CA Final SFM (New Syllabus) Theory

Important Links to connect with faculty:

About the faculty:

- Dinesh Jain is a Chartered Accountant and is currently working in India's premier credit rating agency
- **Rank holder in all three levels of Chartered Accountancy – CA Final (Rank 3), CA IPCC (Rank 9) and CA CPT (Rank 24)**
- **He takes classes for both CA Inter and CA Final.** Enriches student's knowledge on Cost Accounting and Str. Has an experience of eight years in teaching.
- Focuses extensively on conceptual clarity which has enabled multiple students securing exemption in his subjects

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Shiva Ram Marri	Thank you very much sir. Your classes helped me alot in preparation
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Sai Gopal	Thank you very much Sir for explaining such complex topics in easy & lucid manner
Nisha Goyal	Everyone are born with an intent and i feel you are here to Decipher SFM as Simple for Millions.Thanks for these lectures
Anju Rajain	Best lectures on derivatives .. too good sir !
Sangita Patil	Sir, you have excellent way of teaching. I was badly struggling with international finance topic .Your lectures are very helpful. I don't think anyone can teach in such an excellent way. Thank you so much .
Lokesh Kumar	Dear Dinesh Jain sir I have seen all the 6 parts I sincerely apply my thanks to you sir Now I could do most of the sums in this topic because of you sir
Abirami A	Thanks a lot sir.... Yesterday I had 100 marks test on forex and surprisingly Im able to do correctly maximum number of questions even though I complete your videos up to part 8. Once again thanks a lot for your timely help....
Neha Yadav	Hi Sir......Amazing videos , style of teaching and everything...I liked it alot......Thankyou sir......Also kindly let me know If your books are available online
Yuvaraj	Sir, your class super, really very helpful for me.
Krishna Joshi	our way of teaching is very good. Sir..I have enjoyed your lectures very much specifically factoring and forex

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Total		**56**	**76**	**45**	**177**

1. What are the three essential elements of any business? (Category B)

Business need to have the following three fundamental essential elements

- A clear and realistic **strategy**,
- The **financial** resources, controls and systems to see it through and
- The right **management** team and processes to make it happen.

We may summarise this by saying that:

Strategy + Finance + Management = Fundamentals of Business

2. Write short note on strategy? (Category C)

- Strategy may be defined **as the long-term direction** and scope of an organization to achieve competitive advantage through the **configuration of resources** within a changing environment for the **fulfilment of stakeholder's aspirations and expectations**.

3. What are the key decisions falling within the scope of financial strategy? (Category A)

The key decisions falling within the scope of financial strategy include the following:

- **Financing decisions:** These decisions deal with the mode of financing or **mix of equity capital and debt capital**.
- **Investment decisions:** These decisions involve **the profitable utilization of firm's funds especially in long-term projects** (capital projects). Since the future benefits associated with such projects are not known with certainty, investment decisions necessarily involve risk. The projects are therefore evaluated in relation to their expected return and risk.
- **Dividend decisions:** These decisions **determine the division of earnings** between payments to shareholders and reinvestment in the company.
- **Portfolio decisions:** These decisions involve **evaluation of investments based on their contribution to the aggregate performance** of the entire corporation rather than on the isolated characteristics of the investments themselves.

4. Explain the interface between financial policy and strategic management? (Category B)

- 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**.
- **Sources of finance and capital structure** are the most important dimensions of a strategic plan. The need for fund mobilization to support the expansion activity of firm is very vital for any organization.
- 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 which need to be followed for minimizing the risks of excessive loans
- 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
- **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

- Thus, the **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

5. **Explain the different types of strategy? (Category A)**

Following are the three different types of strategy:

- **Corporate Level Strategy:** Corporate level strategy fundamentally is concerned with **selection of businesses in which a company should compete** and also with the development and coordination of that portfolio of businesses. Corporate level strategy should be able to answer three basic questions namely **suitability, feasibility and acceptability**
- **Business Unit Level Strategy:** Strategic business unit (SBO) may be any **profit centre that can be planned independently** from the other business units of a corporation. At the business unit level, the strategic issues are about practical coordination of operating units and **developing and sustaining a competitive advantage** for the products and services that are produced.
- **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.**

6. What is financial planning and what are the components of financial planning? **(Category B)**

- Financial planning is the **backbone of the business planning and corporate planning**. It helps in **defining the feasible area of operation** for all types of activities and thereby defines the overall planning framework.
- Financial planning is a **systematic approach** whereby the financial planner helps the customer to **maximize his existing financial resources** by utilizing **financial tools** to achieve **his financial goals**.

There are 3 major components of Financial planning:

- Financial Resources (FR)
- Financial Tools (FT)
- Financial Goals (FG)

Financial Planning: FR + FT = FG

7. **What makes an organization financially sustainable? (Category C)**

To be financially sustainable, an organisation must:

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

8. **Write short note on sustainable growth rate (SGR)? (Category A)**

- 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 rate, which is defined as the fraction of earnings retained in the business.

SGR = ROE x (1- Dividend payment ratio)

- Sustainable growth models assume that the business wants to:
  - maintain a target capital structure without issuing new equity;
  - maintain a target dividend payment ratio; and
  - increase sales as rapidly as market conditions allow.

1. **Define financial system and explain its significance? (Category B)**

❖ Financial system is a **system of interrelated activities that work together** to achieve a predetermined goal. It includes financial market, financial institutions, financial services and financial instrument **which influence the generation of savings, investment, capital formation and growth**.

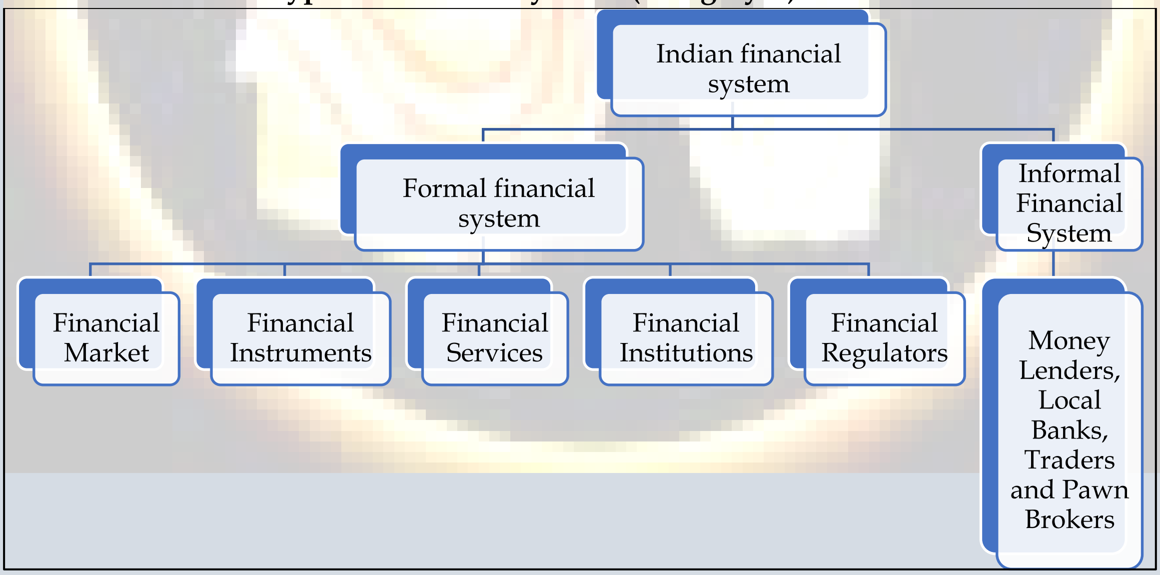
❖ Van Horne defined the financial system as the purpose of financial markets to **allocate savings efficiently in an economy to ultimate users** either for investment in real assets or for consumption.

❖ Christy has opined that the objective of the financial system is to **"supply funds to various sectors and activities of the economy** in ways that promote the fullest possible utilization of resources without the destabilizing consequence of price level changes or unnecessary interference with individual desires."

❖ From the above definitions, it may be said that **the primary function of the financial system is the mobilization of savings, their effective utilization for investment in various sectors of the economy and stimulating capital formation** to accelerate the process of economic growth.

❖ The significance of financial system is due to the following reasons:
  - Leads to **savings**
  - That meets the **fund requirements** of business organisations through financial market
  - Enables the **investment** by business organisation to commence production of goods and services
  - Leads to **capital formation**
  - That ultimately brings **economic growth**

2. **What are the types of financial system? (Category B)**



Types of Financial System

Informal financial system	❖ Informal financial system consists of **moneylenders; Associations, funds, clubs, committees etc**. These people have a system and **they have their own rules** on how they should function in their day to day activities.

	❖ Informal financial system responds **quickly to short term financing** opportunities and allowed low income people access to service not available to them through the formal channel. ❖ Informal financial markets are not subject to **interest rate regulation**. They do not incur legal expenses and their cost of lending and deposit taking tends to be lower than that of formal financial institutions. ❖ However, **the formal financial system is always preferable** because it is systematic and transparent and offers numerous benefits.
Formal financial system	❖ The formal financial system consists of financial institutions, financial markets, financial instrument, and financial services.

3. What role does financial institutions play in formal financial system? (Category A)

- ❖ Financial Institutions **can be classified as banking and non-banking financial institutions**. Banks are creators and providers of credit. While non-banking financial companies are only providers of credit.
- ❖ Financial institutions can be **specialized financial institutions** like Export Import Bank of India (EXIM), Tourism Finance Corporation of India (TFCI), the Infrastructure Development Finance Company (IDFC) etc.
- ❖ They can also be **sector based** such as National Bank for Agriculture and Rural Development (NABARD) and the National Housing Bank (NHB).
- ❖ Further, **Unit Trust of India (UTI) which is in the business of mutual fund, Life Insurance Corporation (LIC) and General Insurance Corporation (GIC)** and its subsidiaries are also classified as financial institutions.
- ❖ **Banking Financial Institutions:** Banking institutions are those institutions, **which participate in the country's payment system**, i.e. they provide transaction services. They play an important role in the **mobilization of deposits and distribution of credit** to various sectors of the economy. A **sound banking system ensures that deposits accumulated from people are productively utilized**.
- ❖ **Non-Banking Financial Institutions:** Non-banking financial institutions are those institutions **which act as mere providers of credit and they do not create credit**, e.g., LIC, UTI, and IDBI.

4. Differentiate between banking institutions and non-banking institutions? (Category A)

Basis of comparison	Banking institutions	Non-banking institutions
Meaning	Bank is a financial intermediary which provides **banking services to general people**. And it requires a **bank license** for that.	Non-banking institutions are basically organization banking services company form of that provides to people **without holding a banking license**.
Transaction Services	Banks **provide transaction services** like providing overdraft facility, issue of cheque books, travelers cheque, demand draft, transfer of funds, etc.	The non-banking institutions **do not provide** any transaction services.
Money supply	Bank deposits constitute a **major part** of the national money supply.	The money supply of the nonbanking institutions is **small**.

Credit creation	Banks **create credit**.	Non-banking institutions **do not create credit**.
Compliance	Banks are required to comply with some of the **legal requirements like Cash Reserve Ratio (CRR) Statutory liquidity Ratio Capital Adequacy Ratio (CAR)**.	Non-banking institutions are **not required to comply** with these legal requirements.
Demand Deposit	They are **not accepted**.	They are accepted.
Payment and settlement system	Contains an **integral part** of the system.	Not a part of the system.

5. What is financial market and what are its functions? (Category B)

- The financial market is a **market where trading of securities** including equities, bonds, **currencies** and derivatives takes place.
- Financial market can be **divided into money market and capital market**.
- **Money market** is a market for **short term securities** having a maturity period of less than one year.
- **Capital Market** is a market for **long term securities** having a maturity period of more than one year. Further, capital market can be divided into **primary market and secondary market**.
- In **primary market**, securities (shares, bonds, debentures) are issued to the public for the **first time**. While in **secondary market**, trading (purchase and sale) takes place in **those securities are already issued to the public**.

Functions of Financial Markets:

- To facilitate **creation and allocation of credit** and liquidity.
- To serve as **intermediaries for mobilization** of savings.
- To help in the process of **balanced economic growth**.
- To provide **financial convenience**.
- To provide information and facilitate transactions at **low cost**.
- To cater to the **various credits needs** of the business organizations.

6. What are financial instruments and what are its characteristics? (Category B)

- Financial instruments are those instruments **which have a monetary value**. These instruments can be classified into **debt-based securities and equity-based securities**.
- Equity based securities consist of equity share capital which is **ownership-based** securities and represents risk capital.
- Debt based securities consists of **bonds and debentures**. Debenture is an acknowledgement of debt which is to be **repaid in full** in certain number of years mentioned **at the time of issue of debenture itself**. On the other hand, **bonds** are financial instruments issued by companies which are basically a **financial contract** between a company (borrower) and investors (lenders).
- **Short-term debt**-based financial instruments are issued for **one year or less**. Securities of this kind come in the form of T-bills and commercial paper. **Long-term debt-based** financial instruments are issued for **more than one year**. These are bonds, debentures and loans.

Characteristics of Financial Instruments

- **Liquidity:** Financial instruments provide liquidity. These can be easily and quickly converted into cash.

- **Marketing:** Financial instruments facilitate easy trading on the market. They have a ready market.
- **Collateral value:** Financial instruments can be pledged for getting loans.
- **Transferability:** Financial instruments can be transferred from one person to another.
- **Maturity period:** The maturity period of financial instruments may be short term, medium term or long term.
- **Transaction cost:** Financial instruments involve buying and selling cost. The buying and selling costs are called transaction costs.
- **Risk:** Financial instruments carry risk. **Equity based instruments are riskier in comparison to debt-based instruments** because the payment of dividend is uncertain.
- **Future trading:** Financial instruments facilitate future trading so as to cover risks arising out of price fluctuations, interest rate fluctuations etc.

7. What are financial services and who are the providers of the same? (Category B)

- Financial services are services **which involves investment, lending, and management of money and assets**. Financial services are needed for the following activities:
  - Borrowing and lending
  - Investing
  - Buying and selling securities
  - Making and enabling payments and settlements
  - Managing risk
- The producers of financial services are **financial intermediaries or institutions such as banks, insurance companies, mutual funds and stock exchanges**. These financial institutions provide financial services such as **merchant banking, leasing, hire purchase, factoring and credit rating**.
- Financial services rendered by financial institutions bridge the gap between lack of knowledge on the part of investors and latest trends in the financial instruments and markets. These financial services are **essential for the creation of new business, expansion of existing industries and economic growth**.

8. Write short note on investment banking? (Category B)

- Companies need cash in order to grow and expand their businesses; **Investment banks sell securities to public investors in order to raise the cash**.
- These securities come in the form of stocks or bonds. Thus, **Investment banks are essentially financial intermediaries**, who assist their clients in raising capital either by underwriting their shares or bonds or by acting as an agent (merchant banker) in the issuance of securities.

9. Write short note on Credit Rating? (Category A)

- Credit Rating means an assessment **made from credit-risk evaluation**, translated into a current opinion as on a specific date on **the quality of a specific debt security** issued or on obligation undertaken by an enterprise **in terms of the ability and willingness of the obligator to meet principal and interest payments** on the rated debt instrument in a timely manner.
- Thus, Credit Rating is:
  - An **expression of opinion** of a rating agency.
  - The opinion is in regard to a **debt instrument**.
  - The opinion is as on a **specific date**.
  - The opinion is dependent on **risk evaluation**.

- The opinion depends on **the probability of interest and principal obligations** being met timely.

10. Write short note on consumed finance? (Category B)

- Consumer credit provides **short term/medium term** loans to finance **purchase of goods or services** for personal use. There are four important sources of consumer finance viz **manufacturers/sellers/dealers, finance companies, banks and credit card companies.**
- In the past, banks provided finance to manufacturing organizations. The **consumers borrowed money from the sellers/dealers directly**.
- Finance companies too entered this arena **while credit card entitles** with the support from banks started operating with substantial success.
- **Employers also provide loan facilities** to salary earners as a part of welfare scheme for their employees. In big concerns, **employees organize themselves into co-operative credit societies** and funds raised by its members through periodical contributions are used as loan assistance at low rate of interest.

11. Write short note on Asset Restructuring/Management Company? (Category A)

- Asset reconstruction company's (ARC) first task is to **manage and convert the sick companies or those companies whose NPA's rose to a significant level** into profitable ones. But, the ARC's face the **risk of suffering loss if the company they are trying to manage may land itself into insolvency**. However, if properly managed, the ARC's may be able to recover them from financial distress, convert them into profitable ones and transfer them to worthy candidates. ARC's **charge a commission or fee from the distressed company for their services**.
- Asset Management Companies (AMC's) pool **large amount of funds** from various source of investors and invest these pooled resources in diverse securities by paying out proportional returns to the investors. **Simply put, they help their client to invest money and buy securities**. They decide what to buy by relying on in-house research and data analytics. **AMC's charges a small fee for this sort of work**.

12. Write short note on Depository Services? (Category B)

- Depository system is concerned with conversion of securities **from physical to electronic form**, settlement of trades in electronic segment, electronic transfer of ownership of shares and electronic custody of securities.
- All securities in the depositories are identical in all respects and are thus fungible. The **ownership and transfer of securities take place by means of book entries**, avoiding the risks associated with paper.

13. What are debit cards and online share trading? (Category C)

- **Debit cards** are also known as **cheque cards**. A debit card is a **plastic card** that provides the cardholder electronic access to his or her bank account(s) at a financial institution.
- **Debit cards look like credit cards** or ATM (automated teller machine) cards, but operate like cash or a personal cheque.
- Debit cards are different from credit cards. While a **credit card is to "pay later,"** **a debit card is to "pay now."** When one uses a debit card his money is immediately deducted from his cheque or savings account.
- **Online stock trading** is **an internet-based stock trading** facility where investor can trade shares through a website without any manual intervention from the broker. It

also provides **investors with rich, interactive information in real time** including market updates, investment research and robust analysis.

14. What are the functions of a financial system? (Category A)

- **Mobilization of savings**: Savings are done by **millions of people** and they need to be mobilized **into financial assets** like currency, bank deposits, post office savings deposits, life insurance policies, mutual funds, bonds or equity shares.
- **Allocations of savings:** Amount of savings mobilized through millions of people will then be **allocated among the needy sectors**. **Direct lending** by the general public has been made possible through **corporate bonds and equities**. Besides, there are banks, insurance companies, and other financial institutions act as a financial intermediary between the ultimate lender and the ultimate borrower. **They mobilize savings of the lender by selling their own liabilities which are deposits, insurance premium amount etc. and make these funds available to needy borrowers at their own risk.**
- **A financial system provides a payment system for the exchange of goods and services**: For exchange or sale of goods and services, **payment in cash** is the most preferred mode. However, large scale businesses deal mostly in **credit transactions**.
- **A financial system provides a mechanism for the pooling of funds to invest in large scale enterprises:** Large corporates raises funds **through bonds, debentures and public deposits** to invest in large scale business enterprises.
- **Provide payment and settlement system**: Banks provide this mechanism **by means of a payment facility** based upon cheques, promissory notes, credit and debit cards. The payment mechanism is now being **increasingly made through electronic means**. The clearing and **settlement mechanism of the stock market is done through corporations**.
- **Monitor corporate performance:** Financial markets and institutions **help to monitor corporate performance and exert pressure** on the corporates to continuously improve their performance.
- **Helps in risk reduction:** The financial system helps in reduction of risk in the financial system **by laying down rules for e.g. SEBI which lays down rules, regulations and guidelines from time to time for efficient and transparent conduct of operations in the capital market**. Risk reduction is achieved by **diversification of portfolios and screening of borrowers**. Market participants also protect themselves from unexpected contingencies **by buying insurance services**.
- **Provide price related information**: Financial markets **provide information which enables the investors to make an informed decision** about whether to buy, sell or hold a financial asset. This information dissemination **facilitates valuation of financial assets**.

15. What are the key elements of a well-functioning financial system? (Category B)

- **A strong legal and regulatory environment**: Capital market is regulated by **SEBI which acts a watchdog of the securities market**. This has been ensured through the passing of SEBI Act, Securities Contract Regulation Act and numerous SEBI rules, regulations and guidelines. Likewise, **money market and foreign exchange market is regulated by RBI** and this has been ensured through various provisions of the RBI Act, Foreign Exchange Management Act etc. Thus, a **strong legal system protects the rights and interests of investors** and acts as a most important element of a sound financial system.

- **Stable money**: Money is an important part of an economy. **Frequent fluctuations and depreciations in the value of money lead to financial crises** and restrict the economic growth.
- **Sound public finances and public debt management:** Sound public finances mean **setting and controlling public expenditures and increase revenues to fund these expenditures efficiently**. Public debt management is the process of establishing and executing a strategy for managing the government's debt in order to raise the required amount of funding. It also includes developing and maintaining an efficient market for government securities.
- **A central bank:** A central bank **supervises and regulates the operations of the banking system.** It acts as a banker to the banks and government, manager of money market and foreign exchange market and also lender of the last resort.
- **Sound banking system:** A well-functioning financial system must have large variety of **banks both in the private and public sector having both domestic and international operations** with an ability to withstand adverse national and international events. They perform varied functions such as operating the payment and clearing system, and foreign exchange market.
- **Information System:** All the participants in the financial system requires information at some stage or the other. **Proper information disclosure practices form basis of a sound financial system**
- **Well-functioning securities market:** A securities market facilitates the issuance of both equity and debt. **An efficient securities market helps in the deployment of funds raised through the capital market to the required sections of the economy, lowering the cost of capital for the firms**, enhancing liquidity and attracting foreign investment.

16. Explain the two types of financial system design? State advantages and disadvantages of both system (Category A)

Types of financial system:

- **Bank based financial systems:** In bank based financial systems, **banks play a pivotal role** in mobilizing savings, allocating capital, overseeing the investment decisions of corporate managers, and providing risk-management facilities. Japan, Germany, France, Italy, Argentina, Pakistan, Srilanka and Bangladesh are some of the countries using this model.
- **Marked based financial systems:** In market based financial systems, the securities **markets share centre stage** with banks in mobilizing the society's savings for firms, exerting corporate control, and easing risk management. USA, UK, Singapore, Malaysia, Korea, Brazil, Mexico, Philippines, Turkey are some of the countries using this model

Advantages and disadvantages of marked based and bank-based system:

Marked based system	Bank based system
Advantages: ❖ Stock markets **facilitate diversification of securities** to enable the investors to reduce risks ❖ Helps the investors **to reduce their risks** ❖ Market based system provides an **information system** which enables investor to make an informed decision	**Advantages:** ❖ **Close relationship** with parties. ❖ Provide **tailor made contracts** ❖ Efficient **risk sharing** ❖ No free rider problem

❖ Facilitate **financing of new technologies.** Therefore, in case of emerging companies with significant financial and technological risks, a market-based system is preferable.	
Disadvantages: ❖ Market based system is **prone to instability** as market may be fluctuating in turbulent times. Consequently, investors are exposed to market risk ❖ There is a **free rider problem**	**Disadvantages:** ❖ Retards innovation and growth as banks may have **preference for low risk**, low return projects ❖ Impedes **competition and entry of new firms** because banks may collude with business managers against investors

Differences between two systems:

- In a market based financial system, the majority of the **financial power is held by the stock market** and the economy is dependent on how well or poorly the stock market is performing. On the other hand, in bank based financial system, the economy is dependent on **how well or poorly the banking system is doing**.
- In a market-based system, **banks are less dependent on interest from loans for their revenue enhancements** and focuses on fee-based services such as checking of accounts. However, in a bank-based system, **they focus their attention more on loans and are more dependent on interest from loans** for their revenue increase.
- In a market-based financial economy, the **wealth is spread more unevenly** while in a bank-based financial system, the economy's wealth is **more evenly spread**.
- Market based financial system constantly changes and each individual within the society has the opportunity **to gain or lose on any given day**. But, in bank based financial system only a **few are given the opportunity to maximize their gain**.
- In a market based financial system, **laws are basically set forth and carried out by the government and are basically based on civil law** rather than common law. Bank based financial system is prevalent **where common law legal system is mostly there.**

17. Explain about the contribution of various types of financial market in economic development? (Category C)

Capital Market	Capital market has an important role in India's industrial growth. Capital market is **the market where long-term debt and equity funds are traded**. Industries which require capital on a large scale may tap the capital market. The primary role of capital market is to **transfer surplus funds to deficit sectors which are in dire need of money**. The capital market performs the crucial function of facilitating capital formation in the economy.
Money Market	Money market is the **market where short-term funds are traded**. he short-term money requirement of the borrowers can be easily met with the funds provided by the money market. Money market plays a key role in banks' liquidity management and the monetary policy of RBI.
Foreign Exchange Market	Inflow of foreign exchange **increases the scale of production and national income of the country**. With the rise in the demand of domestic goods, **resources of a country are fully utilized** and it helps in reducing the unemployment of a country.
Derivative Market	The derivatives market is **the financial market for derivatives** i.e. financial instruments like futures and options, which are derived from other forms of assets. Since all transactions **related to derivatives take place in future,**

	it provides individuals with better opportunities because an individual who want to short (sell) some stock for long time can do it only in futures or options hence the biggest benefit of this is that it gives numerous options to an investor or trader to execute all sorts of strategies.

18. What are the objectives and functions of SEBI? (Category B)

Objective of SEBI:

- The basic objective was to **protect the interest of investors in securities** and promotes the development of securities market.
- Regulating the securities market is also an important objective of SEBI

Functions of SEBI as per SEBI Act, 1992:

- regulating the **business in stock exchanges** and any other securities markets;
- **registering and regulating the working of stock brokers**, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with securities markets in any manner;
- **registering and regulating the working of the depositories**, [participants,] custodians of securities, foreign institutional investors, credit rating agencies and such other intermediaries as the Board may, by notification, specify in this behalf;]
- **registering and regulating the working of venture capital funds** and collective investment schemes, including mutual funds;
- **promoting and regulating self-regulatory** organisations;
- prohibiting **fraudulent and unfair trade practices** relating to securities markets;
- **promoting investors' education and training** of intermediaries of securities markets;
- prohibiting **insider trading** in securities;
- regulating **substantial acquisition of shares** and take-over of companies;
- **calling for information from, undertaking inspection**, conducting inquiries and audits of the stock exchanges, mutual funds, other persons associated with the securities market intermediaries and self- regulatory organizations in the securities market;
- **calling for information and record from any bank or any other authority** or board or corporation established or constituted by or under any Central, State or Provincial Act in respect of any transaction in securities which is under investigation or inquiry by the Board;
- **performing such functions and exercising such powers** under the provisions of the Securities Contracts (Regulation) Act, 1956(42 of 1956), as may be delegated to it by the Central Government;
- levying **fees or other charges for** carrying out the purposes of this section;
- **conducting research** for the above purposes;
- **calling from or furnishing to any such agencies**, as may be specified by the Board, such information as may be considered necessary by it for the efficient discharge of its functions;
- **performing such other functions** as may be prescribed.

19. What are the three types of functions performed by RBI? (Category A)

Banking Functions	❖ **Issuer of Bank Notes** - Under section 22 of the Reserve Bank of India Act, **the bank has the sole right to issue bank notes of all denominations**. The distribution of one-rupee notes and coins and small coins all over the country is undertaken **by the Reserve Bank as agent of the Government**.

	❖ **To act as government banker, agent and adviser** - The second important function of the Reserve Bank of India is to act as Government banker, agent and adviser. **The Reserve Bank is agent of Central Government and of all State Governments in India except the State of Jammu and Kashmir**. ❖ **Bankers' Bank and Lender of the Last Resort** – The commercial banks always look up to RBI in case of any need for funds. Therefore, they are called bankers' bank and lender of the last resort. ❖ **Controller of Credit** - The Reserve Bank of India is the controller of credit i.e. it has the power to influence the volume of credit created by banks in India. It can do so through changing the Bank rate or through open market operations. ❖ **Custodian of Foreign Reserve** - The foreign exchange regulations under the law required that all foreign exchange receipts whether on account of export earnings, investment earnings, or capital receipts, whether on private account or on government account, **must be sold to the RBI either directly or through authorized dealers (mostly commercial banks)**. This resulted in centralization of country's foreign exchange reserves with the RBI and facilitated planned utilization of these reserves, **because all payments in foreign exchange were also controlled by the authorities**.
Supervisory Functions	The Reserve Bank Act, 1934, and the Banking Regulation Act, 1949 **have given the RBI wide powers of supervision and control over commercial and co-operative banks**, relating to licensing and establishments, branch expansion, liquidity of their assets, management and methods of working, amalgamation, reconstruction and liquidation. Further, the RBI is authorized to **carry out periodical inspection of the banks and to call for returns and necessary information from them**.
Promotional Functions	The Central Bank (RBI) **now performs a variety of developmental and promotional functions**, which, at one time, were regarded as outside the normal scope of central banking. So, the Reserve Bank was asked to promote banking habit amongst the people. People are encouraged to open **Jan Dhan Account in urban and rural areas** on the basis of their Aadhar Card. Now, people are asked to resort to online banking as the Government is promoting cashless economy. Banks are also gearing up to this challenge as they will need the required infrastructure to enable the customers to transact through online banking only.

20. Explain the features, duties, powers and functions of Insurance Regulatory and Development Authority of India (IRDAI)? (Category B)

Objective	The main aim of the Insurance Regulatory and Development Authority of India is to protect the **interest of holders of Insurance policies to regulate, promote and ensure orderly growth of Insurance industry** & for matters connected therewith or incidental thereto.
Features	❖ The authority consists of **chairman, whole time members & part time members** and they act as a group of members and work jointly. ❖ The authority has a **perpetual succession**. In case, if any member resigns or die, the authority still continues to work. ❖ The authority has a **common seal** with power to enter into a contract by affixing stamp on the documents. ❖ The authority **can sue or be sued** means the authority can file a case against any person or organization and vice versa.

Powers	a. issue to the applicant a **certificate of registration, renew, modify, withdraw**, suspend or cancel such registration; b. protection of **the interests of the policy holders** in matters concerning assigning of policy, nomination by policy holders, insurable interest, settlement of insurance claim, surrender value of policy and other terms and conditions of contracts of insurance; c. **specifying requisite qualifications**, code of conduct and practical training for **intermediary** or insurance intermediaries and agents; d. specifying the code of conduct for **surveyors and loss assessors;** e. **promoting efficiency** in the conduct of insurance business; f. promoting and **regulating professional organisations** connected with the insurance and reinsurance business; g. levying **fees and other charges** for carrying out the purposes of this Act; h. calling for **information from, undertaking inspection of**, conducting enquiries and investigations including audit of the insurers, intermediaries, insurance intermediaries and other organizations connected with the insurance business; i. control and regulation of **the rates, advantages, terms and conditions** that may be offered by insurers in respect of general insurance business not so controlled and regulated by the Tariff Advisory Committee under section 64U of the Insurance Act, 1938 (4 of 1938); j. specifying the **form and manner in which books of account** shall be maintained and statement of accounts shall be rendered by insurers and other insurance intermediaries; k. regulating **investment of funds** by insurance companies; l. regulating **maintenance of margin of solvency**; m. **adjudication of disputes** between insurers and intermediaries or insurance intermediaries; n. supervising the **functioning of the Tariff Advisory Committee**; o. specifying the **percentage of premium income** of the insurer to finance schemes for promoting and regulating professional organisations; p. specifying the **percentage of life insurance business** and general insurance business to be undertaken by the insurer in the rural or social sector;

21. Write note on importance of Insurance Regulatory and Development Authority (IRDA)? (Category C)

❖ **Regulation of Insurance Sector:** In order to keep the **proper protection of the policy holder's interests**, IRDA **closely observe the different activities of insurance sector** in India.

❖ **Protection of Policyholders Interests:** The core objective or purpose of the Insurance Regulatory and Development Authority is to **protect the interests of policyholders** and IRDA has been doing that

❖ **Awareness to Insurance:** In order to increase the awareness of insurance in the society, IRDA is **trying to convince the prospective investors** about the transparency of the system and the effort being put by the regulator to put this into practice.

❖ **Insurance Market:** Insurance sector has **grown leap and bounds** due to the concerted efforts of Insurance Regulatory and Development Authority with respect to **marketing of insurance products, competition and customer awareness**.

❖ **Development of Insurance Product:** IRDA has **brought a revolution in the development of insurance products**. The development of ULIPs (Unit-Linked Insurance Plans) is the result of privatization of the insurance sector.

- **Competition in the Insurance Sector:** After the advent of privatization in the insurance sector by inviting private players, competition in the insurance sector has increased significantly leading to **comparatively cheaper services and greater customer satisfaction.**
- **Saving and Investment of Individual:** Insurance Regulatory and Development Authority has **made insurance a popular & profitable mode of investment** and inculcate saving habits among various sections of the society.
- **Government Responsibility:** IRDA has make it sure that uniformity in the insurance sector is **being ensured by helping in constant increase in the number of insurers, increasing competition**, number of diversified products and diversification in the activities of the insurers.
- **Banks and Post Offices:** Insurance sector has now become a popular medium for savings & investments and is **gradually diverting the flow of funds from banks & post offices to insurance industry**.
- **Individual Life's:** IRDA has helped in developing an understanding of insurance by putting across a **great impression over the life** of a common man of the society.
- **Stock Market:** Private players in the insurance have developed ULIPs (Unit-Linked Insurance plans) in order to attract more customers. **ULIP is a by-product of modern insurance market**.
- **Indian Economy:** IRDA has an impact over the economic development of the country because **money invested by investors or individuals in various types of insurance products has** channelized the funds of a country for a non-economic activity to economic activity & has made available to the governments of a country in order to implement the various developmental activities in the country.

22. Write short note on National Pension Scheme? (Category B)

Introduction	❖ NPS is an **easily accessible, low cost, tax-efficient**, flexible and portable retirement savings account. Under the NPS, the individual contributes to his retirement account and also his employer can also co-contribute for the social security/welfare of the individual ❖ NPS is designed on **Defined contribution basis** wherein the subscriber contributes to his account, there is no defined benefit that would be available at the time of exit from the system and the **accumulated wealth depends on the contributions made and the income generated from investment of such wealth**
Who can join NPS	❖ Any citizen of India, whether resident or non-resident, subject to the following conditions: **Individuals who are aged between 18 – 60 years** as on the date of submission of his/her application to the POP/ POP-SP. **After attaining 60 years of age**, people will not be permitted to make further contributions to the NPS accounts.
How funds are managed?	❖ The funds contributed by the Subscribers **are invested by the PFRDA registered Pension Fund Managers (PFM's)** as per the investment guidelines provided by PFRDA ❖ At present there are 8 Pension Fund Managers (PFM's) who manage the subscriber funds at the option of the subscriber
Features of retirement account	❖ Every individual subscriber is issued a **Permanent Retirement Account Number (PRAN) card** and has a 12-digit unique number. ❖ Under NPS account, **two sub-accounts – Tier I & II are provided**. Tier I account is mandatory and the subscriber has option to opt

	for Tier II account opening and operation. The following are the salient features of these sub-accounts: o **Tier-I account:** This is a **non-withdrawable retirement account** which can be withdrawn only upon meeting the exit conditions prescribed under NPS. o **Tier-II account:** This is a **voluntary savings facility available** as an add-on to any Tier-1 account holder. Subscribers will be free to withdraw their savings from this account whenever they wish.

23. Explain the need for Real Estate Regulatory Authority (RERA) and its benefits? (Category C)

Benefits of RERA	RERA promises to bring a **justice to the buyer through making strict policies** that have to be fulfilled by the developers to sell their projects. The major problem that real estate in India is facing is that of the **delayed possession given to the home seeker by the rich and the cunning builders**. Thus, RERA will help people by bringing in a **high level of transparency** and discipline that these builders must have to follow.
Need for RERA	Following are the reasons for requirement of RERA: ❖ Selling of flats multiple times to different parties. ❖ Delay in giving possession to the buyer **which happens due to various reasons and malpractices such as funding crisis**, demanding additional charges in the name of facilities, reducing carpet area, changing the plans of the societies etc. ❖ The contracts **made are one-sided in the favour of the developer**, for example, a penalty of a massive 21% if one delay's the payment even by a day

24. What are the objectives of Association of Mutual Funds of India? (Category B)

(i) To define and **maintain high professional and ethical standards** in all areas of operation of mutual fund industry.

(ii) To recommend and **promote best business practices and code of conduct** to be followed by members and others engaged in the activities of mutual fund and asset management including agencies connected or involved in the field of capital markets and financial services.

(iii) To **interact with the Securities and Exchange Board of India (SEBI)** and to represent to SEBI on all matters concerning the mutual fund industry.

(iv) To represent to the **Government, Reserve Bank of India and other bodies** on all matters relating to the Mutual Fund Industry.

(v) To undertake **nationwide investor awareness programme** so as to promote proper understanding of the concept and working of mutual funds.

(vi) To **disseminate information on Mutual Fund Industry** and to undertake studies and research directly and/or in association with other bodies.

(vii) To regulate **conduct of distributors** including disciplinary actions (cancellation of ARN) for violations of Code of Conduct.

(viii) To protect the **interest of investors/unit holders**.

25. What are the functions of Foreign Exchange Dealers Association of India (FEDAI)? (Category C)

❖ FEDAI's major activities include **framing of rules governing the conduct of inter-bank foreign exchange business** among banks vis-à-vis public and liaison with RBI for reforms and development of forex market.

- Some of the functions of FEDAI are
  - **Guidelines and Rules** for Forex Business.
  - **Training of Bank Personnel** in the areas of Foreign Exchange Business.
  - **Accreditation** of Forex Brokers.
  - **Advising/Assisting member** banks in settling issues/matters in their dealings.
  - **Represent member banks** on Government/Reserve Bank of India/Other Bodies.
  - **Announcement of daily and periodical rates** to member banks.

26. Explain the role of Fixed Income Money Market and Derivative Association of India (FIMMDA)? (Category B)

FIMMDA is a **voluntary market body** for the bond, money and derivatives markets. Following is the role of FIMMDA

- Functions as the **principal interface with Regulators** (like Reserve Bank of India, Securities Exchange Board of India, Ministry of Finance - Government of India, International Monetary Fund, World Bank)
- **Mandated by the Reserve Bank of India for valuation of Government Bonds**, Corporate Bonds and Securitized Papers for valuation of investment portfolios of Banks and Primary Dealers.
- Undertakes **developmental activities** such as introduction of benchmarks and new products (e.g. Mumbai Inter-bank Offered Rate, Commercial Papers, Securitized Asset, and Overnight Indexed Swaps).
- Suggests **Legal and Regulatory framework** for the development of new products.
- **Training and Development Support** to the Debt & Derivatives Market.
- **Standardisation** of market practices.

1. **What are the different types of risks faced by an organization? (Category B)**

Strategic Risk	❖ Strategic risk is a risk in which a **company's strategy becomes less effective and it struggles to achieve its goal**. ❖ It could be due to technological changes, a new competitor entering the market, shifts in customer demand, increase in the costs of raw materials, or any number of other large-scale changes
Compliance Risk	❖ **Non-compliance with rules and regulations is known as compliance risk** and the same can lead to penalties in the form of fine and imprisonment ❖ If the company **fails to comply with laws related to a new area or industry or sector**, it will pose a **serious threat to its survival**
Operational Risk	❖ Operational risk (**also known as internal risk**) 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.

2. **What are the various types of financial risk? (Category A)**

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. ❖ This risk also covers the **credit risk** i.e. default by the counter party.
Political Risk	❖ This type of risk is **faced by overseas investors**, as the adverse action by the government of host country may lead to huge loses. ❖ This can arise due to confiscation or destruction of properties, rationing of remittance to home country, restriction on borrowings, invalidation of patents, price control of products, restriction on conversion of local currency of host country into foreign country
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.
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. ❖

3. **The financial risk can be viewed from different perspective. Explain? (Category B)**

❖ **From stakeholder'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.

❖ **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.

❖ **From Government's point of view:** 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 distrust among society at large. Even this risk also includes willful defaulters. This can also be extended to sovereign debt crisis

4. **What is value-at-risk (VAR) and explain its features and application? (Category A)**

Meaning	VAR is a **measure of risk of investment**. VAR answers two basic questions namely (i) What is the worst-case scenario? And (ii) What will be the loss?
Features	❖ **Components of calculations:** VAR is based on time period, confidence level (95% or 99%) and loss in percentage or amount ❖ **Statistical method:** It is type of statistical tool based on standard deviation ❖ **Time horizon:** VAR can be applied for different time horizons say one day, one week, one month and so on. ❖ **Probability:** Assuming the values are normally attributed, probability of maximum loss can be predicted. ❖ **Control Risk:** Risk can be controlled by selling limits for maximum loss. ❖ **Z score:** Z Score **indicates how many standard Deviations is away from Mean value** of a population. VAR = Z score x standard deviation
Application	❖ to measure the **maximum possible loss** on any portfolio or a trading position. ❖ as a **benchmark for performance measurement** of any operation or trading. ❖ to **fix limits for individuals** dealing in front office of a treasury department. ❖ to enable the management to **decide the trading strategies**. ❖ as a tool for **Asset and Liability Management** especially in banks.

5. **What are the various hints indicating counter party risk and how to manage the same? (Category B)**

Hints	❖ Failure to **obtain necessary resources** to complete the project or transaction undertaken. ❖ Any **regulatory restrictions** from the Government. ❖ **Hostile action** of foreign government. ❖ **Let down** by third party. ❖ Have become **insolvent**
Techniques to manage	❖ Carrying out **Due Diligence** before dealing with any third party. ❖ Do not **over commit** to a single entity or group or connected entities. ❖ Know your **exposure limits**. ❖ Review the limits and procedure for **credit approval** regularly. ❖ **Rapid action** in the event of any likelihood of defaults. ❖ Use of **performance guarantee**, insurance or other instruments

6. **How to assess political risk and techniques to manage the same? (Category C)**

Ways to assess political risk	❖ By referring **political ranking** published by different business magazines. ❖ By evaluating **country's macro-economic conditions**. ❖ By **analyzing the popularity** of current government and assess their stability.

	❖ By taking advises from the **embassies** of the home country in the host countries.
Techniques to manage	❖ Local sourcing of raw materials and labour. ❖ Entering into joint ventures ❖ Local financing ❖ Prior negotiations

7. How to identify interest rate risk and currency risk? (Category B)

Identification of interest rate risk:

- Monetary Policy of the Government.
- Any action by Government such as demonetization etc.
- Economic Growth
- Release of Industrial Data
- Investment by foreign investors
- Stock market changes

Identification of currency risk:

- **Government Action:** The Government action of any country has visual impact in its currency.
- **Nominal Interest Rate:** As per interest rate parity (IRP) the currency exchange rate depends on the nominal interest of that country.
- **Inflation Rate:** Purchasing power parity theory discussed in later chapters impact the value of currency.
- **Natural Calamities:** Any natural calamity can have negative impact.
- **War, Coup, Rebellion etc.:** All these actions can have far reaching impact on currency's exchange rates.
- **Change of Government:** The change of government and its attitude towards investment also helps to identify the currency risk.

1. What is security Analysis? (Category C)

- Security Analysis involves a **systematic analysis of the risk return profiles** of various securities which is to help a rational investor **to estimate a value for a company from all the price sensitive information/data** so that he can make purchases when the market under-prices some of them and thereby earn a reasonable rate of return.
- Two approaches viz. **fundamental analysis and technical analysis** are in vogue for carrying out Security Analysis.

2. What is fundamental Analysis? (Category B)

- Fundamental analysis is based on **risk-return characteristics** of securities
- Fundamental analysis is based on the assumption that the **share prices depend upon the future dividends expected by the shareholders**
- The **present value** of the future dividends can be calculated by discounting the cash flows at an **appropriate discount rate** and is known as the **'intrinsic value of the share'**.
- A share that is priced **below the intrinsic value must be bought**, while a share quoting **above the intrinsic value must be sold**
- The key variables that an investor must monitor in order to carry out his fundamental analysis are **economy wide factors, industry wide factors and company specific factors**. In other words, fundamental analysis encompasses economic, industrial and company analyses **(EIC Analysis)**.

3. What is Economic Analysis and what are the factors affecting the same? (Category A)

- Economic analysis is used to **forecast national income with its various components** that have a bearing on the concerned industry and the company in particular.
- **Macro- economic factors** e. g. historical performance of the economy in the past/ present and expectations in future, growth of different sectors of the economy in future with signs of stagnation/degradation at present to be assessed while analyzing the overall economy.
- Trends in **peoples' income and expenditure reflect** the growth of a particular industry/company in future. Consumption affects corporate profits, dividends and share prices in the market.

Factors affecting economic analysis:

Growth rates of national income and related measures	The estimated growth rate of the economy **would be a pointer to the prospects for the industrial sector**, and therefore to the returns investors can expect from investment in shares
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
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**.
Monsoon	Because of the **strong forward and backward linkages**, monsoon is of great concern to investors in the stock market too.

4. What are the techniques used for economic analysis? (Category B)

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. ❖ In spite of **valuable inputs available through this method, it has certain drawbacks:** (i) Survey results do not guarantee that intentions surveyed would materialize. (ii) They are not regarded as forecasts per se, as there can be a consensus approach by the investor for exercising his opinion. ❖ **Continuous monitoring** of this practice is called for to make this technique popular.
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: ❖ **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. ❖ **Roughly Coincidental Indicators:** They reach their peaks and troughs at approximately the same in the economy. ❖ **Lagging Indicators:** They are time series data of variables that lag behind in their consequences vis-a- vis the economy. They reach their turning points after the economy has reached its own already. All these approaches **suggest direction of change** in the aggregate economic activity but nothing about its magnitude. The various measures obtained from such indicators **may give conflicting signals** about the future direction of the economy. Money supply in the economy also affects investment decisions.
Economic Model Building Approach	A **precise and clear relationship** between dependent and independent variables is determined. GNP model building or sectoral analysis is used in practice through the use of national accounting framework. The steps used are as follows: ❖ Hypothesize **total economic demand by measuring total income** (GNP) based on political stability, rate of inflation, changes in economic levels. ❖ **Forecasting the GNP** by estimating levels of various components viz. consumption expenditure, gross private domestic investment, government purchases of goods/services, net exports. ❖ After forecasting individual components of GNP, add them up to obtain the forecasted GNP. ❖ **Comparison is made of total GNP thus arrived at with that from an independent agency for the forecast of GNP and then the overall forecast is tested for consistency.** This is carried out for ensuring that both the total forecast and the component wise forecast fit together in a reasonable manner.

5. What is Industry Analysis and what are the factors affecting the same? (Category A)

- ❖ Industry analysis is **concerned with analysing the expected performance of the specific industry** to which the company belongs
- ❖ First of all, an assessment has to be made regarding all the conditions and factors relating to **demand of the particular product, cost structure of the industry and other economic and Government constraints on the same**. 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**.

Factors affecting industry analysis:

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.
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.
Barriers to Entry	Any industry with **high profitability would attract fresh investments**. The **potential entrants to the industry, however, face different types of barriers to entry**. Some of these barriers are innate to the product and the technology of production, **while other barriers are created by existing firms in the industry.**
Government Attitude	The attitude of the government determinant of its prospects.
State of Competition in the Industry	Factors to be noted are- **firms with leadership capability** and the **nature of competition amongst them** in foreign and domestic market, type of products manufactured viz. **homogeneous or highly differentiated**, demand prospects through classification viz customer-wise/area-wise, changes in demand patterns in the long/immediate/ short run, **type of industry the firm is placed** viz. growth, cyclical, defensive or decline.
Cost Conditions and Profitability	**Factors to be considered are:** ❖ **Cost allocation among various heads** e.g. raw material, labors and overheads and their controllability. Overhead cost for some may be higher while for others labour may be so. Labour cost which depends on wage level and productivity needs close scrutiny. ❖ Product price. ❖ **Production capacity** in terms of installation, idle and operating. ❖ Level of **capital expenditure** required for maintenance / increase in productive efficiency.
Technology and Research	**Things to be probed in this regard are:** ❖ **Nature and type** of technology used. ❖ Expected **changes in technology** for new products leading to increase in sales. ❖ **Relationship of capital expenditure** and sales over means increase in sales. ❖ Money spent in **research and development**. Whether this amount relates to redundancy or not? ❖ Assessment of industry in **terms of sales and profitability** in short, immediate and long run.

6. What are the techniques used in industry analysis? (Category C)

Regression Analysis	❖ Investor diagnoses the factors determining the demand for output of the industry through **product demand analysis**. ❖ Factors to be considered are **GNP, disposable income**, per capita consumption /income, price elasticity of demand. ❖ For identifying factors **affecting demand**, statistical techniques like **regression analysis correlation are used**.

Input-output Analysis	❖ It reflects the **flow of goods and services** through the economy, intermediate steps in production process as goods proceed from raw material stage through final consumption. ❖ This is carried out to **detect changing patterns/trends** indicating growth/decline of industries

7. **What are the factors to be analysed for company analysis? (Company B)**

Net worth and Book Value	❖ Net Worth is **sum of equity share capital, preference 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 the much talked about **book value of a share**. Though the book value is often seen as an indication of the intrinsic worth of the share, this may not be so for two major reasons. ❖ First, the **market price of the share reflects the future earnings potential** of the firm which may have no relationship with the value of its assets. Second, the book value is based upon the **historical costs** of the assets of the firm and these may be gross underestimates of the cost of the replacement or resale values of these assets
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**. ❖ Such methods of financing increase the **risk of liquidity crunch** for the firm, as long-term investments, because of the gestation period involved may not generate enough surpluses in time to meet the short-term liabilities incurred by the firm.
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 **analyze 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**
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. ❖ In this regard the **net capital employed, the net profits, the return on investment and the sales** figures of the company under consideration may be compared with similar data of other companies in the same industry group.
Growth Record	❖ The **growth in sales, net income, net capital employed and earnings per share** of the company in the past few years should be examined. ❖ The following three growth indicators may be particularly looked into: (a) Price earnings ratio, (b) Percentage growth rate of earnings per annum, and (c) Percentage growth rate of net block.
Financial Analysis	❖ An analysis of its financial statements for the past few years would help the **investment manager in understanding the financial solvency and liquidity**, the efficiency with which

	the funds are used, the profitability, the operating efficiency and the financial and operating leverages of the company. ❖ For this purpose, certain fundamental ratios have to be calculated such as earnings per share, price earnings ratio, book value, intrinsic value, return on owner's investment, capital turnover ratios and cost structure ratios
Competitive advantage	❖ A company's long-term success is driven largely by its ability to maintain its competitive advantage. ❖ **Powerful competitive advantages** such as Apple's brand name and Samsung's domination of the mobile market, create a shield around a business that allows it to keep competitors at a distance.
Quality of management	❖ This is an **intangible factor** and 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, the confidence that investors have in a particular business house, its policy vis-a-vis its relationship with the investors, dividend and financial performance record of other companies in the same group, etc**. ❖ Quality of management has to be seen with reference to the **experience, skills and integrity** of the persons at the helm of affairs of the company. ❖ The policy of the management regarding relationship with the shareholders is an important factor since certain business houses believe in **very generous dividend and bonus distributions while others are rather conservative**.
Corporate governance	❖ Whether company is complying with all aspects of **clause 49**. ❖ How well corporate governance policies serve stakeholders? ❖ Quality and timeliness of company financial disclosures. ❖ Whether quality **independent directors** are inducted.
Regulation	❖ Regulations plays an **important role in maintaining the sanctity of the corporate form of organization**. ❖ In Indian listed companies, **Companies Act, Securities Contract and Regulation Act and SEBI Act** basically look after regulatory aspects of a company. ❖ A listed company is also **continuously monitored by SEBI** which through its guidelines and regulations protect the interest of investors.
Location and Labour-management relations	❖ The locations of the company's manufacturing facilities determine its **economic viability** which depends on the availability of crucial inputs like power, skilled labour and raw-materials, etc. Nearness to markets is also a factor considered. ❖ In the past few years, the investment manager has begun looking into **the state of labour-management relations in the company under consideration and the area where it is located**.
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.

Marketability of the shares	❖ Mere listing of a share on the stock exchange does not automatically mean that the share can be sold or purchased at will. ❖ There are many shares which remain inactive for long periods with no transactions being effected. ❖ In this regard, dispersal of shareholding with special reference to the extent of public holding should be seen. The other relevant factors are the **speculative interest in the particular scrip, the particular stock exchange where it is traded and the volume of trading.**

8. **What are the techniques used in company analysis? (Category C)**

Correlation and Regression Analysis	❖ Simple regression is **used when inter relationship covers two variables**. For more than two variables, multiple regression analysis is followed. ❖ Here the inter relationship between variables belonging to economy, industry and company are found out. ❖ The main advantage in such analysis is **the determination of the forecasted values along with testing the reliability of the estimates.**
Trend Analysis	❖ The **relationship of one variable is tested over time using regression analysis**. It gives an insight to the historical behavior of the variable
Decision Tree Analysis	❖ Information relating to the **probability of occurrence of the forecasted value is considered useful**. A range of values of the variable with probabilities of occurrence of each value is taken up. The limitations are reduced through decision tree analysis and use of simulation techniques. ❖ In decision tree analysis, **the decision is taken sequentially with probabilities attached to each sequence.** To obtain the probability of final outcome, various sequential decisions given along with probabilities, **the probabilities of each sequence is to be multiplied and them summed up**

9. **What is technical analysis and what are its assumptions and principles? (Category A)**

Meaning	❖ Technical 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, that since investor psychology follows a certain pattern**, what is seen to have happened before is likely to be repeated. ❖ A technical analyst attempts precisely that. The two basic questions that he seeks to answer are: (i) Is there a discernible trend in the prices? (ii) If there is, then are there **indications that the trend would reverse**? ❖ The methods used to answer these questions are **visual and statistical**. The visual methods are based on examination of a variety of charts to make out patterns, while the statistical procedures analyse price and return data to make trading decisions.
Assumptions	❖ The market value of stock is actually depending on the **supply and demand** for a stock ❖ The supply and demand are actually governed by **several factors**. ❖ Stock prices generally move in trends which continue for a substantial period of time.

	❖ 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	❖ **The Market Discounts Everything:** Many experts criticize technical analysis **because it only considers price movements and ignores fundamental factors**. The argument against such criticism is based on the **Efficient Market Hypothesis**, which states that a company's share price already reflects everything that has or could affect a company. So, **technical analysts generally have the view that a company's share price includes everything including the fundamentals** of a company. ❖ **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. ❖ **History tends to repeat itself:** Technical analysts believe that history tends to repeat itself. Technical analysis **uses chart patterns to analyze subsequent market movements to understand trends**.

10. Explain Dow Theory? (Category A)

Two indices	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.
Three classifications	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**.
Primary movement	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**.
Secondary Movement	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**.
Daily fluctuations	The daily fluctuations are the narrow movements from day-to-day. 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.**
Interpretation of bull/bear market	The theory, in practice, states that if the **cyclical swings of the stock market averages** are **successively higher** 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.
Three moves of bull/bear market	❖ 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.

11. Explain Elliott Wave Theory? (Category A)

Introduction	Elliot found that the **markets exhibited certain repeated patterns or 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
Types of waves	Impulsive patterns and 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 **3 waves** are **against the basic direction** of the basic movement. **Correction involves correcting the earlier rise** in case of bull market and **fall** in case of bear market.
Conclusion	One complete cycle **consists of waves made up of two distinct phases**, bullish and bearish. On **completion of full one cycle** i.e. termination of 8 waves movement, the **fresh cycle starts with similar impulses** arising out of market trading.

12. Explain Random Walk Theory? (Category A)

- ❖ Many investment managers and stock market analysts believe that **stock market prices can never be predicted** because they are not a result of any underlying factors but are mere statistical ups and downs. This hypothesis is known as **Random Walk hypothesis which 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.
- ❖ 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 other words, the fact that there are peaks and troughs in stock exchange prices is a mere statistical happening – successive peaks and troughs are unconnected.
- ❖ The supporters of this theory put out a simple argument. It follows that:
  - o Prices of shares in stock market **can never be predicted**.
  - o 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.
  - o 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).

13. Write short note about various market indicators? (Category C)

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.
Volume of Transactions	❖ 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.
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 price.
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 by calculating rates of return and classifying those securities with historically high average returns as securities with high relative strength is one of them.
Odd-Lot Theory	❖ This theory is a **contrary - opinion 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**.

14. What is support and resistance level? (Category B)

❖ When the index/price **goes down from a peak**, the peak becomes the **resistance level**. When the index/price **rebounds after reaching a trough** 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** because all investors who failed to sell at the high would be keen to liquidate, while whenever the price approaches the **support level**, there is a **buying pressure** as all those investors who failed to buy at the lowest price would like to purchase the share

15. What are the tools to interpret price patterns? (Category C)

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**

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.
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.
Triangular or coil formation	This formation represents a pattern of uncertainty and is difficult to predict which way the price will break out
Flags and Pennants form	This form signifies a phase after which the previous price trend is likely to continue
Double top form	This form represents a bearish development, signals that price is expected to fall.
Double bottom form	This form represents bullish development signalling price is expected to rise.
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.

16. How to identify buy and sell signals provided by moving average analysis? (Category B)

Buy Signal	Sell Signal
❖ Stock price line rise through the moving average line when graph of the moving average line is flattering out. ❖ Stock price line falls below moving average line which is rising. ❖ Stock price line which is above moving average line falls but begins to rise again before reaching the moving average line	❖ Stock price line falls through moving average line when graph of the moving average line is flattering out. ❖ Stock price line rises above moving average line which is falling. ❖ Stock price line which is slow moving average line rises but begins to fall again before reaching the moving average line.

17. What are the arguments in favour and against technical analysis? (Category B)

Supporters of technical analysis	❖ 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. ❖ 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.

	❖ Fundamental information about a company is observed and assimilated 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**.
Detractors of technical analysis	❖ Most technical analysts **are not able to offer a convincing explanation** for the tools employed by them. ❖ Empirical evidence in **support of random walk hypothesis** cast its shadow over the useful ness of technical analysis. ❖ By the time an up-trend and down-trend may have been signalled by technical analysis it may already have taken place. ❖ Ultimately technical analysis must be **self-defeating proposition**. With more and more people employing it, the value of such analysis tends to decline.

18. Explain the efficient market theory and what are the major misconceptions about this theory? (Category B)

Key conclusion	As per this theory, at any given time, **all available price sensitive information is fully reflected in securities' prices**. Thus, this theory implies that no investor can consistently outperform the market as every stock is appropriately priced based on available information
Reason why consistent outperformance cannot happen	❖ Information is **freely and instantaneously** available to all market participants. ❖ **Keen competition** among the market participants more or less ensures that market will reflect intrinsic values. This means that they will fully impound all available information. ❖ Price change **only response to new information** that is unrelated to previous information and therefore unpredictable.
Misconceptions	❖ 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 fluctuate. ❖ 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.
Level of market efficiency	❖ **Weak form efficiency:** Price reflect all information found in the record of past prices and volumes ❖ **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 ❖ **Strong form efficiency:** Price reflect all available information public as well as private

19. What are the challenges to the efficient market theory? (Category C)

❖ **Limited information processing capabilities:** Human information processing capabilities are sharply limited. David Dreman maintained that under conditions of **anxiety and uncertainty,** with a vast interacting information grid, the market can become a giant.

- **Irrational Behaviour:** It is generally believed that **investors' rationality will ensure a close correspondence between market prices and intrinsic values**. But in practice this is not true. J. M. Keynes **argued that all sorts of consideration enter into the market valuation which is in no way relevant to the prospective yield**. The market seems to function largely on **hit or miss tactics rather than on the basis of informed beliefs** about the long-term prospects of individual enterprises.
- **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 wield grate influence over the market**. The monopolistic power enjoyed by them diminishes the competitiveness of the market.

1. **Differentiate between expected return and required rate of return? (Category B)**

❖ Required rate of return is the **minimum rate of return** that the investor is expected to receive while making an investment in an asset over a specified period of time. This is also called **opportunity cost or cost of capital** because it is the highest level of expected return forgone which is available elsewhere from investment of similar risks.

❖ Expected return **reflects the perception of investors**. If the investors expect a return of a particular share **higher than the required return**, then the share is **undervalued**. The reason is that the share will sell for less than its intrinsic value. On the other hand, if the investors expect a return of a particular share **lower than its required rate of return**, then the share is **overvalued**. The reason is that it will sell for a higher price than its intrinsic value.

❖ The difference between expected return and required return is called **expected alpha**

2. **What is equity risk premium? (Category B)**

❖ Equity risk premium is the **excess return that investment in equity shares** provides over a risk-free rate, such as return from tax free government bonds. This excess return compensates **investors for taking on the relatively higher risk of investing** in equity shares of a company.

❖ The size of the premium will change depending upon the level of risk in a particular portfolio and will also change over time as market risk fluctuates. Generally, **high-risk investments are compensated with a higher premium**.

❖ **Equity risk premium = Beta of security x (Market Return – Risk free rate)**

3. **Explain the concept of nominal cash flow and real cash flow? (Category B)**

❖ Nominal cash flow is the **amount of future revenues** the company expects to receive and expenses it expects to pay out, **without any adjustments for inflation**.

❖ On the other hand, **Real cash flow** shows a company's cash flow **with adjustments for inflation**. Since inflation reduces the spending power of money over time, the real cash flow shows the effects of inflation on a company's cash flow.

❖ In the short term and under conditions of low inflation, the nominal and real cash flows are almost identical. However, in conditions of high inflation rates, the nominal cash flow will be higher than the real cash flow.

4. **What is enterprise value and what are the multiples used in relation to enterprise value? (Category B)**

Enterprise value:

❖ Enterprise value is the true economic value of a company. It is calculated by adding market capitalization, long term debt, minority interests minus cash and cash equivalents

❖ Enterprise value is of the following three types:
- Total Enterprise value = Equity + Debt + Minority Interest – Cash and cash equivalents
- Operating Enterprise value = Total enterprise value – market value of non-operating assets such as investments in associates
- Core Enterprise value = Operating enterprise value – Value of non-core assets

Multiples relating to enterprise value:

- **Enterprise value to sales:** This multiple is used for the corporates who maintain negative cash flows or negative earnings. Technological firms generally use this multiple
- **Enterprise value to EBITDA:** EBITDA is the amount available to both debt and equity holders of a company. This multiple is used for valuing capital intensive companies, which generally have substantial depreciation and amortization expenses. An analyst prefers this multiple because it is not affected by depreciation policy and changes in capital structure. The inverse of this multiple is the cash return on total investment

5. Explain the concept of duration of bond? (Category A)

- Duration is nothing but the **average time taken** by an investor to collect his/her investment. If an investor receives a **part of his/her investment** over the time on specific intervals before maturity, **the investment will offer him the duration which would be lesser than the maturity of the instrument**. Higher the coupon rate, lesser would be the duration.
- It measures how quickly a bond will repay its true cost. The longer the time it takes the greater exposure the bond has to changes in the interest rate environment. Following are some of factors that affect bond's duration:
  - **Time to maturity:** The shorter-maturity bond would have a lower duration and less price risk and vice versa.
  - **Coupon rate:** Coupon payment is a key factor in calculation of duration of bonds. The higher the coupon, the lower is the duration and vice versa.

6. What is immunization? (Category B)

- If interest rate goes up although return on investment improves but value of bond falls and vice versa. Thus, the price of Bond is subject to following two risk: (a) Price Risk and (b) Reinvestment Rate Risk
- Further, **with change in interest rates these two risks move in opposite direction**.
- Through the process of immunization selection of bonds shall be in such manner that the effect of above two risks shall offset each other.
- **Immunization happens if the weighted duration of the portfolio is equal to the period for which investment is required to be made**

7. What is term structure theory? (Category C)

- The term structure theories explain the relationship **between interest rates or bond yields and different terms or maturities.** The different term structures theories are as follows:
  - **Unbiased Expectation Theory:** As per this theory the long-term interest rates can be used to forecast short-term interest rates in the future on the basis of rolling the sum invested for more than one period.
  - **Liquidity Preference Theory:** As per this theory forward rates reflect investors' expectations of future spot rates plus a liquidity premium to compensate them for exposure to interest rate risk. Positive slope may be a result of liquidity premium.
  - **Preferred Habitat Theory:** Premiums are related to supply and demand for funds at various maturities – not the term to maturity and hence this theory can be used to explain almost any yield curve shape.

8. What is convexity adjustment? (Category B)

- Duration is a good approximation of the percentage of price change for a small change in interest rate. However, the change cannot be estimated so accurately of convexity effect as duration base estimation assumes a linear relationship.
- This estimation can be improved by adjustment on account of ‘convexity’. The formula for convexity is as follows:
- C* x (Δy)2 x100
- Δy = Change in Yield
- $C = (V_{+} + V_{-} - 2V_0) / (2V_0(\Delta^2)$
- V0 = Initial Price
- V+ = price of Bond if yield increases by Δy
- V- = price of Bond if yield decreases by Δy

9. Write short note on zero coupon bond? (Category A)

- These bonds **do not pay interest** during the life of the bonds. Instead, zero coupon bonds are issued at discounted price to their face value, which is the amount a bond will be worth when it matures or comes due.
- When a zero-coupon bond matures, **the investor will receive one lump sum** (face value) equal to the initial investment plus interest that has been accrued on the investment made. The maturity dates on zero coupon bonds are usually long term. These maturity dates allow an investor for a long-range planning.
- Zero coupon bonds issued by banks, government and private sector companies. However, bonds issued by corporate sector carry a potentially higher degree of risk, depending on the financial strength of the issuer and longer maturity period, but they also provide an **opportunity to achieve a higher return**.

10. Explain Arbitrage Pricing Theory? (Category B)

- Arbitrage pricing theory (APT) is used as an alternative to Capital Assets Pricing Model (CAPM). While the **CAPM formula helps to calculate the market's expected return, APT uses the risky asset's expected return and the risk premium of a number of macroeconomic factors**.
- In a simplistic way, if a **particular asset, say a stock**, has its major influencers as the ‘interest rate fluctuations’ and the ‘sectoral growth rate’, then the stocks’ return would be calculated by using the Arbitrage Pricing Theory (APT) in the following manner:
    - Calculate the risk premium for both these two risk factors (beta for the risk factor 1 – interest rate, and beta of the risk factor 2 – sector growth rate; and,
    - Adding the risk-free rate of return.
- **Required return under APT = R(f) + B1(RP1) + B2(RP2) + …. Bj(RPn)**

1. **What are the objectives of portfolio management? (Category B)**

- **Security/Safety of Principal:** Security not only involves keeping the principal sum intact but also its purchasing power.
- **Stability of Income:** To facilitate planning more accurately and systematically reinvestment or consumption of income.
- **Capital Growth:** It can be attained by reinvesting in growth securities or through purchase of growth securities.
- **Marketability i.e. the case with which a security can be bought or sold:** This is essential for providing flexibility to investment portfolio.
- **Liquidity i.e. nearness to money:** It is desirable for the investor so as to take advantage of attractive opportunities upcoming in the market.
- **Diversification:** The basic objective of building a portfolio is to reduce the risk of loss of capital and/or income by investing in various types of securities and over a wide range of industries.
- **Favourable Tax Status:** The effective yield an investor gets from his investment depends on tax to which it is subjected to. By minimising the tax burden, yield can be effectively improved.

2. **What are the phases of portfolio management? (Category B)**

- Portfolio management is a process and broadly it involves following five phases and each phase is an integral part of the whole process and the success of portfolio management depends upon the efficiency in carrying out each of these phases.
    - **Security Analysis:** Security analysis constitutes the initial phase of the portfolio formation process and consists in examining the risk-return characteristics of individual securities and also the correlation among them.
    - **Portfolio Analysis:** From any chosen set of securities, an indefinitely large number of portfolios can be constructed by varying the fractions of the total investable resources allocated to each one of them.
    - **Portfolio selection:** The goal of a rational investor is to identify the Efficient Portfolios out of the whole set of Feasible Portfolios mentioned above and then to zero in on the Optimal Portfolio suiting his risk appetite
    - **Portfolio revision:** Once an optimal portfolio has been constructed, it becomes necessary for the investor to constantly monitor the portfolio to ensure that it does not lose it optimality.
    - **Portfolio evaluation:** This process is concerned with assessing the performance of the portfolio over a selected period of time in terms of return and risk and it involves quantitative measurement of actual return realized and the risk borne by the portfolio over the period of investment

3. **Explain the traditional approach of portfolio management? (Category C)**

Process of investment as per traditional approach is detailed below:

- **Investor's study includes an insight into his** – (a) age, health, responsibilities, other assets, portfolio needs; (b) need for income, capital maintenance, liquidity; (c) attitude towards risk; and (d) taxation status;
- **Portfolio objectives** are defined with reference to maximising the investors' wealth which is subject to risk. The higher the level of risk borne, the more the expected returns
- **Investment strategy** covers examining a number of aspects including:

- Balancing fixed interest securities against equities;
- Balancing high dividend pay-out companies against high earning growth companies as required by investor
- Finding the income of the growth portfolio;
- Balancing income tax payable against capital gains tax;
- Balancing transaction cost against capital gains from rapid switching; and
- Retaining some liquidity to seize upon bargains.

❖ **Diversification** reduces volatility of returns and risks and thus adequate equity diversification is sought. Balancing of equities against fixed interest-bearing securities is also sought.

❖ **Selection of individual investments** is made on the basis of the following principles:

- Methods for selecting sound investments by calculating the true or intrinsic value of a share and comparing that value with the current market value (i.e. by following the fundamental analysis) or trying to predict future share prices from past price movements (i.e., following the technical analysis);
- Expert advice is sought besides study of published accounts to predict intrinsic value;
- Inside information is sought and relied upon to move to diversified growth companies, switch quickly to winners than loser companies;
- Newspaper tipsters about good track record of companies are followed closely;
- Companies with good asset backing, dividend growth, good earning record, high quality management with appropriate dividend paying policies and leverage policies are traced out constantly for making selection of portfolio holdings.

4. What are the elements of risk in investment? (Category A)

❖ Total risk of a security is the **sum of systematic risk and unsystematic risk**

Systematic Risk:

❖ Systematic risk comprises factors that are **external to a company** (macro in nature) and affect a large number of securities simultaneously. These are mostly uncontrollable in nature

❖ Systematic risk can be further subdivided into interest rate risk, market risk and purchasing power risk

- **Interest rate risk:** This arises due to variability in the interest rates from time to time and particularly affects debts securities like bonds and debentures as they carry fixed coupon rate of interest.
- **Purchasing power risk:** It is also known as **inflation risk**, as it also emanates from the very fact that inflation affects the purchasing power adversely. Nominal return contains both the real return component and an inflation premium in a transaction involving risk of the above type to compensate for inflation over an investment holding period. **Inflation rates vary over time and investors are caught unaware when rate of inflation changes unexpectedly causing erosion in the value of realised rate of return and expected return**.
- **Market risk:** 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 bearish trend

Unsystematic Risk:

- Unsystematic risk includes those factors which are **internal to companies** (micro in nature) and affect only those particular companies. These are **controllable** to a great extent
- Unsystematic risk can be further subdivided into business risk and financial risk.
    - **Business Risk:** Business risk emanates from sale and purchase of securities affected by business cycles, technological changes etc. **Business cycles affect all types of securities** viz. there is cheerful movement in boom due to bullish trend in stock prices whereas bearish trend in depression brings down fall in the prices of all types of securities
    - **Financial Risk:** It arises due to **changes in the capital structure** of the company. It is also known as leveraged risk and expressed in terms of debt-equity ratio. Excess of debt vis-à-vis equity in the capital structure indicates that the company is highly geared

5. **What are the assumptions of Markowitz Model? (Category C)**

- The return on an investment **adequately summarises the outcome** of the investment.
- The investors can **visualise a probability distribution** of rates of return.
- The investors' risk estimates are **proportional to the variance of return** they perceive for a security or portfolio.
- Investors base their investment decisions on **two criteria** i.e. expected return and variance of return.
- All investors are **risk averse**. For a given expected return he prefers to take minimum risk, for a given level of risk the investor prefers to get maximum expected return.
- Investors **are assumed to be rational** in so far as they would prefer greater returns to lesser ones given equal or smaller risk and are risk averse. Risk aversion in this context means merely that, as between two investments with equal expected returns, the investment with the smaller risk would be preferred.
- **'Return' could be any suitable measure of monetary inflows like NPV** but yield has been the most commonly used measure of return, so that where the standard deviation of returns is referred to it is meant the standard deviation of yield about its expected value.

6. **What are the assumptions of Capital Asset Pricing Model? (Category A)**

- **Efficient market:** It is the first assumption of CAPM. Efficient market refers to the **existence of competitive market** where financial securities and capital assets are bought and sold with full information of risk and return available to all participants
- **Rational investment goals:** Investors desire **higher return for any acceptable level** of risk or the **lowest risk for any desired level of return**. Such a rational choice is made on logical and consistent ranking of proposals
- **Risk aversion** in efficient market is adhered to although at times risk seeking behaviour is adopted for gains.
- CAPM assumes that all assets are divisible and liquid assets
- Investors are able to **borrow freely at a risk less rate of interest** i.e. borrowings can fetch equal return by investing in safe Government securities
- Securities can be exchanged without payment of brokerage, commissions or taxes and **without any transaction cost**
- Securities or capital assets face **no bankruptcy or insolvency**

7. **What are advantages and limitation of CAPM? (Category B)**

Advantages:

- **Risk Adjusted Return:** It provides a reasonable basis for estimating the required return on an investment which has risk in built into it. Hence it can be used as Risk Adjusted Discount Rate in Capital Budgeting.
- **No Dividend Company:** It is useful in computing the cost of equity of a company which does not declare dividend.

Limitations

- **Reliability of Beta:** Statistically reliable Beta might not exist for shares of many firms. It may not be possible to determine the cost of equity of all firms using CAPM. All shortcomings that apply to Beta value applies to CAPM too.
- **Other Risks:** By emphasing on systematic risk only, unsystematic risks are of importance to shareholders who do not possess a diversified portfolio.
- **Information Available:** It is extremely difficult to obtain important information on risk free interest rate and expected return on market portfolio as there is multiple risk-free rates for one while for another, markets being volatile it varies over time period.

8. **Write short note on Active portfolio strategy? (Category C)**

An APS is followed by most investment professionals and aggressive investors who strive to **earn superior return after adjustment for risk**. The vast majority of funds (or schemes) available in India follow an "active" investment approach, **wherein fund managers of "active" funds spend a great deal of time on researching individual companies, gathering extensive data** about financial performance, business strategies and management characteristics. Following are the principles of APS:

- **Market Timing:** This involves departing from the normal i.e. **strategy for long run asset mix to reflect assessment of the prospect of various assets in the near future**. Market timing is based on an explicit or implicit forecast of general market movement. A **variety of tools are employed for market timing analysis** namely business cycle analysis, moving average analysis, advance-decline analysis, Econometric models
- **Sector Rotation:** Sector or group rotation **may apply to both stock and bond component of the portfolio**. It is used **more compulsorily with respect to strategy**. The components of the portfolio are used **when it involves shifting**. The weighting for various industry sectors is based on their asset outlook.
- **Security Selection:** Security selection involves a search for **under-price security**. If one has to resort to active stock selection, he may employ fundamental / technical analysis to identify stocks which seems to promise superior return and concentrate the stock components of portfolio on them.
- **Use of specialized investment concept:** To achieve superior return, one has to employ a **specialised concept/philosophy particularly** with respect to investment in stocks. The concept which have been exploited successfully are **growth stock, neglected or out of favour stocks, asset stocks, technology stocks and cyclical stocks**

9. **Explain Passive portfolio strategy? (Category C)**

Passive strategy rests on the tenet that the **capital market is fairly efficient** with respect to the available information. Hence, they search for superior return. Basically, passive strategy involves adhering to two guidelines. They are:

- Create a well-diversified portfolio at a predetermined level of risk.
- Hold the portfolio relatively unchanged over time unless it became adequately diversified or inconsistent with the investor risk return preference.

Example: A fund which is passively managed are called index funds. An Index fund is a mutual fund scheme that invests in the securities of the target Index in the same proportion or weightage

10. What are the criteria for bond selection? (Category B)

Bonds are fixed income avenues. The following factors have to be evaluated in selecting fixed income avenues:

- **Yield to maturity:** The yield to maturity for a fixed-income avenue represent the rate of return earned by the investor, if he invests in the fixed income avenues and holds it till its maturity.
- **Risk of Default:** To assess such risk on a bond, one has to look at the credit rating of the bond. If no credit rating is available relevant financial ratios of the firm have to be examined such as debt equity, interest coverage, earning power etc and the general prospect of the industry to which the firm belongs have to be assessed.
- **Tax Shield:** In the past, several fixed income avenues offer tax shields but at present only a few of them do so.
- **Liquidity:** If the fixed income avenues can be converted wholly or substantially into cash at a fairly short notice it possesses a liquidity of a high order.

11. What are the three approaches for selection of stock? (Category B)

- **Technical analysis** looks at price behaviours and volume data to determine whether the share will move up or down or remain trend less.
- **Fundamental analysis** focuses on fundamental factors like earning level, growth prospects and risk exposure to establish intrinsic value of a share. The recommendation to buy hold or sell is based on comparison of intrinsic value and prevailing market price.
- **Random selection analysis** is based on the premise that the market is efficient and security is properly priced.

12. What are the various types of asset allocation strategies? (Category B)

- **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.
- **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.
- **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.
- **Insured Asset Allocation:** Under this strategy, risk exposure for changing portfolio values (wealth) is adjusted; more value means more ability to take risk.

13. What are the features of alternative investments? (Category B)

- **High Fees** – Being a specific nature product the transaction fees are quite on higher side.
- **Limited Historical Rate** – The data for historic return and risk is very limited where data for equity market for more than 100 years in available.
- **Illiquidity** – The liquidity of Alternative Investment is not good as next buyer not be easily available due to limited market.
- **Less Transparency** – The level of transparency is not adequate due to limited public information available.
- **Extensive Research Required** – Due to limited availability of market information the extensive analysis is required by the Portfolio Managers.

- **Leveraged Buying** – Generally investment in alternative investments is highly leveraged.

14. What are the four approaches to value Real Estate? (Category B)

- **Sales Comparison Approach** – It is like Price Earning Multiplier as in case of equity shares. Benchmark value of similar type of property can be used to value Real Estate.
- **Income Approach** – This approach like value of Perpetual Debenture or unredeemable Preference Shares. In this approach the perpetual cash flow of potential net income (after deducting expense) is discounted at market required rate of return.
- **Cost Approach** – In this approach, the cost is estimated to replace the building in its present form plus estimated value of land. However, adjustment of other factors such as good location, neighbourhood is also made in it.
- **Discounted After Tax Cash Flow Approach** – In comparison to NPV technique, PV of expected inflows at required rate of return is reduced by amount of investment

15. What is mezzanine finance? (Category A)

- It is a blend or hybrid of **long-term debt and equity share**. It is a kind of equity funding combined with the **characteristics of conventional lending** as well as equity.
- This is a highly risky investment and hence mezzanine financer receives higher return.
- This type of financing enhances the **base of equity as in case of default the debt is converted into equity**.
- Mezzanine financing can be used for financing **heavy investments, buyout, temporary arrangement between sanction of heavy loan and its disbursement**. However, compared to western world, this type of financing is not so popular in India.

16. What are the characteristics of venture capital financing? (Category B)

- **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.
- **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 and accordingly it would be investing in that format. they adjust this liquidity premium against the price and required return.
- **High Risk:** VC would not hesitate to take risk. It works on principle of high risk and high return. So higher riskiness would not eliminate the investment choice for a venture capital.
- **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.

17. What are the advantages of venture capital financing? (Category B)

- It injects **long- term equity finance** which provides a solid capital base for future growth.
- The venture capitalist is a **business partner**, sharing both the risks and rewards. Venture capitalists are rewarded with business success and capital gain.
- 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.
- The venture capitalist also has a **network of contacts** in many areas that can add value to the company.

- The venture capitalist **may be capable of providing additional rounds** of funding should it be required to finance growth.
- 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.
- They can also **facilitate a trade sale**.

18. Explain the VC investment process? (Category C)

- **Deal origination:** VC operates directly or through intermediaries. Mainly many practicing Chartered Accountants would work as intermediary and through them VC gets the deal
- **Screening:** Once the deal is sourced the same would be sent for screening by the VC. The screening is generally carried out by a committee consisting of senior level people of the VC
- **Due Diligence:** The screening decision would take place based on the information provided by the company. 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 veracity of the documents taken
- **Deal structuring:** Once the case passes through the due diligence it would now go through the deal structuring. The deal is structured in such a way that both parties win
- **Post investment activity:** In this section, the VC nominates its nominee in the board of the company. The company has to adhere to certain guidelines like strong MIS, strong budgeting system, strong corporate governance and other covenants of the VC and periodically keep the VC updated about certain mile-stones.
- **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: **one way is 'sell to third paty(ies)'**. This sale can be in the form of IPO or Private Placement to other VCs. 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%)

19. What are distressed securities? (Category A)

- It is a kind of **purchasing the securities of companies that are in or near bankruptcy**. Since these securities are available at very low price, the main purpose of buying such securities is to make efforts to revive the sick company. Further, these securities are suitable **for those investors who cannot participate in the market** and those who wants avoid due diligence.
- We can see by taking long position in debt and short position in equity, how investor **can earn arbitrage profit**
- In case company's condition improves because of priority, the investor will get his **interest payment which shall be more than the dividend on his short position in equity shares**. If company is condition further deteriorates the value of both share ad debenture goes down. He will make good profit from his short position.
- **Risks Analysis of Investment in Distressed Securities:** On the face, investment in distressed securities appears to be a good proposition but following types of risks are need to be analyzed.
  - **Liquidity Risk**: These securities may be saleable in the market.
  - **Event Risk**: Any event that particularly effect the company not economy as a whole
  - **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.

1. **Explain the concept and features of Securitization? (Category A)**

- **Concept:** The process of securitization typically involves the **creation of pool of assets from the illiquid financial assets**, such as receivables or loans which are marketable. These assets can be **automobile loans, credit card receivables**, residential mortgages or any other form of future receivables.

Features of Securitization:

- **Creation of Financial Instruments:** The process of securities can be viewed as process of **creation of additional financial product of securities** in market backed by collaterals.
- **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**.
- **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.
- **Structured Finance:** In the process of securitization, financial instruments are **tailor structured to meet the risk return trade** of profile of investor, and hence, these securitized instruments are considered as best examples of structured finance.
- **Trenching:** Portfolio of different receivable or loan or asset are split into several parts **based on risk and return they carry called 'Trenche'**. Each Trench carries a different level of risk and return.
- **Homogeneity:** Under each trenche the **securities are issued of homogenous nature** and even meant for small investors the **who can afford to invest** in small amounts.

2. **What are the benefits of Securitization? (Category B)**

The benefits of securitization can be viewed from the angle of various parties involved as follows:

From the angle of originator	❖ **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. ❖ **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. Further, in case of non- recourse arrangement even the burden of default is shifted. ❖ **Helps to improve financial ratios:** Especially in case of Financial Institutions and Banks, it helps to manage Capital –To-Weighted Asset Ratio effectively. ❖ **Reduced borrowing Cost:** Since securitized papers are rated due to credit enhancement even they can also be issued at reduced rate as of debts and hence the originator earns a spread, resulting in reduced cost of borrowings.
From the angle of investor	❖ **Diversification of Risk:** Purchase of securities backed by different types of assets provides the diversification of portfolio resulting in reduction of risk. ❖ **Regulatory requirement:** Acquisition of asset backed belonging to a particular industry say micro industry helps banks to meet regulatory requirement of investment of fund in industry specific. ❖ **Protection against default:** In case of recourse arrangement if there is any default by any third party then originator shall make good

	the least amount. Moreover, there can be insurance arrangement for compensation for any such default.

3. **Who are the participants in Securitization? (Category A)**

Types of Participants	Primary Participants and Secondary Participants
Primary Participants (Main Parties)	❖ **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 ❖ **Special Purpose Vehicle:** 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 to remove the asset from the Balance Sheet of Originator. Since, **SPV makes an upfront payment** to the originator, it holds the key position in the overall process of securitization ❖ **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	❖ **Obligors:** 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.** The amount due from the obligor is transferred to SPV and they form the basis of securitization process and their credit standing is of paramount importance in the whole process ❖ **Rating Agency:** Since the securitization is based on the pools of assets rather than the originators, the assets have to be assessed in terms of its credit quality and credit support available ❖ **Receiving and Paying agent (RPA):** Also, called Servicer or Administrator, it collects the payment due from obligor(s) 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 ❖ **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 ❖ **Credit Enhancer:** Since investors in securitized instruments are directly exposed to performance of the underlying and sometime may have limited or no recourse to the originator, **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 ❖ **Structurer:** It brings together the **originator, investors, credit enhancers and other parties to the deal of securitization**. Normally, these are **investment bankers** also called arranger of the deal. It ensures that deal meets all legal, regulatory, accounting and tax laws requirements

4. **Explain the mechanism of Securitization? (Category A)**

- **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.
- **Transfer to SPV:** Once assets have been pooled, they are transferred to Special Purpose Vehicle (SPV) especially created for this purpose.
- **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
- **Administration of assets:** The administration of assets in subcontracted back to originator which collects principal and interest from underlying assets and transfer it to SPV, which works as a conduct.
- **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.
- **Repayment of funds:** SPV will repay the funds in form of interest and principal that arises from the assets pooled.
- **Credit Rating to Instruments:** Sometime before the sale of securitized instruments credit rating can be done to assess the risk of the issuer.

5. Explain the problems in Securitization? (Category C)

- **Stamp Duty:** Under Transfer of Property Act, 1882, **a mortgage debt stamp duty which even goes upto 12%** in some states of India and this impeded the growth of securitization in India. It should be noted that since pass through certificate **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
- **Taxation:** Taxation is another area of concern in India. In the **absence of any specific provision relating to securitized instruments** in Income Tax Act experts' opinion differ a lot
- **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
- **Lack of Standardization:** Every originator follows own format for documentation and administration have lack of standardization is another obstacle in growth of securitization
- **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
- **Ineffective foreclosure laws:** For last many years there are efforts are going on for effective foreclosure **but still 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

6. What are the various securitization instruments? (Category A)

- **Pass Through Certificates (PTCs):** Originator 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 has 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**

- **Pay Through Security (PTS):** In contrast to PTC 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**. Further, this structure also **permits the SPV to reinvest surplus funds for short term as per their requirement**. Since, in Pass Through, **all cash flow immediately in PTS** in case of early retirement of receivables plus cash can be used for **short term yield**. This structure also provides the freedom to issue several debt tranch with varying maturities
- **Stripped Securities:** Stripped Securities are created by dividing the cash flows associated with underlying securities into two or more new securities. Those two securities are as follows: (i) Interest Only (IO) Securities and (ii) Principle Only (PO) Securities. 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**

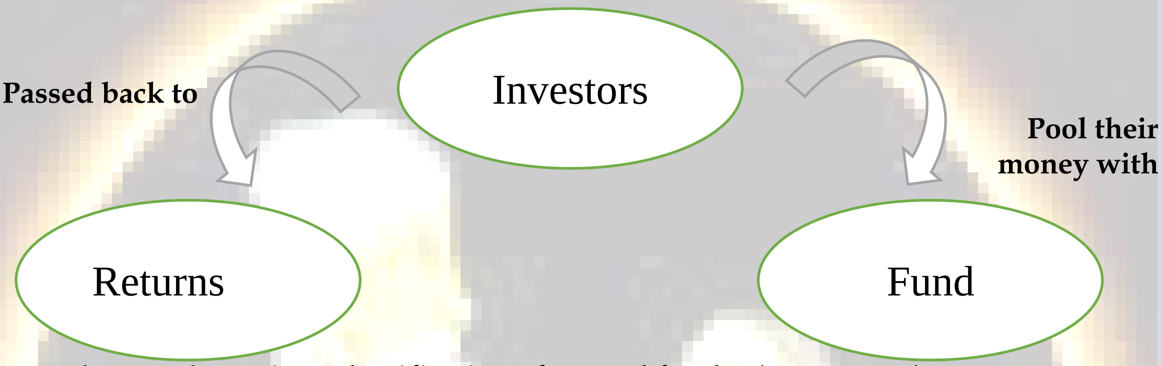
7. How is the pricing of securitized instruments done? (Category C)

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:

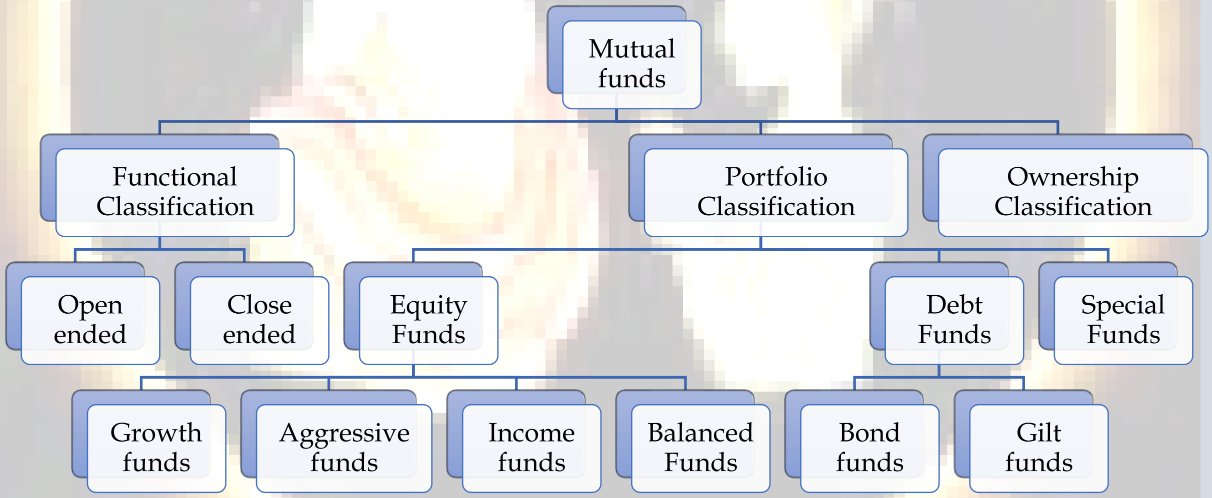
From Originator's Angle	From originator's point of view, the instruments can be priced at a rate at which originator has to incur an outflow and **if that outflow can be amortized over a period of time by investing the amount** raised through securitization
From Investor's Angle	From an investor's angle security price **can be determined by discounting best estimate of expected future cash flows using rate of yield to maturity 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

1. What is a mutual fund? (Category B)

- Mutual fund is a trust that pools together the resources of investors to make a foray into investments in the capital market, thereby making the investor to be part owner of the assets of mutual fund. It is trust **that pools the resources of investors who share a common financial goal.**
- The fund is **managed by a professional money manager** who makes investment in various stocks, bonds or other securities according to the investment objectives established by the Fund.
- Anybody with investible surplus can invest in the funds. The income earned through these investments and the capital appreciation realized by the scheme is shared by the unit holders in proportion to their investment.



2. What are the various classification of mutual funds? (Category A)



Functional Classification	
Open Ended Funds	In an open-ended scheme, the investor can make entry and exit at any time. Also, the capital of the fund is unlimited and the redemption period is indefinite
Close ended funds	In a close ended scheme, the investor can buy into the scheme during Initial Public offering or from the stock market after the units have been listed. The scheme has a limited life at the end of which the corpus is liquidated
Portfolio Classification	
Equity Funds	Equity funds invest primarily in stocks. Equity funds are of the following types: ❖ **Growth Funds:** They seek to provide long term capital appreciation to the investor and are best to long term investors. ❖ **Aggressive Funds:** They look for super normal returns for which investment is made in start-ups, IPOs and speculative shares. They are best to investors willing to take risks.

	❖ **Income Funds:** They seek to maximize present income of investors by investing in safe stocks paying high cash dividends and in high yield money market instruments. They are best to investors seeking current income ❖ **Balanced Funds:** They are a mix of growth and income funds. They buy shares for growth and bonds for income and best for investors seeking to strike golden mean.
Debt funds	Debt funds are of two types: ❖ **Bond Funds:** They invest in fixed income securities e.g. government bonds, corporate debentures, convertible debentures, money market. Investors seeking tax free income go in for government bonds while those looking for safe, steady income buy government bonds or high-grade corporate bonds. Although there have been past exceptions, bond funds tend to be less volatile than stock funds and often produce regular income. ❖ **Gilt Funds:** They are mainly invested in Government securities.
Special funds	❖ **Index Funds:** Every stock market has a stock index which measures the upward and downward sentiment of the stock market. Index Funds are low cost funds and influence the stock market. ❖ **International Funds:** A mutual fund located in India to raise money in India for investing globally. ❖ **Offshore Funds:** A mutual fund located in India to raise money globally for investing in India. ❖ **Sector Funds:** They invest their entire fund in a particular industry e.g. utility fund for utility industry like power, gas, public works. ❖ **Money Market Funds:** These are predominantly debt-oriented schemes, whose main objective is preservation of capital, easy liquidity and moderate income. To achieve this objective, liquid funds invest predominantly in safer short-term instruments like Commercial Papers, Certificate of Deposits, Treasury Bills, G-Secs etc. ❖ **Fund of Funds:** Fund of Funds (FoF) as the name suggests are schemes which invest in other mutual fund schemes. ❖ **Capital Protection Oriented Fund:** The term 'capital protection-oriented scheme' means a mutual fund scheme which is designated as such and which endeavours to protect the capital invested therein through suitable orientation of its portfolio structure. **A typical portfolio structure could be to set aside major portion of the assets for capital safety and could be invested in highly rated debt instruments.** The remaining portion would be invested in equity or equity related instruments to provide capital appreciation. Capital Protection Oriented schemes are a recent entrant in the Indian capital markets and should not be confused with 'capital guaranteed' schemes. ❖ **Gold Funds:** The objective of these funds is to track the performance of Gold. The units represent the value of gold or gold related instruments held in the scheme.
Ownership classification	
Funds are classified into **Public Sector Mutual Funds, Private Sector Mutual Funds and Foreign Mutual Funds**. Public Sector Mutual Funds are sponsored by a company of the public sector. Private Sector Mutual Fund is sponsored by a company of the private sector. Foreign Mutual Funds are sponsored by companies for raising funds in India, operate from India and invest in India	

3. **What are the various types of schemes in mutual funds? (Category B)**

- **Balanced Fund:** It consists of both debt and equity. **It works on the principle that debt portfolio provides stability and the equity provides growth.** The returns of the fund will be moderate.
- **Equity Diversified Funds:** This type of fund ensures high level of diversification and ensures reduction of risk involved in the fund. The following are the types of diversified funds:
    - Flexi cap / Multicap fund
    - Contra fund
    - Index fund
    - Dividend yield fund (Dividend Payout option & Dividend Re investment option)
- **Equity tax linked savings scheme:** It is used as a tax saver under Sec 80C of the Income tax Act, 1961. It also has benefit to give potential returns.
- **Sector funds:** These funds are focussed on a particular industry to take the advantage of industry cycles. They are much riskier than the equity diversified funds. These funds are suitable only for those who already have a portfolio.
- **Thematic funds:** These funds could vary from multi sector, international exposure etc. They have a broader outlook than the sector funds.
- **Arbitrage funds:** The fund seeks to provide better return than debt instruments and lower volatility than equity funds. Arbitrage funds seek to capitalize on the price differentials between the spot and the futures market. This is suitable for conservative investor.
- **Hedge fund:** This is a sort of private investment vehicle which is free from most of the regulations. The fund does not reveal anything about its operations publicly. Hedge funds are aggressively managed portfolio of investments with a goal of generating high returns.
- **Cash fund:** Cash fund is an open-ended liquid scheme that aims to provide returns with low risk and ensure better liquidity. The fund has retail and super institutional plans. There is no entry or exit load.
- **Exchange Traded Fund (ETF):** These funds are listed on the stock exchanges and their prices are linked to the underlying securities. An ETF can be bought by placing an order with the Broker and traded during the market hours at prices closer to its NAV. Following are the types of ETF Products available in the market: (i) Index EFTs (ii) Commodity ETFs (iii) Bond ETFs (iv) Currency ETFs

4. What are the advantages and limitations of mutual funds? (Category C)

Advantages of mutual funds:

- **Professional Management:** The funds are managed by skilled and professionally experienced managers with a back-up of a Research team.
- **Diversification:** Mutual Funds offer diversification in portfolio which reduces the risk.
- **Convenient Administration:** There are no administrative risks of share transfer, as many of the Mutual Funds offer services in a demat form which save investor's time and delay.
- **Higher Returns:** Over a medium to long-term investment, investors always get higher returns in Mutual Funds as compared to other avenues of investment.
- **Low Cost of Management:** No Mutual Fund can increase the cost beyond prescribed limits of 2.5% maximum and any extra cost of management is to be borne by the AMC.
- **Liquidity:** In all the open-ended funds, liquidity is provided by direct sales / repurchase by the Mutual Fund and in case of close ended funds, the liquidity is provided by listing the units on the Stock Exchange.
- **Transparency:** The SEBI Regulations now compel all the Mutual Funds to disclose their portfolios on a half-yearly basis. However, many Mutual Funds disclose this on a quarterly or monthly basis to their investors.

- **Other Benefits:** Mutual Funds provide regular withdrawal and systematic investment plans according to the need of the investors. The investors can also switch from one scheme to another without any load.
- **Highly Regulated:** Mutual Funds all over the world are highly regulated and in India all Mutual Funds are registered with SEBI and are strictly regulated as per the Mutual Fund Regulations which provide excellent investor protection.
- **Economies of scale:** The "pooled" money from a number of investors ensures that mutual funds enjoy economies of scale; it is cheaper compared to investing directly in the capital markets which involves higher charges.
- **Flexibility**: There are a lot of features in a regular mutual fund scheme, which imparts flexibility to the scheme. An investor can opt for Systematic Investment Plan (SIP), Systematic Withdrawal Plan etc. to plan his cash flow requirements as per his convenience.

Drawbacks of mutual funds:

- **No guarantee of Return** – There are three issues involved:
  - All Mutual Funds cannot be winners.
  - A mutual fund may perform better than the stock market but this does not necessarily lead to a gain for the investor.
  - Investors may forgive if the return is not adequate. But they will not do so if the principal is eroded. Mutual Fund investment may depreciate in value.
- **Diversification**: A mutual fund helps to create a diversified portfolio. Though diversification minimizes risk, it does not ensure maximizing returns.
- **Selection of Proper Fund**: It may be easier to select the right share rather than the right fund. For stocks, one can base his selection on the parameters of economic, industry and company analysis.
- **Cost Factor:** Mutual Funds carry a price tag. Fund Managers are the highest paid executives.
- **Unethical Practices:** Mutual Funds may not play a fair game. Each scheme may sell some of the holdings to its sister concerns for substantive notional gains and posting NAVs in a formalized manner.
- **Taxes:** When making decisions about your money, fund managers do not consider your personal tax situations. For example, when a fund manager sells a security, a capital gain tax is triggered, which affects how profitable the individual is from sale.
- **Transfer Difficulties:** Complications arise with mutual funds when a managed portfolio is switched to a different financial firm. Sometimes the mutual fund positions have to be closed out before a transfer can happen.

Chapter 9 – Derivatives Analysis and Valuation

1. **What is a derivative instrument and how does it derive its value? (Category B)**

- **Meaning:** Derivative is a product **whose value is to be derived from the value of one or more basic variables called bases** (underlying assets, index or reference rate). The underlying assets can be **Equity, Forex, and Commodity**
- The importance of underlying asset in derivative instrument is as follows:
  - All derivative instruments are **dependent on an underlying** to have value.
  - The change in value in **a forward contract is broadly equal to the change in value in the underlying**.
  - In the absence of a valuable underlying asset **the derivative instrument will have no value.**
  - On maturity, the position of **profit/loss is determined by the price of underlying instruments**. If the price of the underlying is higher than the

contract price the buyer makes a profit. If the price is lower, the buyer suffers a loss.

2. Who are the main users of derivatives? (Category C)

Users	Purpose
Corporation	To hedge currency risk and inventory risk
Individual investors	For speculation, hedging and yield enhancement
Institutional investor	For hedging asset allocation, yield enhancement and to avail arbitrage opportunities
Dealers	For hedging position taking, exploiting inefficiencies and earning dealer spreads.

3. Differentiate between Cash market and Derivatives market? (Category A)

- In cash market **tangible assets are traded** whereas in derivative market contracts based on **tangible or intangibles assets like index or rates are traded**.
- In cash market, we can purchase **even one share** whereas in Futures and Options **minimum lots are fixed**.
- Cash market is more-risky than Futures and Options segment because in "Futures and Options" risk is limited upto 20%.
- Cash assets may be meant for consumption or investment. Derivative contracts are for hedging, arbitrage or speculation.
- The value of derivative contract is **always based on and linked to the underlying security**. However, this linkage may not be on point-to-point basis.
- In the cash market, a **customer must open securities trading account with a securities depository** whereas to trade futures a customer must open a future trading account with a derivative broker.
- Buying securities in cash market involves **putting up all the money upfront** whereas buying futures simply involves putting up the **margin money**.
- With the purchase of shares of the company in cash market, **the holder becomes part owner of the company. While in future it does not happen**.

4. Distinguish between forward and futures market? (Category A)

Features	Forward Market	Futures Market
Trading	Forward contracts are traded on personal basis or on telephone or otherwise	Futures Contracts are traded in a competitive arena.
Size of contract	Forward contracts are individually tailored and have no standardized size	Futures contracts are standardized in terms of quantity or amount as the case may be
Organized exchanges	Forward contracts are traded in an over the counter market.	Futures contracts are traded on organized exchanges with a designated physical location.
Settlement	Forward contracts settlement takes place on the date agreed upon between the parties.	Futures contracts settlements are made daily via. Exchange's clearing house.
Delivery date	Forward contracts may be delivered on the dates agreed upon and in terms of actual delivery.	Futures contracts delivery dates are fixed on cyclical basis and hardly takes place. However, it does not mean that there is no actual delivery.
Transaction costs	Cost of forward contracts is based on bid – ask spread.	Futures contracts entail brokerage fees for buy and sell order

Marking to Market	Forward contracts are not subject to marking to market	Futures contracts are subject to marking to market in which the loss on profit is debited or credited in the margin account on daily basis due to change in price.
Margins	Margins are not required in forward contract.	In futures contracts every participants is subject to maintain margin as decided by the exchange authorities
Credit risk	In forward contract, credit risk is born by each party and, therefore, every party has to bother for the creditworthiness.	In futures contracts the transaction is a two way transaction, hence the parties need not to bother for the risk.

5. What is Marking to market? (Category C)

It implies the **process of recording the investments** in traded securities (shares, debt-instruments, etc.) at a **value, which reflects the market value of securities** on the reporting date. In the context of **derivatives trading**, the futures contracts are marked to market on **periodic (or daily) basis**. Marking to market essentially **means that at the end of a trading session, all outstanding contracts are repriced at the settlement price of that session**. Unlike the forward contracts, the future contracts are repriced every day. Any loss or profit resulting from repricing would be debited or credited to the margin account of the broker. It, therefore, provides an opportunity to calculate the extent of liability on the basis of repricing. Thus, the **futures contracts provide better risk management measure** as compared to forward contracts.

6. What are the advantages of stock index futures over stock futures? (Category B)

- It adds **flexibility to one's investment portfolio**. Institutional investors and other large equity holders prefer the most this instrument in terms of portfolio hedging purpose. The stock systems do not provide this flexibility and hedging.
- It creates the **possibility of speculative gains using leverage**. Because a relatively small amount of margin money controls a large amount of capital represented in a stock index contract, a small change in the index level might produce a profitable return on one's investment if one is right about the direction of the market. Speculative gains in stock futures are limited but liabilities are greater.
- Stock index futures are the **most cost-efficient hedging** device whereas hedging through individual stock futures is costlier.
- **Stock index futures cannot be easily manipulated** whereas individual stock price can be exploited more easily.
- Since, **stock index futures consists of many securities, so being an average stock**, is much less volatile than individual stock price. Further, it implies **much lower capital adequacy and margin requirements in comparison of individual stock futures**. Risk diversification is possible under stock index future than in stock futures.
- One can sell contracts as readily as one buys them and the amount of margin required is the same.
- In case of individual stocks, the outstanding positions are settled normally against physical delivery of shares. In case of stock index futures, they are settled in cash all over the world on the premise that index value is safely accepted as the settlement price.
- It is also seen that **regulatory complexity is much less** in the case of stock index futures in comparison to stock futures.
- It provides **hedging or insurance protection** for a stock portfolio in a falling market.

7. **Distinguish between options and futures? (Category B)**

- **Nature:** In options, the buyer of the options has the right but not the obligation to purchase or sell the stock. However, while going in for a long futures position, the investor is obligated to square off his position at or before the expiry date of the futures contract.
- **Movement of the Market:** Options traders use a mathematical factor, the delta that measures the relationship between the options premium and the price of the underlying stock. At times, an options contract's value may fluctuate independently of the stock price. By contrast, the future contract will much more closely follow the movement of the underlying stock.
- **The Price of Investing:** When an options investor takes a long position, he or she pays a premium for the contract. The premium is often called a sunk cost. At expiration, unless the options contract is in the money, the contract is worthless and the investor has lost the entire premium. Stock future contracts require an initial margin deposit and a specific maintenance level of cash for mark to market margin

8. **What are the factors affecting value of an option? (Category B)**

- **Price Movement of the Underlying:** The value of calls and puts are affected by changes in the underlying stock price in a relatively straightforward manner. When the stock price goes up, calls should gain in value and puts should decrease. Put options should increase in value and calls should drop as the stock price falls.
- **Time till expiry:** The option's future expiry, at which time it may become worthless, is an important and key factor of every option strategy. Ultimately, time can determine whether your option trading decisions are profitable. To make money in options over the long term, you need to understand the impact of time on stock and option positions.
- **Volatility in Stock Prices:** Volatility can be understood via a measure called statistical (sometimes called historical) volatility, or SV for short. SV is a statistical measure of the past price movements of the stock; it tells you how volatile the stock has actually been over a given period of time
- **Interest Rate**: Another feature which affects the value of an Option is the time value of money. The greater the interest rates, the present value of the future exercise price are less

9. **Write short note on various Greeks (Delta, Gamma, Theta, Rho and Vega)? (Category B)**

Delta	It is the degree to which an option price will move given a small change in the underlying stock price. For example, an option with a delta of 0.5 will move half a rupee for every full rupee movement in the underlying stock.
Gamma	It measures how fast the delta changes for small changes in the underlying stock price. i.e. the delta of the delta. If you are hedging a portfolio using the delta-hedge technique described under "Delta", then you will want to keep gamma as small as possible, the smaller it is the less often you will have to adjust the hedge to maintain a delta neutral position
Theta	The change in option price given a one day decrease in time to expiration. Basically it is a measure of time decay
Rho	The change in option price given a one percentage point change in the risk-free interest rate. It is sensitivity of option value to change in interest rate. Rho indicates the absolute change in option value for a one percent change in the interest rate.
Vega	Sensitivity of option value to change in volatility. Vega indicates an absolute change in option value for a one percent change in volatility

10. Write short note on Embedded derivatives? (Category A)

- 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.
- Derivatives require to be **marked-to-market through the income statement**, other than qualifying hedging instruments. 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**
- An embedded derivative that modifies an instrument's inherent risk (such as a fixed to floating interest rate swap) would be considered closely related. Conversely, an embedded derivative that changes the nature of the risks of a contract is not closely related

1. **Write short note on Nostro, Vostro and Loro Account? (Category A)**

- Banks maintain three types of current accounts in order to facilitate quick transfer of funds in different currencies. These accounts are **Nostro, Vostro and Loro accounts meaning "our", "your" and "their"**
- A bank's foreign currency account maintained by the bank in a foreign country and in the home currency of that country is known as **Nostro Account or "our account with you"**. For example, An Indian bank's Swiss franc account with a bank in Switzerland.
- **Vostro account** is the local currency account maintained by a foreign bank/branch. It is also called **"your account with us"**. For example, Indian rupee account maintained by a bank in Switzerland with a bank in India.
- The **Loro account** is an account **wherein a bank remits funds in foreign currency to another bank for credit** to an account of a third bank.

2. **Explain Merchant Rate and Interbank Rate? (Category C)**

- In foreign exchange market, **banks consider customers as 'merchants'** for historical reasons. **Exchange rates applied to all types of customers** including that for converting inward remittance in USD to INR are called **merchant rates** as against the rates quoted to **each other by banks** in the interbank market, which are called **interbank rates**.
- Exchange margin will be added/subtracted to/from the interbank rate to arrive at the merchant rate for the customer

3. **What are the techniques for exchange rate forecasting? (Category C)**

- **Technical Forecasting:** It involves the use of historical data to predict future values. For example, time series models. Speculators may **find the models useful for predicting day-to-day movements**. However, since the models typically focus on the near future and rarely provide point or range estimates, they are of limited use to MNCs.
- **Fundamental Forecasting:** It is based on the fundamental relationships between economic variables and exchange rates. For example, subjective assessments, quantitative measurements based on regression models and sensitivity analyses. In general, fundamental forecasting is limited by
    - the **uncertain timing** of the impact of the factors,
    - the need to **forecast factors** that have an immediate impact on exchange rates,
    - the omission of factors that are not easily quantifiable, and
    - changes in the sensitivity of currency movements to each factor over time
- **Market-Based Forecasting:** It uses market indicators to develop forecasts. The current spot/forward rates are often used, since speculators will ensure that the current rates reflect the market expectation of the future exchange rate
- **Mixed Forecasting:** It refers to the use of a combination of forecasting techniques. The actual forecast is a weighted average of the various forecasts developed

4. **What are the various participants in foreign exchange market? (Category B)**

- **Non-bank Entities:** Many multinational companies exchange currencies to meet their import or export commitments or hedge their transactions against fluctuations in exchange rate. Even at the individual level, there is an exchange of currency as per the needs of the individual.
- **Banks:** Banks also exchange currencies as per the requirements of their clients.

- **Speculators:** This category includes commercial and investment banks, multinational companies and hedge funds that buy and sell currencies with a **view to earn profit due to fluctuations** in the exchange rates.
- **Arbitrageurs:** This category includes those investors who make profit from price differential existing **in two markets by simultaneously operating** in two different markets.
- **Governments:** The governments participate in the foreign exchange market through the **central banks**. They constantly monitor the market and help in stabilizing the exchange rates

5. What are the types of exposure in foreign exchange market? (Category B)

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 changes. Thus, it deals with cash flows that result from **existing contractual obligations**
Translation exposure	Translation exposure, also called as **accounting exposure**, is the potential for accounting derived **changes in owner's equity to occur because of the need to "translate" foreign currency financial statements** of foreign subsidiaries into a single reporting currency to prepare worldwide consolidated financial statements
Economic Exposure	It refers to the extent to which the **economic value of a company declines due** to changes in exchange rate. It is the overall impact of exchange rate changes on the value of the firm

6. What is a non-deliverable forward contract? (Category A)

- A cash-settled, short-term forward contract on a **thinly traded or non-convertible foreign currency,** where the profit or loss at the time at the settlement date is calculated by taking the **difference between the agreed upon exchange rate and the spot rate at the time of settlement,** for an agreed upon notional amount of funds.
- All NDFs have a fixing date and a settlement date. The fixing date is the date at which the difference between the prevailing market exchange rate and the agreed upon exchange rate is calculated. The **settlement date is the date by which the payment of the difference is due to the party receiving payment**.
- NDFs are commonly quoted for time periods of **one month up to one year**, and are normally quoted and settled in U.S. dollars. They have become a popular instrument for corporations seeking to hedge exposure to foreign currencies that are not internationally traded

7. Distinguish between options and futures? (Category A)

Options	Futures
Only the seller (writer) is obliged to perform	Both the parties are obligated to perform
Premium is paid by the buyer to the seller at the inception of the contract	No premium is paid by any party.
Loss is restricted while there is unlimited gain potential for the option buyer	There is potential/risk for unlimited gain/loss for the futures buyer.
An American option contract can be exercised any time during its period by the buyer.	A futures contract has to be honoured by both the parties only on the date specified

8. What is currency swap? (Category B)

Currency swaps involve an **exchange of liabilities between currencies**. A currency swap can consist of three stages:

- **A spot exchange of principal:** this forms part of the swap agreement as a similar effect can be obtained by using the spot foreign exchange market.
- **Continuing exchange of interest payments during the term of the swap:** this represents a series of forward foreign exchange contracts during the term of the swap contract. The contract is typically fixed at the same exchange rate as the spot rate used at the outset of the swap.
- **Re-exchange of principal on maturity**

A currency swap has the following benefits:

- Treasurers can **hedge currency risk**.
- It can provide **considerable cost savings**. A strong borrower in the Japanese Yen market may be interested in borrowing in the American USD markets where his credit rating may not be as good as it is in Tokyo. Such a borrower could get a better US dollar rate by raising funds first in the Tokyo market and then swapping Yen for US dollars.
- The swap market **permits funds to be accessed in currencies**, which may otherwise command a high premium.
- It offers **diversification of borrowings**

9. What are the strategies for exposure management? (Category C)

Low Risk: Low Reward – All exposures hedged	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 – Selective hedging	This strategy requires **selective hedging of exposures** whenever forward rates are attractive but keeping exposures open whenever they are not.
High Risk: Low Reward -All exposures left unhedged	Perhaps the worst strategy is to leave all exposures unhedged. The risk of destabilization of cash flows is very high. The merit is zero investment of managerial time or effort
High Risk: High Reward – Active Trading	This strategy involves **active trading in the currency market through continuous cancellations** and re-bookings of forward contracts. With exchange controls relaxed in India in recent times, a few of the larger companies are adopting this strategy

1. **What are the complexities in multinational capital budgeting? (Category C)**

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

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

2. **Explain project cash flows and parent cash flows in the context of international capital budgeting? (Category B)**

- Evaluation of a project on the **basis of own cash flows** entails that the project should compete favourably with domestic firms and **earn a return higher than the local competitors**. If not, the shareholders and management of the parent company shall invest in the equity/government bonds of domestic firms. A **comparison cannot be made since foreign projects replace imports and are not competitors with existing local firms**. Project evaluation based on local cash flows avoid currency conversion and eliminates problems associated with fluctuating exchange rate changes.
- **For evaluation of foreign project from the parent firm's angle**, both operating and financial **cash flows actually remitted to it form the yardstick for the firm's performance** and the basis for distribution of dividends to the shareholders and repayment of debt/interest to lenders. An investment has to be evaluated on basis of **net after tax operating cash flows generated by the project.** As both types of cash flows (operating and financial) are clubbed together, it is essential to see that financial cash flows are not mixed up with operating cash flows.

3. **Write short note on Foreign Currency Convertible Bonds (FCCBs)? (Category A)**

- **Meaning:** 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 bondholder the option to convert the bond into stock
- These types of bonds are **attractive to both investors and issuers**. The investors receive the **safety of guaranteed payments on the bond** and are also able to take advantage of any **large price appreciation in the company's stock**. Due to the equity side of the bond, which adds value, the **coupon payments on the bond are lower for the company**, thereby reducing its debt-financing costs

Advantages	Disadvantages
❖ The convertible bond gives the investor the **flexibility to convert the bond into equity at a price or redeem the bond** at the end of a specified period, normally three years if the price of the share has not met his expectations. ❖ Companies prefer bonds as it leads to **delayed dilution of equity** and allows company to avoid any current dilution in earnings per share that a further issuance of equity would cause. ❖ FCCBs are **easily marketable as investors enjoys option of conversion into equity if resulting to capital appreciation**. Further investor is assured of a minimum fixed interest earnings.	❖ **Exchange risk is more** in FCCBs as interest on bonds would be payable in foreign currency. Thus companies with low debt equity ratios, large forex earnings potential only opt for FCCBs. ❖ FCCBs mean **creation of more debt** and a forex outgo in terms of interest which is in foreign exchange. ❖ In the case of convertible bonds, the interest rate is low, say around 3–4% but there is exchange risk on the interest payment as well as re-payment if the bonds are not converted into equity shares.

4. Write short note on American Depository Receipts (ADR)? (Category A)

❖ Depository receipts issued by a company in the **United States of America (USA)** is known as American Depository Receipts (ADRs). Such receipts must be issued in accordance with the provisions stipulated by the **Securities and Exchange Commission of USA** (SEC) which are very stringent.

❖ An ADR is generally created by the **deposit of the securities of a non-United States company with a custodian bank** in the country of incorporation of the issuing company. The custodian bank informs the depository in the United States that the ADRs can be issued

❖ ADRs are **United States dollar denominated and are traded in the same way as are the securities of United States companies**. The ADR holder is entitled to the same rights and advantages as owners of the underlying securities in the home country

❖ One variation of ADR is the GDR which are identical in structure to an ADR, the only difference being that they can be traded in more than one currency and within as well as outside the United States

5. Write short note on Global Depository Receipts (GDR)? (Category A)

❖ A depository receipt is basically a **negotiable certificate**, denominated in a currency not native to the issuer, that represents the **company's publicly - traded local currency equity shares**.

❖ Most GDRs are denominated in USD, while a few are denominated in Euro and Pound Sterling. The Depository Receipts issued in the US are called American Depository Receipts (ADRs), which anyway are denominated in USD and outside of USA, these are called GDRs

❖ Through the issue of depository receipts, companies in India have been able to tap global equity market to raise foreign currency funds by way of equity. In addition, it has been perceived that a **GDR issue has been able to fetch higher prices from international investors than those that a domestic public issue** would have been able to extract from Indian investors

6. Explain the impact of GDRs on Indian Capital Market? (Category B)

❖ Indian stock market to some extent is **shifting from Bombay to Luxemburg**.

❖ There is **arbitrage possibility** in GDR issues.

- Indian stock market is **no longer independent from the rest of the world**. This puts additional strain on the investors as they now need to keep updated with world-wide economic events.
- **Indian retail investors are completely side-lined**. GDRs/Foreign Institutional Investors' placements + free pricing implies that retail investors can no longer expect to make easy money on heavily discounted rights/public issues

7. What are the characteristics of GDR issues? (Category C)

- Holders of GDRs **participate in the economic benefits** of being ordinary shareholders, though **they do not have voting rights**.
- GDRs are settled through **CEDEL & Euro-clear international book entry systems**.
- GDRs are **listed** on the Luxemburg stock exchange.
- Trading takes place between **professional market makers** on an OTC (over the counter) basis.
- The instruments are freely traded.
- They are **marketed globally** without being confined to borders of any market or country as it can be traded in more than one currency.
- Investors earn **fixed income by way of dividends which are paid in issuer currency** converted into dollars by depository and paid to investors and hence exchange risk is with investor.
- As far as the case of liquidation of GDRs is concerned, an investor may get the GDR **cancelled any time after a cooling off period of 45 days**. A non-resident holder of GDRs may ask the overseas bank (depository) to redeem (cancel) the GDRs.

8. What are Euro Convertible bonds? (category B)

A convertible bond is a **debt instrument which gives the holders of the bond an option to convert the bond into a predetermined number of equity shares** of the company. Usually, the price of the equity shares at the time of conversion will have a premium element. The bonds carry a fixed rate of interest. If the issuer company desires, the issue of such bonds may carry call and put option.

1. How interest rates are determined? (Category B)

- **Supply and Demand of money:** When economic growth is high, demand for money increases, pushing the interest rates up and vice versa.
- **Inflation:** The higher the inflation rate, the more interest rates are likely to rise.
- **Government:** Government is the biggest borrower. The level of borrowing also determines the interest rates. Central bank i.e. RBI by either printing more notes or through its Open Market Operations (OMO) changes the key rates (CRR, SLR and bank rates) depending on the state of the economy or to combat inflation.

2. What are the different types of interest rate risk? (Category B)

Gap Exposure	❖ A **gap or mismatch risk** arises from holding assets and liabilities and off-balance sheet items with different principal amounts, maturity dates or re-pricing dates, thereby creating exposure to unexpected changes in the level of market interest rates. This exposure is more important in relation to banking business ❖ Positive Gap indicates that banks **have more interest Rate Sensitive Assets (RSAs)** than interest Rate Sensitive Liabilities (RSLs) ❖ Negative gap indicates that banks have more RSLs than RSAs
Basis Risk	❖ The risk that the **interest rate of different assets, liabilities and off-balance sheet items may change in different magnitude** is termed as basis risk. For example, while assets **may be benchmarked to Fixed Rate of Interest**, liabilities may be benchmarked to floating rate of interest. The degree of basis risk is **fairly high in respect of banks** that create composite assets out of composite liabilities. ❖ When the variation in market interest rate **causes the Net Interest Income (NII) to expand**, the banks have experienced **favourable basis shifts** and if the interest rate movement causes the **NII to contract**, the **basis has moved against** the banks
Embedded Option Risk	❖ **Significant changes in market interest rates** create another source of risk to banks' profitability by **encouraging prepayment of cash credit/demand loans/term loans and exercise of call/put options on bonds/debentures** and/or premature withdrawal of term deposits before their stated maturities. ❖ The **faster and higher the magnitude of changes in interest rate**, the greater will be the embedded option risk to the banks' NII.
Yield Curve Risk	❖ In a floating interest rate scenario**, banks may price their assets and liabilities based on different benchmarks**, i.e. TBs yields, fixed deposit rates, call money rates, MIBOR, etc. ❖ In case the banks use **two different instruments maturing at different time horizon** for pricing their assets and liabilities, any **non-parallel movements in yield curves would affect the NII**
Price Risk	❖ Price risk occurs when **assets are sold before their stated maturities**. In the financial market, bond prices and yields are inversely related. The price risk is closely associated with the trading book, which is created for making profit out of short-term movements in interest rates
Reinvestment Risk	❖ Uncertainty with regard to interest rate at **which the future cash flows could be reinvested is called reinvestment risk.** Any

	mismatches in cash flows would expose the banks to variations in NII as the market interest rates move in different directions
Net Interest Position Risk	❖ The size of **non-paying liabilities is one of the significant factors contributing towards profitability of banks**. Where banks have more earning assets than paying liabilities, interest rate risk arises when the market interest rates adjust downwards

3. **What are the various methods to hedge interest rate risk? (Category A)**

Traditional Methods	**Asset and Liability Management (ALM):** ❖ ALM is one of the important tools of risk management in commercial banks of India ❖ ALM is a **comprehensive and dynamic framework for measuring, monitoring and managing the market risk of a bank**. It is the management of structure of balance sheet (liabilities and assets) in such a way that the **net earnings from interest are maximized** within the overall risk preference (present and future) of the institutions. ❖ The ALM functions extend to liquidly risk management, management of market risk, trading risk management, funding and capital planning and profit planning and growth projection **Forward Rate Agreements (FRA):** ❖ Forward Rate Agreement (FRA) is an **agreement between two parties through which a borrower/ lender protects itself** from the unfavourable changes to the interest rate ❖ It is used by banks to fix interest costs on anticipated future deposits or interest revenues on variable-rate loans indexed to LIBOR ❖ It is an off-Balance Sheet instrument ❖ It does **not involve any transfer of principal**. The principal amount of the agreement is termed "notional" because, while it determines the amount of the payment, actual exchange of the principal never takes place ❖ It is settled at maturity in cash representing the profit or loss ❖ The differential amount is discounted at **post change (actual) interest rate as it is settled in the beginning of the period** not at the end
Modern Methods	**Interest Rate Futures (IRF):** ❖ An interest rate future is a contract between the buyer and seller **agreeing to the future delivery of any interest-bearing asset**. The interest rate future **allows the buyer and seller to lock** in the price of the interest-bearing asset for a future date ❖ A borrower will enter to sell a future today. Then if interest rates rise in the future, the value of the future will fall (as it is linked to the underlying asset, bond prices), and hence a profit can be made when closing out of the future (i.e. buying the future **Interest Rate Options (IRO):** ❖ Interest rate options (Interest Rate Guarantee (IRG)) is a right not an obligation and **acts as insurance by allowing businesses to protect themselves against adverse interest rate movements** while allowing them to benefit from favourable movements. ❖ It should be noted that the **IRO is basically a series of FRAs which are exercisable at predetermined bench marked interest rates on each period** say 3 months, 6 months etc. ❖ Some of the important types of Interest Rate Options are cap option, floor option and collar option

	Interest Rate Swaps (IRS): ❖ In an interest rate swap, the parties to the agreement, termed the swap counterparties, **agree to exchange payments indexed to two different interest rates**. Total payments are determined by the specified notional principal amount of the swap, which is never actually exchanged

4. What are the types of interest rate swaps? (Category B)

Plain Vanilla Swap	❖ This is also called as Generic Swap and it involves the exchange of a fixed rate loan to a floating rate loan. ❖ Floating rate basis can be LIBOR, MIBOR, Prime Lending Rate etc
Basis Rate Swap	❖ This is also called as Non-Generic Swap. Similar to plain vanilla swap with the difference payments based on the **difference between two different variable rates**. For example, one rate may be 1-month LIBOR and other may be 3-month LIBOR. ❖ Two legs of swap are floating but measured against different benchmarks
Asset Swap	❖ Like plain vanilla swaps with the difference **that it is the exchange fixed rate investments such as bonds which pay a guaranteed coupon rate with floating rate investments** such as an index
Amortising Swap	❖ An interest rate swap in which the notional principal for the interest payments declines during the life of the swap. ❖ They are particularly useful for borrowers **who have issued redeemable bonds** or debentures

5. What are swaptions and explain its types? (Category B)

- ❖ An interest rate swaption is **simply an option on an interest rate swap**. It gives the holder the right but not the obligation to enter into an interest rate swap at a specific date in the future, at a particular fixed rate and for a specified term
- ❖ Following are the two types of swaption contracts:
  - o A **fixed rate payer swaption** gives the owner of the swaption the right but not the obligation to enter into a swap where they pay the fixed leg and receive the floating leg
  - o A **fixed rate receiver swaption** gives the owner of the swaption the right but not the obligation to enter into a swap in which they will receive the fixed leg, and pay the floating leg
- ❖ Following are the uses of swaptions:
  - o Swaptions can be applied in a variety of ways for both **active traders as well as for corporate treasurers**
  - o Swap traders can use them for **speculation purposes** or to hedge a portion of their swap books.
  - o Swaptions have become useful tools for **hedging embedded optionality** which is common to the natural course of many businesses.
  - o Swaptions are useful to **borrowers targeting an acceptable borrowing rate**.
  - o Swaptions are also useful to those **businesses tendering for contracts**.
  - o Swaptions also provide **protection on callable/puttable bond issues**

1. **What are the steps in Valuation of unlisted companies? (Category B)**

Step 1	❖ **Take the industry beta:** The beta of similar listed companies would be good starting point. As stated above, the levered beta should be converted into unlevered to remove the impact of debt ❖ Unlevered beta = Beta/(1 + (1-tax rate) x (debt/equity))
Step 2	❖ You need to be acutely aware that unlike listed companies, the financial statements of privately held firms **may be having some gaps in accounting policies and accounting estimates**, that would be needed to be adjusted to determine the correct earnings estimate
Step 3	❖ Find out the Cost of equity using the CAPM technique
Step 4	❖ Compute the WACC for the company by assuming a target debt-equity mix and considering the after-tax cost of debt
Step 5	❖ Since this is a private company, **the owners will demand a return towards 'goodwill'**. However, in some cases, the acquisition price may include sweeteners for the erstwhile owners to continue in the merged firm, which will then dispense off the need to perform this step
Step 6	❖ Future cash flows of the private company will be treated (discounted) using the WACC rate obtained above as the discount factor
Step 7	❖ The sum of the PV of the cashflows generated by the DCF will be the value of the firm

2. **Explain the relative valuation method (Category A)**

❖ Relative Valuation is the method to arrive at a **'relative' value using a 'comparative' analysis to its peers or similar enterprises**. However, increasingly the contemporary financial analysts are using relative valuation in conjunction to the afore-stated approaches to validate the intrinsic value arrived earlier

❖ The Relative valuation, **also referred to as 'Valuation by multiples,'** uses financial ratios to derive at the desired metric (referred to as the 'multiple') and **then compares the same to that of comparable firms**. (Comparable firms would mean the ones having similar asset and risk dispositions, and assumed to continue to do so over the comparison period

❖ Following are the steps in relative valuation method:
   - Find out the 'drivers' that will be the best representative for deriving at the multiple
   - Determine the results based on the chosen driver(s) thru financial ratios
   - Find out the comparable firms, and perform the comparative analysis, and
   - Iterate the value of the firm obtained to smoothen out the deviations

1. What is the rationale for Mergers and Acquisitions? (Category B)

- **Synergistic operating economics:** Synergy May be defined as V (AB) >V(A) + V (B). In other words, the **combined value of two firms or companies** shall be more than their individual value. Synergy is the **increase in performance of the combined firm** over what the two firms are already expected or required to accomplish as independent firms. Economics of scale is one of the reasons for synergy benefits
- **Diversification:** In case of merger between two unrelated companies would lead to reduction in business risk, which in turn will increase the market value consequent upon the reduction in discount rate/ required rate of return
- **Taxation:** The provisions of set off and carry forward of losses as per Income Tax Act may be another strong season for the merger and acquisition. Thus, there will be **Tax saving or reduction in tax liability** of the merged firm
- **Growth:** Merger and acquisition mode enables the firm to grow at a rate faster than the other mode viz., organic growth. The reason being the shortening of 'Time to Market'
- **Consolidation of Production Capacities and increasing market power:** Due to reduced competition, marketing power increases. Further, production capacity is increased by combined of two or more plants

2. What are the various forms(types) of mergers? (Category B)

Horizontal Merger	The two companies which have merged are in the **same industry**, normally the market share of the new consolidated company would be larger and it is possible that it **may move closer to being a monopoly or a near monopoly** to avoid competition
Vertical Merger	This merger happens when two companies that have 'buyer-seller' relationship (or potential buyer-seller relationship) come together
Conglomerate Mergers	Such mergers **involve firms engaged in unrelated type of business operations**. In other words, the business activities of acquirer and the target are **neither related to each other horizontally** (i.e., producing the same or competing products) **nor vertically** (having relationship of buyer and supplier)
Congeneric Mergers	In these mergers, **the acquirer and the target companies are related through basic technologies, production processes or markets**. The acquired company represents an extension of product-line, market participants or technologies of the acquirer
Reverse Merger	Such mergers involve acquisition of a public (Shell Company) by a private company, as it helps private company to **by-pass lengthy and complex process required to be followed in case it is interested in going public**
Acquisition	This refers to the **purchase of controlling interest** by one company in the share capital of an existing company

3. What are the various Take over strategies? (Category B)

When the process of acquisition is unfriendly it is called as takeover. Following are the various takeover strategies:

- **Street Sweep:** This refers to the technique where the acquiring company **accumulates larger number of shares in a target before making an open offer**. The advantage is that the target company is left with no choice but to agree to the proposal of acquirer for takeover.
- **Bear Hug:** When the acquirer threatens the target company to make an open offer, the **board of target company agrees to a settlement with the acquirer** for change of control.

- **Strategic Alliance:** This involves **disarming the acquirer by offering a partnership rather than a buyout**. The acquirer should assert control from within and takeover the target company.
- **Brand Power:** This refers to entering into an **alliance with powerful brands** to displace the target's brands and as a result, buyout the weakened company.

4. What are the various techniques to protect from hostile takeover? (Category C)

- **Divestiture:** In a divestiture the **target company divests or spins off** some of its businesses in the form of an independent, subsidiary company. Thus, reducing the attractiveness of the existing business to the acquirer.
- **Crown jewels:** When a target company uses the tactic of divestiture **it is said to sell the crown jewels**. In some countries such as the UK, such tactic is not allowed once the deal becomes known and is unavoidable.
- **Poison pill:** Sometimes an acquiring company itself becomes a target when it is bidding for another company. **The tactics used by the acquiring company to make itself unattractive to a potential bidder is called poison pills**.
- **Poison Put:** In this case the **target company issue bonds that encourage holder to cash in at higher prices**. The resultant cash drainage would make the target unattractive.
- **Greenmail:** Greenmail refers to an **incentive offered by management of the target company to the potential bidder for not pursuing the takeover**. The management of the target company may offer the acquirer for its shares a price higher than the market price.
- **White knight:** In this a target company offers **to be acquired by a friendly company to escape from a hostile takeover**. The possible motive for the management of the target company to do so is not to lose the management of the company.
- **White squire:** This strategy is essentially the same as white knight and involves sell out of shares to a company **that is not interested in the takeover**. As a consequence, the management of the target company retains its control over the company.
- **Golden parachutes:** When a company offers **hefty compensations to its managers** if they get ousted due to takeover, the company is said to offer golden parachutes. This reduces their resistance to takeover.
- **Pac-man defence:** This strategy aims at the target company **making a counter bid for the acquirer company.** This would force the acquirer to defend itself and consequently may call off its proposal for takeover.

5. Write short note on reverse merger? (Category A)

In a 'reverse takeover', a **smaller company gains control of a larger one**. This type of merger is also known as **'back door listing.** The concept of takeover by reverse bid, or of reverse merger, is thus not the usual case of amalgamation of a sick unit which is non-viable with a healthy or prosperous unit but is a case whereby the entire undertaking of the healthy and prosperous company is to be merged and vested in the sick company which is non-viable. Following are the three tests for reverse merger:

- the assets of the **transferor company are greater than the transferee company**,
- equity capital to be issued by the transferee company pursuant to the acquisition **exceeds its original issued capital**, and
- **the change of control** in the transferee company through the introduction of a minority holder or group of holders.

6. What is divestiture and the various reasons for the same? (Category B)

It means a **company selling one of the portions of its divisions or undertakings** to another company or creating an altogether separate company. There are various reasons for divestment or demerger viz.,

- To pay attention on **core areas** of business;
- The Division's/business **may not be sufficiently contributing** to the revenues;
- The size of the firm may be **too big to handle**;
- The firm may be **requiring cash urgently** in view of other investment opportunities.

7. What are the various forms of divestiture or demerger? (Category A)

Sell off/Partial Sell off	A sell off is the **sale of an asset, factory, division, product line** or subsidiary by one entity to another for a purchase consideration payable either in cash or in the form of securities. Partial Sell off, is a form of divestiture, wherein the firm **sells its business unit or a subsidiary to another because it deemed to be unfit with the company's core** business strategy
Spin-off	Part of the business is **separated and created as a separate firm**. The existing shareholders of the firm get **proportionate ownership**. So, there is no change in ownership and the **same shareholders continue to own the newly created entity** in the same proportion as previously in the original firm. The **management of spun-off division is however, parted with**. Spin-off does not bring fresh cash
Split-up	This involves **breaking up of the entire firm into a series of spin off** (by creating separate legal entities). The parent firm **no longer legally exists** and only the newly created entities survive. For instance, a corporate firm has **4 divisions namely A, B, C, D. All these 4 division shall be split-up to create 4 new corporate firms** with full autonomy and legal status.
Equity Carve Outs	This is like spin off, **however, some shares of the new company are sold in the market by making a public offer**, so this brings cash. More and more companies are using equity carve-outs to boost shareholder value.
Sale of a division	The **seller company is demerging its business whereas the buyer company is acquiring a business**.
Demerger or Division of family-managed business	The family-owned companies are, **under extraordinary pressure to yield control to professional managements**, as, in the emerging scenario of a liberalised economy the capital markets are broadening, with attendant incentives for growth. So, **many of these companies are arranging to hive off their unprofitable businesses or divisions** with a view to meeting a variety of succession problems

8. What are the various ways of doing ownership restructuring? (Category A)

Going Private	This refers to the situation wherein a **listed company is converted into a private company** by buying back all the outstanding shares from the markets.
Management Buyout (MBO)	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

Equity Buyback	This refers to the situation wherein a company **buys back its own shares back from the market**. This results in reduction in the equity capital of the company. This strengthen the promoter's position by increasing his stake in the equity of the company

9. **What are the various steps in successful M&A Programme and what are the reasons for failure of M&A? (Category C)**

There are five principal steps in a successful M & A programme namely

- Manage the pre-acquisition phase.
- Screen candidates.
- Eliminate those who do not meet the criteria and value the rest.
- Negotiate.
- Post-merger integration

Following are some of the reasons for failure of M&A:

- Acquirers generally overpay;
- The value of synergy is over-estimated;
- Poor post-merger integration; and
- Psychological barriers.

10. **What are Cross border Mergers & Acquisitions and what are the reasons for the same? (Category C)?**

- Cross-border M&A is a popular route for global growth and overseas expansion. This refers to a scenario where the target company and acquiring company are based out of different countries
- Factors contributing to cross border M&A are:
  - **Globalization of production** and distribution of products and services
  - **Integration** of global economies.
  - **Expansion of trade** and investment relationships on International level
  - Many countries are **reforming their economic and legal systems**, and providing generous investment and tax incentives to attract foreign investment
  - **Privatisation of state-owned enterprises** and consolidation of the banking industry

1. Explain International Financial Centre? (Category A)

- IFC is a hub that deals with **flow of funds, financial products and financial services in their own land but with different set of regulation and laws.**
- It caters the needs of **the customer outside their own jurisdiction**.
- It Provides flexibility in currency trading, Banking and other financial services.

2. What are the benefits of Establishing IFC? (Category B)

- **Opportunity for qualified professionals** working **outside India** come here and practice their profession.
- A platform for qualified and talented professionals to **pursue global opportunities without leaving their homeland**.
- Stops Brain Drain 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 complicated financial derivative** can be started from India.

3. What are the constituents of IFC? (Category C)

Highly Developed Infrastructure	❖ It is a prerequisite for **creating a platform** to offer internationally completive financial services
Stable Political Environment	❖ It is also a perquisite to **accelerate foreign participation in growth of Financial centre**, Destabilised Political Environment brings country risk Investment by foreign nationals.
Strategic Location	❖ The location of the centre should be strategic. E.g Near to airport, Seaport and Friendly weather.
Quality Life	❖ The quality of life at the center showed be good as **center retains highly paid professional** from own country as well from outside.
Rationale Regulatory framework	❖ IFC should **be fair and transparent**
Sustainable Economy	❖ The economy should be sustainable and should possess **capacity to absorb all the shocks** as it will boost investors confidence.

4. How Islamic Finance is different from Conventional Finance? (Category A)

Basis	**Islamic Finance**	**Conventional Finance**
Promotion	❖ Islamic Finance promotes just, fair and balanced society. Hence, **interest is prohibited**.	❖ Based on commercial objectives and interest must be paid irrespective of outcome of business.
Ethical framework	❖ Structured on **ethical and moral framework of Sharia**. Verses from the holy Quran and tradition from As-Sunnah are two divine guidance.	❖ No such framework.
Speculation	❖ The financial **transactions** should be **free** from the elementof **uncertainty** (Gharar) and **gambling** (Maisir)	❖ No such restrictions.

Unlawful Goods and Services	❖ Islamic Finance must **not be involved** in any transactions not involve **trade not allowed as per Islamic principles** such as alcohol, armaments, pork and other socially detrimental products.	❖ There are no such restrictions

5. Explain the Concept of Riba? (Category A)

❖ In Islamic Finance, Riba means **interest** or usury. Money is considered as medium of exchange, store of value or unit of measurement only, hence Riba is considered haram i.e**. unfair reward to the provider of capital for little or no effort or risk undertaken.**

❖ Riba is equated with **wrongful appropriation of property belonging to others** and hence depositors are asked to accept principal only and forego principal even, if borrower is unable to repay the same.

6. What are all the Islamic Financial Instruments? (Category A)

Mudaraba	❖ One party provides **100% Capital** and the other party provides **Specialised Knowledge** and entrusted with exclusive responsibility of working. ❖ Profit and Loss is shared among Pre-decided Ratio
Musharaka	❖ It is a kind of joint business venture wherein **all parties** provide the **capital** in the business in **agreed ratio** and also have right to participate in the business. ❖ Profit is shared in Pre-decided ration and the Loss is shared in their Capital Contribution
Sukuk	❖ It is a kind of '**Debt Certificate**' representing ownership in business or assets and through this instrument **company borrows the money it appears to be conventional debt instruments** but is differs in following aspects: • To have share in profit of assets. • To have share in the underlying assets on realization of assets.
Ijara	❖ It is a kind of lease financing arrangement wherein **one party transfer the asset to other partly for some specific time** for specific fee which includes capital cost of assets and profit margin of the lessor the responsibility for maintenance of the leased items remains with the lessor.
Murabaha	❖ It is a **cost plus contract** it is a kind of **trade credit or loans** and mainly helps exporters and importer in meeting their funding requirements. ❖ The main feature of this arrangement is that **profit margin of the financier** is known to the buyer. ❖ In this arrangement financier buys the assets and sells to the client (buyer) and buyer pays to the financier in installments consisting of two elements (Cost of asset financed and Financiers profit on acquisition of asset)
Istisna	❖ It is a kind of funding arrangements **for long term construction contracts** wherein client pays some initial amount and balance amount is payable is repaid in installments. The whole project is funded by the financer and completion of project it is delivered to the client.
Salam	❖ It is analogues to forward contract in the conventional finance. ❖ Sale is based on **Cash-on delivery**

	❖ This sale shall be at the **discounted price** so that financer could make some profit out of the deal ❖ It is prohibited in commodoties such as Gold, Silver and other type of Monetary Assets.

1. **What is a Startup to avail Government Schemes? (Category A)**

- Incorporated as either a Private Limited Company or a Registered Partnership Firm or a Limited Liability Partnership in India **not prior to 5 years**
- **Turnover** for any fiscal year has not exceeded INR **25 crore**
- Entity should not have been formed by splitting up or reconstruction a business already in Existence
- Working towards **innovation, development, deployment or commercialization of new product, processes or services driven by technology or intellectual property**

2. **Explain some of the Sources for funding a start-up? (Category B)**

Personal Financing	It is important because most of the investors will not put money into a deal if **they see that the entrepreneurs have not contributed from their personal Source**
Personal Credit Lines	It is based on **one's Personal credit efforts**, Bank will provide this facility only when the business has enough cash flows to repay the line of credit. **E.g. Credit Cards**
Family and Friends	These people will generally fund, without even thinking whether the idea works or not, However, the **loan obligations** to friends and relatives should always be in writing as a **promissory note or otherwise.**
Peer-to-Peer Lending	In this 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 endeavours.
Crowd Funding	It uses **small amounts of capital from a large number of Individuals**, It makes use of the easy accessibility of vast networks of people through social media and crowdfunding websites to bring investors and entrepreneurs together.
Micro loans	A **small Loan given by Single individual or aggregated** at a lower Interest.
Vendor Financing	In this a **company lends money to its customers** so that they can buy products from the manufacturers. E.g. Extending credit period from 30 days to 45 days
Purchase order financing	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
Factoring Account receivables	**A facility is given to the seller who has sold the good on credit to fund his receivables till the amount is fully received**

3. **What do you Mean by Pitch Presentation in context of Start-up Business? And Explain the methods to approach a pitch presentation? (Category B)**

- Pitch deck presentation is a **short and brief presentation** (<20Min) to investors explaining about the **prospects of the company** and why they should invest into the startup business.
- Pitch presentation can be made either during face to face meetings or online meetings with potential investors, customers, partners, and co-founders.

Introduction

- First step is to give a **short introduction**.It should be Short and Sweet
- One can use this opportunity to get the interest of investors

Team

- Next step is to introduce the team members
- Because the investors will want to know the people who are going to make the product or service Successfull

Problem

- The promoter should be able to **explain the problem he is going to solve and Solutions emerging from it**
- The investors should be convinced that the newly introduced product will solve the Problem.

Solution

- It is very important to **describe as to how the company is planning to solve theproblem.**
- E.g.: Flipkart Started its business in 2007, it brought e-commerce in India, they Introduced Cash on Delivery Basis .

Marketing

- The investors are deeply interested in marketing, so the Investor has to **communicate the Market size of the product and the target Customers**.

Projections

- Projected financial statements can be prepared which gives an organisation a breif idea about **where is the business heading** ? whether the business will be making Profit or Loss
- Financial Prjections includes Income Statement,CFS and Balance Sheet

Competition

- Every Business organisation has competition even if the product or service is new and unique.
- It is necessary to **highlight, how the product or service are different from their competitors**

Business Model

- The term business model is a wide term denoting core aspects of a business includingpurpose, business process, target customers, offerings, strategies, infrastructure, organizationalstructures, sourcing, trading practices, and operational processes and policies including culture.
- Is also beneficial to discuss the lifetime value of the customer and what should be the strategyto keep him glued to their product.

Financing

- If a startup business firm has raised money,it is preferable to talkabout how much money has already been raised, who invested money into the business and what they did about it
- .If no money has been raised till date, an explanation can be made regarding how much work has been accomplished with the help of minimum funding that the company is managed to raise.

4. What are the modes of Financing for Startups? (Category B)

Bootstrapping	❖ An individual is said to be boot strapping **<u>when he or she attempts to found and build a company from personal finances</u>** or from the operating revenues of the new company ❖ On the other hand, investment by startups from their own savings leads to cautious approach.
Angel Investor	❖ Angel investors invest in small startups or entrepreneurs, they are among an entrepreneur's family and friends. ❖ The capital angel investors provide may be a **<u>one-time investment to help the business propel or an ongoing injection of money to support and carry the company</u>** through its difficult early stages. ❖ Angel investors are also called informal investors, angel funders, private investors, seed investors or business angels. ❖ Some angel investors invest through crowdfunding platforms online or build angel investor networks to pool in capital.
Venture Capital Funds	❖ Venture capital is money provided by **<u>professionals who alongside management invest in young</u>**, rapidly growing companies that have the potential to develop into significant economic contributors.

5. Explain Venture capital Financing and their Characteristics? (category A)

❖ Venture capital means funds made available for startup firms and small businesses with **<u>exceptional growth potential</u>**.

❖ Venture capital is **<u>money provided by professionals who alongside management invest in young</u>**, rapidly growing companies that have the potential to develop into significant economic contributors.

❖ Venture Capitalists generally:

- Finance **<u>new and rapidly</u>** growing companies
- Purchase **<u>equity</u>** securities
- Assist in the development **<u>of new products or services</u>**
- **<u>Add value</u>** to the company through active participation.

<u>Characteristics of Venture capital Financing :</u>

Long time Horizon	❖ The fund will invest **minimum** period of investment of **3** years and the **maximum** period can be **10** years
Lack of Liquidity	❖ It assumes that there would be less liquidity on the equity it gets and accordingly it would be investing in that format.
High Risk	❖ It works on principle of **high risk and high return**. So, high risk would not eliminate the investment choice for a venture capital.
Equity participation	❖ VC would be investing in the form of equity of a company, it helps to **participate in the management and help the company grow.**

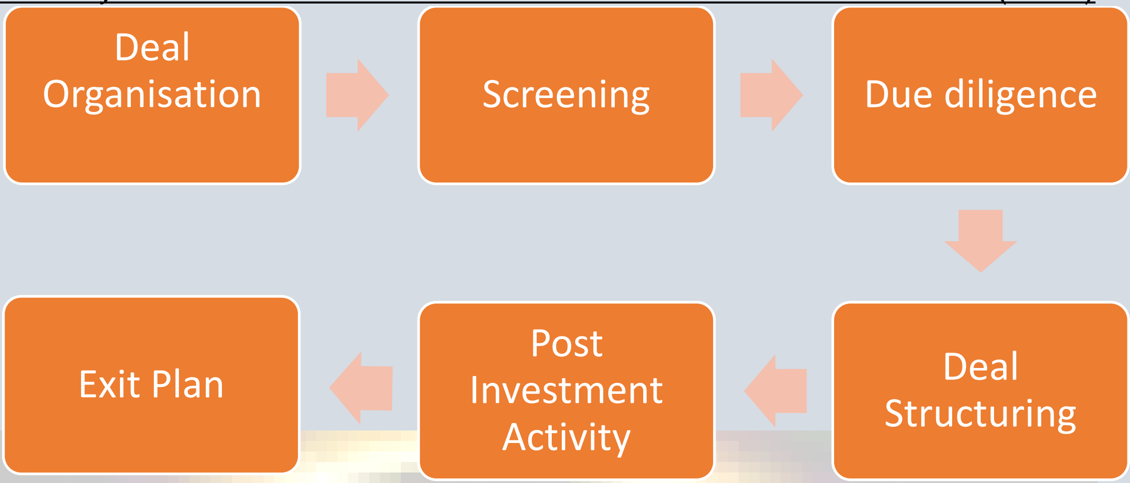
6. **What are all the advantages of Bringing Venture Capital (VC) in the company? (Category B)**

- ❖ It injects **long- term equity finance** which provides a solid capital base for future growth.
- ❖ The venture capitalist is a business partner, **sharing both the risks and rewards**. Venture capitalists are rewarded with business success and capital gain.
- ❖ 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.
- ❖ The venture capitalist also has a **network of contacts** in many areas that can add value to the company.
- ❖ The venture capitalist may be capable of **providing additional rounds of funding** should it be required to finance growth.
- ❖ 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 (National Association of Securities Dealers Automated Quotations)
- ❖ They can also facilitate a **trade sale**.

7. **What are the stages of funding VC? (Category C)**

Financial stage	Periods (Lock-in Period)	Risk Perception	Activity to be financed
Seed Money	7-10	Extreme	For supporting a concept or idea or R&D for product Development
Start up	5-9	Very high	Initializing prototypes operations or developing
First stage	3-7	High	Start commercials marketing production
Second stage	3-5	Sufficiently high	Expand market and growing working capital need
Third stage	1-3	Medium	Expand market and growing working capital need
Fourth Stage	1-3	Low	Facilitating Public Issue

8. **Explain Venture capital Investment Process? (Category C)**



Deal Organisation:

- ❖ VC operates Directly or through intermediaries,
- ❖ Before sourcing the deal, the VC would inform the intermediary or its employees about the following so that the sourcing entity does not waste time :
  - o Sector focus
  - o Stages of business focus
  - o Promoter focus
  - o Turn over focus

Screening:

- ❖ The screening is generally carried out by a **committee** consisting of senior level people of the VC. Once the screening happens, it would select the **company for further processing**. The decision would take place based on the information provided by the company.

Due Diligence:

- ❖ This is mainly the process by which the VC would try to **verify the veracity of the documents taken.** This is generally handled by external bodies, mainly renowned consultants.

Deal Structuring:

- ❖ The deal is structured in such a way that **both parties win**. In many cases, the **convertible structure** is brought in to ensure that the promoter retains the right to buy back the share.
- ❖ Besides, in many structures to facilitate the exit, the VC may put a condition that promoter has also to sell part of its stake along with the VC. Such a clause is called tag-along clause.

Post Investment Activity:

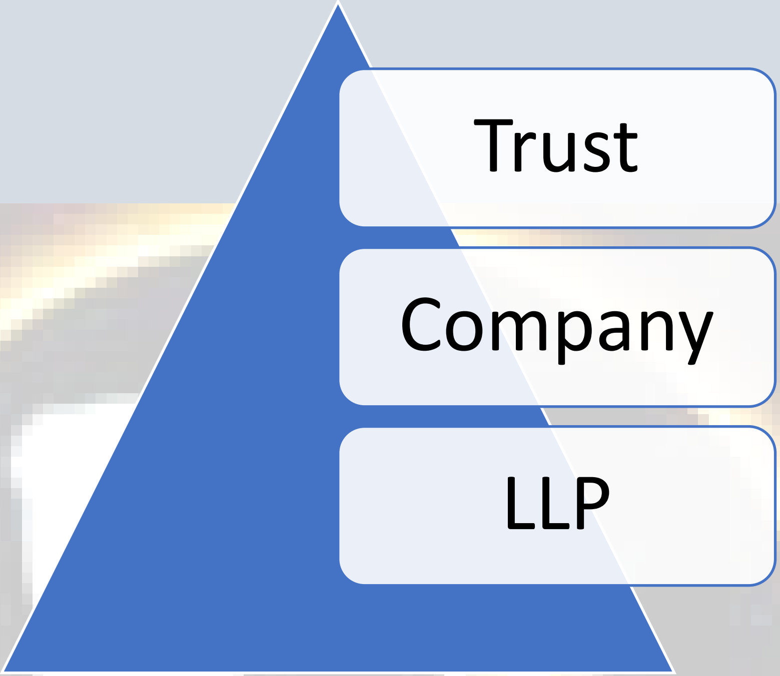
- ❖ The VC nominates its nominee in the board of the company. The company has to adhere to certain guidelines like strong MIS, strong budgeting system, strong corporate governance and other covenants of the VC and periodically keep the VC updated about certain mile-stones.

Exit Plan:

- ❖ The VC nominates its nominee in the board of the company. The company has to **adhere to certain guidelines like strong MIS, strong budgeting system, strong corporate governance** and other covenants of the VC and periodically keep the VC updated about certain mile-stones.

- Exit happens in two ways: one way is'**sell to third party(ies)**'. This sale can be in the form of IPO or Private Placement to other VCs. 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%)

9. **Explain the structure of Venture Capital Fund in India? (Category A)**



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

Domestic funds	❖ It is usually structured as a o Domestic vehicle for the pooling of funds from the investor and o a separate Investment adviser that carries those duties for asset manager. ❖ The choice of entity for the pooling vehicle falls between a trust and a company, with the trust form prevailing due to its operational flexibility
Offshore Funds	**Offshore Structure:** ❖ Under this structure, an **investment vehicle** (an **LLC** or an LP organized in a jurisdiction outside India) 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:** ❖ **Overseas investors pool their assets in an offshore vehicle that invests in a locally managed trust**, whereas domestic investors directly contribute to the trust.

10. **Explain some of the methods in which a Startup Firm can bootstrap? (category C)**

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 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**.
Factoring	❖ This is a financing method where **accounts receivable** of a business organization is sold to a commercial finance company to raise capital. ❖ Factoring can be performed on a **non-notification** basis. It means customers may not be told that their accounts have been sold. ❖ It can actually **reduce costs** associated with maintaining accounts receivable such as bookkeeping, collections and credit verifications ❖ **Factoring can be a very useful tool for raising money and keeping cash flowing**.
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 a 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.

1. **Define Micro, Small and Medium Enterprises under MSMED Act (Category A)**

The MSMED Act, 2006, defines the Micro, Small and Medium Enterprises based on the

- Investment in **Plant and Machinery** for those engaged in manufacturing or production, processing or preservation of Goods, and on the
- Investment in **Equipment for enterprises** engaged in providing or rendering of Services

Manufacturing and service Sector

Enterprises	Investment in Plant & Machinery (Manufacturing Sector)	Investment in Equipment (Service Sector)
Micro	Does not exceed Rs.25 Lakh	Does not exceed Rs.10 Lakh
Small	Rs.25 Lakh – Rs 5 Crore	Rs.10 Lakh – Rs 5 Crore
Medium	Rs.5 Crore – Rs.10 Crore	Rs.5 Crore – Rs.10 Crore

2. **How MSMED Act is Facilating the Micro,Small and Medium Enterprises ? (Category C)**

Micro, Small and Medium Enterprises Development (MSMED) Act, 2006, is provided for facilitating the **promotion and development and enhancing the competitiveness** of micro, small and medium enterprises (MSME) and for matters connected therewith or incidental thereto, emphasized on the following:

- Remove **impediments** due to multiple laws
- Introduce **statutory consultative** and recommendatory bodies in MSME policies
- **Statutory registration** procedures of MSMEs
- Statutory basis for **purchase preference** and credit policies
- **Improve realization** of payments of MSMEs

3. **How do MSME get Finance? Which Bank Lend Loans to MSME ? (Category C)**

Financial assistance in India for MSME units is available from a variety of institutions. The important ones are:

- Commercial/Regional Rural/Co-operative Banks.
- **SIDBI:** Small Industries Development Bank of India (refinance and direct lending)
- **SFCs/SIDCs:** State Financial Corporations (e.g. Delhi Financial Corporation)/State Industrial Development Corporations.

Purpose for which loans are received:

Type of loan	Purpose	Lending institution
Long- and medium-term loan	Fund purchase of land, construction of factory building/shed and for purchase of machinery and equipment.	SFC, SIDBI, SIDC, Banks
Short term loan	**Working capital requirements**, which fund the purchase of raw materials and consumables, payment of wages and other immediate manufacturing and administrative expenses	Commercial Banks

4. **What are all the documents required for Applying Loan? (Category C)**

The details of documentation that need to be provided with the loan application are indicated below:

- **Balance Sheet and Profit Loss Statement** for last three consecutive years of firms owned by Promoters
- Income Tax Assessment Certificates of Partners/Directors
- Proof of Possession of Land/Building
- Architect's estimate for construction cost
- Partnership deed/Memorandum and Articles of Associations of Company
- Project Report
- Budgetary Quotations of Plant and Machinery

5. How World Bank is Supporting SME? (Category B)

Small and Medium Enterprises (SME) play a major part in most economies in terms of employment generation. However, they are less likely to secure bank loans than large firms. World bank aims to improve SMEs access to **finance and find innovative solutions** to unlock sources of capital.

Advisory Support for Financial Sector Infrastructure:

- **Credit Reporting Systems** are important as better credit information can lead to increased credit for SMEs.
- **Secured Transaction Registries** ensure that SMEs can provide moveable collateral as the basis for more lending.
- **Modernized Insolvency Regimes** can help restructure viable businesses while also promoting the efficient and effective "exit" of those firms that are not economically efficient.
- **Streamlining of Payments Systems** supports the more efficient movement of money throughout the economy, including G2B, B2B, remittances and other payments.

The World Bank can help establish the **legal and institutional framework for strong financial infrastructure systems**.

Lending Operations and Policy Work:

- SME Lines of Credit provide **dedicated bank financing** – frequently for longer tenors than are generally available in the market – to support SMEs for investment, growth, export and diversification.
- **Partial Credit Guarantee Schemes (PCGs)** – the design of PCGs is crucial to SMEs' success, and support can be provided to design and capitalize such facilities.
- Early Stage Innovation Finance provides equity and debt/quasi-debt to start up or high growth firms which may otherwise not be able to access bank financing.
- **Policy work, analytical work, and other Advisory Services** can also be provided in support of SME finance activities.

6. What are all the schemes implemented for MSME? (Category C)

Plan Scheme 'Training and Manpower Development'	❖ Participation in the International Exhibitions/ Fairs. ❖ Training Programmes on Packaging for Exports ❖ Marketing Development Assistance Scheme for MSME exporters (MSME-MDA) ❖ National Award for Quality Products.
Export Promotion from the small-scale sector has been accorded a high priority in the India's export promotion strategy	❖ **Participation in the International Exhibitions/Fair**: It is purely **promotional scheme to give exposure to the products of micro, small enterprises** which otherwise are not in a position to participate in the exhibitions/ fairs at their own cost. Under the scheme, exhibits of the selected export-worthy units are displayed in the exhibition that provides an opportunity to MSEs in

	demonstrating their capabilities before the international community. ❖ **Training Programmes on Packaging for Exports:** The main objective of scheme is to **<u>generate much needed consciousness in the industry</u>** about the packaging problems of MSME exporters and to educate the entrepreneurs about the latest packaging techniques and designs of the packaging. ❖ **Market Development Assistance Scheme for MSME exporters (MSME-MDA):** This scheme has been introduced With a view **<u>to increase participation of representatives of participating units</u>** ❖ **National Award for Quality Products** - The objectives of the scheme are as follows: ➢ To encourage **<u>small scale industries to produce quality products</u>** conforming to national and international standards. ➢ To propagate a **<u>culture of quality consciousness</u>** amongst a vast section of Small Scale manufacturing units. ➢ To install a **<u>sense of confidence</u>** of small industry products in the minds of the domestic consumers and to enhance the image of Indian products in export market.

7. What are all the Benefits available for MSME under MSME Act? (Category A)

❖ It enables **<u>reservation of certain items</u>** for exclusive manufacture of MSME enterprises. It helps them to **<u>protect their interest</u>**.
❖ This policy helps in **<u>generating employment</u>** for the people and consequently, enhances the standard of living of people.
❖ To **<u>encourage the small scale units</u>**, SEZs are required to allocate 10% space for small scale units.
❖ Under the MSME act, protections are offered in relation to **<u>timely payment by buyers</u>** to MSME's.
❖ Assistance is also available in **<u>obtaining finance; help in marketing; technical guidance; training and technology upgradation,</u>** etc.
❖ Further, an enterprise, whose post-issue face value does not exceed Rs. 25,00,00,000(Rupees Twenty Five Crores only), is entitled to obtain certain exemptions from the eligibility requirements under the ICDR(Issue of Capital and Disclosure Requirements) Regulation.

8. What is the Criteria for Listing in SME? (Category A)

Incorporation	The Company shall be incorporated under the Companies Act, 2013.
Financials	❖ **<u>Post Issue Paid up Capital:</u>** The post-issue paid up capital of the company shall be at least **Rs. 3 crores**. ❖ **<u>Net worth:</u>** Net worth (excluding revaluation reserves) of at least **Rs.3 crore** as per the latest audited financial results. ❖ **<u>Net Tangible Assets</u>** At least **Rs.3 crore** as per the latest audited financial results. ❖ **<u>Track Record:</u>** Distributable profits in terms of Section 123 of the Companies Act 2013 for at least two years out of immediately preceding three financial years (each financial year has to be a period of at least 12 months). Extraordinary income will not be considered for the purpose of calculating

	distributable profits. Or, the net worth shall be at least Rs.5 crores.
Other Requirements	❖ It is mandatory for a company to have a website. ❖ It is mandatory for the company to facilitate trading in demat securities and enter into an agreement with both the depositories.
Disclosures	A certificate from the applicant company / promoting companies stating the following: ❖ "The Company has not been referred to the Board for Industrial and Financial Reconstruction(BIFR)." Note: Cases where company is out of BIFR is allowed. ❖ There is no winding up petition against the company, which has been admitted by the court or a liquidator has not been appointed.

9. Describe the guidelines for SME Listing and its benefits? (Category A)

Guidelines for SME Listing	(i) **Capital**: The post issue face value capital should not exceed **Rs.Twenty-five crores**. (ii) **Trading lot size** ❖ The minimum application and trading lot size shall not be less than Rs 1,00,000/-. ❖ The minimum depth shall be Rs.1,00,000/- and at any point of time it shall not be less than Rs.1,00,000/-. ❖ The investors holding with less than Rs.1,00,000/- shall be allowed to offer their holding to the Market Maker in one lot. ❖ However in functionality the market lot will be subject to revival after a stipulated time. **(iii) Participants:** The existing Members of the Exchange shall be eligible to participate in SME Platform. **(iv) Underwriting:** The issues shall be 100% underwritten and Merchant Bankers shall underwrite 15% in their own account.
Benefits of Listing in SME	❖ **Easy access to Capital**: BSE SME provides an avenue to raise **capital through equity** infusion for growth oriented SME's. ❖ **Enhanced Visibility and Prestige**: The SMEs benefit by greater **credibility** and **enhanced financial status** leading to demand in the company's shares and higher valuation of the company. ❖ **Encourages Growth of SMEs**: Equity financing provides growth opportunities like **expansion, mergers and acquisitions** thus being a cost effective and tax efficient mode. ❖ **Ensures Tax Benefits:** In case of listed securities Short Term Gains Tax is 15% and there is absolutely no Long Term Capital Gains Tax. ❖ **Enables Liquidity for Shareholders:** Equity financing enables liquidity for shareholders provides growth opportunities like expansion, mergers and acquisitions, thus being a cost effective and tax efficient mode. ❖ **Equity financing through Venture Capital:** Provides an incentive for Venture Capital Funds by creating **an Exit Route and thus reducing their lock in period**.

	❖ **Efficient Risk Distribution:** Capital Markets ensure that the capital flows to its best uses and those riskier activities with higher payoffs are funded. ❖ **Employee Incentives:** Employee Stock Options ensures stronger employee commitment, participation and recruitment incentive.

10. **What is the status of lending by banks to MSME sector? (Category C)**

❖ Bank's lending to the Micro and Small enterprises engaged in the manufacture or production of goods specified in the first schedule to the Industries (Development and regulation) Act, 1951 and notified by the Government from time to time is reckoned **for priority sector advances**.

❖ However, **bank loans up to Rs.5 crore per borrower / unit to Micro and Small Enterprises engaged in providing or rendering of services** and defined in terms of investment in equipment under MSMED Act, 2006 are eligible to be reckoned for priority sector advances. Lending to Medium enterprises is not eligible to be included for the purpose of computation of priority sector lending.

11. What is meant by Priority Sector Lending? (Category A)

❖ Priority sector lending include only those sectors, as part of the priority sector that **impact large sections** of the population, the weaker sections and the sectors which are **employment-intensive** such as **agriculture**, and Micro and Small enterprises.

12. Are there any targets prescribed for lending by banks to MSMEs? (Category C)

❖ As per extant policy, certain targets have been prescribed for banks for lending to the Micro and Small enterprise (MSE) sector.

❖ In terms of the recommendations of the Prime Minister's Task Force on MSMEs banks have been advised to achieve **a 20 per cent year-on-year growth in credit** to micro and small enterprises, a 10 per cent annual growth in the number of micro enterprise accounts and **60% of total lending to MSE** sector as on preceding March 31st to Micro enterprises.

❖ In order to ensure that sufficient credit is available to micro enterprises within the MSE sector, banks should ensure that

40 Percent of the total advances to MSE sector should go to

- Micro (manufacturing) enterprises having investment in plant and machinery up to Rs. 10 lakh and
- Micro (service) enterprises having investment in equipment up to Rs. 4 lakh ;

20 per cent of the total advances to MSE sector should go to

- Micro (manufacturing) enterprises with investment in plant and machinery above Rs. 10 lakh and up to Rs. 25 lakh, and
- Micro (service) enterprises with investment in equipment above Rs. 4 lakh and up to Rs. 10 lakh.

Thus, 60 per cent of MSE advances should go to the micro enterprises.

13. Are there specialized bank branches for lending to the MSMEs? (Category C)

❖ **Public sector banks** have been advised to open **at least one specialized branch in each district.** The banks have been permitted to categorize their MSME general banking branches having **60% or more of their advances to MSME sector**, as specialized MSME branches for providing better service to this sector as a whole.

❖ As per the policy package announced by the Government of India for stepping up credit to MSME sector, the public sector banks will ensure specialized MSME branches in identified clusters/centres with preponderance of small enterprises to enable the entrepreneurs to have **easy access to the bank credit and to equip bank personnel to develop requisite expertise**.

❖ Though their core competence will be utilized for extending finance and other services to MSME sector, they will have operational flexibility to extend finance/render other services to other sectors/borrowers.

14. How do banks assess the working capital requirements of borrowers? (Category B)

❖ The banks have been advised by RBI to put in place loan policies governing extension of credit facilities for the MSE sector duly approved by their Board of Directors of RBI.

❖ Banks have, however, been advised to sanction limits after proper appraisal of the genuine working capital requirements of the borrowers keeping in mind their business cycle and short term credit requirement.

❖ As per Nayak Committee Report, **working capital limits** to SSI units is computed on the basis of minimum **20% of their estimated turnover up to credit limit of Rs.5 crore**.

15. Is there any provision for grant of composite loans by banks? (Category C)

❖ A composite loan limit of **Rs.1crore** can be sanctioned by banks to enable the MSME entrepreneurs to avail of their working capital and term loan requirement through Single Window.

❖ All scheduled commercial banks have been advised, that the banks which have **sanctioned term loan singly or jointly must also sanction working capital (WC) limit** singly (or jointly, in the ratio of term loan) to avoid delay in commencement of commercial production thereby ensuring that there are no cases where term loan has been sanctioned and working capital facilities are yet to be sanctioned.

16. What is cluster financing? (Category A)

❖ Cluster based approach to lending is intended to provide a **full-service approach to cater to the diverse needs** of the MSE sector which may be achieved through extending banking services to recognized MSE clusters.

❖ A cluster based approach may be more beneficial

- **(i)** in dealing with **well-defined and recognized groups**
- (ii) availability of appropriate information for risk assessment
- (iii) monitoring by the lending institutions and
- (iv) reduction in costs.

❖ The banks have, therefore**, been advised to treat it as a thrust area and increasingly adopt the same for SME financing**.

❖ The Ministry of Micro, Small and Medium Enterprises has also approved a list of clusters under the Scheme of Fund for Regeneration of Traditional Industries (SFURTI) and Micro and Small Enterprises Cluster Development Programme (MSE-CDP) located in 121 Minority Concentration Districts.

❖ Accordingly, banks have been advised to take appropriate measures to improve the credit flow to the identified clusters. Banks have also been advised that they should open more MSE focused branch offices at different MSE clusters which can also act as counseling. Centres for MSEs. Each lead bank of the district may adopt at least one cluster

17. Is credit rating mandatory for the MSE borrowers? (Category B)

❖ Credit rating is **not mandatory** but it is in the interest of the MSE borrowers to get their credit rating done as it would **help in credit pricing** that is cost of funds (interest and other charges etc.) of the loans taken by them from banks.