MUTUAL FUNDS

1) **What is Mutual Fund?**
   - MF is a financial institution formed as a trust that pools savings of investors sharing common objectives
   - This pooled investment amount is then further invested into various financial instrument like Debt, Equity, cash, etc. as per the fund objective
   - It offers an opportunity to invest in a diversified Portfolio, Managed by professionals
   - As of 2017, there are 42 AMCs in India with more than 20 Lakh Crores of AUM

2) **Open-ended vs Close-ended Schemes.**
   - **Open Ended** Scheme do not have maturity period
   - These schemes are available for subscription and repurchase on a continuous basis
   - Investor can conveniently buy and sell unit
   - **Close Ended** Scheme have a fixed maturity period
   - It is open for subscription only for limited period at the time of launch of the scheme
   - To provide an exit route they have to be compulsorily listed on stock exchange

3) **Exchange traded fund**
   - ETFs are launched by an AMC or other entity.
   - ETFs were introduced in US in 1993 and came to India around 2002.
   - It is a hybrid product that combines the features of an index mutual fund and stock.
   - Their prices are linked to the underlying index
   - They are bought & sold like any other stock on stock exchange
   - Since they can be placed in Demat account, there is no paper work involved for investing in an ETF

4) **Money Market Mutual Fund (MMMFs)**
   - MMMFs invest in money market which is a market for short term borrowing and lending
   - Such schemes invest in safe, highly liquid instruments commercial papers, certificates of deposits and government securities
   - They channelize the idle short term funds, particularly of Corporates, to those who require such funds
   - Short-term/emergency requirements of various firms are met by such Mutual Funds

5) **Conditions to be fulfilled by an AMC**
   - The Memorandum and Articles of Association of the AMC is required to be approved by the SEBI.
   - No appointment of a director of an AMC shall be made without the prior approval of the trustees.
   - The AMC undertakes to comply with SEBI (Mutual Funds) Regulations, 1996.
   - Minimum net worth of an AMC should be Rs.10 Crores, of which not less than 40% is to be contributed by the sponsor.
   - Recently, SEBI has given 3 years time for AMCs to meet the new Rs. 50 Crores Minimum Net Worth requirement

Who can be appointed as AMC

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- A company formed and registered under Companies Act 1956 and which has obtained the approval of SEBI to function as an asset management company may be appointed by the sponsor of the mutual fund.
- The AMC is involved in the daily administration of the fund &has three departments:
- Fund Management;
- Sales and Marketing and
- Operations and Accounting

Obligations of the AMC

- AMC shall manage the affairs of mutual funds and operate schemes of such fund.
- AMC shall take all reasonable steps and exercise due diligence to ensure that the investment of the mutual funds pertaining to any scheme is not contrary to the provisions of SEBI Regulations and the trust deed of the mutual fund

6) Advantages & Drawbacks of investing in MF

Advantages:

- Professional Management
- Diversification
- Convenient Administration
- Return Potential
- Low Costs
- Liquidity

Disadvantages:

- No guarantee of returns
- Risk of unethical practices like front-running
- At times, they are subject to lock in period
- At times, they are subject to different kind of hidden costs
- No choice of security selection

7) Signals that indicate investors to exit a mutual fund scheme?

- If the Fund, Consistently under performs the broad based index
- If the Fund, Consistently under performs its peer group
- When the mutual fund changes its Objectives
- When a veteran fund manager, has been replaced by a new entrant

8) Methods for evaluating performance of Mutual Fund

Sharpe Ratio

- The excess return earned over the risk free return on portfolio to the portfolio's total risk measured by the standard deviation.
- It is often used to rank the risk-adjusted performance of various portfolios over the same time.
- Higher the Sharpe ratio, better a portfolio's returns & vice versa
- Sharpe Ratio = $\frac{R_l - R_f}{\sigma}$

Treynor's Ratio

- This ratio is similar to the Sharpe Ratio except it uses Beta of portfolio instead of standard deviation.
- It evaluates the performance of a portfolio based on the systematic risk of a fund.
- Treynor Ratio = $\frac{R_l - R_f}{\sigma}$

Jensen's Alpha

It is a comparison of actual return of the fund with the benchmark portfolio of the same risk.

- Alpha is the excess of actual return over the expected returns (as per CAPM)

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Sharpe Ratio = Alpha = Ri – [Rf + β (Rm-Rf)]

PORTFOLIO MANAGEMENT

9) Portfolio Management & Its Objectives?

Portfolio Management

- It is a combined holding of all kinds of financial instruments
- All investment avenues are put together in a common basket wherein they have varying elements of risk & return.
- It is selection of securities or various investment options in the portfolio
- It involves maintaining a proper combination of securities relevant to the investors risk & return objective.

Objectives of Portfolio Management

- Maximize Returns
- Minimize Risk
- Liquidity
- Capital appreciation
- Regular Income by way of dividends and interest
- Diversification

10) Standard Deviation, Co Variance , Correlation

Standard Deviation (σ)

- It is average of deviation (Change or volatility) from the mean
- It denotes uncertainty of Stock prices or returns deviating from its expected returns.
- Therefore, higher the standard deviation, higher is the risk.

Covariance

- The joint risk which identifies the combined risk between two securities in a portfolio is called covariance.
- A positive covariance indicates both stocks moving together in the same direction.
- A negative covariance indicates opposite movements between the stocks.
- A covariance of Zero or near zero indicated no relation or no co-movement between the two stocks.

Correlation (r or P)

- It is a standardized version of covariance
- It is a relative measure which shows the direction as well as the extent of the direction
- Correlation ranges from -1 to +1

11) Modern Portfolio Approach

- Also known as **"Mockowitz Model"** or **Risk "Return Optimization"** it was derived by Prof. Harry Mockowitz, in 1959.
- He won noble prize for the same in 1990
- It provides a logical/ mathematical framework that helps investors to optimize their risk & return.
- This theory further helped for more portfolio theory including CAPM, SHARPE Index Model etc.

12) Factors affecting investment decisions in portfolio management.

- Investor's return objective
- Investor's risk tolerance
- Investor's liquidity requirements
- Investor's taxation concerns
- Market volatility
- Regulatory Changes

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13) Distinguish between 'Systematic risk' and 'Unsystematic risk'.

Systematic risk	Unsystematic risk
✓ Also known as Market Specific Risk	Also known as Co-Specific Risk
✓ Arises to general economic & market related factors	Arises due to Co-specific factors which are more internal in nature
✓ Such risks affect every Company in that particular sector/economy.	Such risks affects the particular company only & hence can be protected /insured
✓ It is therefore unavoidable & cannot be removed by diversification.	It is avoidable & can be diversified by increasing number of stocks.

TOTAL RISK = SYSTEMATIC + UNSYSTEMATIC RISK

14) Discuss CAPM & its relevant assumptions.

- Capital Asset Pricing Model (CAPM), was developed by Prof. William Sharpe, a Noble Prize Winner
- The model explains the relationship between the expected return, non-diversifiable risk and the valuation of securities.
- Expected return on security = $R_f + \beta(R_m - R_f)$

Relevant Assumptions of CAPM

- Investors make choices on the basis of risk and return;
- Investors have homogeneous expectations of risk and return;
- Information is freely and simultaneously available to investors;
- There are no taxes, transaction costs, restrictions on short rates or other market imperfections

15) Arbitrage Pricing Theory

- Based on the law of one price, if an asset is priced different in different market, then arbitrage brings it to the same price.
- APT is based on the return generated by factor models.
- Under CAPM a single factor model is used where the asset price depends upon a single factor such as Sensex, GDP, inflation etc.
- Under multiple factor model a number of variable are taken into accounts for the asset pricing such as interest rates, market, industrial production, GDP, etc.
- $E(r) = R_f + \beta_1 x R_1 + \beta_2 x\ R_{p2} + \beta_3 x\ R_{p3} + \ldots + \beta_n\ x\ R_{pn}$
- β =Sensitivity of factor 1,2,3….n on stock
- Rp=Risk premium=Actual Return - Expected return

16) Discuss the Random Walk Theory.

- 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 behavior of stock market prices is unpredictable and that

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there is no relationship between the present prices of the shares and their future prices.

- It may be said that prices on the stock exchange behave exactly the way a drunk would behave while walking in a blind lane, i.e., up and down.

17) Discuss how the risk associated with securities is affected by Government policy.

- Licensing Policy
- Changes in FDI and FII rules.
- Export and import restrictions
- Restrictions on shareholding
- Changes in Taxation

18) Explain the three form of Efficient Market Hypothesis.

As per the study carried out by technical analyst it was observed that information is slowly incorporated in the price and it provides an opportunity to earn excess profit. However, once the information is incorporated then investor can not earn this excess profit.

There exist three levels of market efficiency:-

(i) **Weak form efficiency** – Price reflect all information found in the **record** of past prices and volumes.

(ii) **Semi – Strong efficiency** – Price reflects information found in the record & also all other **publicly** available information.

(iii) **Strong form efficiency** – Price reflect all available information i.e. public as well as **private**.

VALUATION OF SECURITIES

19) Strengths and Weakness of Fundamental Research

Strengths

- Helps in evaluating better investment opportunity
- Helps in understanding business models &strategies of the company
- Helps in understanding the overall industries, sectors and economic growth

Weakness

- Very time consuming
- Very costly to do in depth research
- A lot of assumption resulting into huge error
- Biased reporting

20) Techniques used in Economic Analysis

(a) Anticipatory Surveys:

- Help investors to form an opinion about the future state of the economy
- It incorporates expert opinion
- Future spending habits of consumers are taken into account

(b) Barometer/Indicator Approach:

- Leading Indicators
- Roughly Coincidental Indicators -
- Lagging Indicators

(c) 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

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DIVIDEND POLICY

21) Factors Determining the Dividend Policyf a Company

- Liquidity
- Repayment of old debt
- Uncertain stability of profits
- Legal considerations & boundaries
- Tax considerations
- Inflation

22) Constrains on paying Dividend

- **Legal:** Under Section 205(1) of the Companies Act 1956, dividend is to be paid out of current profits or past profits after depreciation.
- **Liquidity**: Ability to pay dividends depends on cash and liquidity position of the company.
- **Access to the Capital Market**: If new shares have to be issued to raise control earnings are diluted & payment of dividends may be withheld
- **Investment Opportunities:** If investment opportunities are inadequate, it is better to pay dividends and raise external funds

23) Traditional & Walters & MM Approach

I. TRADITIONAL/ GRAHAM & DODD APPROACH

- According to the traditional approach by Graham and Dodd, the stock market places considerably more weight on dividends than on retained earnings.

  P = m (D + E/3) Where,

  P = Market Price per share D = Dividend per share

  E = Earnings per share m = a Multiplier.
- As per this model, in the valuation of shares the weight attached to dividends is equal to four times the weight attached to retained earnings.
- The weights provided by Graham and Dodd are based on their subjective judgments and not derived from objective empirical analysis.

WALTERS APPROACH

- The formula is given by Prof. James E. Walter, he argues that in the long run, share prices reflect only the present value of expected dividends. It focuses on two factors which influences Market Price

(i) Dividend Per Share.

(ii)Relationship between IRR and cost of capital (Ke)

$$P = \frac{D + \frac{r}{k_e}(E - D)}{Ke}$$

P = Price or Market value of the ordinary shares

R = Return on retained profits

Ke = Cost of Capital

E = Earnings per share

D = Dividend per share

MM APPROACH

- As per MM Approach dividend policy of a company is irrelevant in determining shareholders wealth

$P_o = \frac{D_1 + P_1}{1 + K_e}$

Where, P_1 = Expected price (next year)

P_o = Current price

D_1 = Expected dividend (next year)

K_e = Cost of capital

ASSUMPTION OF MM MODEL:

- Shares can be purchased or sold in any fraction
- No transaction costs
- No taxation

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FOREX

24) Nostro, Vostro and Loro Accounts

NOSTRO Account:

- It means "Our account with you"
- It is an account of a domestic bank with the foreign bank for foreign currency.
- Eg.: IDBI Bank in Mumbai, has an account with CITI bank, New York for US$.

VOSTRO Account:

- It means "Your account with us"
- It is an account maintained by a foreign bank with domestic bank for of domestic currency.
- Eg: Bank of America, WDC has an account with Bank of India, New Delhi, for INR

LORO Account:

- It means "their account with you"
- The term Loro is used when the account (Nostro/ Vostro) is referred by the bank other than the account maintained bank
- Eg.: SBI, Mumbai has an account with CITI Bank, New York but referred by Janta Sahakari Bank.

25) Direct vs Indirect Quotes

DIRECT QUOTES	INDIRECT QUOTES
When base currency is foreign currency while variable currency is domestic currency, it is called as direct quotes.	When base currency is domestic currency & variable currency is foreign currency it is an indirect quote.
Eg. $1 = Rs.50 is a direct quote in India	Eg. 1$ = Rs.50 is an indirect quote in USA
Direct rates are expressed in India to the base of 1unit in foreign currency except for Japanese yen whose relation is expressed to the base of 100 units.	Indirect rates are expressed in India to the base of100 i.e, 100 units of domestic currency. Eg.100Rs. = $ 2
In US, direct rates are termed as American Quotes	In US indirect quotes are termed as European Quotes

26) Cross currency using vehicle currency

- When foreign currency is not easily available because of reasons like illiquidity, lower volume of transactions with a country, political factors, regulation etc, we use an indirect way of exchanging the respective currency.
- This exchange is routed through a common currency which is easily available or acceptable for both the parties and is very liquid in nature with both the respective currencies. Such a common currency is known as vehicle currency.
- US$ and Euro are most commonly used vehicle currencies in the World

27) Leading & Lagging

- Leading means advancing a payment i.e. making a payment before it is due.
- Lagging involves postponing a payment i.e. delaying payment beyond its due date.

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- In Forex market Leading and lagging are used for two purposes:-
  (1) Hedging foreign exchange risk
  (2) Shifting the liquidity by modifying the credit terms between inter-group entities

28) Arbitrage vs Speculation vs Hedging

	Arbitrage	Speculation	Hedging
1.	It is simultaneous buying & selling of same assets in two different markets	It is buying & holding the position & waiting for the results	It is protection of an unfavorable position through derivative instruments
2.	It is a risk free activity	It is a conscious acceptance of risk	It is protection against financial risk
3	Arbitrage operation always results in profits.	Such transaction may or may not result in profit.	It results in no profit no loss.
4.	Personal analytical skills are not of much importance in arbitrage operation	A very high level of technical knowledge plays an important role in speculation activity	Proper hedging methodology requires sound knowledge

29) IRP & PPP

Interest Rate Parity (IRP)

- IRP states that in an open or globalized economy the amount invested in one country should be equal to the amount invested in another country/ Currency when converted with the respective exchange rate.
- IRP gives a forward rate also known as no-arbitrage point, which means that when amount invested in either of the countries, the result is no profit or no loss due to the forward rate. **Forward =Spot** $\frac{(1+i_D)}{(1+i_F)}$

  Where, **iD =** Domestic Interest Rate and
  if= Interest Rate in foreign country

Purchasing Power Parity (PPP)

- PPP theory states that the exchange rate between two countries reflects the relative purchasing power of the two countries i.e. the price at which a basket of goods can be bought in the two countries.
- PPP says that the purchasing power of a consumer will be similar while purchasing goods in foreign currency or in domestic currency.
- This PPP is determined by the rate of inflation of both the countries. It is based on concept of "Law of one price.

  Forward = Spot $\frac{(1+i_D)}{(1+i_F)}$

  Where, **iD =** Domestic Inflation Rate and
  if = Inflation Rate in foreign country

30) "Operations in foreign exchange market are exposed to a number of risks." Discuss.

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A firm dealing with foreign exchange may be exposed to the following types of risks:

(i) Transaction Exposure:
- Transaction exposure is an actual exposure.
- It is due to trade transactions only and can be covered by using derivatives like forward, futures, options etc.

(ii) Translation Exposure:
- It is an accounting exposure related to translation of accounts from one currency to another.
- It is a national exposure only.

(iii) Economic Exposure:
- Economic exposure measures the probability of fluctuations in foreign exchange rate that will affect the value of the firm.
- It is a degree to which business is adversely affected due to unfavorable foreign exchange movement.
- It is difficult to cover economic exposure.

DERIVATIVES

31) What is a "derivative"? Explain recommendations of the L.C. Gupta Committee on derivatives

Derivatives are those assets whose value is determined from the value of some underlying assets. The underlying asset may be equity, commodity, currency, etc.

Based on the report of Dr. L.C. Gupta Committee the following recommendations are accepted by SEBI on Derivatives:

- Permission to existing stock exchange to trade derivatives provided they meet the eligibility conditions including adequate infrastructural facilities, on-line trading and surveillance system and minimum 50 members opting for derivative trading etc.
- Initial margin requirements and capital adequacy norms shall be prescribed.
- Annual inspection of all the members operating in the derivative segment by the Stock Exchange.
- The clearing corporation/house to settle derivatives trades.

32) What is the significance of an underlying in relation to a derivative instrument?

The underlying of a derivative may be a share, a commodity or any other asset which has a marketable value & which is subject to market risks. The importance of underlying in derivative instruments 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 of the underlying.
- In the absence of a valuable underlying assets, the derivative instrument will have no value.
- On maturity, the position of profit/loss is determined by the price of the underlying instruments.

33) Rolling Settlement

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- It was introduced by SEBI to fasten the settlement process, in both exchanges on January 12, 2000.
- This cycle starts & ends on the same day and the settlement take place on 'T+2' day, which is 2 business days from the date of the transaction.
- For e.g. the transaction done on Monday will be settled on the Wednesday and the transaction done on Tuesday will be settled on Thursday and so on
- Most exchanges of the world now have T+2 settlement periods

34) Meaning and Advantages of Netting

It is a technique of optimizing cash flow movements where instead of actual delivery of assets, only net cash flow is exchanged

Advantages derived from netting system includes,

- Reduces the number of cross border transactions between subsidiaries
- Decreases transaction costs associated with foreign exchange conversion
- Decreases overall administrative costs of such cash transfers
- Improves cash flow forecasting
- Settles accounts through coordinated efforts among all subsidiaries.

35) Forward vs Futures vs Options

Forward	Future	Options
It is OTC in nature	Trade on exchanges only	Trades on exchange as well as OTC
It is a customized / tailor made contract	It is a standardized (as per exchange) contract	Each contract has underline of several units known as lot size
Less regulated	Highly regulated	Regulated if through exchange
High default risk	No Counter party risk	Risk only to the extent of the premium
Less liquid in nature	High liquidity	Liquid on Exchange

36) Embedded derivatives

- An embedded derivative is a derivative instrument that is combined in another contract known as the host contract.
- The host contract might be a debt or equity instrument, a lease, an insurance contract or a sale or purchase contract.
- An embedded derivative can arise from deliberate financial engineering and intentional shifting of certain risks between parties.
- **Eg:** Callable Bonds, Putable Bonds, Convertible Bonds.

37) What are Stock futures? What are the opportunities offered by Stock futures? How are Stock futures settled

- It is a financial derivative product where the underlying asset is an individual stock. It is also called equity future
- Stock Futures offer high leverage with around 20% initial margin

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- They Offer opportunities to arbitrage and earn riskless profit
- It is an effective risk management tool for positions in Spot/Cash Market
- Futures are settled by delivery, i.e., by merging derivatives position into cash segment.

38) Marking to Market (M to M)

- 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
- At the end of a trading session, all outstanding contracts are repriced at the settlement price of that session
- Any loss or profit resulting from repricing would be debited or credited to the margin account of the broker
- It Provides better risk management measure as it compared to forward contracts.

39) Significance of LIBOR in international financial transactions.
LIBOR stands for London Inter Bank Offered Rate. Other features of LIBOR are as follows:

- It is the base rate of exchange with respect to which most international financial transactions are priced.
- It is used as the base rate for a large number of financial products such as options and swaps.
- Banks also use LIBOR as the base rate when setting the interest rate on loans, savings and mortgages.
- It is monitored by a large number of professionals and private individuals world-wide.

40) Write a short note on Options

- An option is contract that gives the holder a right, without any obligation, to buy or sell an asset at an agreed price on or before a specified period of time
- The option to buy an asset is known as a **Call** option and the option to sell an asset is called **Put** option.
- **European** Option: When an option is allowed to be exercised only on the maturity date.
- **American** Option: When an option is exercised anytime before its maturity date.

41) Factors affecting value of Option

(a) Price of the Underlying: 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.

(b) Time: The option's future expiry, at which time it may become worthless, is an important factor of every option strategy.

If days pass without any significant change in the stock price, there is a decline in the value of the option

Also, the value of an option declines more rapidly as the option approaches the expiration day

(c) Volatility: It tells you how volatile the stock has actually been over a given period of time

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(d) Interest Rate- The greater the interest rates, the present value of the future exercise price is less

42) Distinguish between Intrinsic Value and Time Value of Option

Intrinsic Value (IV)

- IV is that part of option premium which represent the extent to which the option is in the money
- For call option, gains would be made if (St > x) & IV=St-X (Where St = Spot at maturity & X = Strike price)
- For put option, gains would be made if (St < x) & IV=X-St
- If the option is ATM or OTM it is worth less and has no intrinsic value.

Time Value of option:

- Time value denotes the probability that an option would expire **In The Money** (ITM) by its maturity.
- If the probability is high, time value will be higher and vice versa. This time value is also called **Extrinsic** value.
- If the stock price does not changed more from the day of purchase of option, till expiry, time value decays i.e. fall to "Zero".

NOTE

Option Premium = Intrinsic Value + Time Value

TV= Option Premium – IV

IV cannot be negative; at max it can be 0. Therefore, **Option Premium** can never be negative

43) Put Call Parity

- Put-call parity is a principle that defines the relationship between price of European put & call options of the same asset, with the same underlying asset, strike price and expiration date
- If the prices of the Put and Call Options differ, the Parity does not hold, and an Arbitrage Opportunity exists
- Traders can earn a theoretically risk-free profit

The equation expressing put-call parity is:

$S_0 + P_0 = C_0 + xe^{-rf}$

S_e - Long stock

P_0 = Long Put

C_0 = Long Call

e^{-rt} - Present value (PV) of Strike price

44) Black & Scholes and its Assumptions

- In 1973, Fisher Black, Myron Scholes & Robert C Merton, Introduced a Model on Pricing of Option, for which they received a Noble Prize in Economic Science.
- The model Utilizes Five Criteria given as below: Stock Price in Spot, Strike Price, Time to Maturity, Risk Free Rate of Return and the Most Important one; Standard Deviation/Volatility. Below are its **Assumptions**:
- European Options are considered
- No transaction costs
- Interest rates are constant
- Stocks do not pay dividend
- Stock returns are normally distributed over a period of time, &
- The variance of the return is constant over the life of an Option.

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45) Caps, Floors and Collars options.

Cap Option

- It is a series of call options.
- Purchase of a Cap enables the borrowers to fix in advance a maximum borrowing rate for a specified amount and for a specified duration
- The buyer of Cap pays a premium to the seller of Cap.

Floor Option

- It is a series of put option
- Purchase of a Floor enables a lender to fix in advance, a minimal rate for placing a specified amount for a specified duration
- The buyer of the floor pays the premium to the seller.

Collars Option

- It is a combination of a Cap and Floor.
- The purchaser of a Collar buys/sells a Cap and simultaneously sells/buys a Floor.
- Mostly Banks take such position to avoid the Cost (Premium) on Buying an Option to set it off by Selling an Option.

46) Forward Rate Agreements

- FRA is an OTC derivative instrument
- It is an OFF Balance Sheet Item
- Here an agreement is made to Borrow or Lend a Notional Amount for a Relevant Underlying period After a Certain Time Period.
- The **Buyer** of FRA is the Borrower party who wants to cover the risk of Rising Interest rates (Increasing Reference Rate)
- The **Seller** of FRA is the Lender party who wants to cover the risk of Falling Interest rates (Decreasing Reference Rate)

FRAPayment

$$= \frac{(\text{Reference Rate} - \text{Rate of FRA}) \times \text{Notional Principle} \times \left(\frac{\text{Days}}{360}\right)}{\left[\left[1 + \left(\text{Rate of FRA} \times \left(\frac{\text{Days}}{360}\right)\right]\right]}$$

47) Plain Vanila Swaps, Basis Rate Swaps, Asset Swaps, Amortizing Swaps

(i) Plain Vanilla Swap

- Also called Generic Swap.
- It involves exchange of a fixed rate loan to a floating rate loan.
- Floating rate can be based on LIBOR, MIBOR, Prime-Lending Rate etc.

(ii) Basis Rate Swap

- It is Swap based on the different Benchmark basically it is difference between two variable rates.
- For Ex: One rate may be 1Month LIBOR & other may be 3Month LIBOR

(iii) Asset Swap

- It is a Swap between two different assets with different features.
- For Ex: a Swap can also be constructed between - a BOND & an INDEX based on Stocks

(iv) Amortizing Swap

- It is 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.

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48) Debt Securitization/Asset Securitization

- It is a method of recycling of funds.
- Year, Assets generating steady cash flows are packaged together & against them market securities can be issued.
- Generally, the process of securitization is without recourse i.e. the investor bears the credit risk of default and the issuer is under an obligation to pay to investors only if the cash flows are received by issuer from the collateral.
- The process is classified as below:

The origination function- A borrower seeks a loan from finance company, bank or housing company.

The pooling function - Similar loans or receivables are clubbed together to create an underlying pool of assets

The securitization function - This pool is transferred in favour of a SPV

CAPITAL BUDGETING

49) NPV vs IRR

- NPV is expressed in financial values (in Rs) while IRR is expressed in percentage terms
- In NPV, cash flows are assumed to be re-invested at cost of capital rate while In IRR, cash flows are assumed to be re-invested at rate or IRR Itself
- The different rankings given by the NPV and IRR methods could be due to size & time disparity problem and unequal expected lives
- In case of conflict in rankings a Project is selected on the basis of NPV instead of IRR

50) Explain the concept 'Zero date of a Project' in project management.

- It is a date from which implementation of the project begins.
- It is a starting point of incurring cost. The project completion period is counted from the zero date
- The pre-project activities should be completed before zero date
- Many activities like determination of plant capacity, selection of site, manpower planning and recruiting key personnel etc. should be completed before the ZERO DATE.

51) Write short note on Social Cost Benefit analysis

Social Cost Benefit Analysis

- Only commercial evaluation of projects is not enough to justify commitment of funds to a project
- A different yardstick has to be adopted for evaluating a projects of social importance
- Traditional project evaluation techniques may not be relevant to judge the real impact of their burden as costs to the society
- Importance is attached to the social desirability of projects like employment generation potential, value addition, foreign exchange benefit, living standard improvement etc.
- This technique has got more relevance in the developing countries where public capital needs precedence over private capital.

52) The contents of a Project Report.

- Past records & performance of project team

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- Industry analysis necessary for understanding the cyclical and Other Changes
- Economic analysis like the demand & supply position of a Product
- Cost of project ingredients like Land, Plant & Machinery, etc
- Inputs required like raw material, manpower, etc and its availability
- Social cost benefit analysis - Ecological Costs and repercussions to the Product market
- Technical Analysis & Financial Analysis
- SWOT analysis
- Project implementation schedule

53) Capital Rationing

- Capital is not unlimited & also all projects may not be worth Investing
- A proper decision has to be taken to optimize the available resources
- Capital rationing means the utilization of existing funds in most profitable manner
- IRR or NPV are the best basis of evaluation even under capital rationing situations.
- Projects are to be ranked in the order of NPV
- The objective is to select projects with Maximum NPV.
- However, Capital rationing also depends on whether the project is Divisible or Indivisible.

54) Write a brief note on project appraisal under inflationary conditions.

- Project Appraisal is generally an exercise in measurement and analysis of cash flows expected to occur over the life of the project.
- During inflationary conditions, the Project Cost increases & it also erodes purchasing power of consumers adversely affecting the demand pattern. Under such circumstances, project appraisal has to be done generally keeping in view the following guidelines:
- Make provisions for cost escalation keeping in view the rate of inflation
- Adjustments should be made in profitability and cash flow projections
- The rate of return should be acceptable which also accommodates the rate of inflation per annum.
- Projects having early payback periods should be preferred
- Adjust each year's cash flows to an inflation index
- Adjust the 'Acceptance Rate' (cut-off) with revised projections

55) What are the steps for simulation analysis?

1. Modeling the project-The model shows the relationship of NPV with parameters and exogenous variables.
2. Specify values of parameters and probability distributions of exogenous variables.
3. Select a value at random from probability distribution of each of the exogenous variables.
4. Determine NPV corresponding to the randomly generated value of exogenous

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variables and pre-specified parameter variables.

5. Repeat steps (3) & (4) a large number of times to get a large number of simulated NPVs.
6. Plot frequency distribution of NPV

LEASING

56) What is cross border leasing? State its objectives

- Cross-border leasing is a leasing agreement where lessor and lessee are situated in different countries. This raises significant additional issues relating to tax avoidance and tax shelters.

Objectives of Cross Border Leasing

- Utilization by the lessor of tax depreciation allowances to reduce its taxable income
- Utilize nonrecourse debt to finance a substantial portion of the equipment cost
- Utilize very favourable "leveraged lease" financial accounting treatment for the overall transaction.
- Easier for a lessor to repossess the leased equipment following a lessee default
- Leasing provides the lessee with 100% financing.

57) What are the characteristic features of Financial and Operating Lease?

Financial Lease

- It is an intermediate term to long-term arrangement.
- The lease is more or less fully amortized during the primary lease period.
- The costs of maintenance, taxes, insurance etc., are to be incurred by the lessee unless the contract provides otherwise.
- The lessor is only a Financier and is not interested in the asset.

Operating Lease

- The lease term is significantly less than the economic life of the equipment.
- The lease rental is generally not sufficient to fully amortize the cost of the asset.
- The costs of maintenance, taxes, insurance are the responsibility of the lessor.
- The lessor has the option to recover the cost of the asset from another party on cancellation of the lease by leasing out the asset.

MONEY MARKET

58) Money market & its features? What kind of inefficiencies it is suffering from?

Meaning/Features

- It is a market for short term borrowing & lending of Funds
- Helps Invest Idle short term funds
- Helps in borrowing for working capital requirements
- The ticket size per transaction is hugely high
- Market consists of mostly institutional players only

Inefficiencies:

- Markets not integrated
- High volatility
- Players restricted

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- Reserve requirements
- Lack of transparency
- Seasonal shortage of funds
- Heavy Stamp duty

59) Money Market v/s Capital Market.

Money Market	Capital Market
It deals for funds of short-term requirement (less than a year)	It deals with funds of long-term requirement (more than 1 year)
Supplies funds for working capital requirement	Supplies funds for fixed capital requirements
Each single instrument is of a large amount	Each single instrument is of a small amount
Risk involved here is less	Risk is higher in most cases

60) Call Money

- It is a part of the money market where, day to day surplus funds, mostly of banks, are traded
- It is the most liquid of all short-term money market segments
- The maturity period varies from 1 to 14 days
- The money that is lent for one day in call money market is also known as **'overnight money'**
- The interest paid on call loans are known as the **call rates**
- The banks borrow from call money market to meet the CRR requirements that they should maintain with RBI every fortnight and is computed as a percentage of Net Demand and Time Liabilities (NDTL).

61) Repo and a Reverse Repo

- Repo is a rate at which Commercial Bank borrow from RBI
- Reverse Repo is a rate at which Commercial Bank deposit funds with RBI
- Here funds are raised by selling securities & simultaneously agreeing to repurchase them after sometime at higher price
- Indian Repo market is governed by Reserve Bank of India
- Current (2015) Repo & Reverse Repo is at 6.75% & 5.75%, respectively

62) Commercial Paper

A commercial paper is an unsecured money market instrument issued in the form of a promissory note

The regulation of CP comes under the purview of the Reserve Bank of India

Eligibility criteria for issuer of commercial paper

- The company isrequired to obtain the necessary credit rating from the rating agencies such as CRISIL, ICRA etc.
- The minimum current ratio should be 1.33:1 based on classification of current assets and liabilities.
- For public sector companies there are no listing requirement but for companies other than public sector, the same should be listed on one or more stock exchanges.
- All issue expenses shall be borne by the company issuing commercial paper
-

63) Certificate of Deposits

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- Sold by banks, certificates of deposit (better known as CDs) are low-risk – and relatively low-return — investments suitable for investing surplus cash
- CDs are among the safest investment a person can make.
- The interest rate is determined ahead of time
- The principal plus interest is guaranteed once the CD matures.

64) Treasury bills

- Treasury bills are short-term debt instruments of the Central Government, maturing in a period of less than one year
- Treasury bills are issued by RBI on behalf of the Government of India for periods ranging from 14 days to 364 days through regular auctions
- Treasury bills are sold through an auction process
- Treasury bills are issued at discount and redeemed at par
- Largest holders of the treasury bills are commercial banks, trust, mutual funds and provident funds

65) Inter-Bank Participation Certificate

- They are short term instruments to even out the short term liquidity within the Banking system particularly when there are imbalances affecting the maturity mix of assets in Banking Book.
- It can be issued by schedule commercial bank and can be subscribed by any commercial bank.
- There are **two types** of participation certificates, with risk to the lender and without risk to the lender
- Under '**with risk participation**', the issuing bank will reduce the amount of participation from the advances outstanding and participating bank will show the participation as part of its advances.
- Under **without risk participation**, the issuing bank will show the participation as borrowing from banks and participating bank will show it as advances to bank.

66) CRR & SLR

CRR

- It is a percentage of money banks need to keep with themselves in the form of cash.
- Banks deposit this amount with RBI and it is in the jurisdiction of the apex bank to keep it high or low depending upon the cash flow in the economy.
  - When RBI lowers CRR, it allows banks to have surplus money.
  - A higher CRR means banks have lesser amount of money.
  - Present rate of CRR is 4% (2015)

SLR

- It is a ratio of cash deposits that banks have to maintain in the form of gold, cash, and other securities approved by RBI.
- The latest SLR is 21.50% (2015), but RBI has power to increase it up to 40%.

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BONDS

67) Price Yield Relationship

- Bond prices are sensitive to changes in interest rate
- Bond prices and yield have inverse relationship
- Change in price of bond & yield also depends on the maturity of bond
- As the maturity of bond increases, changes in bond prices (sensitivity) also increases with respect to similar change in yield and vice versa

68) Zero Coupon Bonds

- These bonds do not pay interest during the life of the bonds.
- They are issued at discounted price & redeemed at their face value.
- On maturity, the investor will receive one lump sum (face value) amount equal to the initial investment + interest that has been accrued on the investment made.
- ZCBs are issued by banks, government and private sector companies
- ZCBs have duration = maturity

69) Euro Convertible Bonds

- They are convertible bonds issued by Indian companies in foreign market
- Usually price of equity shares at the time of conversion will fetch premium.
- There Bonds carry fixed rate of interest.
- The issue of bonds may carry two options:

a) **Call option**:

- The issuer can call the bonds for redemption before the date of maturity.
- This call option forces the investors to convert the bonds into equity.

b) **Put option**:

- It enables the buyer of the bond a right to sell his bonds to the issuer company at a pre-determined price and date.
- The payment of interest and the redemption of the bonds will be made by the issuer-company in foreign currency.

70) Foreign Currency Convertible Bonds.

FCCBs are important source of raising funds from abroad. Their salient features are

- FCCB is a Convertible bond, denominated in a foreign currency issued by an Indian company to be converted into shares in Indian Rupees.
- Prior permission of the Department of Economic Affairs, Government of India, and Ministry of Finance is required for their issue.
- There will be a domestic and a foreign custodian bank involved in the issue of such bonds.
- FCCB shall be issued subject to all applicable laws relating to the issue of capital by a company.
- Conversion of bond to FCCB will not give rise to any capital gains tax in India.

71) External Commercial Borrowings (ECBs)

- ECB include bank loans, supplier credit, securitized instruments, credit from export credit agencies and borrowings from multilateral financial institutions.

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- Securitized instruments may be FRNs, FRBs etc.
- The government permits the ECB route for variety of purposes namely expansion of existing capacity as well as for fresh investment.
- There are caps & ceilings on ECBs so that macro economy goals are better achieved.
- Units in SEZ are permitted to use ECBs under a special window.

72) What is interest rate risk, reinvestment risk & default risk ? What are the types of risk involved in investments in G-Sec.?

Interest Rate Risk:

- Interest Rate Risk is also known as Market Risk or Price risk
- It is on account of inverse relation between price of bond and the interest rate.
- As the interest rate rises the price of a security will fall

Re-investment Risk:

- It is Present in securities, which generate cash flows in form of periodic coupons.
- The YTM calculation assumes that the cash flows generated during the life of a security is reinvested at the rate of YTM.
- It is the risk that future coupons from a bond will not be reinvested at the interest rate when the bond was initially purchased.

Credit/ Default Risk:

- It is the risk where in the companies or individuals will be unable to make the required payments on their debt obligations.
- Higher the risk, higher is the return required, and vice versa.
- Maturity risk is the risk associated with the likelihood of government issuing a new security in place of redeeming the existing security.
- In case of Corporate Securities it is referred to as credit risk.

73) Why should the duration of a coupon carrying bond always be less than the time to its maturity?

- Duration is the average time taken by an investor to recover 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 and vice versa
- Duration can only be = maturity in case of ZCBs.

INDIAN CAPITAL MARKET

74) Write short note on :-

a) GDR b) ADR c) IDR

Global Depository Receipt (GDRs):

- In GDR, local companies issue capital in foreign country mostly in European countries
- GDRs are issued as well as traded in foreign currency
- It gives the domestic company a global branding

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- The holders of GDR, however, do not have voting rights
- Reliance Industries was the first company to raise capital through GDR

American Depository Receipts (ADRs):

- When non US companies issue shares on US stock Exchange it is called ADRs
- ADRs were first introduced in 1927
- ADRs are issued as well as traded in US Dollars
- Infosys issued the First Exchange traded ADR in 1998-98

Indian Depository Receipt (IDRs):

- A foreign company listing its shares on NSE or BSE has to list through IDRs
- IDRs are issued as well as traded in INR
- Standard Chartered plc was the first foreign company to issue IDR in India
  - For issuing IDRs, the foreign companies have to meet some additional requirements over & above those needed by a domestic company intending to make an IPO in India.

75) Impact of GDRs on Indian Capital Market?

- GDRs gave accessibility in terms of raising financial resources abroad to internationally prudent companies from abroad at competitive cost.
- GDR are basically negotiable certificates denominated in US dollars, that represent a non-US company's publicly traded local currency (Indian rupee) equity shares
- GDR helps to tap global equity market to raise foreign currency funds by way of equity.
- A considerable amount of foreign investment has found its way in the Indian market which has improved liquidity in the capital market.
- It has now become necessary for Indian capital market to adopt international practices in its working including financial innovations.

76) Forfeiting and Factoring.

Factoring	**Forfeiting**
It may be with or without recourse to the supplier.	It is without recourse to the exporter.
Involves trade receivables of short maturities.	Deals in trade receivables of medium and long term maturities.
It does not involve dealing in negotiable instruments	It involves dealing in negotiable instrument
The seller (client) bears the cost of factoring.	The overseas buyer bears the cost of forfeiting.

77) Types/ Forms of Factoring

Depending upon the features built into the factoring arrangement to cater to the varying needs of trade/citizens, there can be different kinds of factoring:

- Recourse and non-recourse factoring
- Advance and maturity factoring
- Full factoring:
- Disclosed and undisclosed Factoring
- Domestic and export/Cross Border Factoring

Parties involved to a cross border factoring transaction:

- Exporter (client)

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- Importer (customer)
- Export factor
- Import Factor

It is also known as two-factor system.

78) Meaning of NBFC & What are the different categories of NBFCs?

- Non-Banking Financial Institutions are regulated by RBI under RBI Act, 1934.
- They are engaged in the business of loans and advances, acquisition of shares/stock/bonds/debentures/securities issued by Government or local authority or other securities of like marketable nature, leasing, hire-purchase, insurance business, chit business
- It does not include any institution whose principal business is that of agriculture activity, industrial activity, sale/purchase/construction of immovable property.
- **Different categories of NBFC are**
  - Loan Companies
  - Investment Companies
  - Asset Finance Companies

79) Explain briefly the regulation of NBFCs under RBI Act.

RBI regulates the NBFC through the following measures:

- Mandatory registration & minimum owned funds
- Only RBI authorized NBFCs can accept public deposits
- RBI prescribes the ceiling of interest rate and public deposits
- RBI prescribes the period of deposit
- RBI inspectors conduct inspections of such companies

80) Differences between a bank and an NBFC?

NBFCs function similarly as banks; however there are a few differences:

- An NBFC cannot accept demand deposits;
- An NBFC is not a part of the payment and settlement system and as such an NBFC cannot issue cheques drawn on itself; and
- Deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available for NBFC depositors unlike in case of banks.
- NBFCs are not subject to CRR/SLR

CREDIT RATING

81) What is Credit Rating

- It is an expression of opinion of a rating agency 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.

At present there are rating agencies like:

- Credit Rating Information Services of India Ltd. (CRISIL).
- Investment Information and Credit Rating Agency of India (ICRA).
- Credit Analysis and Research Limited (CARE).
- Foreign Agencies-Fitch, Moody's, S&P, etc.

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82) Limitations of Credit Rating?

- Conflict of interest by providing multiple services
- Industry specific rather than company specific
- High rating changes which can change over period of time
- Corporate Governance issues with biased ratings at times
- It may not be feasible/affordable for small issues

83) CAMEL model in credit rating

CAMEL model adopted by the rating agencies focuses on the following aspects-

- ***Capital***- It checks ability of issuer to raise further borrowings.
- **Assets**- It checks the revenue generating capacity of existing/proposed assets, ageing and recoverability, etc.
- **Management**- It checks the extent of involvement & quality of management personnel
- **Earnings**- It checks the ability & stability of earnings to cyclical fluctuations
- **Liquidity**- It checks the efficiency in management of working capital, receivables, cash, etc.

STRATEGIC FINANCE

84) Interface/ Linkage of Financial Policy and Strategic Management

Maximizing value to the shareholders is the ultimate objective of Strategic Financial Management. The linkage can be clearly seen in respect of many business decisions. For example:

- Sources of raising capital
- Finding the best combination i.e. optimum capital structure
- Opportunity cost of capital (WACC) for acceptance of investment decisions
- Investment and fund allocation in the best projects – budgeting decisions
- A dividend policy decision – whether & how much to distribute or retain

85) Balancing Financial Goals vis-a-vis Sustainable Growth

- The concept of sustainable growth can be helpful for planning healthy corporate growth.
- SGR is measure of how much a firm can grow without borrowing more money. SGR = ROE x (1- Dividend payment ratio)
- A conflict can arise if growth objectives are not consistent with the value of the organization's sustainable growth.
- The SGR is consistent with the observed evidence that most corporations are reluctant to issue new equity
- Sustainable growth models assume that the business wants to:

a) Maintain a target capital structure without issuing new equity;
b) Maintain a target dividend payment ratio; and
c) Increase sales as rapidly as market conditions allow.

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M & A

86) Short Note on Merger & Acquisitions

- An Acquisition is when both the acquiring and acquired companies are still left standing as separate entities at the end of the transaction.
  Eg: Coke – Thumbs up
- A Merger results in the legal dissolution of one of the companies, and a consolidation dissolves both the parties and creates a new one, into which the previous entities are merged.
  Eg: Glaxo – Smithline = GlaxoSmithline
- The merger and acquisition of companies are governed by the Company Law in India which has undergone a complete overhaul and a new law being passed in 2013.

87) Financial Restructuring

- It is carried out internally in the firm with the consent of its various stakeholders.
- It is a suitable mode of restructuring of corporate firms that have incurred accumulated sizable losses over a number of years.
- A vast majority of such firms are likely to have a potential for liquidation, financial restructuring is one such measure for the revival for these firms
- To achieve the desired objective, firms need to restart with a fresh balance sheet, which does not contain past accumulated losses and fictitious assets.

88) Synergy in the context of Mergers and Acquisitions

Synergy May be defined as follows:

When the combined value of two companies is more than their individual value it is said to be SYNERGY.

V (AB) >V(A) + V (B)

It may result due to many factors such as:

- Economies of Scale & Scope
- Reduction in operating and various other fixed costs
- Access to cheaper funds
- Geographical advantage
- More efficient management

89) Types of Mergers/ Conglomerate Merger

Following are major types of mergers:

- **Horizontal Merger**: Two companies of same Industry & at Same Stage
  Ex: Tata Motors & JLR
- **Vertical Merger:** Two companies of same Industry but at different stage
  Ex: Tata Motors &Tata Steel
- **Conglomerate Mergers:** Two unrelated-Industry Companies
  Ex: Sun Pharma & Suzlon
- **Congeneric**:
  The acquirer and the target companies are related through basic technologies, production processes or markets.
  Merger between companies in same industries but different product
  Ex: Goibibo a travel portal acquiring redbus.in, a bus booking portal
- **Reverse Merger:** It involves acquisition of a public/ listed company by a private company
  Ex: ICICI reverse merged with ICICI Bank Ltd. in 2002

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90) Classification of Merger/ Takeover Strategies

Classification of Merger / Takeover Strategies

Take Over Strategies: Other than Tender Offer the acquiring company can also use the following techniques:

- **Street Sweep:** Here the Acquirer makes an open offer.
- **Bear Hug**: Here the Acquirer threatens the target to agree to a settlement
- **Strategic Alliance**: Disarming the Acquirer by offering a partnership rather than a buyout.
- **Brand Power**: Entering into an alliance with powerful brands to displace the target's brands and thus to make it to sell once it is weakened up.

91) Explain the term "Demerger".

- It refers to a situation where an 'undertaking' is transferred or sold to another purchasing entity.
- Even after demerger; the transferring company would continue to exist and may do business.
- Demerger is used as a suitable scheme in the following cases:
  a) Restructuring of an existing business
  b) Division of family-managed business
  c) Management 'buy-out'.

92) Takeover by reverse bid

When the smaller company gains control of a larger one then it is called "Takeover by reverse bid". This concept has been successfully followed for revival of sick industries. Reverse takeover takes place in the following cases:

- When the Target company (big company) is a financially weak company
- When the Acquirer (the small company) already holds a signification portion of shares of the Target company (small company)
- When the top management in the Acquirer Company wants, to release themselves of their responsibilities

93) Explain the term 'Buy-Outs'. (PM)

- A buy-out happens when a person or group of persons gains control of a company by buying all or a majority of its shares.
- There are two common types of buy-outs: Leveraged Buyouts (LBO) and Management Buy-outs (MBO).
- **LBO** is the purchase of assets or the equity of a company where the buyer uses a significant amount of debt and very little equity capital of his own for payment of the consideration for acquisition.
- **MBO** is the purchase of a business by its management, who step-in and acquire the business from the owners, and run the business for themselves.
- Buy-outs are one of the most common forms of privatization

94) Equity curve out vs spin off

Equity Curve Out

- The parent company sells stake in subsidiary company for cash proceeds through an IPO
- Unlike Spin Offs, an Equity Curve Out generates capital, since subsidiary shares are sold to public

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- It is used mostly when the Co. does not believe that a single buyer for the entire business is available or if the Co. wants to maintain some control over the business unit.

SPIN OFF

- Here the parent company divests business unit by making that unit its own new standalone company
- Instead of giving share to Public, here shares of subsidiary company are issued to existing shareholder
- Here, the original company may still own an equity stake

95) Primary & Secondary Capital Markets

Primary Capital Markets

- In primary market new issues are Launched (IPOs)
- Companies, governments and other groups obtain financing through debt or equity based securities.
- The issuing company receives cash proceeds from the sale, which is then used to fund operations or expand the business.
- Here, the transaction is basically between the Issuing Co & Shareholders

Secondary Capital Markets

- It is a place whereby shareholders trade amongst themselves
- It is a platform provided by the Company for its shareholders to buy/sell new/existing shares
- There are various other participants like brokers, analysts, traders, speculators, etc.
- The trading happens on recognized stock exchanges like BSE, NSE, etc.

96) Write a short note on 'Book building'. (PM)

- It is a technique used for marketing a public offer of equity shares of a company.
- It does not pre-determine the issue price (in case of equity shares) or interest rate (in case of debentures) and invite subscription to the issue.
- It starts with an indicative price band (or interest band) which is determined through invites bids from prospective investors at different prices.
- Those who bid are required to pay the full amount.
- Based on the response received from investors the final price is selected.
- The merchant banker (called in this case Book Runner) has to manage the entire book building process.

97) Explain the term "Offer for Sale".

- Instead of dealing directly with the public, a company offers the shares/debentures through a sponsor, typically a Bank or Institution.
- The company allots shares to the sponsor at an agreed price who then passes the consideration money to the company and in turn gets the shares duly transferred to him.
- After a specified period the shares are issued to the public by the sponsor with a premium & the sponsor gets the shares listed in one or more stock exchanges.

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- Thus, it enables the company to raise the funds easily and immediately.

98) Write short note on Green shoe option.

- It is an option that allows the underwriter of an IPO to sell additional shares if the demand is high
- Certain provisions are made to issue additional shares or bonds to underwriters for distribution, if there is exceptional interest of investors in terms of over-subscription of some issues called as Hot Issue
- The option was recently used by the Underwriters of Online Retailer - Alibaba Group, during its IPO in 2014

99) Functions of a stock exchange

- Liquidity and marketability of securities
- Fair price determination
- Source for long term funds.
- Helps in capital formation
- Creating investment opportunity for small investors
- Transparency in terms of providing all the company data

100) How is a stock market index calculated?

- A base year is set along with a basket of base shares.
- The changes in the market price of these shares are calculated on a daily basis.
- The shares included in the index are those shares which are traded regularly in high volume decided by the Exchange from time to time.
- In case the trading in any share exits or falls down heavily then it gets excluded and another company's shares replace it.

Following steps are involved in calculation of index on a particular date:

a) Calculate Market Capof all companies comprising the index.
b) Calculate the Total Market Cap by adding the Individual Market Cap
c) Computing Index **(NIFTY / SENSEX)** of next day as follows :

Index value = Index on previous Day = $\frac{\textbf{Total market capitalisation for current day}}{\textit{Total capitalisation of the previous day}}$

101) Explain the main function of an investment bank. Role of Investment Banks in Private Placements.

A summary of investment banking functions:

- Managing an IPO(Initial Public Offering)
- Issue of debt / equity
- Mergers and Acquisitions
- Private Placement
- Financial Restructuring

Private Placement:

- The Work is more of a **sell-side** M&A representation
- Finding a buyer by writing the Private Placement Memorandum
- Contacting potential strategic or financial buyers for clients
- Help in negotiating the terms of the deal
- They charge a fixed percentage FEE of the size of the transaction

102) Short note on depository participant.

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- An organization holding securities of investors in electronic form and which renders services related to transactions in securities is called a Depository.
- The depository is a safe keeper of securities for and on behalf of the investors.
- The securities are held in electronic form just like cash in a bank account & are credited to the investor's account maintained by this DP
- All corporate benefits such as Dividends, bonus, rights etc. are issued to security holders directly into their account instead of the physical form.

103) Advantages of holding securities in 'Demat' form

From an **individual** investor point of view

- It is speedier and avoids delay in transfers
- It avoids lot of paper work
- It saves on stamp duty
- No chance of getting lost

From the **issuer** company point of view

- Savings in printing certificates, postage expenses
- Stamp duty waiver.
- Easy monitoring of buying/selling patterns in securities.

104) Explain the term 'Insider Trading' and why Insider Trading is punishable?

- The insider is any person who accesses the price sensitive information of a company before it is published to the general public.
- Insider includes corporate officers, directors, owners of firm etc. who hold substantial interest & information in the company and does the act of buying or selling or dealing in securities based on this unpublished inside information with the intention of making abnormal profit's and avoiding losses.
- This inside information includes dividend declaration, issue or buys back of securities, amalgamation, mergers or take over, major expansion plans etc.
- It is an unethical practice, lawfully prohibited& hence punishable.
- The high profile insider trading Case of Rajat Gupta from GOLDMAN SACHS & Rajaratnam, owner of a Hedge Fund in USA, became a big highlight in the recent times.

105) Dow Jones Theory

The Dow Jones theory classifies the movements of the prices on the share market into three major categories:

- ***Primary Movements:***
  It is the largest trend lasting for more than one year
  It moves in the same direction until there is confirmed reversal
- ***Secondary Movement:***
  It is an intermediate trend that last from few weeks to few months
  It moves in the opposite direction of the primary trend
- ***Daily Movements***:
  There are irregular fluctuations which occur every day in the market.
  These fluctuations are without any definite trend.

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