Purchasing Power Parity.
Purchasing Power Parity theory focuses on the ‘inflation - exchange rate’ relationship. There are two forms of PPP theory:
- The ABSOLUTE FORM, also called the ‘Law of One Price’ suggests that ‘prices of similar products of two different countries should be equal when measured in a common currency’. If a discrepancy in prices as measured by a common currency exists, the demand should shift so that these prices should converge (become equal).
- The RELATIVE FORM is an alternative version that accounts for the possibility of market imperfections such as transportation costs, tariffs, and quotas. It suggests that ‘because of these market imperfections, prices of similar products of different countries will not necessarily be the same when measured in a common currency’. However, it states that the rate of change in the prices of products should be somewhat similar when measured in a
common currency, as long as the transportation costs and trade barriers are unchanged.

The formula for computing the forward rate using the inflation rates in domestic and foreign countries is as follows:  

\[ F = S \frac{(1+i_F)}{(1+i_D)} \]

Where \( F \) — Forward Rate of Foreign Currency and \( S \) — Spot Rate, \( i_D \) — Domestic Inflation Rate and \( i_F \) — Inflation Rate in foreign country.

Thus PPP theory states that the exchange rate between two countries reflects the relative purchasing power of the two countries i.e. the price at which a basket of goods can be bought in the two countries.

**QUESTION NO.3** What are the complexities involved in international capital budgeting?

Multinational Capital Budgeting has to take into consideration the different factors and variables which affect a foreign project and are complex in nature than domestic projects. **The factors crucial in such a situation are:**

(a) Cash flows from foreign projects have to be converted into the currency of the parent organization. (b) Parent cash flows are quite different from project cash flows. (c) Profits remitted to the parent firm are subject to tax in the home country as well as the host country. (d) Effect of foreign exchange risk on the parent firm’s cash flow. (e) Changes in rates of inflation causing a shift in the competitive environment and thereby affecting cash flows over a specific time period. (f) Restrictions imposed on cash flow distribution generated from foreign projects by the host country. (g) Initial investment in the host country to benefit from the release of blocked funds. (h) Political risk in the form of changed political events reduce the possibility of expected cash flows. (i) Concessions/benefits provided by the host country ensures the upsurge (rise) in the profitability position of the foreign project. (j) Estimation of the value in multinational capital budgeting is difficult since the buyers in the parent company have divergent views on acquisition of the project.

**QUESTION NO.4** Explain the problems that are faced in International Capital Budgeting Decision and how these can be overcome.

The various types of problems faced in International Capital Budgeting analysis are as follows:

(1) Multinational companies investing elsewhere are subjected to foreign exchange risk in the sense that currency appreciates/ depreciates over a span of time. To include foreign exchange risk in the cash flow estimates of any project, it is necessary to forecast the inflation rate in the host country during the lifetime of the project. Adjustments for inflation are made in the cash flows depicted in local currency. The cash flows are converted in parent country’s currency at the spot exchange rate multiplied by the expected depreciation rate obtained from purchasing power parity.

(2) Due to restrictions imposed on transfer of profits, depreciation charges and technical differences exist between project cash flows and cash flows obtained by the parent organization. Such restriction can be diluted by the application of techniques viz internal transfer prices, overhead payments. Adjustment for blocked funds depends on its opportunity cost, a vital issue in capital budgeting process.

(3) In multinational capital budgeting, after tax cash flows need to be considered for project evaluation. The presence of two tax regimes along with other factors such as remittances to the parent firm in the form of royalties, dividends, management fees etc., tax provisions with held in the host country, presence of tax treaties, tax discrimination pursued by the host country between transfer of realized profits vis-à-vis local re-investment of such profits cause serious impediments to multinational capital budgeting process. MNCs are in a position to reduce overall tax burden through the system of transfer pricing. For computation of actual after tax cash flows accruing to the parent firm, higher of home/ host country tax rate is used. If the project becomes feasible then it is acceptable under a more favourable tax regime. If not feasible, then, other tax saving aspects need to be incorporated in order to find out whether the project crosses the hurdle rate.

**QUESTION NO.5** Explain the difference between Forward and Future Contract?
### Features of Forward vs Futures Contracts

<table>
<thead>
<tr>
<th>Feature</th>
<th>Forward</th>
<th>Futures</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Trading</td>
<td>Forward contracts are traded on personal basis or on telephone or otherwise.</td>
<td>Futures Contracts are traded in a competitive arena.</td>
</tr>
<tr>
<td>2. Size of Contract</td>
<td>Forward contracts are individually tailored and have no standardized size</td>
<td>Futures contracts are standardized in terms of quantity or amount as the case may be. (i.e., there is lot size requirement)</td>
</tr>
<tr>
<td>3. Organized Exchanges</td>
<td>Forward contracts are traded in an over the counter market. (Ex: Bank)</td>
<td>Futures contracts are traded on organized exchanges with a designated physical location.</td>
</tr>
<tr>
<td>4. Settlement</td>
<td>Forward contracts settlement takes place on the date agreed upon between the parties.</td>
<td>Futures contracts settlements are made daily via Exchange’s clearing house.</td>
</tr>
<tr>
<td>5. Delivery Date</td>
<td>Forward contracts may be delivered on the dates agreed upon and in terms of actual delivery.</td>
<td>Futures contracts delivery dates are fixed on cyclical basis and it hardly takes place. However, it does not mean that there is no actual delivery.</td>
</tr>
<tr>
<td>6. Transaction Costs</td>
<td>Cost of forward contracts is based on bid - ask spread*</td>
<td>Futures contracts entail brokerage fees for buy and sell order.</td>
</tr>
<tr>
<td>7. Marking to Market</td>
<td>Forward contracts are not subject to marking to market</td>
<td>Futures contracts are subject to marking to market in which the loss or profit is debited or credited in the margin account on daily basis due to change in price.</td>
</tr>
<tr>
<td>8. Margins</td>
<td>Margins are not required in forward contract.</td>
<td>In futures contracts every participant is subject to maintain margin as decided by the exchange authorities.</td>
</tr>
<tr>
<td>9. Credit Risk</td>
<td>In forward contract, credit risk is born by each party and, therefore, every party has to bother for the creditworthiness.</td>
<td>In futures contracts the transaction is a two-way transaction, hence the parties need not to bother for the risk. [Extra Note: stock exchange rules are strict and hence very less chance of default.]</td>
</tr>
</tbody>
</table>

**Question No. 6** Describe the salient features of Foreign Currency Convertible Bonds.

The salient features of FCCBs are as follows:

1. FCCB is a bond **denominated in a foreign currency** issued by an Indian company which can be converted into shares of the Indian Company denominated in Indian Rupees.
2. **Prior permission** of the Department of Economic Affairs, Government of India, Ministry of Finance is required for their issue.
3. There will be a **domestic and a foreign custodian** bank involved in the issue.
4. FCCB shall be issued **subject to all applicable Laws** relating to issue of capital by a company.
5. Tax on FCCB shall be **as per provisions of Indian Taxation Laws** and Tax will be deducted at source.
6. Conversion of bond to FCCB will not give rise to any **capital gains tax in India**.

**7. MUTUAL FUND**

**Question No. 1** Explain the concept of side pocketing in mutual funds? OR Side pocketing enhances the value of the Mutual fund. Do you agree? Briefly explain the process of side pocketing.

Yes, Side Pocketing enhances the value of a mutual fund. In simple words, a **Side Pocketing in Mutual Funds leads to separation of risky assets from other investments and cash holdings**. The **purpose** is to make sure that money invested in a mutual fund, which is linked to **stressed assets, gets locked**, until the fund recovers the money from the company and avoid distress selling of illiquid securities.

**Process of Side Pocketing:** The **modus operandi** is simple. Whenever the rating of a mutual fund decreases,
the fund shifts the illiquid assets into a side pocket so that current shareholders can be benefitted from the liquid assets. Consequently, the Net Asset Value (NAV) of the fund will then reflect the actual value of the liquid assets.

Side Pocketing is beneficial for those investors who wish to hold on to the units of the main funds for long term. Therefore, the process of Side Pocketing ensures that liquidity is not the problem even in the circumstances of frequent allotments and redemptions. Side Pocketing is quite common internationally. However, Side Pocketing has also been resorted to neglect the investors of genuine returns. In India recent fraud in the Infrastructure Leasing and Financial Services (IL&FS) has led to many discussions on the concept of side pocketing as IL&FS and its subsidiaries have failed to fulfill its repayments obligations due to severe liquidity crisis. The Mutual Funds have given negative returns because they have completely written off their exposure to IL&FS instruments.

QUESTION NO.2 Write short note on 'Exchange Traded Funds'? OR What are its key features? OR What are its advantages? OR What are the types of ETF products are available in the market?

Exchange Traded Funds (ETFs) were introduced in US in 1993 and came to India around 2002. 

Key features: An Exchange Traded Fund (ETF) is a hybrid product that combines the features of an index fund. These funds are listed on the stock exchanges and their prices are linked to the underlying index. The authorized participants act as market makers for ETFs. ETFs can be bought and sold like any other stock on an exchange. In other words, ETFs can be bought or sold any time during the market hours at prices that are expected to be closer to the NAV at the end of the day. Therefore, one can invest at real time prices as against the end of the day prices as is the case with open-ended schemes. An ETF combines the valuation feature of a mutual fund or unit investment trust, which can be bought or sold at the end of each trading day for its net asset value.

Advantage: There is no paper work involved for investing in an ETF. These can be bought like any other stock by just placing an order with a broker. ETFs may be attractive as investments because of their low costs, tax efficiency, and stock-like features.

Following types of ETF products are available in the market:

- Index ETFs: Most ETFs are index funds that hold securities and attempt to replicate the performance of a stock market index.
- Commodity ETFs: Commodity ETFs invest in commodities, such as precious metals and futures.
- Bond ETFs: Exchange-traded funds that invest in bonds are known as bond ETFs. They thrive during economic recessions because investors pull their money out of the stock market and into bonds (for example, government treasury bonds or those issues by companies regarded as financially stable). Because of this cause and effect relationship, the performance of bond ETFs may be indicative of broader economic conditions.
- Currency ETFs: Currency ETFs are exchange-traded funds that track the relative value of a currency or a basket of currencies. Currency ETFs allow ordinary individuals to gain exposure to the forex market through a managed fund.

QUESTION NO.3 Differentiate between open ended and close ended fund?

(i) Number Of Units: The number of units outstanding under the schemes of Open Ended Funds keeps on changing. Number of units under Close Ended Funds is fixed.

(ii) Maturity Period: Open Ended schemes usually don’t have a fixed maturity period whereas Close Ended Schemes have fixed maturity period.

(iii) NAV / Market Price: The price at which an investor buys or sells shares of a Close Ended Fund after the NFO (New Fund Offer) is the market price, as determined by the demand and supply market principles. In contrast, the price at which an investor buys or sells shares of a mutual fund is the NAV of the Mutual Fund at the close of a given business day.

(iv) Sale and Purchase: The Units of Open Ended Funds are available for subscription and redemption on an ongoing basis. An investor is allowed to join or withdraw from the fund at any time by the mutual fund
companies at NAV related prices. The Units of Close Ended Funds can be purchased or sold by the investor only from the secondary market i.e stock market after the initial public offerings.

(v) **Listing**: Open Ended Funds are not listed on any stock exchange. While listing of close ended funds are compulsory on any Stock Exchange.

(vi) **Declaration**: In case of an open ended mutual fund, NAVs being declared on a daily basis but for a close ended mutual fund this is declared only on a weekly basis.

(vii) **Liquidity**: Closed ended funds are not liquid. Open ended funds are Liquid.

**QUESTION NO.4** Explain tracking error in brief?

- Tracking error can be defined as the divergence or deviation of a fund’s return from the benchmarks return it is following. The passive fund managers closely follow or track the benchmark index. Although they design their investment strategy on the same index but often it may not exactly replicate the index return. In such situation, there is possibility of deviation between the returns. The tracking error can be calculated on the basis of corresponding benchmark return vis a vis quarterly or monthly average NAVs. Higher the tracking error higher is the risk profile of the fund. If the funds outperform or underperform their benchmark indices; it clearly indicates that of fund managers are not following the benchmark indices properly. Other reason for tracking error are as follows: (i) Transaction cost (ii) Fees charged by AMCs (iii) Fund expenses (iv) Cash holdings (v) Sampling biasness Thus from above it can be said that to replicate the return to any benchmark index the tracking error should be near to zero. The Tracking Error is calculated as follows: $\text{TE} = \sqrt{\frac{\sum_{n=1}^{n} (d-Ad)^2}{n-1}}$

where, $d$ = Differential return ; $Ad$ = Average differential return ; $n$ = No. of observation

**QUESTION NO.5** Explain the different methods for evaluating the performance of a mutual fund.

**Methods for Evaluating the Performance**

1. **Sharpe Ratio**
   - The excess return earned over the risk free return on portfolio to the portfolio's total risk measured by the standard deviation. This formula uses the volatility of portfolio return. The Sharpe ratio is often used to rank the risk-adjusted performance of various portfolios over the same time. The higher a Sharpe ratio, the better a portfolio's returns, relative to the amount of investment risk, the investor has taken.
   
   $S = \frac{\text{Return of portfolio} - \text{Risk Free Return}}{\text{Standard Deviation of Portfolio}}$

2. **Treynor Ratio**
   - This ratio is similar to the Sharpe Ratio except it uses Beta of portfolio instead of standard deviation. Treynor ratio evaluates the performance of a portfolio based on the systematic risk of a fund. Treynor ratio is based on the premise that unsystematic or specific risk can be diversified and hence, only incorporates the systematic risk (beta) to gauge the portfolio's performance.
   
   $T = \frac{\text{Return of portfolio} - \text{Risk Free Return}}{\text{Beta of Portfolio}}$

3. **Jensen’s Alpha**
   - The comparison of actual return of the fund with the benchmark portfolio of the same risk. Normally, for the comparison of portfolios of mutual funds this ratio is applied and compared with market return. It shows the comparative risk and reward from the said portfolio. Alpha is the excess of actual return compared with expected return.

**QUESTION NO.6** The idea of Quant Fund is stock-picking free from human intervention. Discuss.

- The given statement is true to a certain extent in reference to Mutual Funds where the concept of Quant Fund
is becoming popular day by day. Quant Fund follows a data-driven approach for stock selection or investment decisions based on a pre-determined rules or parameters using statistics or mathematics based models. Contrary to an active fund Manager who selects the quantum and timing of investments i.e. entry or exit, this fund completely rely on an automated programme for making decision for quantum of investment as well as its timings. It does not mean that there is no human intervention at all, the Fund Manager usually focuses on the robustness of the Models in use and also monitors their performance and do some modification whenever it is required. Sometime a Quant Fund manager is confused with Index Fund Manager but it is not so as the Index Fund Manager may entirely hands off the investment decision purely based on Index, while Quant Fund Manager often designs and monitors models that throw up the choices. The main advantage of Quant Fund is that it eliminates the human biasness and subjectivity. Further using model based approach also ensures consistency in strategy across the market conditions. Also since the Quant Fund normally follows passive strategy, the exposure ratio tends to be lower. Since Quant Fund uses highly sophisticated strategies investors who well understand Stock Valuation methods, different stock picking styles, the market sentiments and derivatives etc. should invest in the same. Since Quant Fund are tested on the basis of historical data and past trends, they cannot altogether be ignored but also cannot be used blindly as good indicators. Thus, overall it can be said that whether it is human or a machine it is not easy to beat the market.

8. MERGER & ACQUISITION

QUESTION NO.1 Explain the reasons of Reverse Stock Split ?

Reverse Stock Split is a process whereby a company decreases the number of shares outstanding by combining current shares into fewer or lesser number of shares. For example, in a 5:1 reverse split, a company would take back 5 shares and will replace them with one share. Considering above mentioned ratio, if company has 100 million shares outstanding before split up, the number of shares would be equal to 20 million after the reverse split up. Although, reverse stock split does not result in change in Market value or Market Capitalization of the company but it results in increase in price per share.

Reasons for Reverse Split Up: Generally, company carries out reverse split up due to following reasons:
(i) Avoiding delisting from stock exchange: Sometimes as per the stock exchange regulation if the price of shares of a company goes below a limit it can be delisted. To avoid such delisting company may resort to reverse stock split up.
(ii) Avoiding removal from constituents of Index: If company’s share is one of the constituents of market index then to avoid their removal of scrip from this list, the company may take reverse split up route.
(iii) To avoid the tag of “Penny Stock”: If the price of shares of a company goes below a limit it may be called “Penny Stock”. In order to improve the image of the company and avoiding this stage, the company may go for Reverse Stock Split.
(iv) To attract Institutional Investors and Mutual Funds: It might be possible that institutional investors may be shying away from acquiring low value shares. Hence to attract these investors, the company may adopt the route of “Reverse Stock Split” to increase the price per share.

QUESTION NO.2 Explain management buyouts and leveraged buyouts? State the purpose of a leveraged buyout with the help of an example.

Management Buy Outs: Buyouts initiated by the management team of a company are known as a management buyout. In this type of acquisition, the company is bought by its own management team. MBOs are considered as a useful strategy for exiting those divisions that does not form part of the core business of the entity.

Leveraged Buyout (LBO): An acquisition of a company or a division of another company which is financed entirely or partially (50% or more) using borrowed funds is termed as a leveraged buyout. The target company no longer remains public after the leveraged buyout; hence the transaction is also known as going private. The deal is usually secured by the acquired firm's physical assets.
Purpose of a leveraged buyout with the help of an example:

- The **intention behind an LBO transaction** is to improve the operational efficiency of a firm and increase the volume of its sales, thereby increasing the cash flow of the firm. This extra cash flow generated will be used to pay back the debt in LBO transaction. - After an, LBO the target entity is managed by private investors, which makes it **easier to have a close control** of its operational activities. - The LBOs **do not stay permanent.** Once the LBO is successful in increasing its profit margin and improving its operational efficiency and the debt is paid back, it will go public again. - **Companies that are in a leading market position** with proven demand for product, have a strong management team, strong relationships with key customers and suppliers and steady growth are likely to become the target for LBOs. - **In India the first LBO took place** in the year 2000 when Tata Tea acquired Tetley in the United Kingdom. The deal value was Rs 2135 crores out of which almost 77% was financed by the company using debt. The intention behind this deal was to get direct access to Tetley’s international market. The largest LBO deal in terms of deal value (7.6 Billion) by an Indian company is the buyout of Corus by Tata Steel.

**QUESTION NO.3** Reconcile differences between Carve-out and Spin Off.

- **Equity Curve out** can be defined as partial spin off in which a company creates its own new subsidiary and subsequently bring out its IPO. It should be however noted that parent company retains its control and **only a part of new shares are issued to public.**

- On the other hand in **Spin off** parent company **does not receive any cash** as shares of subsidiary company are issued to existing shareholder in the form of dividend. Thus, **shareholders in new company remain the same** but not in case of Equity curve out.

**9. DERIVATIVES**

**QUESTION NO.1** Write a short note on : EMBEDDED DERIVATIVES ?

- **Meaning Of Derivative:** A derivative is defined as a contract that has **all the following characteristics:**
  (i) **its value changes** in response to a specified underlying, e.g. an exchange rate, interest rate or share price; (ii) **it requires little or no initial net investment;** (iii) **it is settled at a future date.**

  The most common derivatives are **currency forwards, futures, options, interest rate swaps** etc.

- **Meaning Of Embedded Derivative:** An embedded derivative is a derivative instrument that is **embedded in another contract** - the host contract. The **host contract** might be a debt or equity instrument, a lease, an insurance contract or a sale or purchase contract.

- **Marked-to-Market Requirement:** Derivatives **requires to be marked-to-market** through the income statement. This requirement on embedded derivatives are **designed to ensure that mark-to-market through the income statement cannot be avoided** by including - embedding - a derivative in another contract or financial instrument that is not marked- to market through the income statement.

- **Example:** A **coal purchase contract** may include a clause that links the price of the coal to a pricing formula based on the prevailing electricity price or a related index at the date of delivery. The coal purchase contract, which qualifies for the executory contract* exemption, is described as the host contract, and the pricing formula is the embedded derivative. The pricing formula is an embedded derivative because it changes the price risk from the coal price to the electricity price.

- **How It Arises:** An embedded derivative can arise from deliberate financial engineering and intentional shifting of certain risks between parties. Many embedded derivatives, however, arise inadvertently* through market practices and common contracting arrangements. Even purchase and sale contracts that qualify for executory contract* treatment may contain embedded derivatives. An embedded derivative causes modification to a contract’s cash flow, based on changes in a specified variable.

**QUESTION NO.2** What are Types of Commodity Swaps ?
There are two types of commodity swaps: fixed-floating or commodity-for-interest.

(a) Fixed-Floating Swaps: They are just like the fixed-floating swaps in the interest rate swap market with the exception that both indices are commodity based indices.

General market indices in the international commodities market with which many people would be familiar include the S&P Goldman Sachs Commodities Index (S&PGSCI) and the Commodities Research Board Index (CRB). These two indices place different weights on the various commodities so that, they will be used according to the swap agent’s requirements.

(b) Commodity-for-Interest Swaps: They are similar to the equity swap in which a total return on the commodity in question is exchanged for some money market rate (plus or minus a spread).

QUESTION NO.3 EXPLAIN cash settlement and physical settlement in derivatives contracts and their relative advantages and disadvantages?

(i) The physical settlement in case of derivative contracts means that underlying assets are actually delivered on the specified delivery date. In other words, traders will have to take delivery of the shares against position taken in the derivative contract. In case of cash settlement, the seller of the derivative contract does not deliver the underlying asset but transfers the Cash. It is similar to Index Futures, where delivery is impossible, since they have to be settled in cash.

(ii) The main advantage of cash settlement in derivative contract is high liquidity because of more derivative volume in cash segment. Also due to high liquidity, difference (spreads) between bid-ask is narrowed. Also if the stock is liquid, the impact cost* of bigger trades will be lower.

(iii) Due to cash settlement adverse move can be hedged. For example, the investors can take a covered short derivative position by selling the future while still holding the underlying security.

(iv) Cash settlement also, facilitates the traders to do speculation. The speculative trading may worry the regulators but it is also true that without speculative trading, it will not be possible for the derivative market to stay liquid. So, this leads to some arguments in favour of physical settlement in derivative contract. One advantage of physical settlement is that it is not subject to manipulation by both the parties to the derivative contract. This is so because the entire activity is monitored by the broker and the clearing exchange.

(v) However, one main disadvantage of physical delivery is that it is almost impossible to short sell a stock in the Indian Market.

Therefore, in the end, it can be concluded that, though, physical settlement in derivative contract does curb manipulation, it also affects the liquidity in the derivative segment.

QUESTION NO.4 EXPLAIN Co-location/Proximity Hosting?

The co-location or proximity hosting is a facility which is offered by the stock exchanges to stock brokers and data vendors whereby their trading or data-vending systems are allowed to be located within or at close proximity to the premises of the stock exchanges, and are allowed to connect to the trading platform of stock exchanges through direct and private network. Moreover, pursuant to the recommendations of the TAC of SEBI, stock exchanges are advised to allow direct connectivity between co-location facility of one recognized stock exchange and the colocation facility of other recognized stock exchanges. Stock exchanges are also advised to allow direct connectivity between servers of a stock broker placed in colocation facility of a recognized stock exchange and servers of the same stock broker placed in colocation facility of a different recognized stock exchange.

This facility should be available to all the co-located brokers, who are desirous to avail such connectivity, in a fair and equitable manner. Further, in light of the public comments received and in consultation with Technical Advisory Committee (TAC) of SEBI and Secondary Market Advisory Committee (SMAC) of SEBI and in order to facilitate small and medium sized Members, who otherwise find it difficult to avail colocation facility, due to various reasons including but not limited to high cost, lack of expertise in maintenance and troubleshooting, etc. to avail co-location facility, SEBI has directed the stock exchanges to introduce ‘Managed Co-location Services’. Under this facility, space/rack in co-location facility shall be allotted to eligible vendors by the stock exchange.
QUESTION NO.1 Interpret the CAPM and state its assumption?

- The Capital Asset Pricing Model was developed by Sharpe, Mossin and Linter in 1960.
- The model explains the relationship between the expected return, non-diversifiable risk (beta) and the valuation of securities. It is based on the premise that the diversifiable risk of a security is eliminated when more and more securities are added to the portfolio. However, the systematic risk (beta) cannot be diversified.
- The systematic risk can be measured by beta. The expected return of a security is: Expected return on security = Rf + Beta (Rm - Rf)
- The CAPM, when plotted on the graph paper is known as the Security Market Line (SML).
- Relevant Assumptions of CAPM: (i) The investor’s objective is to maximize the utility of terminal wealth*; (ii) Investors make choices on the basis of risk and return; (iii) Investors have identical time horizon; (iv) Investors have homogeneous expectations of risk and return; (v) Information is freely and simultaneously available to investors; (vi) There is risk-free asset, and investor can borrow and lend unlimited amounts at the risk-free rate; (vii) There are no taxes, transaction costs, restrictions on short rates* or other market imperfections; (viii) Total asset quantity is fixed, and all assets are marketable and divisible. Thus, CAPM provides a conceptual framework for evaluating any investment decision with a goal of producing future returns.

QUESTION NO.2 What are ASSET ALLOCATION STRATEGIES?
There are four asset allocation strategies:

(a) Integrated Asset Allocation: Under this strategy, capital market conditions and investor objectives and constraints are examined and the allocation that best serves the investor’s needs while incorporating the capital market forecast is determined.

(b) Strategic Asset Allocation: Under this strategy, optimal portfolio mixes based on returns, risk, and co-variances is generated using historical information and adjusted periodically to restore target allocation within the context of the investor’s objectives and constraints.

(c) Tactical Asset Allocation: Under this strategy, investor’s risk tolerance is assumed constant and the asset allocation is changed based on expectations about capital market conditions.

(d) Insured Asset Allocation: For investors prone to risk, the insured asset allocation is the ideal strategy to adopt. It involves setting a base asset value from which the portfolio should not drop from. If it drops, the investor takes the necessary action to avert the risk. Under this strategy, risk exposure for changing portfolio values (wealth) is adjusted; more value means more ability to take risk.

QUESTION NO.3 Explain the strategy of Portfolio rebalancing under which the value of a portfolio shall not fall below a specified value in normal market conditions.

- Under Constant Proportion Portfolio Insurance (CPPI) strategy investor sets a floor below which he does not wish his asset to fall called floor, which is invested in some non-fluctuating assets such as Treasury Bills, Bonds etc. The value of portfolio under this strategy shall not fall below this specified floor under normal market conditions. This strategy performs well especially in bull market as the value of shares purchased as cushion increases. In contrast in bearish market losses are avoided by sale of shares. It should however be noted that this strategy performs very poorly in the market hurt by sharp reversals. The following equation is used to determine equity allocation: Target Investment in Shares = multiplier (Portfolio Value – Floor Value) Where Multiplier is a fixed constant whose value shall be more than 1.
11. INTEREST RATE RISK MANAGEMENT

QUESTION NO.1 What do you mean by the term ‘Cheapest to Deliver’ in context of Interest Rate Futures?

〜 The CTD is the bond that minimizes difference between the quoted Spot Price of bond and the Futures Settlement Price (adjusted by the conversion factor).〜 It is called CTD bond because it is the least expensive bond in the basket of deliverable bonds.〜 CTD bond is determined by the difference between cost of acquiring the bonds for delivery and the price received by delivering the acquired bond. This difference gives the profit or loss of the seller of the futures.〜 Profit of seller of futures = (Futures Settlement Price x Conversion factor) - Quoted Spot Price of Deliverable Bond〜 Loss of Seller of futures = Quoted Spot Price of deliverable bond - (Futures Settlement Price x Conversion factor)〜 That bond is chosen as CTD bond which either maximizes the profit or minimizes the loss.

12. CORPORATE VALUATION

QUESTION NO.1 Differentiate between Economic Value Added and Market Value Added.

〜 Economic Value Added (EVA) - EVA is a holistic method of evaluating a company’s financial performance in terms of its contribution to the society at large. The core concept behind EVA is that a company generates ‘value’ only if there is a creation of wealth in terms of returns in excess of its cost of capital. The formula is as below:

EVA = NOPAT – (Invested Capital x WACC) Or NOPAT – Capital Charge

〜 Market Value Added (MVA) - MVA means Current Market Value of the firm minus Invested Capital. It is an alternative way to gauge performance efficiencies of an enterprise, albeit from a market capitalization point of view, the logic being that the market will discount the efforts taken by the management fairly. Hence, MVA is the true value added that is perceived by the market while EVA is a derived value added that is for the more discerning investor.

QUESTION NO.2 Explain how Cash flow-based approach of valuation is different from Income based approach and also explain briefly the steps involved in this approach.

〜 As opposed to the asset based and income based approaches, the cash flow approach takes into account the quantum of free cash that is available in future periods, and discounting the same appropriately to match to the flow’s risk.
〜 Simply speaking, if the present value arrived post application of the discount rate is more than the current cost of investment, the valuation of the enterprise is attractive to both stakeholders as well as externally interested parties (like stock analysts). It attempts to overcome the problem of over-reliance on historical data.
〜 There are essentially five steps in performing DCF based valuation: (i) Arriving at the ‘Free Cash Flows’ (ii) Forecasting of future cash flows (also called projected future cash flows) (iii) Determining the discount rate based on the cost of capital (iv) Finding out the Terminal Value (TV) of the enterprise (v) Finding out the present values of both the free cash flows and the TV, and interpretation of the results.

13. VALUATION OF SECURITY

QUESTION NO.1 What is the meaning of Money Market Instruments?

〜 The money market is a market for short-term financial assets which can be turned over quickly at low cost.
〜 The instruments of money market are characterised by

(a) Short duration, (b) Large volume, (c) De-regulated interest rates.
(d) The instruments are highly liquid. (e) They are safe investments owing to issuers inherent financial strength.
〜 The various types of instruments of money market are discussed in the following paragraphs:

QUESTION NO.2 What is the difference between Repurchase Options (Repo.) and Reverse Repurchase Agreement (Reverse Repo)?

Following are major differences between Repo and Reverse Repo:
(a) Repo rate is the rate at which Reserve Bank of India (RBI) lends to Commercial Banks for a short period of time against Government Securities. On the other hand, Reverse Repo is the rate at which Commercial Banks lend to RBI. 
(b) A transaction is called a Repo when viewed from the perspective of the seller of securities (the party acquiring funds) and Reverse Repo when described from the point of view of the supplier of funds. Thus, whether a given agreement is termed a Repo or a Reverse Repo depends largely on which party initiated the transaction.
(c) The purpose of Repo is to fulfill the deficiency of funds. While the purpose of Reverse repo is to reduce excess liquidity in the economy.
(d) The Repo rate is comparatively high in comparison to Reverse Repo rate.
(e) The Repo rate strives to contain inflation in the economy. The Reverse repo aims to control money supply in the economy.

QUESTION NO.3 What is the difference between convertible Debentures and Warrants?

Following are major differences:
(i) In warrant, option of conversion is detachable while in convertible it is not so. Due to this reason, warrants can be separately traded.
(ii) Warrants are exercisable for cash payment while convertible debenture does not involve any such cash payment.

QUESTION NO.4 Modified Duration is a proxy not an accurate measure of change in price of a Bond due to change interest rate. Discuss.

Although Modified Duration is a measure of volatility or change in the price of a Bond consequent upon change in the yield or interest rates as it assumes a linear relationship between the Modified Duration and the price of a Bond but is not accurate measure because of Convexity. Accordingly the relationship between change in the interest rate and bond value is non-linear i.e. convex curve to the origin as shown below:

From the above diagram it is clear that the actual effect of change in interest rate on Bond Price is different from the predicted linear relationship.

APPENDIX [MEANING OF SOME DIFFICULT TERMS USED IN THIS BOOKLET]

Forward and Backward Linkages: For an industry, backward linkages are directed towards suppliers; while the forward linkages are directed towards consumers.
Crowd Psychology: Crowd psychology is the broad study of how individual behavior is impacted when large crowds group is together.

Designed Roulette Wheel: It is a game of chance in which a small ball is dropped onto a wheel that is spinning and the players guess in which hole it will finally stop. A type of Gambling.

Indicator: Leading means before event occurs, Lag means after the event occurs and Coincidental means exactly at the same time when event occurs. These indicators help in doing research in economy activity.

Time series data: Time series forecasting helps us to predict future values based on previously observed values.

Skewness: It means to twist or distort/not straight.

Desynchronization: It is the relation that exists when things occur at unrelated times. Its opposite is synchronization which means the operation or activity of two or more things at the same time or rate.

Tranches (Trenching): They are pieces of debt or securities designed to divide risk or group characteristics in order to be marketable to different investors.

Non Recourse & Recourse: Recourse debt refers to an agreement where the lender can attach borrower assets, while non-recourse debt refers to an agreement where the lender cannot do so.

Homogeneity: If a group of things are homogeneous, they're all the same or similar.

Spread: It means difference between inflow and outflow.

Foreclosure: It is a legal process in which a lender attempts to recover the balance of a loan from a borrower who has stopped making payments to the lender by forcing the sale of the asset used as the collateral for the loan.

Credit Enhancer: The process of reducing credit risk by requiring collateral, insurance, or other agreements to provide the lender with reassurance that it will be compensated if the borrower defaulted.

Trade Sale: A trade sale is the sale of a business, or part of the business, to another business.

Factoring: It is a financial service in which the business entity sells its bill receivables to a third party.

Host country: When USA Company invest in India, India is termed as Host Country.

Repatriation: The sending of money back to one’s own country.

Lehman Brothers: It was a company which still holds the record for the largest bankruptcy in US history.

Sovereign Debt Crisis: A sovereign debt crisis is when a country is unable to pay its loan.

Willful Defaulter: A willful defaulter is an entity or a person that has not paid the loan back despite the ability to repay it.

Inadvertently: without intention; accidentally.

Executory Contract: An executory contract is a contract made by two parties in which the terms are set to be fulfilled at a later date.

Terminal Wealth: Value of an asset at the end of its useful life.

Mezzanine Finance: It is a blend or hybrid of long term debt and equity shares.

Modus Operandi: A particular way or method of doing something.

NO Restrictions on short rates: It means an entity can borrow money for short period of time.

Congeneric merger: An example of a congeneric merger is when banking giant Citicorp merged with financial services company Travelers Group in 1998. In a deal valued at $70 billion, the two companies joined forces to create Citigroup Inc. While both companies were in the financial services industry, they had different product lines.

Disarming: to deprive of a weapon

Reverse Merger: It is also defined as “When an acquiring company is weaker than the target company.

Predator: a person who ruthlessly exploits others.

Organic growth: It is the growth a company achieves by increasing output and enhancing sales internally.

Open: Here open means that in this market there is no fixed maturity.

Majors: In India currency futures are available in following currencies only: US Dollars (USD), Euro (EUR), Great Britain Pound (GBP) and Japanese Yen (JPY).

Impact cost: Impact cost is the cost that a buyer or seller of stocks incurs while executing a transaction.

Wreck: destroy
Dissemination: the action or fact of spreading something, especially information, widely.

**Full capital convertible**: In layman's terms, full capital account convertibility allows local currency to be exchanged for foreign currency without any restriction on the amount.

**CEDEL**: Centrale de Livraison de Valeurs Mobilières. It is a centralized clearing system of EUROPE.

**OTC**: Over-the-counter (OTC) refers to such agreements which are not listed in stock market. As oppose to this, there is a an exchange traded product that is traded on an organized exchange.

**Indexation**: It is the process that takes into account inflation from the time you bought the asset to the time you sell it.

**Market Maker**: A dealer in securities or other assets who undertakes to buy or sell at specified prices at all times.
CONGRATULATE
MR. ABHISHEK
PLACED IN APPLE
DREAMS COMES TRUE

Gud Evening Sir,
It is a very Proud Movement for me to inform you that,
i'm Abhishek from Your satellite Classes,
N I have been placed in Apple (U.S) With an Annual Package of $158000,..
Thankyou So Much Sir..
You Really Great Sir..
It was Great Learning With You..

7:25 PM

SARBHI AGARWAL AIR 1 NOV 2008 WORKING AT HSBC HONGKONG
IN INVESTMENT BANKING DIVISION WITH 70+ LAKH ANNUAL PACKAGE
TIME TO CHOOSE FINANCE AS A CAREER AND TARGET AIR-1 WITH 100% MARKS