

MOCK TEST PAPER – 1
FINAL COURSE: GROUP – I
PAPER – 2: STRATEGIC FINANCIAL MANAGEMENT
SUGGESTED ANSWERS/HINTS

1. (a)

(i) Current future price of the index

$$= 5000 + 5000 (0.09 - 0.06) \frac{4}{12} = 5000 + 50 = 5,050$$

∴ Price of the future contract = Rs. 50 x 5,050 = Rs. 2,52,500

(ii) Hedge ratio = $\frac{1010000}{252500} \times 1.5 = 6$ contracts

Index after three months turns out to be 4500

$$\text{Future price will be} = 4500 + 4500 (0.09 - 0.06) \times \frac{1}{12} = 4,511.25$$

Therefore, Gain from the short futures position is = 6 x (5050 – 4511.25) x 50 = Rs. 1,61,625

Note: Alternatively we can also use daily compounding (exponential) formula

(b) **CALCULATION OF NPV**

	Rs.
PV of cash inflows (Rs. 45,000 x 3.169)	1,42,605
Initial Project Cost	<u>1,20,000</u>
NPV	<u>22,605</u>

If initial project cost is varied adversely by 10%*

NPV (Revised) (Rs. 1,42,605 - Rs. 1,32,000) Rs. 10,605

Change in NPV (Rs. 22,605 – Rs. 10,605) / Rs. 22,605 i.e. 53.08 %

If annual cash inflow is varied adversely by 10%*

Revised annual inflow Rs. 40,500

NPV (Revised) (Rs. 40,500 x 3.169) – (Rs. 1,20,000) (+) Rs. 8,345

Change in NPV (Rs. 22,605 – Rs. 8,345) / Rs. 22,605 63.08 %

If cost of capital is varied adversely by 10%*

NPV (Revised) (Rs. 45,000 x 3.103) – Rs. 1,20,000 (+) Rs. 19,635

Change in NPV (Rs. 22,605 – Rs. 19,635) / Rs. 22,605 13.14 %

Conclusion: Project is most sensitive to 'annual cash inflow'.

*Note: Students may please note that they may assume any other percentage rate other than 10 % say 15%, 20 % 25 % etc.

- (c) Here Canara Bank shall buy US\$ and credit Rs. to Vostro account of ABN-Amro Bank. Canara Bank's buying rate will be based on the Inter-bank Buying Rate (as this is the rate at which Canara Bank can sell US\$ in the Interbank market)

Accordingly, the Interbank Buying Rate of US\$ will be Rs. 51.3625 (lower of two)

Equivalent of US\$ for Rs. 15 million at this rate will be

$$= \frac{15,000,000}{51.3625} = \text{US\$ } 2,92,041.86$$

- (d) Return for the year (all changes on a per year basis)

Particulars	Rs. /Unit
Change in price (Rs. 13.00 – Rs. 12.25)	0.75
Dividend received	1.25
Capital gain distribution	<u>1.00</u>
Total Return	<u>3.00</u>

$$\text{Return on investment} = \frac{3.00}{12.25} \times 100 = 24.49\%$$

If all dividends and capital gain are reinvested into additional units at Rs. 12.50 per unit the position would be.

Total amount reinvested = Rs. 2.25 × 300 = Rs. 675

$$\text{Additional units added} = \frac{\text{Rs. } 675}{12.50} = 54 \text{ units}$$

Value of 354 units as on 31-12-2010 = Rs. 4,602

Price paid for 300 units on 31-12-2009 (300 × Rs. 12.25) = Rs. 3,675

$$\text{Return} = \frac{\text{Rs. } 4,602 - \text{Rs. } 3,675}{\text{Rs. } 3,675} = \frac{\text{Rs. } 927}{\text{Rs. } 3,675} = 25.22\%$$

2. (a) The annual change in cash flows through entering into a factoring agreement is:

Savings	Amount in (Rs.)	Amount in (Rs.)
Administration cost saved		1,00,000
Existing average debtors [Rs. 1,00,00,000/365) x 80 days]	21,91,781	
Average New Debtors [(Rs. 1,00,00,000/365) x 60 days]	<u>16,43,836</u>	
Reduction in debtors	<u>5,47,945</u>	
Cost there of @80%	<u>4,38,356</u>	
Add: Interest saving @15% p.a. on Rs. 4,38,356		65,753
Add: Bad Debts saved @.005 of Rs. 1,00,00,000		<u>50,000</u>
	Total	2,15,753
Less: Annual charges @2% of Rs. 1,00,00,000		<u>2,00,000</u>
Net annual benefits of factoring		<u>15,753</u>

Therefore, the factoring agreement is worthwhile and should be undertaken.

- (b) (i) **Working Notes:**

Present Value of Cash Flows (CF) upto 5 years

Year End	CF of Yes Ltd. (Rs. lakhs)	PVF @15%	PV of CF (Rs. lakhs)	CF of Merged Entity (Rs. lakhs)	PV of CF of Merged Entity (Rs. lakhs)
1	175	0.870	152.25	400	348.00
2	200	0.756	151.20	450	340.20
3	320	0.658	210.56	525	345.45
4	340	0.572	194.48	590	337.48
5	350	0.497	<u>173.95</u>	620	<u>308.14</u>
			<u>882.44</u>		<u>1679.27</u>

PV of Cash Flows of Yes Ltd. after the forecast period

$$TV_5 = \frac{CF_5(1+g)}{K_e - g} = \frac{350(1+0.05)}{0.15 - 0.05} = \frac{367.50}{0.10} = \text{Rs.}3675 \text{ lakhs}$$

PV of TV_5 = Rs.3675 lakhs x 0.497 = Rs.1826.475 lakhs

PV of Cash Flows of Merged Entity after the forecast period

$$TV_5 = \frac{CF_5(1+g)}{K_e - g} = \frac{620(1+0.06)}{0.15-0.06} = \frac{657.20}{0.09} = \text{Rs.7302.22 lakhs}$$

$$PV \text{ of } TV_5 = \text{Rs.7302.22 lakhs} \times 0.497 = \text{Rs.3629.20 lakhs}$$

Value of Yes Ltd.

	Before merger (Rs. lakhs)	After merger (Rs. lakhs)
PV of CF (1-5 years)	882.440	1679.27
Add: PV of TV_5	<u>1826.475</u>	<u>3629.20</u>
	<u>2708.915</u>	<u>5308.47</u>

(ii) Value of Acquisition

= Value of Merged Entity – Value of Yes Ltd.

$$= \text{Rs.5308.47 lakhs} - \text{Rs.2708.915 lakhs} = \text{Rs.2599.555 lakhs}$$

(iii) Gain to Shareholders of Yes Ltd.

$$\text{Share of Yes Ltd. in merged entity} = \text{Rs.5308.47 lakhs} \times \frac{1}{1.5} = \text{Rs.3538.98 lakhs}$$

Gain to shareholder = Share of Yes Ltd. in merged entity – Value of Yes Ltd. before merger

$$= \text{Rs.3538.98 lakhs} - \text{Rs.2708.915} = \text{Rs.830.065 lakhs}$$

3. (a) (i) Payback period = $\frac{5,00,000}{1,25,000} = 4.00$

PV factor closest to 4.00 in 8 years is 4.078 at 18%

Thus IRR = 18%

Note: Students may also arrive at the answer of 18.63% instead of 18% if exact calculation are made as follows:-

PV factor in 8 years at 19% is 3.9544

Interpolating for 4.00

$$IRR = 18\% + \frac{4.0776 - 4.000}{4.0776 - 3.9544} = 18.63\%$$

(ii) Desired lease rent to earn 20% IRR before expenses and taxes:

$$\text{Lease Rent} = \frac{5,00,000}{PVIFA_{8\text{yr}, 20\%}} = \frac{5,00,000}{3.837} = \text{Rs. 1,30,310.14 p.a.}$$

- (iii) Revised lease rental on school bus to earn 20% return based on the given conditions.

$$PV \text{ factor } [(X - E - D) (1 - T) + D] + (PV \text{ factor} \times S.V.) = Co$$

$$3.837 [(x - 50,000 - 50,000) (1 - .4) + 50,000] + (.233 \times 1,00,000^*) = 5,00,000$$

$$3.837 [6x - 60,000 + 50,000] + 23,300 = 5,00,000$$

$$2.3022x = 5,15,070$$

$$x = 2,23,729.47$$

This may be confirmed as lease rental	2,23,729.47
Less: Expenses + Depreciation	<u>1,00,000.00</u>
EBT	1,23,729.47
Less tax 40%	<u>49,491.79</u>
PAT	74,237.68
Add: Depreciation	<u>50,000.00</u>
CFAT	<u>1,24,237.68</u>

$$\frac{Co - PV \text{ of } SV}{CFAT} = \frac{5,00,000 - 23,300}{1,24,237.68} = 3.837 \text{ or } 20\%$$

* **Note:** Alternatively, STCG can also be considered as net of tax.

(b) Modigliani and Miller (M-M) – Dividend Irrelevancy Model:

$$P_0 = \frac{P_1 + D_1}{1 + K_e}$$

Where,

P_0 = Existing market price per share i.e. Rs. 120

P_1 = Market price of share at the year-end (to be determined)

D_1 = Contemplated dividend per share i.e. Rs. 6.4

K_e = Capitalisation rate i.e. 9.6%.

(i) (a) Calculation of share price when dividend is declared:

$$P_0 = \frac{P_1 + D_1}{1 + K_e}$$

$$120 = \frac{P_1 + 6.4}{1 + 0.096}$$

$$120 \times 1.096 = P_1 + 6.4$$

$$P_1 = 120 \times 1.096 - 6.4$$

$$= 125.12$$

(b) Calculation of share price when dividend is not declared:

$$P_0 = \frac{P_1 + D_1}{1 + K_e}$$

$$120 = \frac{P_1 + 0}{1 + 0.096}$$

$$120 \times 1.096 = P_1 + 0$$

$$P_1 = 131.52$$

(ii) Calculation of No. of shares to be issued:

(Rs. in lakhs)

Particulars	If dividend declared	If dividend not declared
Net Income	160	160
Less: Dividend paid	<u>51.20</u>	<u>-----</u>
Retained earnings	108.80	160
Investment budget	<u>320</u>	<u>320</u>
Amount to be raised by issue of new shares (i)	<u>211.20</u>	<u>160</u>
Market price per share (ii)	125.12	131.52
No. of new shares to be issued (ii)	1,68,797.95	1,21,654.50
Or say	1,68,798	1,21,655

4. (a) (i) Receipt under three proposals

(a) Proposal of Mr. Peter

$$\text{Invoicing in £ will produce} = \frac{\text{€ 2.8 million}}{1.1965} = \text{£ 2.340 million}$$

(b) Proposal of Mr. Wilson

$$\text{Forward Rate} = \text{€1.1970} - 0.0055 = 1.1915$$

$$\text{Using Forward Market hedge Sterling receipt would be } \frac{\text{€ 2.8 million}}{1.1915}$$

$$= \text{£ 2.35 million}$$

(c) Proposal of Ms. Karen

The equivalent sterling of the order placed based on future price (€1.1943)

$$= \frac{€2.8 \text{ million}}{1.1943} = £2,344,470 \text{ (rounded off)}$$

$$\text{Number of Contracts} = \frac{£2,344,470}{62,500} = 37 \text{ Contracts (to the nearest whole number)}$$

Thus, € amount hedged by future contract will be = $37 \times £62,500 = £23,12,500$

Buy Future at €1.1943

Sell Future at €1.1873

€0.0070

Total loss on Future Contracts = $37 \times £62,500 \times €0.0070 = €16,188$

After 6 months

Amount Received €28,00,000

Less: Loss on Future Contracts € 16,188

€ 27,83,812

Sterling Receipts

$$\text{On sale of € at spot} = \frac{€27,83,812}{1.1873} = £2.3446 \text{ million}$$

- (ii) Proposal of option (b) is preferable because the option (a) & (c) produces least receipts. Further, in case of proposal (a) there must be a doubt as to whether this would be acceptable to German firm as it is described as a competitive market and Zaz is moving into it first time.

- (b) (i) Security A has a return of 8% for a risk of 4, whereas B and F have a higher risk for the same return. Hence, among them A dominates.

For the same degree of risk 4, security D has only a return of 4%. Hence, D is also dominated by A.

Securities C and E remain in reckoning as they have a higher return though with higher degree of risk.

Hence, the ones to be selected are A, C & E.

- (ii) The average values for A and C for a proportion of 3 : 1 will be :

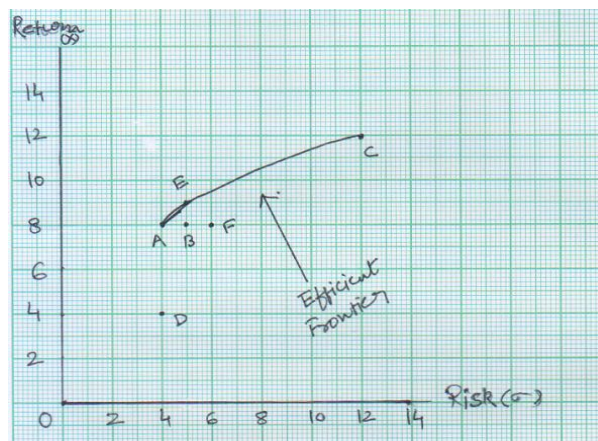
$$\text{Risk} = \frac{(3 \times 4) + (1 \times 12)}{4} = 6\%$$

$$\text{Return} = \frac{(3 \times 8) + (1 \times 12)}{4} = 9\%$$

Therefore:	75% A	E
	25% C	—
Risk	6	5
Return	9%	9%

For the same 9% return the risk is lower in E. Hence, E will be preferable.

Alternatively, it can also be computed by use of Graph as follows:



Since securities other than A, E and C are not on Efficient Frontier they are rejected.

5. (a) Working Notes

Calculation of Interest Payment on 9% Debentures

$$\text{PVAF } (9\%, 6) = 4.486$$

$$\text{Annual Installment} = \frac{\text{Rs. 22.50 crore}}{4.486} = \text{Rs. 5.0156 crore}$$

Year	Balance Outstanding (Rs. Crore)	Interest (Rs. Crore)	Installment (Rs. Crore)	Principal Repayment (Rs. Crore)	Balance (Rs. Crore)
1	22.5000	2.025	5.0156	2.9906	19.5094
2	19.5094	1.756	5.0156	3.2596	16.2498
3	16.2498	1.462	5.0156	3.5536	12.6962
4	12.6962	1.143	5.0156	3.8726	8.8236

Statement showing Value of Equity

Particulars	2013-14 (Rs. Crore)	2014-15 (Rs. Crore)	2015-16 (Rs. Crore)	2016-17 (Rs. Crore)
EBIT	48.0000	57.0000	68.0000	82.0000
Interest on 9% Debentures	2.0250	1.7560	1.4620	1.1430
Interest on 8% Loan	12.8000	12.8000	12.8000	12.8000
EBT	33.1750	42.4440	53.7380	68.0570
Tax* @35%	11.6110	14.8550	18.8080	23.8200
EAT	21.5640	27.5890	34.9300	44.2370
Dividend @12.5% of EAT*	2.6955	3.4490	4.3660	5.5300
	18.8685	24.1400	30.5640	38.7070
Balance b/f	Nil	18.8685	43.0085	73.5725
Balance c/f	18.8685	43.0085	73.5725	112.2795
Share Capital	82.5000	82.5000	82.5000	82.5000
	101.3685	125.5085	156.0725	194.7795

*Figures have been rounded off.

In the beginning of 2013-14 equity was Rs. 82.5000crore which has been grown to Rs. 194.7795 over a period of 4 years. In such case the compounded growth rate shall be as follows:

$$(194.7795/82.5000)^{1/4} - 1 = 23.96\%$$

This growth rate is slightly higher than 20% as projected by Mr. Smith.

If the condition of VenCap for 18 shares is accepted the expected share holding after 4 years shall be as follows:

No. of shares held by Management	6.00 crore
No. of shares held by VenCap at the starting stage	2.25 crore
No. of shares held by VenCap after 4 years	4.05 crore
Total holding	6.30 crore

Thus, it is likely that Mr. Smith may not accept this condition of VenCap as this may result in losing their majority ownership and control to VenCap. Mr. Smith may accept their condition if management has further opportunity to increase their ownership through other forms.

(b) (i) Rate used for discounting shall be yield. Accordingly ZCB shall fetch:

$$= \frac{10000}{(1+0.075)^{10}} = \text{Rs. } 4,852$$

(ii) The day count basis is actual number days / 365. Accordingly annualized yield shall be:

$$\text{Yield} = \frac{\text{FV-Price}}{\text{Price}} \times \frac{365}{\text{No. of days}} = \frac{100000-98500}{98500} \times \frac{365}{81} = 6.86\%$$

Note: Alternatively, it can also be computed on 360 days a year.

(iii) Price GOI 2023 would fetch

$$= \text{Rs. } 10.71 \text{ PVAF}(8\%, 10) + \text{Rs. } 100 \text{ PVF}(8\%, 10)$$

$$= \text{Rs. } 10.71 \times 6.71 + \text{Rs. } 100 \times 0.4632$$

$$= \text{Rs. } 71.86 + \text{Rs. } 46.32 = \text{Rs. } 118.18$$

(iv) Price GOI 2018 Bond would fetch:

$$= \text{Rs. } 5 \text{ PVAF}(4\%, 10) + \text{Rs. } 100 \text{ PVF}(4\%, 10)$$

$$= \text{Rs. } 5 \times 8.11 + \text{Rs. } 100 \times 0.6756$$

$$= 40.55 + 67.56 = 108.11$$

6. (a)

Day	Principal (Rs.)	MIBOR (%)	Interest (Rs.)
Tuesday	10,00,00,000	7.75	21,233
Wednesday	10,00,21,233	8.15	22,334
Thursday	10,00,43,567	8.12	22,256
Friday	10,00,65,823	7.95	21,795
Saturday & Sunday (*)	10,00,87,618	7.98	43,764
Monday	10,01,31,382	8.15	<u>22,358</u>
Total Interest @ Floating			1,53,740
Less: Net Received			<u>317</u>
Expected Interest @ fixed			<u>1,53,423</u>
Thus Fixed Rate of Interest			0.07999914
Approx.			8%

(*) i.e. interest for two days.

Note: Alternatively, answer can also be calculated on the basis of 360 days in a year.

(b)

(A) Cash Outflow		Rs.
(i)	In case machine is upgraded: Upgradation Cost	<u>10,00,000</u>
(ii)	In case new machine installed: Cost	20,00,000
	Add: Installation cost	<u>50,000</u>
	Total Cost	20,50,000
	Less: Disposal of old machine Rs. 50,000 – 40% tax	<u>30,000</u>
	Total Cash Outflow	<u>20,20,000</u>

Working Note:

- (i) Depreciation – in case machine is upgraded
Rs. 10,00,000 ÷ 5 = Rs. 2,00,000
- (ii) Depreciation – in case new machine is installed
Rs. 20,50,000 ÷ 5 = Rs. 4,10,000
- (iii) Old existing machine – Book Value is zero. So no depreciation.

(B) Cash Inflows after Taxes (CFAT)

Year	Old Existing Machine	Upgraded Machine			
	(i) EAT/CFAT Rs.	(ii) EAT Rs.	(iii) DEP Rs.	(iv) CFAT Rs.	= (iv)-(i) Incremental CFAT Rs.
1	5,00,000	5,50,000	2,00,000	7,50,000	2,50,000
2	5,40,000	5,90,000	2,00,000	7,90,000	2,50,000
3	5,80,000	6,10,000	2,00,000	8,10,000	2,30,000
4	6,20,000	6,50,000	2,00,000	8,50,000	2,30,000
5	6,60,000	7,00,000	2,00,000	9,00,000	2,40,000

Cash Inflow after Taxes (CFAT)

Year	New Machine			
	(vi) EAT Rs.	(vii) DEP Rs.	(viii) CFAT Rs.	(ix) = (viii) – (i) Incremental CFAT (Rs.)
1	6,00,000	4,10,000	10,10,000	5,10,000
2	6,40,000	4,10,000	10,50,000	5,10,000
3	6,90,000	4,10,000	11,00,000	5,20,000
4	7,40,000	4,10,000	11,50,000	5,30,000
5	8,00,000	4,10,000	12,10,000	5,50,000

P.V. AT 15% - 5 Years – on Incremental CFAT

Year	Upgraded Machine			New Machine		
	Incremental CFAT Rs.	PVF	Total P.V. Rs.	Incremental CFAT	PVF	Total PV Rs.
1	2,50,000	0.870	2,17,500	5,10,000	0.870	4,43,700
2	2,50,000	0.756	1,89,000	5,10,000	0.756	3,85,560
3	2,30,000	0.658	1,51,340	5,20,000	0.658	3,42,160
4	2,30,000	0.572	1,31,560	5,30,000	0.572	3,03,160
5.	2,40,000	0.497	<u>1,19,280</u>	5,50,000	0.497	<u>2,73,350</u>
Total P.V. of CFAT			8,08,680			17,47,930
Less: Cash Outflows			<u>10,00,000</u>			<u>20,20,000*</u>
N.P.V. =			<u>1,91,320</u>			<u>- 2,72,070</u>

*Acquisition Cost (including installation cost)

Rs. 20,50,000

Less: Salvage Value of existing machine net of Tax

Rs. 30,000

Rs. 20,20,000

As the NPV in both the new (alternative) proposals is negative, the company should continue with the existing old Machine.

7. (a) Many investment managers and stock market analysts believe that stock market prices can never be predicted because they are not a result of any underlying factors but are mere statistical ups and downs. This hypothesis is known as Random Walk hypothesis which states that the behaviour of stock market prices is unpredictable and that there is no relationship between the present prices of the

shares and their future prices. Proponents of this hypothesis argue that stock market prices are independent. A British statistician, M. G. Kendall, found that changes in security prices behave nearly as if they are generated by a suitably designed roulette wheel for which each outcome is statistically independent of the past history. In other words, the fact that there are peaks and troughs in stock exchange prices is a mere statistical happening – successive peaks and troughs are unconnected. In the layman's language it may be said that prices on the stock exchange behave exactly the way a drunk would behave while walking in a blind lane, i.e., up and down, with an unsteady way going in any direction he likes, bending on the side once and on the other side the second time.

The supporters of this theory put out a simple argument. It follows that:

- (a) Prices of shares in stock market can never be predicted. 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 (high price of stocks) and troughs (low price of stocks).
- (b) Some of the techniques used for economic analysis are:
- (i) **Anticipatory Surveys:** They help investors to form an opinion about the future state of the economy. It incorporates expert opinion on construction activities, expenditure on plant and machinery, levels of inventory – all having a definite bearing on economic activities. Also future spending habits of consumers are taken into account.
 - (ii) **Barometer/Indicator Approach:** Various indicators are used to find out how the economy shall perform in the future. The indicators have been classified as under:
 - (1) *Leading Indicators:* They lead the economic activity in terms of their outcome. They relate to the time series data of the variables that reach high/low points in advance of economic activity.
 - (2) *Roughly Coincidental Indicators:* They reach their peaks and troughs at approximately the same in the economy.
 - (3) *Lagging Indicators:* They are time series data of variables that lag behind in their consequences vis-a-vis the economy. They reach their turning points after the economy has reached its own already.All these approaches suggest direction of change in the aggregate economic activity but nothing about its magnitude.
 - (iii) **Economic Model Building Approach:** In this 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.

- (c) A very important phenomenon witnessed in the Mergers and Acquisitions scene, in recent times is one of buy - outs. A buy-out happens when a person or group of persons gain control of a company by buying all or a majority of its shares. A buyout involves two entities, the acquirer and the target company. The acquirer seeks to gain controlling interest in the company being acquired normally through purchase of 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 when threatened with the sale of its business to third parties or frustrated by the slow growth of the company, step-in and acquire the business from the owners, and run the business for themselves. The majority of buy-outs is management buy-outs and involves the acquisition by incumbent management of the business where they are employed. Typically, the purchase price is met by a small amount of their own funds and the rest from a mix of venture capital and bank debt.

Internationally, the two most common sources of buy-out operations are divestment of parts of larger groups and family companies facing succession problems. Corporate groups may seek to sell subsidiaries as part of a planned strategic disposal programme or more forced reorganisation in the face of parental financing problems. Public companies have, however, increasingly sought to dispose of subsidiaries through an auction process partly to satisfy shareholder pressure for value maximisation.

In recessionary periods, buy-outs play a big part in the restructuring of a failed or failing businesses and in an environment of generally weakened corporate performance often represent the only viable purchasers when parents wish to dispose of subsidiaries.

Buy-outs are one of the most common forms of privatisation, offering opportunities for enhancing the performances of parts of the public sector, widening employee ownership and giving managers and employees incentives to make best use of their expertise in particular sectors.

- (d) In interbank transactions, foreign exchange is transferred from one account to another account and from one centre to another centre. Therefore, the banks maintain three types of current accounts in order to facilitate quick transfer of funds in different currencies. These accounts are Nostro, Vostro and Loro accounts meaning "our", "your" and "their". A bank's foreign currency account maintained by the bank in a foreign country and in the home currency of that country is known as Nostro Account or "our account with you". For example, An Indian bank's Swiss

franc account with a bank in Switzerland. Vostro account is the local currency account maintained by a foreign bank/branch. It is also called “your account with us”. For example, Indian rupee account maintained by a bank in Switzerland with a bank in India. The Loro account is an account wherein a bank remits funds in foreign currency to another bank for credit to an account of a third bank.

- (e) **Call Money:** The Call Money is a part of the money market where, day to day surplus funds, mostly of banks, are traded. Moreover, the call money market is most liquid of all short-term money market segments.

The maturity period of call loans vary 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 call rate is expected to freely reflect the day-to-day lack of funds. These rates vary from day-to-day and within the day, often from hour-to-hour. High rates indicate the tightness of liquidity in the financial system while low rates indicate an easy liquidity position in the market.

In India, call money is lent mainly to even out the short-term mismatches of assets and liabilities and to meet CRR requirement of banks. The short-term mismatches arise due to variation in maturities i.e. the deposits mobilized are deployed by the bank at a longer maturity to earn more returns and duration of withdrawal of deposits by customers vary. Thus, the banks borrow from call money markets to meet short-term maturity mismatches.

Moreover, the banks borrow from call money market to meet the cash Reserve Ratio (CRR) requirements that they should maintain with RBI every fortnight and is computed as a percentage of Net Demand and Time Liabilities (NDTL).