## Indian Financial System

### Key Elements
- **Key elements of well functioning Financial System**
  1. A strong legal and regulatory environment is must
  2. Stable Money
  3. Sound public finances and public debt management
  4. A Central Bank
  5. Sound Banking System
  6. Information System
  7. Well functioning securities market.

### Design
- **Corporations which provide services as intermediaries of financial markets**
  - A broad term describing any marketplace where trading of securities, including equities, bonds, commodities and derivatives occurs.
  - Are those Instruments which have a monetary value.
  - Are services which involves investment, lending, and management of money and assets.

### Functions
- **Financial Instruments**
  - Classified as banking and non-banking financial institutions.
  - Banks are creators and providers of credit. While in secondary market, capital market can be divided into debt based securities and equity based securities.
  - Money market is a market for short term securities having a maturity period of more than one year.
  - Equity based securities consists of bonds and debentures.
  - Debenture is an acknowledgement of debt which has to be repaid in full in certain number of years mentioned at the time of issue of debenture itself.
  - Capital market is a market for long term securities having a maturity period of more than one year.
  - Debentures are financial instruments issued by companies which are basically a financial contract between a company (borrower) and investors (lenders).

### Types
- **Financial Institutions**
- **Financial Markets**
- **Financial Instruments**
- **Financial Services**
- **Regulatory Authorities**

### Market Based vs Bank Based

<table>
<thead>
<tr>
<th>Advantage</th>
<th>Bank Based</th>
<th>Disadvantage</th>
<th>Bank Based</th>
<th>Disadvantage</th>
</tr>
</thead>
</table>
| 1. Facilitate diversification of securities | 1. Close relationship with partners; | 1. Mark based system is prone to instability as market may fluctuating in turbulent times. | 2. Provide tailor made contracts; | 2. Unsuitability of system.
| 2. Helps in investors to reduce their risk. | 3. Efficient risk sharing; | 3. Consequently, investors are exposed to market risk. | 4. No free rider problem; | 4. System suffers from moral hazard.
| 3. Provides an information system. | | 5. There is a free rider problem. | | |

### Market Based
- **The economy is dependent on well how or poorly the stock market is performing.**
- **The economy is dependent on well how or poorly the banking system is doing.**
- **Wealth is spread more unevenly.**
- **Wealth is more evenly spread.**
- **Opportunities to gain or lose are more evenly spread.**
- **Opportunities to gain or lose are more unevenly spread.**
- **The wealth is spread more unevenly.**
- **Opportunities to gain or lose are more evenly spread.**

### Bank Based
- **The wealth is spread more unevenly.**
- **Opportunities to gain or lose are more evenly spread.**
- **Wealth is more evenly spread.**
- **Opportunities to gain or lose are more evenly spread.**
- **Opportunities to gain or lose are more evenly spread.**
- **Wealth is spread more unevenly.**
- **Opportunities to gain or lose are more evenly spread.**
- **Opportunities to gain or lose are more evenly spread.**

### Regulatory Authorities
- **SEBI**
  - Functions of SEBI
    1. Regulating the business in stock exchanges,
    2. Prohibiting fraudulent and unfair trade practices,
    3. Promoting investors’ education and training,
    4. Regulating insider trading in securities,
    5. regulating take over of companies.
- **RBI**
  - Functions of RBI
    1. Banking Functions
    2. Supervisory Functions
    3. Promotional Functions
- **IRDA**
  - Functions of IRDA
    1. Regulation of Insurance Sector
    2. Protection of Policy Holders Interest
    3. Awareness of Insurance
    4. Development of Insurance Product
    5. Saving and Investment of Individual
- **PFRDA**
  - Functions of PFRDA
    1. Auto Chained for distribution
    2. Pension Tax Benefit
    3. Stringent Tax Benefit
    4. Single
    5. Regulated
    6. Low Cost
- **REOA**
  - Functions of REOA
    1. FACILITY TO TAKE OVER
    2. FACILITY TO TAKE OVER BERTH
    3. FACILITY TO TAKE OVER DOLLAR

### Mathematical Formulas
- **Functions of Financial Instruments**
  - In primary market, securities schemes, bonds, debentures are issued to come for the public for the first time.
  - While in secondary market, trading (purchase and sale) takes place in those securities which are already issued to the public.
  - On the other hand, financial instruments are issued by companies which are basically a financial contract between a company (borrower) and investors (lenders).

### Characteristics of Financial Instruments
- **Liquidity**
- **Marking**
- **Collateral Value**
- **Risk**
- **Transferability**
- **Maturity Period**
- **Transaction Cost**
- **Future Trading**

### Types of Financial Services
- **Financial Services**
  - Investment Banking
  - Credit Rating
  - Consumer Finance
  - Housing Finance
  - Factoring
  - Depositary Services

### Other
- **AMFI**
  - Promotional Functions
- **FEDAI**
  - Promotional Functions
- **FIMMDA**
  - Promotional Functions
Financial Policy & Corporate Strategy

3 Essential Elements of Any Business

1. Clear and realistic strategy
2. The financial resources, controls and systems to see it through
3. The right management team and processes to make it happen;

1. Financial planning is the backbone of the business planning and corporate planning;
2. It helps in defining the feasible area of operation;
3. The financial planner helps the customer to maximize its existing financial resources by utilizing financial tools to achieve its financial goals;
4. There are 3 major components of Financial planning:
   1. Financial Resources (FR)
   2. Financial Tools (FT)
   3. Financial Goals (FG)

1. Financial planning is the cornerstone of business planning and corporate planning;
2. It helps in defining the feasible area of operation;
3. The financial planner helps the customer to maximize its existing financial resources by utilizing financial tools to achieve its financial goals.

It is simple, “Work hard when it’s time to work and drink hard when it’s time to celebrate, don’t put average efforts, this is what is going to change your entire life. When you are going to travel on your dream path, it’s not going to be easy but yes it’s going to be worth it.”

International Financial Management

Financial Planning

Strategies at Different Hierarchy Level

Corporate Level

- It is concerned with selection of businesses in which a company should compete and also with the development and coordination of that portfolio of businesses.
- Financial Resources (FR)
- Financial Tools (FT)
- Financial Goals (FG)

Business Level

- Pre-operational coordination of operating units to ensure that the resources of the entire business are used to the best advantage.
- Determines the kind and number of customers to which services are produced.

Functional Level

- It is concerned with the stakeholders’ satisfaction and can be financial or non-financial.

Decisions falling within Financial Strategy

1. Financing decisions
2. Investment decisions
3. Capital structure decisions
4. Dividend decisions
5. Portfolio decisions
6. Dividend decisions

Interface of Financial Policy & Strategic Management

1. Sources of finance
2. Investment decisions
3. Capital structure
4. Dividend decisions

What makes an Organisation Sustainable?

1. Have more than one source of income;
2. Have more than one way of generating income;
3. Do strategic, action and financial planning regularly;
4. Have adequate financial systems;
5. Have a good public image;
6. Be clear about its values;
7. Have financial autonomy.

International Capital Budgeting

Complexities involved in International Capital Budgeting

1. Cash flows from foreign projects have to be converted into the currency of the parent organization.
2. Profits remitted to the parent firm are subject to tax in the home country as well as the host country.
3. Different political factors cause a shift in the competitive environment and thereby affecting cash flows over a specific time period.
4. Restrictions imposed on cash distributions generated from foreign operations by the host country.
5. Political risk in the form of changed political events reduce the possibility of expected cash flows.
6. Calculation of the terminal value in multinational capital budgeting is difficult since the buyers in the parent company may have divergent views on acquisition of the project.

Foreign Currency Convertible Bonds

- A type of convertible bond issued in a currency different than the issuer’s domestic currency.
- A convertible bond is a mix between a debt and equity instrument.
- It acts like a bond by making regular coupon and principal payments, but these bonds also give the holder the option to convert the bond into stock.

Advantages

- Flexibility to convert the bond into equity at a price or redeem the bond at the end of a specified period.
- Companies prefer bonds as it leads to delayed dilution of equity and allows company to avoid any current dilution in earnings per share.
- Investor is assured of a minimum fixed interest earnings.

Disadvantages

- Exchange risk is more in FCBBs as interest on bonds would be payable in foreign currency.
- FCBBs mean creation of more debt and a foreign output in terms of interest which is in foreign exchange.
- The interest rate is low, say around 3–4%.

American Depository Receipts

1. U.S. banks simply purchase a large lot of shares from a foreign company, bundle the shares into groups and release them on either the NYSE, AMEX or Nasdaq.
2. The depository bank sets the ratio of U.S. ADRs per home country shares. This ratio can be anything less than or greater than 1. For example, a ratio of 4:1 means that one ADR share represents the same as four foreign common shares in the foreign company.

Advantages

- ADSs allow US investor to invest in companies outside North America with greater ease.
- By investing in different countries, you have the potential to capitalize on emerging economies.

Disadvantages

- ADSs come with more risks, involving political factors, exchange rates and so on.
- Language barriers and a lack of standards regarding financial disclosure can make it difficult to research foreign companies.

Global Depository Receipts

- GDR is similar to an ADR, but it is a depository receipt sold outside of the United States and outside of the home country of the issuing company.
- If the Indian Company which has issued ADRs in the American market wishes to further extend it to other countries such as Europe, then they can sell these ADRs to the public of Europe and the same would be named as GDRs.

Advantages of GDR to Issuing Company

- Accessibility to foreign capital markets.
- Rise in the capital because of foreign investors.

Disadvantages

- The investor an option to convert the bond into equity at a fixed price after the minimum lock-in period.
- The price of equity shares at the time of conversion will have a premium element.
- The bond carry a fixed rate of interest.

Euro Convertible Bonds

1. Euro Convertible bonds are quasi-debt securities (Securities) which can be converted into depository receipts or local shares.
2. ECBs offer the investor an option to convert the bond into equity at a fixed price after the minimum lock-in period.
3. The price of equity shares at the time of conversion will have a premium element.
4. Indian companies which have opted ECBs issue are Jindal Steel, Reliance, Essar, Gujarat, Shriram etc.
5. Indian companies are increasingly looking at Euro-Convertible bond in place of Global Depository Receipts because GDRs are falling into disfavour among international fund managers.

Advantages of GDR to Investor

- Helps in diversification, hence reducing risk.
- More transparency since competitor's securities can be compared

International Sources of Finance

International Working Capital Management

Objectives of International Cash Management

1. To minimize currency exposure risk
2. To minimize overall cash requirements of the company as a whole without disturbing smooth operations of the subsidiary or its affiliate
3. To minimize transaction costs
4. To minimize foreign exchange risks
5. To take advantage of economies of scale as well as reap benefits of superior knowledge.

How Centralised Cash Management helps MNCs

1. To maintain minimum cash balance during the year
2. To manage judiciously requirements of the centre
3. To optimally use various hedging strategies so that MNCs foreign exchange exposure is minimised.
4. To aid the centre to generate maximum returns by investing all cash reserves optimally
5. To aid the centre to take advantage of multinational netting so that transaction costs and currency exposure are minimised
6. To make maximum utilisation of transfer pricing mechanism so that the firm enhances its profitability and growth.

It’s simple, “Work hard when it’s time to work and drink hard when it’s time to celebrate, don’t put average efforts, this is what everybody is doing around you and you are doing no good. You can do much better than anybody. Put that extra effort because this is what is going to change your entire life. When you are going to travel on your dream path, it’s not going to be easy but yes it’s going to be worth it.”
**Risk Management**

**Types**

- **Strategic Risk**
  - A risk in which a company's strategy becomes less effective and it struggles to achieve its goals.
- **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. Noncompliance leads to penalties in the form of fine and imprisonment.
- **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 causes are: 
    - People
    - Process
    - Systems
- **Financial Risk**
  - Financial risk is referred as the unexpected changes in financial conditions such as prices, exchange rate, credit rating, and interest rate etc. Also people who borrowed money and who are unable to pay the amount is a type of Financial Risk.
- **Counterparty Risk**
  - Example: An employee paying Rs.1,00,000 from the account of the company instead of Rs.10,000. This is a type of misappropriation risk. An organization can always verify whether the person who is the employee and check the work of that person. A simple electronic system that will flag off an unusual amount.
- **Political Risk**
  - Example: An employee paying Rs.1,00,000 from the account of the company instead of Rs.10,000. This is a type of misappropriation risk. An organization can always verify whether the person who is the employee and check the work of that person. A simple electronic system that will flag off an unusual amount.
- **Commodity Risk**
  - Example: Once in Asia when it failed to check the quality of touch screen mobile phones.
- **Interest Rate Risk**
  - Example: Liquor baron Vijay Mallya, wanted in India for defaulting over Rs 8,000 crore, was arrested in London. Mallya's Mallya Brewing Company Ltd (MBC), which has set up a joint venture with Kingfisher Airlines in 2013, and continuous updating of SEBI guidelines, each business organization has to comply with plethora of rules, regulations and guidelines. Noncompliance leads to penalties in the form of fine and imprisonment.
- **Inflation Risk**
  - Example: An employee paying Rs.1,00,000 from the account of the company instead of Rs.10,000. This is a type of misappropriation risk. An organization can always verify whether the person who is the employee and check the work of that person. A simple electronic system that will flag off an unusual amount.
- **Currency Risk**
  - Example: Foxconn, which makes touch screen mobile phones for its clients, has become a market leader in selling touch screen mobile phones.
- **Country Risk**
  - Example: Example: In case of Nokia.

**Evaluation**

- **Stakeholder’s Angle**
  - 1. Equity shareholders
  - 2. Financial Institution
  - 3. Government
  - 4. Exchange Rate
- **Company’s Angle**
  - 1. 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 financial liquidity.
  - 2. From Government’s point of view, the financial risk can be viewed as failure of any bank or like Lehman Brothers down grading of any financial institution leading to spread of distress among society at large.
- **Government’s Angle**
  - 1. From Government’s point of view, the financial risk can be viewed as failure of any bank or like Lehman Brothers down grading of any financial institution leading to spread of distress among society at large.
  - 2. From Government’s point of view, the financial risk can be viewed as failure of any bank or like Lehman Brothers down grading of any financial institution leading to spread of distress among society at large.

**Meaning**

- **VaR**
  - 1. 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.
  - 2. VaR answers two basic questions:
    - What is worst case scenario?
    - What will be lost?
  - 3. VaR answers the question, “What is my worst-case scenario?” or “How much could I lose in a really bad month?”
  - 4. For example, if a portfolio of stocks has a one-day 5% VaR of Rs. 1 million, that means that there is a 0.05% probability that the portfolio will fall in value by more than Rs.1 million over a one-day period if there is no trading. Informally, a loss of Rs.1 million or more on this portfolio is expected in 1 day out of 20 days (because of 5% probability). A loss which exceeds the VaR threshold is termed a “VaR breach.”
  - 5. If a daily VaR is stated as Rs10,000 to a 95% level of confidence, this means that during the day there is a only a 1% chance that the loss on the next day will be greater than Rs10,000.

**Components of Calculations: VaR calculation is based on following 3 components**

- **Time Period**
- **Confidence Level**
  - Generally 95% and 99%
  - Loss in percentage or in amount

**Statistical Method: VaR is a type of statistical tool based on Standard Deviation.**

**Control Risk: Risk can be controlled by selling limits for standard deviation.**

**Application**

- To measure the maximum possible loss on any portfolio or a trading position.
- As a tool for Asset and Liability Management especially in banks.

**Formula**

\[
VAR_t = \text{SD}_t \times Z \text{ Score} + \text{SD}_t \times \text{t} \text{ days}
\]

\[
VAR_t = \text{VAR}_t + \text{VAR}_t \times \text{t} \text{ days}
\]
**Fundamental Analysis**

Fundamental analysis is a method of evaluating a security in an attempt to measure its intrinsic value, by examining related economic, financial and other quantitative and qualitative factors.

### Economic Analysis

- **Macro-economic factors** are to be assessed while analyzing the overall economy, and economic growth. These factors may include:
  - Growth Rates of National Income and Related Measures
  - Growth Rates of Industrial Sector
  - Inflation
  - Monetary and Fiscal Policies
  - International Trade

### Industry Analysis

An assessment has to be made regarding all the conditions and factors relating to demand of the particular product, cost structure of the industry. Since the basic profitability of any company depends upon the economic prospects of the industry to which it belongs, an appraisal of the particular industry's prospects is essential.

### Company Analysis

Company analysis is a process carried out by investors to evaluate securities, considering factors related to the company’s profile, products and services as well as profitability. This requires careful examination of the company’s quantitative and qualitative fundamentals.

### Technical Analysis

Technical analysis relies upon chart analysis rather than the information in the financial statements.

### Market Indicators

- **Breadth Index**
- **Volume of transactions**
- **Confidence Index**
- **Relative Strength Analysis**

### Data Analysis

- **Efficient Market Hypothesis**
- **Dow Jones Theory**
- **Elliot Wave Theory**
- **Random Walk Theory**

### Interpreting Price Patterns

- **Price Patterns**
  - **Triangles**
  - **Candlesticks**

### Relative Strength Theory

Relative strength theory is a contrary-opinion theory. It assumes that the average person is usually wrong and that a contrary opinion is more likely to be right. The relative strength concept suggests that the prices of some securities or assets exhibit relative strength in a market. Securities that rise relatively faster in a bull market or decline more slowly in a bear market are more likely to outperform the market.Relative strength can be measured in several ways.

**Assumptions**

1. Value of stock depends on the supply and demand for a stock.
2. The supply and demand is actually governed by several factors.
3. Stock prices move in trends which continue for a substantial period of time.
4. Technical analysis relies upon chart analysis rather than the information in the financial statements.

**Principles**

1. **Market dominance occurring**
   - The trend market
   - Uptrend
   - Slowed Trend
   - Down Trend
2. **The 2 phases of primary trend**
   - Accumulation Phase
   - Distribution Phase
3. **Market indices must match each other**
   - Volume must confirm trend change
   - Trend reversal to offer signals for possible new trend

**Theories**

1. **Three Lessons**
   - Markets Have a Memory
   - Markets are Fair
   - Market Indices are Profitable

2. **Challenges**
   - Limited Profit Potential: Processing Capabilities
   - Manipulative Influences

3. **Forms**
   - Price Information
   - Public Information
   - Private Information
   - Market Information

**Classification of Waves**

- **Inverted Waves**: Waves that are curved at the top or bottom.
- **Reversal Waves**: Waves that change direction along a trend.
- **Reacting Waves**: Waves that change direction along a trend.

**Classifications**

- **Upward trend**
- **Sideways trend**
- **Downward trend**

**Corrections Patterns**

- **Reversal Waves**
- **Reacting Waves**
- **Inverted Waves**

**Identification Patterns**

- **Prices of shares in stock market**
- **Prices of commodities**

**Support & Resistance Level**

- **Support Level**
- **Resistance Level**

**Charts**

- **Line Chart**
- **Bar Chart**
- **Point & Figure Chart**
- **Candlestick Chart**

**Market Indicators**

- **Breadth Index**
- **Volume of Transactions**
- **Confidence Index**
- **Relative Strength Analysis**

**Data Analysis**

- **Efficient Market Hypothesis**
- **Dow Jones Theory**
- **Elliot Wave Theory**
- **Random Walk Theory**

**Interpreting Price Patterns**

- **Price Patterns**
  - **Triangles**
  - **Candlesticks**

**Relative Strength Theory**

Relative strength theory is a contrary-opinion theory. It assumes that the average person is usually wrong and that a contrary opinion is more likely to be right. The relative strength concept suggests that the prices of some securities or assets exhibit relative strength in a market. Securities that rise relatively faster in a bull market or decline more slowly in a bear market are more likely to outperform the market. Relative strength can be measured in several ways.

1. **Calculating rates of return** and identifying those securities with historically high average returns as securities with high relative strength or use of shares.
2. **Even ratios like the 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.**

**This theory is a contrary-opinion theory.**

**The odd lot theory is used primarily to predict tops in bull markets, but also to predict movements in individual securities.**

---

**Security Analysis**

Security analysis is a method of share price movements based on a study of price graphs or charts on the assumption that share price trends are repetitive.
In finance, valuation is the process of determining the present value (PV) of an asset. Valuations can be done on assets (for example, investments in marketable securities such as stocks, options, business enterprises, or intangible assets such as patents and trademarks) or on liabilities (e.g., bonds issued by a company). Valuations are needed for many reasons such as investment analysis, capital budgeting, merger and acquisition transactions, financial reporting, tax liabilities to determine the proper tax liability, and in litigation.

### Security Valuation

**Overview**

- **Required Rate of Return**
  - Discount Rate
  - Internal Rate of Return
- **Discount Rate**
  - Discount Rate is the rate at which present value of future cash flows is determined.
  - Discount rate is normally the required rate of return which is also called as cost of capital.
- **Internal Rate of Return**
  - IRR is the discount rate at which project's net present value equals zero.

**Return Concepts**

- **Dividend Based**
  - CAPM Return
  - CAPM Return: \( \frac{E(R_m) - R_f}{\sigma_m} \)
- **Equity Valuation**
  - EPS: Earnings Per Share
  - PE Multiple: Price-Earnings Ratio

**Valuation**

- **Single Period Holding**
  - \( PV = \frac{C + RV}{(1 + YTM)} \)
- **Multi Period Holding**
  - \( PV = \sum_{t=1}^{N} \frac{C_t + RV_t}{(1 + YTM)} \)

**Earnings Based**

- **Security Valuation**
  - FCFF: Free Cash Flow to Firm
  - FCFF = EBITDA - Capital Expenditure - Net Working Capital

**Cash Flow Based**

- **Rights Share**
  - Cash Flow Based
  - Rights Share Value

**Enterprise Value**

- **Enterprise Value**
  - EV Multiplier
  - EV Multiplier = Market Value of Equity / Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA)

**Immunization**

- **Forward Rates**
  - An investor can purchase a two-year bill at par (pay rate is 10%) or by a one-year bill (pay rate is 8%) and roll into another one-year bill once maturities.

**Forward Curve**

- **Term Structure Theories**
  - The term structure theories explain the relationship between interest rates or bond yields and the time to their maturities.

**Bond Valuation**

- **Convertibles Bonds**
  - Ratio which shows at what premium the convertible bond is trading in the market
  - \( CP(P) = \frac{CP(P)}{PV(P)} \times 100 \)

- **Straight Value of the Bond**
  - It is the price when the bond would trade if it were not convertible to stock. Its then is equivalent to a non-convertible bond.

- **Minimum Value of the Convertible Bond**
  - A convertible bond should at the lowest trade at the higher of conversion value or straight value.

- **Downside Risk**
  - Convertible price or straight price of the bond.
  - DR(P) = \( \frac{MP(P) - CP(P)}{CP(P)} \times 100 \)

- **Convertible Price Parity or Market Conversion Price**
  - Price at which the investor will neither gain nor lose on buying the bond and exercising the conversion privilege
  - \( CP(P) = \frac{MP(P)}{\frac{DR(P)}{100} + 1} \)

- **Favourable Income Per Share**
  - It represents extra income earned in Bond over dividend income in shares.
  - (Dividends on Bond - Dividends on Equity Share)

- **Term Premium**
  - \( TP = \frac{MP(P) - CP(P)}{CP(P)} \times 100 \)

**My favorite things in life don’t cost any money. It’s really clear that the most precious resource we all have is Time. I’m as proud of many of the things we haven’t done as the things we have done. Innovation is saying no to a thousand things.**
Do You Know?

1. Market beta is 1, Total Risk (o) = Systematic Risk + Unsystematic Risk
2. Beta - ve (stock moves in opposite direction), +ve (stock moves in same direction), 0 (stock movement is independent of the market)
3. Risk reduction means actual risk (o) of the portfolio is less than the weighted average risk of the securities that constitutes the portfolio. This is the point where one can say that diversification has resulted into risk reduction.
4. Beta measures the sensitivity of returns of the stock to the market. High beta represents high risk, low beta: low risk
5. In CAPM if more than one risk free rate of return is given, then it is better to go moderate
6. Security or other financial instruments that are not currently owned, and subsequently (also known as shorting or going short) is the practice of selling securities without owning them.
7. The technique of identifying firms with publicly traded securities, which are engaged solely within a portfolio in order to minimize the impact that any one security will have on the weight being the proportion of investment in a security.
8. Return Coefficient of variation is used where we cannot decide which securities to select from many with the given return and SD. Hence we take average of all. Aggressive may resort highest rate whereas conservative can take a low rate.
9. In CAPM if more than one risk free rate of return is given, then it is better to go moderate
10. Beta measures the sensitivity of returns of the stock to the market. High beta represents high risk, low beta: low risk
11. In finance short selling (also known as shorting or going short) is the practice of selling securities or other financial instruments that are not currently owned, and subsequently repurchasing them ("covering").
The Active portfolio management relies on the fact that investors can generate returns that can beat the market. It involves higher than average costs and it's not always taking advantage of market inefficiencies.

Passive asset management relies on the fact that markets are efficient and it is not possible to beat the market returns regularly. It’s possible to meet the promised returns of the portfolio.

Asset Allocation Strategies

1. Strategic asset allocation is an investment strategy focused on the investment risk and expected returns. This strategy is based on the theory that the market is efficient, and that the only way to beat the market is to buy and hold the right mix of assets. The mix of assets is based on the investor's risk tolerance and investment goals. With this strategy, you continually rebalance your portfolio and manage your risk exposure. This strategy is best suited for investors who are willing to trade off some return for less risk.

Dynamic Asset Allocation

1. With an insured asset allocation strategy, you establish a base portfolio value under which the portfolio should not be allowed to drop. If the portfolio value drops below this base value, you adjust your asset allocation to bring it back up to the base value. This strategy is best suited for investors who are willing to adjust their asset allocation to maintain a constant portfolio value.

Integrated Asset Allocation

1. With all of the other mentioned strategies, you increase the likelihood of future market returns, but at the expense of increased risk. This strategy, on the other hand, includes all aspects of asset allocation, including risk management and diversification. This strategy is best suited for investors who are willing to take on a comprehensive approach to asset allocation and risk management.

Interest Rate Swaps

1. This technique is used by Portfolio Managers to protect the bond portfolio against changes in interest rates. This technique has been discussed in greater details in the chapter on Interest Rate Risk Management.

Other Portfolio Strategy

1. Patient Portfolio

This type of portfolio involves making investments in "expensive stocks" that provide good returns and big rewards along with carrying big risks. This portfolio is a collection of stocks of companies of different sizes that are rapidly growing and expected to generate rapid annual earnings growth over the next few years.

2. Aggressive Portfolio

This type of portfolio involves making investments in "expensive stocks" that provide good returns and big rewards along with carrying big risks. This portfolio is a collection of stocks of companies of different sizes that are rapidly growing and expected to generate rapid annual earnings growth over the next few years.

3. Conservative Portfolio

This type of portfolio involves making investments in "expensive stocks" that provide good returns and big rewards along with carrying big risks. This portfolio is a collection of stocks of companies of different sizes that are rapidly growing and expected to generate rapid annual earnings growth over the next few years.
**Distressed Securities**

1. It is a kind of purchasing the securities of companies that are in near bankruptcy.
2. The main purpose of buying such securities is to make efforts to revive the sick company.
3. Suitable for those investors who cannot participate in the market and those who wants avoid due diligence.

**Analysis of Risk before investing in DS**

- ** Liquidity Risk** – These securities may not be salable in the market.
- ** Event Risk** – Any event that particularly affect the company not as economy.
- ** Market Risk** – This is another type of risk though it is not important.
- ** Human Risk** – The judge’s decision on the company in distress also play a big role.

**Hedge Funds**

- ** Types**
  - ** Open Ended**
  - ** Closed Ended**

- ** Features**
  - Hedge funds utilize a variety of financial instruments to reduce risk, enhance returns and minimize the correlation with equity and bond markets.
  - Many, but not all, hedge fund strategies tend to hedge against downturns in the markets being traded.
  - Many hedge funds have the ability to deliver non-correlated returns.
  - Many hedge funds have an objective of consistency of return and capital preservation rather than magnitude of return or capital growth.
  - Many hedge funds are managed by experienced investment professionals who are generally disciplined and diligent.

- ** Benefits**
  - Hedge funds have a fixed number of shares and are traded among investors on an exchange. Like stocks, their share price is determined according to supply and demand, and they often trade at a discount or a premium to their net asset value.
  - Hedge funds use a variety of strategies to generate returns, including derivatives, arbitrage, and macroeconomic analysis.
  - Hedge funds have lower transparency than mutual funds or exchange-traded funds.

**Exchanges**

- ** Traded Funds**
  - ** Commodity**
  - ** Managed Futures**
  - ** Mezzanine Finance**

**Commodities**

- ** Reasons for Complexity in Valuation**
  - 1. Inefficient Market
  - 2. Liquidity
  - 3. Comptition
  - 4. High Transaction Cost
  - 5. No Organised Market

**Approaches used for Valuation**

- 1. Sales Comparison Approach
- 2. Income Approach
- 3. Cost Approach
- 4. Discounted Cash Flow Approach

**Venture Capital**

- **Meaning**
  - Venture capital means funds made available for startup firms and small businesses with exceptional growth potential. Venture capital is money provided by professionals who have a long-term management investment in young, rapidly growing companies that have the potential to develop into significant economic contributors.

- **Characteristics**
  - 1. Long Time Horizon: fund will invest with a long time horizon in mind.
  - 2. Lack of Liquidity: VC assumes that there would be less liquidity on the equity it gets and accordingly it would be investing in that format.
  - 3. High Risk: VC works on principle of high risk and high reward.
  - 4. Equity Participation: This would be the VC participate in the management and help the company grow.

**Exchanges**

- **Closely Held Companies**
  - 1. Professional
  - 2. Low Cost
  - 3. Management
  - 4. Liquidity
  - 5. No Organised Market

**Venture Capital**

- **Meaning**
  - Venture capital means funds made available for startup firms and small businesses with exceptional growth potential. Venture capital is money provided by professionals who have a long-term management investment in young, rapidly growing companies that have the potential to develop into significant economic contributors.

- **Characteristics**
  - 1. Long Time Horizon: fund will invest with a long time horizon in mind.
  - 2. Lack of Liquidity: VC assumes that there would be less liquidity on the equity it gets and accordingly it would be investing in that format.
  - 3. High Risk: VC works on principle of high risk and high reward.
  - 4. Equity Participation: This would be the VC participate in the management and help the company grow.

**Meaning**

- Hedge funds are often open-ended and closed-ended structures.
- Hedge fundNAV of the scheme generally calculated at the close of every trading day, whereas buy and sell prices are directly from a fund.

**Advantages**

- 1. Solid Capital Base: Provides a solid capital base for future growth.
- 2. Risk & Rewards: Venture Capital shares both Risk and Reward.
- 3. Advice & assistance: Provide practical advice and assistance to the company based on past experience.
- 4. Network of Contacts: Venture capitalist also has a network of contacts in many areas that can add value to the company.
- 5. Additional Funding: Capable of providing additional rounds of funding should it be required to finance growth.
- 6. IPO: Preparing a company for an initial public offering (IPO) of its shares onto the stock exchanges.
- 7. Trade Sale: Also facilitate a trade sale.

**Exits Points**

- ** Holding period return**
  - NAV = NAV_{t-1} + Cg_{t} + 1
  - NAV_{t} = NAV_{t-1} + Cg_{t} + 1

**Schemes**

- ** Functional Classification**
  - 1. Open Ended Scheme
  - 2. Close Ended Scheme
  - 3. Interval Schemes: Interval schemes are a cross between open-ended and close-ended structure

**Characteristics**

- 1. Consistent under performance
- 2. Changes in objectives of Mutual Fund
- 3. Changes in objectives of Investor
- 4. Replacement of Fund Manager

**Meaning**

- A Mutual Fund is a trust that pools money of a number of investors. The trust is managed by professional fund managers who invest the money collected from investors in capital market instruments such as shares, debentures and other securities.

**Characteristics**

- 1. No Guarantee return
- 2. High Fees & Expenses
- 3. Fund Manager
- 4. Management Risk
- 5. Diversification
- 6. Funds Turnover Ratio

**Meaning**

- Hedge funds are often open-ended and closed-ended structures.
- Hedge fundNAV of the scheme generally calculated at the close of every trading day, whereas buy and sell prices are directly from a fund.

**Advantages**

- 1. Solid Capital Base: Provides a solid capital base for future growth.
- 2. Risk & Rewards: Venture Capital shares both Risk and Reward.
- 3. Advice & assistance: Provide practical advice and assistance to the company based on past experience.
- 4. Network of Contacts: Venture capitalist also has a network of contacts in many areas that can add value to the company.
- 5. Additional Funding: Capable of providing additional rounds of funding should it be required to finance growth.
- 6. IPO: Preparing a company for an initial public offering (IPO) of its shares onto the stock exchanges.
- 7. Trade Sale: Also facilitate a trade sale.

**Exits Points**

- ** Holding period return**
  - NAV = NAV_{t-1} + Cg_{t} + 1
  - NAV_{t} = NAV_{t-1} + Cg_{t} + 1

**Schemes**

- ** Functional Classification**
  - 1. Open Ended Scheme
  - 2. Close Ended Scheme
  - 3. Interval Schemes: Interval schemes are a cross between open-ended and close-ended structure

**Characteristics**

- 1. Consistent under performance
- 2. Changes in objectives of Mutual Fund
- 3. Changes in objectives of Investor
- 4. Replacement of Fund Manager

**Meaning**

- Hedge funds are often open-ended and closed-ended structures.
- Hedge fundNAV of the scheme generally calculated at the close of every trading day, whereas buy and sell prices are directly from a fund.

**Advantages**

- 1. Solid Capital Base: Provides a solid capital base for future growth.
- 2. Risk & Rewards: Venture Capital shares both Risk and Reward.
- 3. Advice & assistance: Provide practical advice and assistance to the company based on past experience.
- 4. Network of Contacts: Venture capitalist also has a network of contacts in many areas that can add value to the company.
- 5. Additional Funding: Capable of providing additional rounds of funding should it be required to finance growth.
- 6. IPO: Preparing a company for an initial public offering (IPO) of its shares onto the stock exchanges.
- 7. Trade Sale: Also facilitate a trade sale.
Securitization

1. Process of securitization typically involves the creation of a pool of assets from the illiquid financial assets such as receivables or loans which are marketable.
2. It is the process of repackaging or re bundling of illiquid assets into marketable securities.
3. These assets can be automobile loans, credit card receivables, residential mortgages or any other form of future receivables.

Features

1. Creation of Financial Instruments
2. Bundling and Unbundling
3. Tools of Risk Management
4. Structured Finance
5. Trenching
6. Homogenity

Participants

Primary Participant
1. Originator
2. Special Purpose Vehicle
3. The Investors

Secondary Participant
1. Obligors
2. Rating Agency
3. Receiving and paying agent
4. Agent or Trustee
5. Credit Enhancer
6. Structurer

Mechanism

1. Creation of Pool of Assets
2. Transfer to SPV
3. Sale of Securitized Papers
4. Administration of assets
5. Recurse to Originator
6. Repayment of funds
7. Credit Rating to Instruments

Problems

1. Stamp Duty
2. Taxation
3. Accounting
4. Lack of standardization
5. Inadequate Debt Market
6. Ineffective Foreclosure laws

Stripped Securities

1. In PTCs all cash flows are passed to the performance of the securitized assets. To avoid this limitation there is another structure i.e PPTS.
2. In contrast to PTC in PPTS, SPV debt securities backed by the assets and certain of its new restructuring scheme. More over in contrast to PTC, this structure is created on the basis of amount of cash flows generated from the assets.
3. Further, the structure also permits the SPV to retrieve surplus funds for short term as per their requirement.
4. This structure also provides the freedom to issue several debt tranches with varying maturities.

Instruments

Pass Through Certificates (PTCs)
1. Originator (seller of the assets) transfers the entire receipt of cash in the form of interest or principal repayment from the assets sold.
2. These represent direct claim on the investors on all the assets that has been securitized.
3. Since all cash, they are transferred the investors eventually becomes beneficial owner in the assets held in the SPV.
4. Since it is created by SPV, the risk principal is also proportionately distributed among the security holders.
5. Further due to these characteristics of receivables, the sale of securitized by the final payment of assets, all the securities are terminated Simultaneously.

Pay Through Securities (PTS)
1. Stripped Securities are created by dividing the cash flows associated with underlying securities into two or more new securities. These two securities are as follows:
   a. Interest Only (IO) Securities
   b. Principal Only (PO) Securities

Stripped Securities

1. Stripped Securities are created by dividing the cash flows associated with underlying securities into two or more new securities. These two securities are as follows:
   a. Interest Only (IO) Securities
   b. Principal Only (PO) Securities

Securitization in India

1. It is the Citibank who pioneered the concept of securitization in India by bundling of auto loans in securitized instruments.
2. Thereafter many organizations securitized their receivables. Although started with securitization of auto loans it moved to other types of receivables such as sales tax defaults, aircraft receivables etc.
3. 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.
4. It has become an important source of funding for micro finance companies performing Assets (NPAs) without approaching to Court.
5. It has become an important source of funding for micro finance companies especially the Citi Bank who pioneered the concept of securitization in India by bundling of auto loans in securitized instruments.
6. In order to encourage securitization, the Government has come out with the Pay Through Securities (PTS).
7. The Pay Through Securities (PTS) is an extension of the bundle structure by allowing the borrowers to have the freedom of choosing the maturity and tranches.
8. The Pay Through Securities (PTS) is an extension of the bundle structure by allowing the borrowers to have the freedom of choosing the maturity and tranches.
9. The Pay Through Securities (PTS) is an extension of the bundle structure by allowing the borrowers to have the freedom of choosing the maturity and tranches.

Benefits

1. From the angle of Originator
   a. Off- Balance Sheet Financing
   b. More specialisation in main business
   c. Helps to improve financial ratios
   d. Reduced borrowing Cost
   e. From the angle of Investor
   f. Diversification of Risk
   g. Regulatory requirement
   h. Protection against default

Pricing of Instruments

From Orignator’s Angle
The instruments can be priced at a rate which orignator has to incur an outflow

From Investor’s Angle
Security price can be determined by discounting best estimate of expected future cash flows using rate of yield to maturity of a security of comparable security with respect to credit quality and average life of the securities.

Corporate Valuation

1. Information for its internal stakeholders,
2. Comparison with similar enterprises for understanding efficiency.
3. Future public listing of the enterprise,
4. Strategic planning, for e.g. finding out the value driver of the enterprise, or for a correct deployment of surplus cash,
5. Ball park price (i.e. as approximate price) for acquisition, etc.

Methods of Valuation

1. Asset Based
   - Total Assets - Long Term Debt
2. Earnings Based
   - Value of the Equity = EAT * (1 - t)
   - Value of the Company = EAT / * (1 - t)
3. Cash Flow Based
   - Enterprise Value Based
     - Enterprise Market Value - Market Value of Equity + Market Value of Debt + Market Value of non-Controlling interests
   - Market Value of Equity
     - Earnings Based
     - Price to Earnings (P/E)
     - Earnings Per Share (EPS)

Relative Valuation

The Relative valuation, also referred to as ‘Valuation by multiples’, uses financial ratios to derive at the desired metric (related to the ‘multiple’) and then compares the same to that of comparable firms.

In the process, there may be extrapolations set to the desired range to achieve the target set. To elaborate:
1. Find out the ‘drivers’ that will be the best representative for deriving at the multiple. Drivers can be:
   a. Enterprise value based multiples, which would comprise primarily of EV/EBITDA, EV/Invested Capital, and EV/Sales.
   b. Equity value based multiples, which would comprise of E/P ratio and P/E.
2. Determine the results based on the chosen driver(s) through financial ratios.
3. Find out the comparable firms, and perform the comparative analysis, and
4. Derive the value of the firm obtained to smooth out the deviations.

The only way to do great work is to love what you do. - Steve Jobs | The question isn’t who is going to let me; it’s who is going to stop me. | You can’t connect the dots looking forward; you can only connect them looking backwards. So you have to trust that the dots will somehow connect in your future. You have to trust in something—your gut, destiny, life, karma, whatever. This approach has never let me down, and it has made all the difference in my life.
Foreign Exchange and Risk Management

1. **Transaction Exposure**
   - It measures the effect of an exchange rate change on outstanding obligations that existed before exchange rates changed but were settled after the exchange rate change.
   - Example: If an Indian exporter has a receivable of Rs100,000 due in six months and if the dollar deprecates relative to the rupee a cash loss occurs. Conversely, if the dollar appreciates relative to the rupee, a cash gain occurs.

2. **Purchasing Power Parity Theory**
   - It states that higher inflation in one country will be offset by depreciation in the currency of that country.
   - When Exchange Rates are in Direct Quote
     \[ 1 + \text{r}_d = \text{F} \times \left(1 + \text{r}_f\right) \]
     \[ 1 + \text{r}_d \times \text{F} = 1 + \text{r}_f \]
     \[ 1 + \text{r}_d \times \text{F} = 1 + \text{r}_f \]
   - Where, `r_d` = Interest Rates of Domestic currency and `r_f` = Spot Rate

3. **Economic Exposure**
   - It refers to the extent to which a change in the exchange rate of a foreign currency value of a company can damage its ability to change in exchange rate. It is the overall impact of exchange rate changes on the value of the firm.
   - Operational of exchange rate changes significantly affect the cost of a firm’s inputs and the prices of its outputs and thereby influence its competitive position substantially.

International Fisher Effect

According to the IFE, ‘nominal risk-free interest rates contracts are not impacted by return and spotted inflation’. This means that if investors of all countries require the same real return, interest rate differentials in these countries may be the result of differential in expected inflation.

Direct & Indirect Quotations
- **Direct Quote**
  - Where the Value in exchange rate is in Home Currency
  - `1/0.011 = 1/90`
  - `125/0.011 = 11,363.64`

Theories in Forex

- **Interest Rate Parity Theory**
  - It states that higher interest in one country will be offset by depreciation in the currency of that country.
  - When Exchange Rates are in Direct Quote
    \[ 1 + \text{r}_d = \text{F} \times \left(1 + \text{r}_f\right) \]
    \[ 1 + \text{r}_d \times \text{F} = 1 + \text{r}_f \]
    \[ 1 + \text{r}_d \times \text{F} = 1 + \text{r}_f \]
  - Where, `r_d` = Interest Rates of Domestic currency and `r_f` = Spot Rate

- **Covered Interest Rate Parity**
  - It states that the size of the Forward Premium (Discount) should be approximately equal to the interest rate differential between the two countries.

1. **Transaction Exposure**
   - It measures the effect of an exchange rate change on outstanding obligations that existed before exchange rates changed but were settled after the exchange rate change.
   - Example: If an Indian exporter has a receivable of Rs100,000 due in six months and if the dollar deprecates relative to the rupee a cash loss occurs. Conversely, if the dollar appreciates relative to the rupee, a cash gain occurs.

2. **Purchasing Power Parity Theory**
   - It states that higher inflation in one country will be offset by depreciation in the currency of that country.
   - When Exchange Rates are in Direct Quote
     \[ 1 + \text{r}_d = \text{F} \times \left(1 + \text{r}_f\right) \]
     \[ 1 + \text{r}_d \times \text{F} = 1 + \text{r}_f \]
     \[ 1 + \text{r}_d \times \text{F} = 1 + \text{r}_f \]
   - Where, `r_d` = Interest Rates of Domestic currency and `r_f` = Spot Rate

3. **Economic Exposure**
   - It refers to the extent to which a change in the exchange rate of a foreign currency value of a company can damage its ability to change in exchange rate. It is the overall impact of exchange rate changes on the value of the firm.
   - Operational of exchange rate changes significantly affect the cost of a firm’s inputs and the prices of its outputs and thereby influence its competitive position substantially.

International Fisher Effect

According to the IFE, ‘nominal risk-free interest rates contracts are not impacted by return and spotted inflation’. This means that if investors of all countries require the same real return, interest rate differentials in these countries may be the result of differential in expected inflation.
**Interest Rate Risk Management**

### Determinants
1. Supply and Demand: When economic growth is high, demand for money increases, pushing interest rates up and vice versa.
2. Inflation - The higher the inflation rate, the more interest rates are likely to rise.
3. Government: Government is the biggest borrower. The level of borrowing also determines the interest rates.

### Traditional Methods
1. **Asset & Liability Management**
   - **Interest Rate Futures**
     - An interest rate future is a contract between the buyer and seller agreeing to the future delivery of an interest-bearing asset.
     - Interest rate futures are used to hedge against the risk that interest rates will move in an adverse direction, causing a cost to the company.
     - Currently, Interest Rate Futures segment of SEBI offers two instruments i.e. Futures on 6 year, 10 year and 3 year Government of India Securities and 6 day Government of India Treasury Bill (GSTB).

2. **Forward Rate Agreement**
   - A forward rate agreement (FRA) is an over-the-counter contract between parties that determines the rate of interest to be paid or received on an obligation beginning at a future start date.
   - An FRA involves two counterparties: the fixed rate receiver (lender) and the floating rate receiver (long). Thus, being long the FRA (Fixed Pay) means that you gain when Libor rates increase because you have to pay for rate even if the Libor has increased.
   - If we are the fixed receiver, then it is understood without saying that we also are the floating payer, and vice versa.

3. **Interest Rate Options**
   - An interest rate option is an agreement to enter into a future rate swap at a specific date in the future, at a specific rate.
   - It gives the holder the right but not the obligation to enter into the rate swap.

4. **Interest Rate Swaps**
   - An interest rate swap is an agreement between two counterparties in which one stream of future interest payments is exchanged for another based on a specified principal amount.

### Modern Methods
1. **Swaptions**
   - Swaptions are also useful to those businesses tendering for borrowing rate.
   - Swaptions are useful to borrowers targeting an acceptable borrowing rate.
   - Swaptions are also useful to treasurers managing their floating lines of credit.

### Methods to Measure
1. **The traditional Maturity Gap Analysis**
   - For measure the interest rate sensitivity of earnings.

2. **Duration to measure interest rate sensitivity of capital**

3. **Simulation and Value at Risk**

### Other Financial Instruments
- **Swaps**
- **Collars**
- **Caps**
- **Futures**
- **Swaptions**

### Glossary
- **Basis Swap**: A simple swap which involves the exchange of fixed and floating interest rate streams.
- **Basis Rate Swap**: A basis swap is a floating-floating interest rate swap. A simple example is a swap of 3-month Libor for 3-month Libor.
- **Cash Against Cash (CASH):** Where the interest payments are exchanged for another based on a notional principal amount that is fixed or floating.
- **Cashflow Rate Swap**: A cashflow rate swap is an interest rate swap with the notional principal amount that is fixed or floating.
- **Conversion Factor**: The conversion factor is a multiplier that is used to convert a bond's market price into an equivalent notional principal amount.
- **Duration**: The duration of a financial instrument is a measure of its sensitivity to changes in interest rates.
- **Interest Rate Swap**: An interest rate swap is a contract between two counterparties that agree to exchange interest payments on a notional principal amount.
- **Optionality**: Optionality refers to the right to enter into an interest rate swap at a future date.
- **Swaption**: A swaption is a derivative instrument where the buyer of a swaption has the right but not the obligation to enter into a forward rate agreement.
- **Swap**: A swap is a contract between two counterparties that agree to exchange interest payments on a notional principal amount.
- **Swapbook**: A swapbook is a collection of interest rate swaps held by a financial institution.
- **Swap Option**: A swap option is a derivative instrument where the buyer of a swap option has the right but not the obligation to enter into a swap.

### VayankKothari

### Syllabus
1. **Types**
   - **Plain Vanilla Rate Swap**
   - **Swaptions**

2. **Features**
   - **Uses**
   - **Categories**

### Types

1. **Plain Vanilla Rate Swap**
   - In this swap, Party A pays to Party B a predetermined, fixed rate of interest or a specified notional interest rate.
   - Currently, Party B agrees to make payments based on a floating interest rate to Party A that is not the same as the fixed rate.
   - The combination of a fixed-rate and a floating-rate swap is called a collar.

2. **Basis Rate Swap**
   - A basis swap is a floating-floating interest rate swap.
   - A simple example is a swap of 3-month Libor for 3-month Libor.

### Features

1. **Uses**
   - **Collars**
   - **Swaptions**

2. **Categories**
   - **Bilateral Transaction**
   - **European Transaction**
   - **American Transaction**

For the past 31 years, I have looked in the mirror every morning and asked myself: ‘If today were the last day of my life, would I want to do what I am about to do today?’ Every day for years has been ‘No’ for too many days in a row, I know I need to change something.

I'm convinced that about half of what separates successful entrepreneurs from the non-successful ones is pure perseverance.
Mergers, Acquisitions and Corporate Restructuring

**Definitions**

**Mergers**
Mergers can be defined as “The combination of one or more corporations or business entities into a single business entity, the joining of two or more companies to achieve greater efficiency of scale and productivity.”

**Acquisitions**
An acquisition or takeover is the purchase of one business or company by another company or entity. This includes acquiring directly or indirectly shares, voting rights, assets or control over management of assets of another enterprise.

**Corporate Restructuring**
Corporate Restructuring refers to the changes in the composition of a firm’s own or more business portfolios in order to have a more profitable enterprise. Simply, reorganizing the structure of the organization to fetch more profits from the same situation or at least to prevent the present situation.

**Divestiture / Demerger**
It refers to the selling a particular division, asset, product line, subsidiary or factory to another entity for an agreed with the seller which may be payable either in cash or securities.

**Spin off**
It refers to the separation of the part of the existing business and creating a new entity. Shareholders of the existing company continue to be the shareholders of the new entity.

**Split up**
A corporate action in which a single company splits into two or more separately run companies. Shares of the original company are exchanged for shares in the new companies. After a split-up, the shareholders of the remaining part of the company may have different demands.

**Equity Carve Outs**
Similar to spin off, with the difference that the parent company sold a separate business, the carved-out company usually in an IPO while remaining the part will bring some cash into the company.

**Sale of a Division**
In the case of a sale of a division, the seller company is disposing of its business whereas the buyer company is acquiring a business.

**Financial Restructuring**

1. Synergistic operating economics: it is in other words, the combined value of two firms shall be more than their individual value.
2. Diversification: Greater the combination of statistically independent or negatively correlated income streams of merged companies, there will be higher reduction in the business risk in comparison to companies having income streams which are positively correlated to each other.
3. Taxation: In the case of acquisition the losses of the target company will be allowed to set off against the profits of the acquiring company.
4. Growth: Mergers and acquisition mode enables the firm to grow at a rate faster than the other mode via, organic growth.
5. Consolidation of Production: Production capacity is increased by combining two or more plants.

**Objectives of M&A**

1. Horizontal growth is usually between two companies in the same business sector. The example of horizontal merger would be if a health care system buys another health care system.
2. Vertical merger represents the buying of supplier or customer. In the same example as above if a health care system buys the ambulance services from its service suppliers then it is an example of vertical merger.
3. Diversification, horizontal and vertical mergers can help the firm by making its business less dependent on one industry.
4. Concentration of Characteristics of the merger is the third form of M&A process which deals with the merger between two or more companies. The example of conglomerate M&A may include a scenario if the health care system buys a restaurant chain.

**Reasons for M&A Failures**

1. No common vision.
2. Nasty surprises resulting from poor due diligence.
3. Poor governance.
4. Poor communication.
5. Poor program management.
7. Weak leadership.

**Benefits of Reverse Merger**

1. Easy access to capital market.
2. Increase in visibility of the company in corporate dilution.
3. Tax benefits on carry forward losses acquired public company.
4. Cheaper and easier route to become a public company.

**Reasons for Reverse Merger**

1. For company which has not much share capital.
2. For company who believes in the future of the company but the management is not eager to raise financing.
3. For company which is willing to raise financing in a lesser amount.

**Financial Selling Company**

1. Competitive pressure is increasing.
2. No access to new technologies and developments.
3. Strong market entry barriers. Geographical presence could not be enhanced.
4. Poorly positioned on the supply and demand side.
5. No efficient utilisation of distribution capabilities.
6. New strategic thrusts were found for better utilization of free funds and financial assets. This accelerates the pace of shareholders the selling of some part of the surplus cash.
7. Not enough capital to complete the project.
8. Possibility to sell the business at an attractive price or it is in best interest of the shareholders to dispose of the subsidiary.

**Equity BuyBack**

1. A leveraged buyout (LBO) is an acquisition where the purchase price is financed through a combination of debt and equity and in which the cash flows or assets of the target are used to serve and repay the debt.
2. Since the debt always has a lower cost of capital than the equity, the returns on the equity increase with increasing debt. The debt effectively serves as a lever to increase returns on payable debt.
3. A levered buyout can be structured in several forms such as a roll-up buyout, secondary buyout and term loan buyout, among others, and can exist in growth situations, restructuring situations and insolvencies.

**Takeover Strategies**

1. Tender Offer is a public, open offer or invitation usually announced in a newspaper advertisement by a prospective acquirer to all stockholders of a publicly traded corporation (the target corporation) to tender their stock for sale at a specified price during a specified time, subject to the tendering of a minimum and maximum number of shares.
2. In Street Sweep the larger number of target company’s shares are quickly purchased by the acquiring company before it makes an open offer.
3. Bear Hug: A buyout offer irrespective of stockholders of a company targeted for acquisition that there is little likelihood they will refuse the offer.
4. Strategic Alliance is a kind of partnership between two enterprises in which they take advantage of each other’s cost strengths like proprietary processes, intellectual capital, research, market penetration, manufacturing and distribution capabilities etc. They will have open door relationship with another entity and will mutually retain control.
5. Brand Power: Acquirer Company comes into an alliance with powerful brands that cut down the brands of the target company making it weaker and then acquirer company simply takes over the target company.

**Takeover by Reverse Bid**

1. Reverse Takeover: “Acquisition” usually refers to a purchase of a smaller firm by a larger one. Sometimes, however, a smaller firm will acquire management control of a larger and/or longer-established company and retain the name of the latter for the post-acquisition combination.
2. Reverse Merger: A form of transaction that enables a private company to be publicly listed in a relatively short time frame. A reverse merger occurs when a primarily held company (often one that has strong prospects and is eager to raise financing) buys a publicly listed shell company usually with no business and limited assets. Three test requirements for takeover by reverse bid are:
   a. The assets of the target company are greater than the company.
   b. Equity capital to be issued by the transferee company for acquisition should exceed its original share capital.
   c. There should be a change of control in transferee company by way of introduction of a minority holder or group of holders.

**Management Buyouts**

1. A management buyout (MBO) is a form of acquisition where a company’s existing manager acquires a large part or all of the company from either the parent company or from the private owners.
2. An MBO can occur for a number of reasons:
   a. The owners of the business want to retain & sell the company to the management team.
   b. The owners of the business have lost faith in the company and are willing to sell it to the management (this belief is the function of the business in order to get some value for the business.

**Cross Border M&A**

1. Cross-border M&A is a popular route for global growth and overseas expansion.
2. Major factors that motivate multinational companies to engage in cross-border M&A include:
   a. Globalization of production and distribution of products and services.
   b. Integration of global economies.
   c. Expansion of trade and investment relationships on International level.
   d. Many countries are reforming their economic and legal systems, and providing generous investment and tax incentives to attract foreign investment.
   e. Privatization of state-owned enterprises and stabilization of the banking industry.

**Ways of Demerger**

1. Sell off: It refers to the selling a particular division, asset, product line, subsidiary or factory to another entity for an agreed with the seller which may be payable either in cash or securities.
2. Spin off: It refers to the separation of the part of the existing business and creating a new entity. Shareholders of the existing company continue to be the shareholders of the new entity.
3. Split up: A corporate action in which a single company splits into two or more separately run companies. Shares of the original company are exchanged for shares in the new companies. After a split-up, the shareholders of the remaining part of the company may have different demands.
4. Equity Carve Outs: Similar to spin off, with the difference that the parent company sold a separate business, the carved-out company usually in an IPO while remaining the rest will bring some cash into the company.
5. Sale of a Division: In the case of a sale of a division, the seller company is disposing of its business whereas the buyer company is acquiring a business.

**Antitakeover Strategy**

1. Crown Jewel Defense: Sell off the entire or some of the company’s most valuable assets.
2. Poison Pill: It lures the target company’s management to make sure that the acquiring company simply never manages to achieve an important part of the shareholders of the company without the consent of the board.
3. Poison Port: Here the company issue bonds which will encourage the holder of the bonds to cash in at each price that will result in Target Company becoming insolvent.
4. Greenmail: Greenmail involves repurchasing a block of shares which it is held by a single shareholder or other using a tactic, at a premium over the stock price in return for an agreement called as standstill agreement. In this agreement it is stated that seller will no longer be able to dispose of shares for a period of time longer than five years.
5. White Knight: The target company seeks for a friendly bid for the Acquirer company and let the acquire company defend itself which will call off the proposal of takeover.
**International Financial Centre**

1. What is IFC?
2. Benefits of IFC
3. Constituents of IFC

**What is IFC?**

- International Financial Centre (IFC) is the financial center that caters to the needs of the customers outside their own jurisdiction.
- IFC is a hub that deals with flows of funds, financial products and services through its own land but with different set of accounts.
- Thus, these centers provide flexibility in currency trading, insurance, banking and other financial services.
- Account of SBI in Bank of America
- Bank of America
- Account for ICICI Bank
- The account held by State Bank of India with Bank of America

**Benefits of IFC**

- Opportunity for qualified professionals working outside India to learn and practice their profession.
- A platform for qualified and talented professionals to pursue global opportunities without leaving their homeland.
- Scope of Work from India.
- Bringing back those financial services transactions presently carried out abroad by overseas financial institutions/entities or branches or subsidiaries of Indian Financial Market.
- Trading of complex financial derivatives can be started from India.

**Constituents of IFC**

- Account for ICICI Bank
- The account held by State Bank of India with Bank of America

---

**Islamic Finance**

**Meaning**

- **Riba**
- **Differentiate Conventional & Islamic Finance**

**Types of IFC**

- Global (GIFCs)
- Regional (RIFCs)

**Regional (RIFCs)**

Serve their national economies rather than their regions or the world –

- This are centres like Paris, London, Tokyo and Singapore that provide a wide range of ISFs but cater mainly to the needs of their national economies rather than their regions or the world –
- One may call them national IFCs

**Global (GIFCs)**

Serve their region rather than their national economies and are of non-governance of such Dubai, Hong Kong:

- These are centres that provide financial services to all financial institutions/entities or branches in India
- These are centres that provide financial services to all financial institutions/entities or branches in India
- Mubarakah
- Salam

**Non-global and non-regional, ordinary IFCs**

- These are centres that provide financial services to all financial institutions/entities or branches in India
- These are centres that provide financial services to all financial institutions/entities or branches in India
- Mubarakah
- Salam

**Financial Instruments**

- A cash-settled, short-term forward contract on a thinly traded or non-convertible foreign currency
- The profit or loss at the time of settlement date is calculated by taking the difference between the prevailing market rate and the agreed upon exchange rate at the time of settlement, for an agreed upon notional amount of funds.
- All NDFs have a fixed date and a settlement date.
- The fixing date is the date at which the difference between the prevailing market rate and the agreed upon exchange rate is calculated.
- The settlement date is the date by which the payment is made. For delivery and is normally quoted and settled in the US dollars.
- They have become a popular instrument for corporations seeking to hedge exposure to foreign currencies that are not internationally traded.

**Conventional Finance**

- Basis: Islamic Finance
- Interest must be paid in respect of the losses

**Islamic Finance**

- Basis: Islamic Finance
- Riba is prohibited
- Sporulation (uncertainty)
- The financial transaction should be free from an element of Gaming (Gharan), Gambling (Maysir, Corinthians (Ribā)), Ignorance (Jahl)

There are no such restrictions

---

**...Continued _Foreign Exchange & Risk Management**

**Nostro, Vesto & Loro Account**

- **Our account with your bank**
- **Your account with our bank**
- **Your account with a foreign bank**

**Market Participants & Pips**

- Participates in the foreign exchange market can be categorised as follows
- 

**Pips**

- PIP is the Price Interest Point
- It is the smallest unit by which a currency exchange rate can change.
- E.g., USD/INR quoted to a customer is R1.6175.
- The minimum value this rate can change is either R1.6174 or R1.6176.
- In other words, for USD/INR quote, the pip size is 0.01.
- In foreign currency exchange, it is the tick size in share quotations.
- Hence, in Indian interbank market, USD-INR rate is quoted up to 4 decimal point.
- Minimum value change will be at the tune of 0.0001.
- Spot EUR/USD is quoted at a bid price of 1.0123 and an ask price of 1.0129.

**NDFs**

- A contract wherein, as an Exporter, you have no Foreign Currency to Deliver at maturity and as an Importer you have no Local Currency to deliver at maturity.
- As an Exporter or an Importer you would like to roll over the contract which effectively means spot settlement and booking of new contract for later date.

**Rationale behind the rollover bin the following:**

1. Non receipt of Foreign Currency from client (as per contract terms and conditions)
2. Shortage of local currencies (import payment)
3. Non-agreement of payment with clients
4. Non availability of longer period forward contracts as normally forward contracts are available maximum for one year and to hedge the exposure for the period more than one rollover contract shall be used.

**Strategies for Exposure Management**

- **Low Risk: Low Reward**
- This option involves automatic hedging of exposures in the forward market as soon as they arise, irrespective of the attractiveness or otherwise of the forward rate.
- **Low Risk: Reasonable Reward**
- This strategy requires selective hedging of exposures whenever forward rates are attractive but keeping exposures open whenever they are not.
- **High Risk: Low Reward**
- Perhaps the worst strategy is to leave all exposures unhedged. The risk of destabilization of cash flows is very high, and it is worth incurring management costs for risk control.
- **High Risk: High Reward**
- This involves active trading in the currency market through continuous cancellations and rebookings of forward contracts.
Small and Medium Enterprises

Purpose of MSMED Act

1. Remove impediments due to multiple laws
2. Introduce statutory and advisory bodies in MSME policies
3. Statutory registration procedures of MSMEs
4. Statutory basis for preference to MSMEs
5. Improve realization of payments of MSMEs

SME Exchange

An SME Exchange is a stock exchange dedicated for trading shares / securities of SMEs which otherwise find it difficult to get listed on the Main Board. The concept originated from the difficulties faced by SMEs in gaining visibility and attracting sufficient trading volumes when listed along with other stocks on the Main Board of stock exchanges.

Benefits of listing on SME Exchange

1. Easy access to Capital
2. Enhanced Visibility and Prestige
3. Efficient Risk Distribution
4. Employee Incentives
5. Companies shall be incorporated under the Companies Act, 2013.
6. Trading Lot Size
7. Trading Lot Size
8. Trading Lot Size

Documents for Listing

1. Balance Sheet and Profit Loss Statement for last three consecutive years of incorporation
2. Income Tax Assessment Certificates of Partner/Directors
3. Proof of Possession of Land/Building
4. Architect’s estimate for construction cost
5. Partnership deed/Memorandum and Articles of Association
6. Project Report
7. Budgetary Quotations of Plant and Machinery

Criteria for SME Listing

1. The minimum subscription to be not less than Rs. 1,00,000
2. The minimum subscription to be not less than Rs. 1,00,000
3. The minimum subscription to be not less than Rs. 1,00,000
4. The minimum subscription to be not less than Rs. 1,00,000
5. The minimum subscription to be not less than Rs. 1,00,000

Sources of Finance

Commercial/Regional Rural/Cooperative Banks
SEDIIB Small Industries Development Bank of India (reincidence and direct lending)
SIDBI Small Industries Development Bank of India
SFCs/SIDCs State Financial Corporations (e.g. Delhi Financial Corporations/State Industrial Development Corporations)

SME Financing

1. Easy access to Capital
2. Enhanced Visibility and Prestige
3. Efficient Risk Distribution
4. Employee Incentives

Export Promotion Strategy

India’s export promotion strategy includes simplification of procedures, incentives for high-value production of exports, preferential treatments to MSMEs in the market development fund, and special provisions in the trade development assistance scheme.

Export Growth Schemes

A key area of the World Bank Group’s focus is to promote MSMEs’ access to finance

- Lending Operations and Policy Work
  - SIFEs (Small Industries Finance Enterprises)’s lending programs
  - Policy work, analytical work, and other Advisory Services

- Role of World Bank
  - IDA
  - Grameen Bank
  - Agribank

Entrepreneurship

1. Role of World Bank
2. Lending Operations and Policy Work
3. Export Promotion Strategy
4. Export Growth Schemes
5. Role of World Bank
6. Lending Operations and Policy Work
7. Export Promotion Strategy
8. Export Growth Schemes

StartUp India Initiative

1. Overview
2. Overview
3. Overview
4. Overview
5. Overview
6. Overview
7. Overview
8. Overview

StartUp India

1. Overview
2. Overview
3. Overview
4. Overview
5. Overview
6. Overview
7. Overview
8. Overview

1. Overview
2. Overview
3. Overview
4. Overview
5. Overview
6. Overview
7. Overview
8. Overview

1. Overview
2. Overview
3. Overview
4. Overview
5. Overview
6. Overview
7. Overview
8. Overview