CHAPTER 1 – FINANCIAL POLICY AND CORPORATE STRATEGY

Profit max as a financial obj suffers from multiple limitations. They are:

a) Level of operation for long run profit maximization may not catch up with the optimum levels under short run profit max goal. In that case one assigns more importance to short run profit max thereby ignoring long range obj
b) It also ignores Risk consideration in strategic planning. As a result, 2 projects with same expected profit are equally good under profit maximization rule. Under the profit cum risk consideration the project with lesser variability will be preferred by the investor than one with higher variability
c) It does not take into a/c effects of time. It treats inflows of equal magnitude to be received at diff points of time as equal thereby ignoring time value of money

INTERFACE OF FINANCIAL POLICY AND STRATEGIC MGT – The interface can be well understood if we appreciate the fact that the starting point of an org is money and the end point is also money again. Offer of the org is only a vehicle that links up the starting and end point. No org can run the existing business and promote a new expansion project without a suitable internally mobilized financial base or both internally and externally mobilized financial base

Sources of finance and capital structure are the most important dimensions of strategic plan. The generation of funds maybe from ownership capital and or borrowed capital

Along with mobilization of funds, policy makers are to decide also on the capital structure to indicate the desired mix of equity and debt capital. Another dimension is the investment and fund allocation decisions – decisions reg investment in Fixed and Current Assets. Dividend policy is another imp area. Stability of dividend has a +ive impact on share price.

From the above, it can be inferred that financial policy of a company cannot be worked out in isolation of other functional aspects. It has a wider appeal and closer link with overall org performance and direction of growth

CHAPTER 2 – PROJECT PLANNING AND CAPITAL BUDGETING

CONTENTS OF A PROJECT REPORT:

a) Promoters
b) Industry Analysis
c) Economic Analysis
d) Cost of project
e) Inputs
f) Technical Analysis
g) Financial Analysis

h) Social Cost Benefit Analysis
i) SWOT Analysis
j) Project Implementation Schedule

SOCIAL COST BENEFIT ANALYSIS: Approach for evaluation of projects. Its features are

a) It includes many economic activities having indirect effects on which there is no possibility of putting a market value
b) If savings are inadequate, money going into investment is regarded more valuable than money going into current consumption
c) Society values given quantum of addl consumption going to diff sections of the population differently. So distributional considerations are imp
d) For society, taxes are transferred from the project in hand to govt and does not involve real cost
e) Relative valuation placed on future consumption compared to current consumption is diff for the society. Also effect of perceived uncertainties may be different
f) Society may want to discourage consumption of certain goods and promote that of others

SHADOW PRICE OF INVESTMENT: Society as a whole gives imp to future generations than that accorded by pvt decision makers. Imperfections of capital markets lead to less than optimal total investment. Money devoted to investment in terms of immediate consumption is much more than money itself

SHORTCOMINGS OF SIMULATION ANALYSIS: a) Difficult to model the project and specify probability distribution of exogenous variables b) Simulation is inherently imprecise c) Realistic simulation being likely to be complex would probably be considered by mgt expert and not by the decision maker d) In determining NPV in simulation, Risk free discount rate is used. It is used to avoid pre- judging risk, which is reflected in the dispersion of the distribution of NPV. The NPV takes a diff meaning which is diff to interpret

CAPITAL ASSET PRICING MODEL APPROACH FOR CAPITAL BUDGETING:

The CAPM is based on assumption that total risk of an investment consists of 2 components: a) Systematic risk b) Unsystematic risk

Systematic risk arises from economic factors e.g. inflation, govt exp, money supply having a bearing on the existence of every firm although the effect may vary from firm to firm. Systematic risk cannot be overcome by diversification. Unsystematic risk arises from factors which are specific to a firm: development of a new process, plant break down, access to market etc. It can be eliminated by diversification

CHAPTER 3 – LEASING DECISIONS

CROSS BORDER LEASING: Leasing arrangement where lessor and lessee are situated in different countries. Often, the original owner of an asset is not subject to taxation in any country and therefore not able to claim depreciation. The transaction often involves an entity selling an asset (e.g. power plant, sewerage system) to an investor (who can claim depreciation) and long term leasing it right back (often referred as sale leaseback)

Other objectives of cross border leasing

a) Lessor is often able to utilize nonrecourse debt to finance a substantial portion of the equipment cost
b) Also, depending on the structure, in some countries the lessor can utilize very favorable "leveraged lease" financial accounting treatment for the overall transaction
c) In some countries, it is easier for a lessor to repossess the leased equipment following a lessee default because the lessor is n owner and not a mere secured lender
d) Leasing provides the lessee with 100% financing

CHAPTER 5 – INDIAN CAPITAL MARKET

PRIMARY MARKET: A market where new securities are bought and sold for the first time or the IPO market

SECONDARY MARKET: A market in which an investor purchases a security from another investor rather than the issuer, subsequent to the original issuance in the primary market. E.g. Stock Exchanges and Over the counter market

ROLLING SETTLEMENT CYCLES: This cycle starts and ends on the same day and the settlement takes place on the "T+5" day, which is 5 business days from the date of transaction. Hence the transaction on Monday will be settled on following Monday and transaction on Tue on next Tue and so on. Unlike a NSE or BSE weekly settlement cycle, in a rolling settlement, the decision has to made at the conclusion of trading session on the same day

ADV: Payments are quicker – Increased liquidity. From an investor's perspective it reduces delays. Also reduces tendency for price trends to get exaggerated. Investors thus get a better price as well as act at their leisure

CLEARING HOUSES: It is an exchange associated body charged with the function of ensuring (guaranteeing) the financial integrity of each trade

Working: The clearing house acts as the medium of transactions between the buyer and seller. Every contract between a buyer and a seller is substituted by 2 contracts so that clearing house becomes the buyer to every seller and the seller to every buyer. In a transaction where P sells futures to R, R is replaced by the clearing house and the risk taken by P becomes insignificant. Similarly the credit risk taken by R is taken over by the clearing house.

DIFF TYPES OF DERIVATIVE RISK- a) Credit Risk – i) Pre- settlement risk – Risk of loss due to a counterparty defaulting on a contract during the life of a transaction

ii) Settlement Risk – Risk of loss due to the counterparty's failure to perform on its obligation after an institution has performed on its obligation under a contract on the settlement date

b) Market Risk – Risk of loss due to adverse changes in the market value of an instrument or portfolio of instruments

c) Liquidity Risk – a) Market liquidity b) Funding liquidity

d) Operational Risk – Risk of Loss occurring as a result of inadequate systems and control, deficiencies in information systems, human error etc

e) Legal risk f) Regulatory risk g) Reputation risk

EMBEDDED DERIVATIVE – It 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 etc. Derivatives require being marked-to-market through income statement, other than qualifying hedge instruments. This requirement on embedded derivatives are designed to ensure that market-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

TYPES OF COMMODITY SWAPS: a) Fixed Floating swaps – They are just like the fixed- floating swaps in the interest rate swap market with the exception that both the indices are commodity based indices.

b) Commodity-for-interest swaps – Similar to equity swap in which a total return on the commodity in question is exchanged for some money market rate (plus or minus a spread)

VALUING COMMODITY SWAPS: The following factors must be accounted (at minimum)

a) The cost of hedging
b) The institutional structure of the particular commodity market in question
c) The liquidity of the underlying commodity market
d) Seasonality and its effects on the underlying commodity market
e) The variability of the future bid/offer spread
f) Brokerage fees
g) Credit risk, capital costs and admn. Costs

OTC DERIVATIVES: A derivative contract which is privately negotiated. OTC trades have no anonymity, and they generally do not go through a clearing corporation. Every derivative product can traded on OTC (pvt negotiations) or an exchange

CHAPTER 6 – SECURITY ANALYSIS

THE DOW THEORY – The Dow Theory is based upon movt of 2 indices, constructed by Charles Dow, Dow Jones Industrial Average (DJIA) and Dow Jones Transportation Average (DJTA). These averages reflect the aggregate impact of all kinds of information on the market. The movt of market is divided into 3 – All going at the same rate- primary movt, secondary movt and the daily fluctuations. The primary movt is the main trend of the market which lasts from 1 year to 36 months or longer. This trend is normally called bear or bull market. The secondary movt of the market is shorter in duration than the primary movt and is opposite in direction. It lasts from 2 weeks to a month or more. The daily fluctuations are the narrow movements from day to day. These fluctuations are not part of the Dow Theory Interpretation of Stock Market.

SUPPORT AND RESISTANCE LEVELS: When the index/ price go down from a peak, the peak becomes the resistance level. When the index/price rebounds after reaching a trough subsequently, the lower value becomes the support level. The price is then expected to move between these levels. Whenever the price approaches the resistance level, there is a selling pressure because all those 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

INTERPRETING PRICE PATTERNS

a) Channel – A series of uniformly changing tops and bottoms give rise to a channel formation. A downward sloping channel would indicate declining prices and an upward sloping channel would imply rising prices
b) Wedge – A wedge is formed when the tops (resistance) and bottoms (support) change in the opposite direction (i.e. if the tops are decreasing then the bottoms are increasing and vice versa) or when they are changing in the same direction at diff rates over time
c) Heads and Shoulders - It is a distorted drawing of a human form, with large lump (for head) in the middle of the two smaller humps (for shoulders). This is perhaps the single most important pattern to indicate a reversal of price trend
d) Gap – It is the difference between the opening price on a trading day and the closing price of the previous trading day. The wider is the gap the stronger is 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

BOLLINGER BANDS – A band is plotted with two standard deviations away from a simple moving average. Because standard deviation is a measure of volatility, Bollinger bands adjust themselves to the market conditions. When the markets become more volatile, the bands widen (move away from the average) and during less volatile periods the bands contract (move closer to the average). The tightening of the bands is often used by technical traders as an early indication that the volatility is about to increase sharply

CHAPTER 7 – PORTFOLIO THEORY

RANDOM WALK THEORY – Many investment managers 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 the stock market prices is unpredictable and that there is no relationship between the present prices of the shares and the future prices. The supporters of this theory put the following arguments

a) Prices of shares in stock market can never be predicted
b) 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
c) There may be periodical ups or downs in share prices, but no connection can be established between two successive peaks and troughs

OBJ OF PORTFOLIO MGT –

a) Safety/ Security of Principal
b) Stability of Income
c) Capital growth
d) Marketability
e) Liquidity
f) Diversification
g) Favorable tax status

FORMULAION OF PORTFOLIO STRATEGY – ACTIVE PORTFOLIO STRATEGY (APS)

4 principle vectors of an active strategy –

a) <u>Market timing</u> - Based on explicit/ implicit forecast of general market movement
b) <u>Sector rotation</u> – It may apply to both stock and bond component of the portfolio. The components of the portfolio are used when it involves shifting
c) <u>Security Selection</u> – Search for an underpriced security
d) <u>Use of specialized investment concept</u> – Adv – i) Focus one's effort on a certain kind of investments that reflects one's ability and talent ii) Avoid the distraction of pursuing other alternatives iii) Master an approach through continuous practice

<u>SUMARY OF TRADING MOTIVATIONS, TIME, HORIZON AND TIME Vs PRICE PREFERNCES</u>

TRANSACTIONS	**MOTIVATIONS**	**TIME HORIZONS**	**TIME Vs PRICE PREFERNCE**
VALUE BASED TRANSACTOR	Discrepancy bet value and price	Weeks to months	Price
INFORMATION BASED TRANSACTOR	New Information	Hours to days	Time
LIQUIDITY BASED TRANSACTOR	Release or absorb cash	Hours to days	Time

PSEUDO INFO. BASED TRANSACTOR	Apparently new information	Hours to days	Time
DEALERS	Accommodation	Minutes to hour	Indifferent

MAIN FEATURES OF HEDGE FUNDS:

a) Hedge funds vary enormously in terms of investment returns, volatility and risk
b) Many hedge funds have the ability to deliver non-market correlated returns
c) Many hedge funds have as an objective consistency of returns and capital preservation rather than magnitude of returns
d) Most hedge funds are managed by experienced investment professionals who are generally disciplined and diligent
e) Most hedge fund managers are highly specialized and trade only within their area of expertise and competitive advantage

CHAPTER 8 – FINANCIAL SERVICES IN INDIA

INVESTMENT BANK: An investment bank does not have an inventory of cash deposits to lend as commercial bank does. In essence, an investment bank acts as an intermediary and matches sellers of stocks and bonds with buyers of stocks. That companies use investment bank toward the same and as they use commercial banks. If a company needs capital, it may get a loan from a bank, or it may ask as investment bank to sell equity or debt (stocks or bonds)

SOME FUNCTIONS OF INVESTMENT BANK: a) Issue of IPO b) Hiring the managers c) Due Diligence and Drafting d) Marketing e) Issue of debt

MERCHANT BANKERS: Acts as key intermediary between the company and issue of capital. Major functions include

a) Determining the type of securities to be issued
b) Drafting of prospectus and application forms
c) Compliance with procedural formalities
d) Appointment of registrars to deal with share application and transfer
e) Listing of securities
f) Arrangement of underwriting
g) Placing of issue
h) Selection of brokers and bankers to the issue

THE MAIN DUTIES OF DEBENTURE TRUSTEE include the following:

a) Call for periodical report from the company
b) Inspection of books of accounts, records, registration of the company and the trust property to the extent of discharging the claims

c) Take possession of trust property, in acc with provisions of trust deed
d) Enforce security in the interest of debenture holders
e) Carry out all the necessary acts for the protection of the debenture holders and to do needful to resolve their grievances
f) Ensure refund of money in acc with the Companies Act

CREDIT RATING – Means an assessment made from the credit risk evaluation, translated into a current opinion as on a specific date on the quality of 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 instruments in a timely manner

Credit Rating does not in any way linked with:

a) Performance Evaluation of the rated entity unless called for
b) Investment Recommendation by the rating agency to invest or not in the instrument to be rated
c) Legal compliance by the issuer – entity through audit
d) Opinion on the holding company, subsidiaries or associates of the issuer entity

CREDIT RATING AGENCIES IN INDIA – a) Credit Rating Info Services of India ltd. (CRISIL) b) Investment Info and Credit Rating Agency (ICRA) c) Credit Analysis and Research Ltd (CARE) d) Fitch Ratings India (P) Ltd

CREDIT RATING PROCESS:

a) Request from issuer and analysis
b) Rating committee
c) Communication to mgt and appeal
d) Pronouncement of the rating
e) Monitoring of the assigned rating
f) Rating watch
g) Confidentiality of Info
h) Rating / Credibility
i) Rating Coverage
j) Rating scores

LIMITATIONS OF CREDIT RATING: a) Rating Changes b) Industry Specific rather than company specific c) Cost Benefit Analysis d) Conflict of Interest e) Corporate Governance Issues like – i) rating agencies getting more of its revenue from a single service or group ii) Rating agencies enjoy a dominant position engaging in aggressive competitive practices by refusing to rate a collateralized/ securitized instrument iii) greater transparency in the rating process viz. in the disclosure fo assumptions leading to specific public rating

CAMEL MODEL IN RATING – CAMEL stands for – Capital, Asset, Mgt, Earnings and Liquidity. Focuses on

a) Capital – Composition of retained earnings and external funds raised; fixed dividend component for preference shares and fluctuating dividend component for equity shares and adequacy of long term funds adjusted to gearing levels; ability of issuer to raise further borrowings
b) Assets – Revenue generating capacity of existing/ proposed assets , fair values, tech/ physical obsolescence , linkage of asset values to turnover, consistency , appropriation of methods of depreciation etc
c) Mgt – Extent of involvement of mgt personnel, team work, authority, timeliness, effectiveness and appropriateness of decision making along with directing mgt with achieving corporate goals
d) Earnings – Absolute levels, trends, stability, adaptability, to cyclical fluctuations, ability of entity to service existing and addl debts proposed
e) Liquidity – Effectiveness of working capital mgt, corporate policies for stock and creditors, mgt and the ability of the corporate to meet their commitments in the short term

CONSUMER FINANCE: Consumer Credit provides short term/ medium term loans to finance purchase of goods or services for personal use. 4 imp sources – Manufacturers/ sellers/dealers, finance companies, banks, credit card companies

Structure of Loans: Loan amount, Interest charges for the borrowed period, loan amount together with interest to be repaid by the borrower

ASSET RESTRUCTURING/ MANAGEMENT COMPANY: A mutual fund is an investment vehicle suitable for retail investors who have a limited amount of money, lack of exposure, knowledge and skill. A mutual fund management company shall manage its fund with honesty and care to preserve the best interests of its unit holders with professional knowledge and competence. The management company shall manage the fund strictly in accordance with the policy and obj of the fund as specified in the mutual fund proposal and prospectus. The fund shall invest in types of securities or assets having diversification and investment limits specified by law

RESTRCITIONS OF BUSINESS ACTIVITIES OF ASSET MGT CO:

The asset mgt company shall

a) Not act as a trustee of any mutual fund
b) Not undertake any other business activities except activities in the nature of [portfolio mgt services] mgt and advisory services to offshore funds, pension funds, PF etc
c) The asset mgt co shall not invest In any of its schemes unless full disclosure of its intention to invest has been made in the offer document

APPOINTMENT OF CUSTODIAN: a) The mutual fund shall appoint a custodian to carry out the custodial services for the schemes of the fund and sent intimation of the same to the Board within fifteen days of appointment of custodian

b) No custodian in which the sponsor or its associates hold 50% or more of the voting rights of the share capital of the custodian or where 50% or more of the directors of the custodian represent the interest of the sponsor or its associates shall acts as custodian for a mutual fund constituted by the same sponsor or any of its associates or subsidiary company

DEPOSITORY SYSTEM: 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 thus are fungible. The ownership and transfer of securities take place by means of book entries, avoiding risks associated with paper

Physical	Dematerialized
1) Actual Delivery of shares is to be exchanged	1) No actual delivery of shares is needed
2) Open Delivery can be kept	2) Not possible to keep delivery open
3) Processing time is long	3) Processing time is less
4) Stamp charges @ 0.5% are levied for transfer	4) No stamp charges are required for transfer
5) For sales transaction, no charges other than brokerage are levied	5) Sales transactions are also charged
6) For buy transaction, delivery is to be sent to company for Registration	6) No need to send the document to the company for Registration

<u>The major benefits accruing to investors and other market players are as follows</u>:

a) Securities are held in a safe and convenient manner
b) Transfer of securities is affected immediately
c) Stamp duty for transfer is eliminated and transaction costs are reduced
d) Paper work is minimized
e) Bad deliveries, fake securities and delays in transfers are eliminated
f) Payment of dividends and interest is expedited by the use of electronic clearing system

<u>There are however risks</u>:

a) Systemic failure
b) Addl. record keeping
c) Cost of Depository Participant (DP)
d) Human fraud

<u>**CHAPTER 9 – MUTUAL FUNDS**</u>

SECTOR FUNDS: Highly focused on a particular industry. Basic obj is to enable the investors to take adv of industry cycles. Since sector funds ride on market cycles, they have the potential to offer good returns if the timing is perfect

THEMATIC FUNDS: A thematic fund focuses on trends that are likely to result in the 'out – performance' by certain sectors of companies. In other words, the key factors are those that can make a difference to business profitability and market values

CASH FUND – Cash fund is an open ended liquid scheme that aims to generate returns with lower volatility and higher liquidity through a portfolio of debt and money market instrument. The fund will have retail institutional and super institutional plans. Each plan will offer growth and dividend options.

EXCHANGE TRADED FUNDS (ETF) – An ETF is a hybrid product that combines the features of an index fund. These funds are listed on the stock exchanges and their prices are linked to the underlying index. The authorized participants act as market makers for ETFs. ETFs can be bought and sold like any other stock on an exchange. In other words, ETF s can be bought and sold any time during the market hours at prices that are expected to be closer to the NAV at the end of the day. Therefore one can invest at real time prices as against the end of the day prices as is the case with open- ended schemes

KEY PLAYERS IN MUTUAL FUNDS

a) Sponsor: Company est under Co's Act forms a mutual fund
b) Asset Mgt Company
c) Trustee: The trust is headed by Board of Trustees. The trustee holds the property of the mutual fund in trust for the benefit of unit holders and looks into the legal requirements of operating and functioning of the mutual fund
d) Unit Holder
e) Mutual Fund

CLASSIFICATION OF MF – FUNCTIONAL CLASSIFICATION

a) **Open Ended** – The investor can make entry and exit at any time. Also the capital of the fund is unlimited and the redemption period is indefinite
b) **Close Ended** – 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

ADV OF MF: a) Professional Mgt b) Diversification c) Convenient Admn d) Higher returns e) Low cost of mgt f) Transparency g) Liquidity h) Highly Regulated

DRAWBACKS OF MF:

a) No guarantee of return - All MF cannot be winners. A MF may perform better than the stock market but this does not mean gain for the investor. Investors may forgive if the return is not adequate but may not forgive if principle is eroded
b) Diversification – Though diversification reduces risk, it does not ensure max returns
c) Selection of proper fund – Easy to select right share rather than the right fund. For stocks, one can base the selection based on parameters of economic, industry analysis. In case of MF past performance is the only criteria, but past cannot predict the future
d) Cost factor
e) Unethical Practices

SIGNALS HIGHLIGHTING THE EXIT OF THE INVESTOR FROM THE MF SCHEME

a) When the MF consistently underperforms the broad based index
b) When the MF consistently underperforms its peer group instead of it being in the top
c) When the MF changes its objectives
d) When the investor changes his obj of investing
e) When the fund mgr, handling the MF has been replaced by a new entrant whose image is not known

MONEY MARKET MFs – Introduced to enable individual investors to gain from money market instruments since it is practically impossible to invest in instruments like Commercial Papers (CP). The broad framework:

a) Investment by individuals and other bodies would be in the form of negotiable and transferrable instruments and MMMF deposit accounts
b) The re-purchase would be subject to a min lock in period of 3 months
c) Min Investment – Rs 1 lac
d) Funds will not subject to reserve requirement as these will be invested in Money Market Instruments
e) Min 20% of funds – Invested in 182 days treasury bills
f) Max 20% of funds – Call Money markets

CHAPTER 10 – MONEY MARKET OPERATIONS

INSTRUMENTS

INTER BANK PARTICIPATION CERTIFICATE (IBPC) – Short term instruments to even out the short term liquidity within the banking system. The IBPC can be issued by scheduled commercial bank and can be subscribed to by any commercial bank. The IBPC is issued against an underlying advance, classified standard and the aggregate amount of participation in any account time issue. During the currency of the participation, the aggregate amount of participation should be covered by the outstanding balance in account. While the participation without it can be issued for a period not exceeding 90 days. Participation is now with risk for a period between 91 days and 180 days.

COMMERICAL BILLS – Drawn by a seller of goods on a buyer of goods. The need for physical transfer of bills has been waived and the rediscounting institution can raise the Derivative Usance promissory notes (DUPNs). These DUPNs are sold to investors in convenient lots and maturities (15days to 90 days) on the basis of genuine trade bills, discounted by the discounting bank

CERTIFCATE OF DEPOSITs (CDs) – Negotiable term- deposits accepted by commercial bank from bulk depositors at market related rates. The CDs can be issued by scheduled commercial banks at a discount to face value for a period from 3 months to 1 year. The CDs can be issued for a min amount of Rs. 5 lacks to a single investor. CDs above Rs. 5 lacks to in multiples of Rs.1 lacks. No limit on the total quantum of funds raised through CDs. The discount on CDs is deregulated and is market determined. The CDs can be negotiated on or after 30 days of issue to the primary investor

COMMERCIAL PAPER (CP) – Unsecured debt instrument in the form of a promissory note issued by highly rated borrowers for tenors ranging between 15 days and 1 year. Corporate raise funds through CPs on an ongoing basis throughout the year. Some go in for CP issuance to redeem old issues

DEBT SECURITIZATION: Converting retail loans into whole sale loan and their reconverting into retail loans. For e.g. a bank lends Rs. 10 lacks each to 300 borrowers as part of its loan portfolio. The total debt thus on the books will be Rs. 30 crores. By the way of securitization, the bank can break the entire portfolio of loans/ debt of Rs. 30 crores into a paper of Rs. 300 each for instance, and market it in the secondary market for investors. The idea is that an individual body cannot go on lending sizable amount for about a longer period continuously but if the loan amount is divided in small pieces and made transferrable like negotiable instruments in the secondary market, it becomes to finance large projects having long gestation period.

REPURCHASE OPTIONS (Repo) AND READY FORWARD (RF) CONTARCTS –

Repo – Under this transactions the borrower places with the lender certain acceptable securities against funds received and agrees to reverse the transaction on a pre- determined future date at agreed interest cost. No fixed period has been prescribed for this transaction. However generally repo transactions are for a min period of 14 days and max period of 1 year.

READY FORWARD Transactions are structured to suit the req. of both the borrower and lender and have therefore become extremely popular. The borrower has adv of raising funds against its securities without altering its assets mix while the lender finds a safe avenue giving attractive returns

CHAPTER 11 – FDI, FII AND IFM

EXTERNAL COMMERCIAL BORROWINGS – **ECB** are defined to include:

a) Commercial bank loans
b) Buyer's credit
c) Supplier's credit
d) Securitized instruments such as floating rate notes, fixed rate bonds etc
e) Credit from official export credit agencies
f) Commercial borrowings from the private sector window of multilateral financial institutions such as IFC, ADB, AFIC, CDC etc
g) Investment by FII in dedicated debt funds

FOREIGN CURRENCY COVERTIBLE BOND (FCCB):

ADV of FCCBs –

a) 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 3 years if the price of the share has not met his expectations
b) Companies prefer bonds as it leads to delayed dilution of equity and allows company to avoid any current dilution In EPS that a further issuance of equity would cause
c) FCCBs are easily marketable as investors enjoy option of conversion into equity if resulting to capital appreciation. Further investor is assured of a min fixed interest earnings

DISADV of FCCBs

a) 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
b) FCCBs mean creation of more debt and a forex outgo in terms of interest which is in forex
c) 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

MAIN OBJ OF AN EFFECTIVE SYS OF INTERNATIONAL CASH MGT:

a) To minimize currency exposure risk
b) To minimize overall cash requirements of the company as a whole without disturbing smooth operations of the subsidiary or its affiliate
c) To minimize transaction costs

d) To minimize country's political risk
e) To take advantage of economies of scale as well as reap benefits of superior knowledge

NUMEROUS WAYS OF OPTIMISING CASH FLOWS:

a) Accelerating cash inflows
b) Managing blocked funds
c) Leading and Lagging strategy
d) Using netting to reduce overall transaction costs by eliminating number of unnecessary conversions and transfer of currencies
e) Minimizing tax on cash flow through International Transfer Pricing

MANAGING BLOCKED FUNDS: The host country may block funds of the subsidiary to be sent to the parent or make sure that earnings generated by the subsidiary be re invested locally before being remitted to the parent so that the jobs are created and unemployment reduced. The subsidiary may be instructed to obtain bank finance locally from the parent firm so that blocked funds may be utilized to pay off bank loans. The parent company has to assess the potential future funds blockage in a foreign country. MNC s have to be aware of political risks cropping up due to unexpected blockage of funds and devise ways to benefit their shareholders by using different methods for moving blocked funds through Transfer pricing strategies, direct negotiations, leading and lagging and so on

The adv of Leading and Lagging are

a) No formal recognition of indebtedness is required and the credit terms can be altered
b) It helps in minimizing forex exposure and helps in transferring liquidity among affiliates by changing credit terms and is dependent on the opportunity cost of funds both paying and receiving units
c) It is an aggressive technique aimed at taking adv of expected revaluations and devaluations of currency movements

CHAPTER 12 – FOREX EXPOSURE AND RISK MGT

INTERNATIONAL FISHER EFFECT (IFE) – According to it, 'nominal risk free interest rates contain a real rate of return and anticipated inflation'. This means if investors of all countries may be the result of differential in expected inflation. The IFE theory suggests that foreign currencies with relatively high interest rates will depreciate because the high nominal interest rates reflect expected inflation. The nominal interest rate would also incorporate the default risk of an investment

RISK CONSIDERATIONS – TYPES OF RISKS

a) Financial Risk
b) Business Risk
c) Credit or Default risk

d) Country Risk
e) Interest Rate Risk
f) Political Risk
g) Market risk
h) Forex risk

CHAPTER 13 – MERGERS &ACQUISITIONS & RESTRUCTURING

TAKE OVER STRATEGIES:

a) Street Swap – Acquiring company accumulates lager no of shares in a target before making an open offer
b) Bear Hug – Acquirer threatens the target to make an open offer , the board of target company agrees to a settlement with the acquirer for change of control
c) Strategic Alliance – Disarming the acquirer by offering partnership rather than a buyout
d) Brand Power- Entering into alliance with powerful brands to displace the target's brands and as a result, buyout the weakened company

TAKEOVER BY REVERSE BID: A smaller company gains control over of a larger one. Not the usual case of amalgamation of a sick unit which is non viable with healthy unit but here the entire undertaking of the viable unit is vested in the sick company.

3 tests in a takeover by reverse bid that are to be satisfied are

a) Assets of the transferor company are greater than the transferee company
b) Equity capital to be issued by the transferee company pursuant to the acquisition exceeds its original issued capital
c) The change of control in the transferee company through the introduction of minority holder or group of holders

DEFENDINFG A COMPANY IN A TAKEOVER BID – DEFENSIVE TACTICS

a) Divestiture – The target company divests or spins off some of its business in the form of independent, subsidiary company.
b) Crown Jewels – When a target company uses the tactic of divestiture it is said to sell the crown jewels
c) 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
d) 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
e) Greenmail – Incentive offered by mgt of the target company to potential bidder for not pursuing the takeover

f) White Knight – A target company offers to be acquired by a friendly company to escape from hostile takeover
g) 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
h) 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
i) Pac-man defense – This strategy aims at the target company making a counter bid for the acquirer company.

CORPORATE CONTROLS –

a) Going Private – A listed company is converted into a pvt co by buying back all the outstanding shares from the markets
b) **Buy-outs** – Also known as Management Buy-outs. In this case, the mgt of the company buys a particular part of the business from the firm and then incorporates the same as a separate entity. The existing mgt, sometimes is short of funds to pay for buyout and therefore resort to heavy debt financing nearly 90-95% from investors etc. The buyout is termed as Leveraged Buyout (LBO). The LBO involves participation by 3^{rd} party (lenders) and the mgt no longer deals with diff shareholders, but instead with the lenders only. However heavy debt financing in LBO leads to dramatic increase in the debt ratio posing heavy risk.
c) Mgt Buy Ins – It is a hybrid form involving both existing and new mgts
d) Full Buyouts – When a person, group or body acquires over 90% or 95% of the equity of a public listed company, it is incumbent upon the residual shareholders to sell their shares to the buyer at a fair price that is set by the regulatory authority. Not legislated in India

REASONS FOR FAILURE OF MERGERS

a) Acquirers generally overpay
b) The value of synergy is over-estimated
c) Poor post-merger integration
d) Psychological Barriers