Krivii Eduspace

For May 24 & Onwards

Simplified! AFM THEORY

Covers: 5 'Pure' Theory Chapters

- Updated for May 24 & Onwards
- Complete Coverage - Study Mat, Past years, RTPs, MTPs
- Interactive!! Learn Theory with Fun :)

Finance Acharya

Jatin Nagpal (CA, FRM)

Simplified! AFM THEORY (UPDATED)

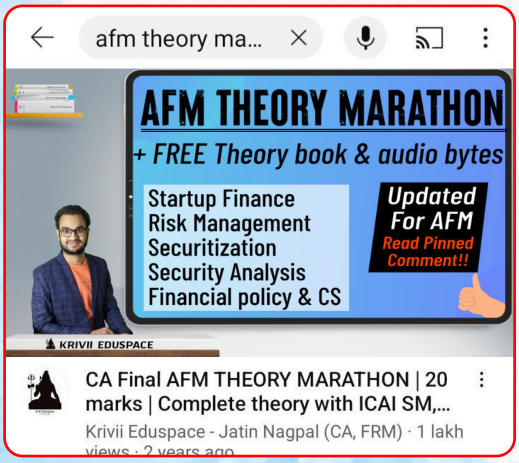
By Finance Acharya – Jatin Nagpal (CA, FRM)

Imp!! Must Read

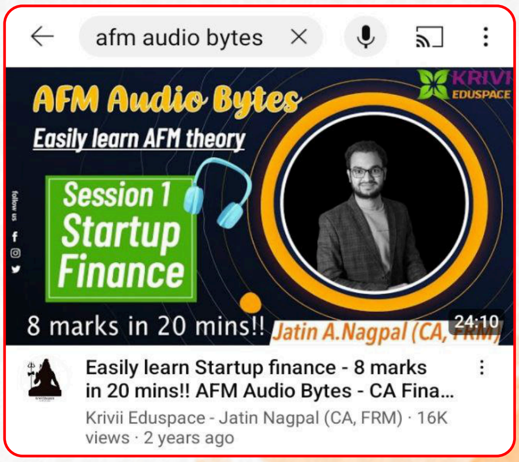
There are **NO CHANGES** in AFM theory (as compared to SFM). **So existing Theory Marathon is 100% relevant for AFM May 24 & onwards.**

Note:: A few new theory topics are added in AFM. We have covered these new topics in this book & will also upload a small video on Youtube covering these new topics. Stay Tuned!!

Quick Index



1st: For best preparation – Watch "AFM Theory Marathon". Search "AFM Theory Krivi Eduspace" on Youtube.



Then: For learning & retention Listen "AFM Audio Bytes". Search "AFM Audio Bytes Krivi Eduspace" on Youtube.

Student Reviews...

Check out our **AFM Saviour batch**!

Complete conceptual Coverage **in very limited time!!**

SSFM Vanshika
last seen recently

Good Evening sir, myself Vanshika Singh. I am texting you to Thank you for being a truly outstanding teacher. Your passion for teaching and your dedication to your students is obvious in everything you do. I feel so lucky to have been part of your SFM Saviour Batch. I hope you know the priceless impact you are making in so many lives. You make the concepts so easy for me that I can't express I was the one who used to run from this subject having no interest in securities, portfolios forex derivatives etc, but now after completing your batch I am able to solve questions with no much efforts and I am enjoying doing them. Thank you so much sir once again for all your efforts in making fabulous notes and simplified question bank.
20:17

@user-si5ty2ve6t • 2 mo ago

Revising portfolio management in 5hrs including every minute detail(basic se bhi basic detail) is really an art sir
You have mastered it sir
I can confidently say i dont have to mug up any formula now onwards

Thank you so much sir

And guys if you are in doubt whether to trust these young dynamic Faculty or to go for the so called legends
I have spent 20k for SFM alone and trust me they taught only what sir has taught in the lecture nothing more nothing less and their books were neither updated upto date nor were as per ICAI standards
But sir's books are also simplified and has everything covered with wide variety of qstns and he has provided them for free dev manush hain sir
So you can happily trust Jatin sir

SSFM Shraddha Mi...

Dropped in to really Thank you from the bottom of my heart Sir.
I got to know about SFM saviour at the very end moment before seeing your question bank I was judging myself for not being able to solve the question banks only to realise at the end that quite a lot of solutions were really very complicated.

When I used your question bank I realised that it was not entirely me. Yes I do have the ultimate responsibility but your QB is so good for people who are doing self study.
22:36

Aanchal Jangir • 47 min ago

The best part about your teaching is that you bring all these isolated, almost extraterrestrial concepts close to earth for us to understand by relating them to real life examples.

Selection of students in college by giving a cut off marks is the same as selection of stocks by giving a cut off Treynor ratio.

Superb Explanation Sir.

And also I'd like to add that, your book can be described by this short phrase. It's just simply, "Beauty with Brains."

I genuinely hope the world gets more teachers like you, so that true learning can truly take place.

1

AFM Theory Marathon Students' Comments...

Comments 116

Shruti Sarawgi • 2 mo ago
Thank you sir .your one video hlped me today alot..able to write theories of all four chapters correctly with much ease especially audio bytes was awesome....Thanks alot

nishtha chopra • 2 mo ago
Thanks from the bottom of my heart for this lectures and world's best theory notes.. Today exam went well and theory played a very major role... Desi Limts HELL yaad aya paper dekh kr and sath he ap yaad aye... First time practical subject ki theory mein practical se jyada confidence tha 😅😅😅😅😅

Comments 116

SPalei • 2 mo ago
Sir, I could attempt 20/20 theory alll thanks to you 🙏 I'm so so grateful... May the Lord give you all the success, fame and recognition that u deserve and help you reach more and more needful students..

1

Yatesh Chadda • 2 mo ago
More power to you sir. You have done a commendable job, No doubt!
A day will surely come when your name will be in leading ones. Blessings always <3 <3

4 1

• 1 REPLY

Comments 126

Mack Z • 2 days ago
Yaar aise gems kaha chupe hote hai.
Maja aa gaya sahab.
Itni shiddat se koi padha sakta hai wo bhi theory aur fir mujhe samajh Jaye in one go matlab ki bande me dam hai..

Grateful and thankful for making this masterpiece free for all.

Translate to English

1

srujana k • 3 days ago (edited)
Thank you so much sir
All theorie chapters under one roof🙏

Comments 126

Harsh Baldua • 2 mo ago (edited)
Sir I hadn't touched SFM theory till date, & of the same opinion, "20 marks k liye kaun mehnat kare itni"

So Glad to find you, even 1 day before exam...
Watched it completely!!
It was really amazing sir!! 😀👏👏

Now I'm so confident, that my invested time in 1day before exam will surely enhance my marks.
Thank you so much 🥰

Ayush Bhagat • 2 mo ago
Very nice

Comments 116

Kamlesh Kumar • 2 mo ago
I never seen SFM faculty like u who teach SFM theory like u teach.

I love the way u teach and yr concept clearity is another level.
Thanks 😊

2

• 2 REPLIES

Comments 25

saurabh yadav • 2 mo ago
Big thanks sir for completing that chapter ....sir aap kitni easy way me explain kr diya ki ..maza hi aa gya .tnx again sir ..

Translate to English

eswar reddy • 2 mo ago

Startup Finance

CHAPTER AT GLANCE

You started a new co.	GROWING BIGGER?	Big Company (like Paytm)	Other topics
Need some INNOVATIVE WAYS to finance	Get funds from - Bootstrapping - Angel Investors - Venture capitals	Deal regularly with VCs - Characteristics - Advantages - Process - Stages - VC funds	- Pitch presentation - Startup India Initiative

1. SOME INNOVATIVE WAYS TO FINANCE A STARTUP OR NON BANK FINANCE FOR STARTUPS

Friend ka PC	Micro PC	Vendor Purchase krega Factors ko
1. Family & Friends - Loans should be in writing (eg: promissory notes) 2. Personal financing - Else investors may not put their money 3. Personal Credit lines - Eg: Credit cards. Banks will provide this based on cash flow position.	4. Microloans - Given by individuals at lower interest to new business ventures. 5. Peer-to-peer lending - People form small & ethnic business groups that support each other. 6. Crowdfunding - Small amount of capital from large number of individuals. Eg:crowdfunding website.	7. Vendor Financing - Co. lends money to its customer so that he can buy products from co. itself. Depends on credit worthiness of customer. 8. Purchase order financing - Advance funds required to complete an order. Startup can earn profit on the order and can then pay back the Purchase order financing co. 9. Factoring Accounts receivable - Startup can sell its debtors to factor. Factor will pay most of the sold amount upfront & rest of the amount later.

2.1 MODES *of financing*

At a very basic stage the startup uses funds from INNOVATIVE sources like friends & family, credit cards etc. But as it grows, it requires more funds and thats when sources like Angel investors and venture capitalists come into picture.

A. BOOTSTRAPPING

Funding the co. using OPERATING REVENUES of the new co. or from personal finances.

Benefit - The entrepreneur retains the control over the co.

2. ANGEL INVESTORS

- Invests OWN money in SMALL startups
- Can be among family/friends of entrepreneur (who aims to help the entrepreneur) or can be an affluent individual (who invest in exchange for equity ownership.)

Also known as Seed investors, Private investors, Informal investors, Business angels etc.

3. VENTURE CAPITAL FUNDS

- An investment vehicle that invests investors' funds.
- Managed by professionals.
- Invests in equity of young co. with huge growth potential.

2.2 SHORT NOTES (4 MARKS)

BOOTSTRAPPING

(1st write the above short note on bootstrapping)

TRADE CREDIT
- suppliers maybe on unwilling to extend credit
- Show suppliers a well crafted financial plan

FACTORING
- Accounts receivable are sold to a commercial finance company
- It can be on non-notification basis i.e. without telling customer that their account is sold.
- Reduces cost such as bookkeeping, collection etc.
- Frees up money tied in receivables.

LEASING

Reduces capital required (compared to purchasing)

Benefits to Lessee
- Smaller payments & Tax benefit on lease rentals.

Benefits to lessor
- Tax benefits (depreciation) & Profit from lease.

ANGEL INVESTORS

(1st write above short note on angel investors)

(Student Note - family & friends as Angels)
- They may provide one time investment or an ongoing injection of money
- Provides more favourable terms compare to other lenders
- Opposite to venture capitalist

(Student Note - affluent individuals as Angels)
- Invest in exchange of equity or convertible debt
- Although Angel investors use their own money but the entity that provides fund maybe a limited liability company, a trust or an investment fund etc.
- Professional angel investors define their exit strategy. Eg: Exit via IPO or acquisition.

3. DEAL REGULARLY WITH VENTURE CAPITALISTS

3.1 Characteristics of VC financing

"HELL"

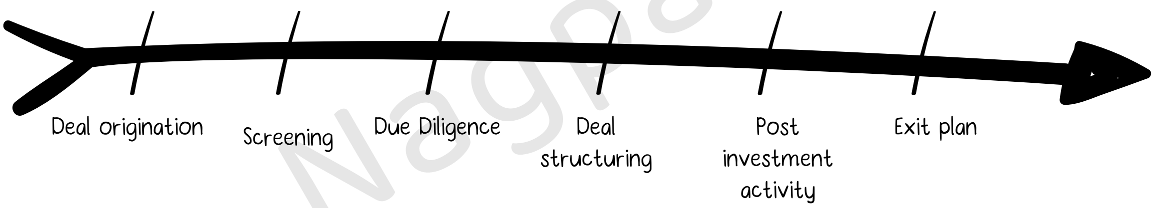
1. High-risk high return - VC works on high-risk high return principal.
2. Equity participation - VC gets equity. Participate in the management. A lot of board decisions can be supervised by VC.
3. Long-term horizon - 3 to 10 years
4. Lack of liquidity - since there is less liquidity on the equity that VC gets. Therefore they adjust liquidity risk premium against the price and required return.

3.2 Advantages of bringing in VC

"A-LION"

1. Additional rounds of funding - VC can provide additional funds if required.
2. Long term Equity - Sharing both risks & rewards.
3. IPO - VCs are experienced in preparing co. for IPO.
4. Other co. experience - VCs can provide advice based on their past experience with other co.v
5. Network of contacts - This can be very valuable for a startup company.

3.3 VC process



STEP 1: DEAL ORIGINATION	VC operates directly or indirectly through intermediaries (also known as sourcing entity). VC obtains an INFORMATION MEMORANDUM (IM) which covers - Business model, valuation & exit plan.
STEP 2: SCREENING	Generally, done by a committee consisting senior personnel of the VC.
STEP 3: DUE DILIGENCE	Verify the accuracy of the documents taken. Due diligence is often handled by external bodies. Its fees may be paid by VC or may be shared between VC & Investee co.
STEP 4: DEAL STRUCTURING	Deal is structured in a way that both the parties win. Often a convertible structure is brought to ensure that the promoter retains its right to buy back the shares.
STEP 5: POST INVESTMENT ACTIVITY	VC nominates its nominee in the board of the company. The company has to adhere to certain guidelines like strong MIS, strong corporate governance and other covenants of the VC.
STEP 6: EXIT PLAN	Mainly exit happens in two ways: a) Sell to 3rd parties – example IPO or private placement to other VCs. b) Buyback commitment from promoter at an agreed rate who often have right to 1st refusal.

3.4 Structure of VC Funds in India

DOMESTIC FUND

It raises funds domestically. In this:
a) Domestic vehicle is used for pooling of funds. This can be a trust or co. as India does not recognise LLP as pooling vehicle.

b) Duties of asset manager is carried out by a separate Investment advisor.

OFFSHORE FUNDS

Offshore structure

An investment vehicle directly makes investment into Indian companies.

Assets are managed by an offshore manager. Investment advisor in India identifies deals and carries out the due diligence.

Unified structure

This is used when domestic investors are expected to participate in the fund.

Overseas investors pool their assets in an offshore vehicle that invests in locally many trust, whereas domestic investors directly contribute to the trust.

3.5 Stages of VC Funding

Financial Stage/Round	Lock-in Period (yrs)	Risk Perception	ACTIVITY TO BE FINANCED
Seed money	7-10	Extreme	Low level financing. 1. for proving new idea/concept or 2. for R&D.
Startup	5-9	Very High	1. Product development - Prototypes and 2. for Marketing
First stage	3-7	High	1. Early manufacturing 2. Marketing
Second stage	3-5	Sufficiently High	Working capital (co. Selling product but not yet profitable)
Third stage	1-3	Medium	Expansion money for newly profitable co. A.k.a. 'Mezzanine financing.'
Fourth stage	1-3	Low	Facilitating public issue i.e. Going public. Also called 'Bridge financing'.

NOTE

NOTE ON VC FUNDS IN INDIA

Started in the decade of 1970. After 10 years, first all India venture capital funding was started by IDBI, ICICI and IFCI.
In November 1998, the government announced it guidelines that focused on a very narrow description of venture capital and hence proved to be extremely restrictive. This made investment in VC highly risky and unattractive.
VC investing got a big boost by the IT revolution in 1997 as the VC became prominent founders of the growing IT and telecom industry.

4.1 PITCH PRESENTATION

Growing Big? Time to make a pitch presentation

Pitch presentation = A brief presentation (<20 mins) explaining the prospects of the company. Quick overview of the business plan & convincing the investors why they should invest in the startup.

ITne Pange Se अच्छा एक Mota Patla Chucha BF फँसाओ

1. Introduction: Brief account of yourself i.e. who are you? Huge milestones achieved.
2. Team: Introduce people behind the scenes. Background of promoter.
3. Problem: Explain the problem that the product is going to solve.
4. Solution: How the product will solve the stated problem.
5. Marketing/sales: Market size, profile of target customers, how are you planning to attract the customers.
6. Projections (or Milestones): Projected financial statement about where is the business heading. Will it be making profit or loss. Includes
   - Income statement - Balance sheet - Cash flow statement
7. Competition: How your product is different from competitors. If acquired any competitor -> then details of the acquisition.
8. Business Model: The way in which co. earns revenue & profit. Includes business processes, strategies, Infrastructure etc. Gross profit is used as a measure of effectiveness of business model.
9. Financing: If no money raised -> how much work is accomplished. If money raised earlier -> how much raised, who invested, how that money was utilised etc.

STARTUP INDIA INITIATIVE

Definition of Startup

1. Up to 10 years from its date of incorporation or registration.
2. Incorporated as either a Pvt. Ltd. Co. or a Registered Partnership Firm or a LLP in India.
3. Turnover for any fiscal year has not exceeded INR 100 crore.
4. Entity should not have been formed by splitting up or reconstruction a business already in existence.
5. Working towards innovation, development or improvement of products, processes or services Or has a high potential of employment generation or wealth creation.

Benefits of Startup India

1. Simple registration process - completely online
2. Tax holiday - for 3 years provided startup gets a certification from Inter-Ministerial Board (IMB)
3. Tenders - Exempted from experience requirement while applying for govt. tenders.
4. Simplified compliances - various compliances have been simplified for start-ups to save time and money.
5. Reduced patent & trademark registration cost– Government will bear the facilitative fees for patents and trademarks and the start-up will bear only the statutory fees.

Questions

Q1: Compare and contrast start-ups and entrepreneurship. Describe the priorities and challenges which start-ups in India are facing. (RTP Nov 19, MTP Nov 19, MTP March 18, MTP March 18)

Ans: Major differences between startup and entrepreneurship:

(i) Start up is a part of entrepreneurship. Entrepreneurship is a broader concept and it includes a startup firm.

(ii) Main aim of startup is to build a concern and build a product or service. Objective of an already established entrepreneurship concern is to capture best opportunities with their limited resources..

(iii) A startup generally does not have a major financial motive whereas an established entrepreneurship concern mainly operates on financial motive.

Priorities regarding start-ups in India

The priority is on bringing more and more smaller firms into existence. So, the focus is on need based, instead of opportunity based entrepreneurship. Encourage self- employment rather than large, scalable concerns.

Main Challenges that startups are facing

i) Getting the right talent. Shortage of skilled workforce can hinder startup's growth and development.

ii) Startups has to comply with numerous regulations which escalate its cost.

Q2: Explain the documents that are required to make up Financial Presentations during Pitch. (MTP May 20)

Income statement: This projects how much money the business will generate by projecting income and expenses. For 1st year in business, create a monthly income statement. For 2nd year, quarterly statements & for following years, just make an annual income statement.

Cash flow statement: A projected cash flow statement will depict how much cash will be coming into the business and out of that cash how much cash will be utilized into the business.

Balance sheet: The balance sheet shows the business's overall finances including assets, liabilities and equity. Typically one will create an annual balance sheet for one's financial projections.

Q3: Explain the term business model with the help of an illustration. (MTP Dec 21)

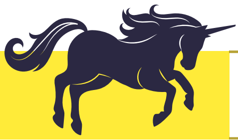
Business model is the way in which a company generates revenue and earns profit. Analysts use "Gross profit" as a way to compare the efficiency and effectiveness of a firm's business model.

It's important to tell investors in pitch presentation about how co. will generate revenue. It is better to show a list of the various revenue streams for a business model and the timeline for each of them.

The term business model is a wide term denoting core aspects of a business including purpose, target customers, offerings, strategies, infrastructure, and operational processes and policies including culture.

Example of business model – Two companies (A & B) are engaged in the business of renting movies. Both have revenue of Rs.5 crores. But co. A which is engaged in physical renting of movies has gross profit of only Rs.1 crores (due to higher storage & logistics costs). Whereas co. B offer movies online, and has Gross profit of Rs.3 crores, even with the same revenue of Rs.5 crores. This is due to lower storage and distribution costs of Co. B.

5. UNICORN

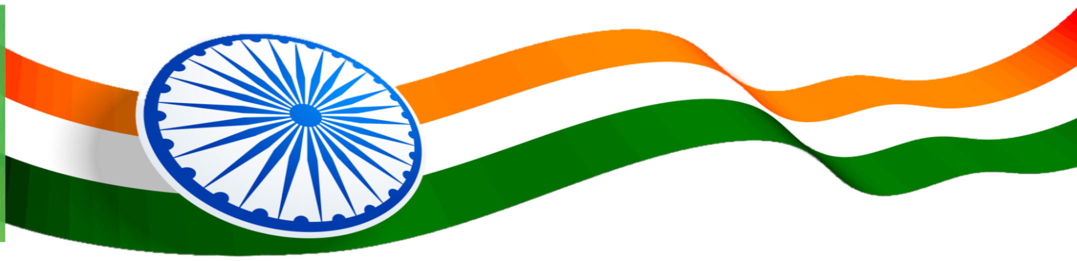


Unicorn = privately held start-up co. with valuation $\geq$ US$ 1 billion.

(i) Privately held start-up
(ii) Valuation $\geq$ US$ 1 Billion
(iii) Emphasis is on rarity of success of such start-up.
(iv) Other common features are new ideas, disruptive innovation, high on technology etc.

(i) "Unicorn" term was coined by VC Aileen Lee in 2013.
(ii) Next milestone = Decacorn (value > US$ 10 billion)
(iii) India = 3rd largest ecosystem for startups.
(iv) As of 2022, India has over 59,000 DPIIT-recognized startups (with 107 unicorns)

Startups in India



HOW GOVT PROMOTED STARTUP IN INDIA

1. Programs like Startup India and StandUp India gave a major boost to Startups in India.

2. By setting up a SIDBI-run Electronic Development Fund (EDF), the Indian Govt. became a Limited Partner (LP) in a fund for the first time ever.

3. Easy finance options such as Mudra Scheme, tax benefits like 100% tax holiday under section 80-IAC and exemption from angel taxation also provided push to the Indian start-ups.

STARTUP INDIA SEED FUND SCHEME (SISFS)

1) SISFS was Created by DPIIT in Jan 2021 with an outlay of ₹945 Crores.

2) Aim = provide financial assistance for Proof of Concept, prototype development, product trials, and commercialization.

3) It will support an approx. 3,600 entrepreneurs through 300 incubators in next 4 years.

4) A start-up can get seed fund of as much as ₹50 Lacs under SISFS.

6.4 Recognition criteria of DPIIT (for startups)

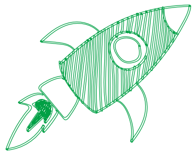
1. Incorporated $\leq$ 2 years ago at the time of application
2. Business idea to develop a product / service with market fit, viable commercialization and scope of scaling.

(*DPIIT = Department of Promotion of Industry and Internal Trade)

Priority sectors for SISFS:

BHARAT	MODI	WIFE	SE
B = Biotechnology H = Healthcare A = Agriculture R = Railways T = Textile	M = Mobility O = Oil & Gas D = Defence I = Impact (Social impact)	W = Water & Waste management I = Inclusion (Financial inclusion) F = Food processing E = Energy	S = Space E = Education

New AFM Addition: (This page contains new topics added in AFM)



Why India Became a Sustainable environment for startups ?

(i) Pool of Talent - Millions of students graduate every year. Many of these students begin their own ventures contributing to the startup growth in India.

(ii) Cost Effective Workforce - Workforce in India is cost effective. So, cost of setting up and running a business is comparatively lower.

(iii) Increasing use of the Internet - India has the 2nd largest internet user base (after China). Start-ups leverage this easy access to the internet.

(iv) Technology – Major tech developments has made various business processes quick, simple & efficient. Many startups are working in areas of AI & Blockchain.

(v) Variety of Funding Options Available – Like angel investors, VC etc. Easing of FDI norms has also increased foreign funding in Indian start-up ecosystem.

3.2 SUCCESSION PLANNING

Identifying critical positions in an org. and developing action plans for individuals to assume those positions. It ensures that right people are available for the right jobs today and in future.

It ensures that businesses are fully prepared to promote all employees. It is an imp. priority for family-owned businesses as most of them are managed by a non-family leader even though ownership lies with family.

BUSINESS SUCCESSION STRATEGY

Step 1 – Evaluate key leadership positions: - To evaluate this, risk or impact assessment can be performed.

Step 2 – Map competencies required: - Identify qualifications, behavioral & technical competencies required to perform the role successfully.

Step 3 – Identify competencies of current workforce: - Identify if internal options can deliver expected results.

Step 4 – Bridge Leader: - In family owned business appointment of an outsider as 'bridge leaders' will help to prepare young family members for leadership role.

CHALLENGES IN SUCCESSION PLANNING

(1) Founder mindset might be different than the corporate mindset – This puts off seasoned corporate leaders from joining even matured start-ups.

(2) Premature for startups to implement business succession - Certain startups are at early growth stage and too much of processes would lead to growth slow-down.

(3) Founders are the face of startups – One cannot imagine a startup without a founder.

Why is there a need for succession planning?

1. **Risk mitigation** – If existing leader quits, then it may take 6-9 months to find a new candidate.
2. **Cause removal** – If the existing leader is removed by court, management, stakeholders etc.
3. **Talent pipeline** – It keep employees motivated as they have better visibility about their career paths.
4. **Conflict Resolution Mechanism** – it is helpful in promoting transparent communication & conflict settlement.
5. **Aligning** – In family owned business succession planning helps to align with the culture & vision of the business.

Risk Management

CHAPTER AT A GLANCE

RISK AT ORGANISATION LEVEL

- STRATEGIC RISK
- COMPLIANCE RISK
- OPERATIONAL RISK
- FINANCIAL RISK
  - Counter-party risk
  - Political risk
  - Interest rate risk
  - Currency risk
  - Liquidity risk

1. FINANCIAL RISKS FROM DIFFERENT STAKEHOLDER'S VIEWPOINT

<u>From Stakeholder's Viewpoint</u>

EQUITY SHs - View Debt-equity ratio as a risk. As they are least prioritized in the event of winding up of co.

LENDERS - View Debt-equity ratio as risk. As high debt = higher default risk.

<u>From Govt.'s Viewpoint</u>

- sovereign debt crisis
- failure of any bank
- down grading of any financial institution leading to spread of distrust among society.
- wilful defaulters.

<u>From Company's Viewpoint</u>

If a company borrows excessively or lend to someone who defaults, then can be forced to go into liquidation.

2. RISKS FACED AT ORGANISATIONAL LEVEL

STRATEGY RISK

- Risk that co. strategy may become less effective and it my struggle to achieve its goal.
- This may be due to technological changes, a new competitor entering the market, shifts in customer demand etc.

Eg: Nokia failed to develop touchscreen mobile phones which enabled Samsung to become a market leader.

COMPLIANCE RISK

- Risk that co. may not be able to comply with the rules & regulations applicable to it such as companies law, SEBI regulations etc.

- This risk increases when the company enters into a new line of business.

Eg: an automobile company venturing into sugar cane business.

OPERATIONAL RISK

This relates to failure on part of the company to cope with day to day operational problems. Operational risk relates to 'people' as well as 'processes'.

Eg: an employee paying out Rs.1,00,00 from the account of the company instead of Rs.10,000.

FINANCIAL RISK

- Risk due to unexpected changes in financial conditions such as prices, exchange rate, credit rating etc. - Though political risk is not a financial risk in direct sense but same can be included as any unexpected political change in any foreign country may lead to financial loss.
- It can be broadly classified as:

i) counterparty risk ii) political risk iii) interest-rate risk iv) currency risk v) liquidity risk.

3.1 COUNTER PARTY RISK

Risk that counterparty may not honour its obligation.
Eg: non-repayment of borrowing and interest. Failure to deliver the goods for which payment is already made.
IT ALSO COVERS 'CREDIT RISK' i.e. DEFAULT BY COUNTERPARTY.

IDENTIFY CPR

<u>Restricted Resources HIT</u>

i) Any regulatory restrictions from Govt.
ii) Failure to obtain necessary resources to complete a project or transaction undertaken.
iii) Hostile action of foreign government.
iv) Insolvent - 3rd party became Insolvent.
v) Let down by Third party.

TECHNIQUES TO MANAGE CPR

<u>DESI Limits</u>

i) Due diligence - Carry due diligence before dealing with any 3rd party.
ii) Exposure - Know your exposure limits.
iii) Single entity - Do not overcommit to a single entity or group of connected entities.
iv) Insurance - Use Insurance, performance guarantee etc.
v) Limits - Review credit limits regularly.

3.2 POLITICAL RISK (PR)

Risk faced by an overseas investor that the adverse actions of the govt. of host country may lead to huge losses.

What is PR (1st write above definition of PR)

Restricted PRICE

1. Restriction on conversion of currency.
2. Price control of products.
3. Rationing of remittance to home country.
4. Invalidation of patents.
5. Confiscation of overseas properties.
6. (External) borrowings - Restriction as to borrowings.

ASSESS Political Risk

Political MAP

1. Political Ranking - Refer Political rankings published by different business magazines.
2. Macro-economic conditions - Evaluate
3. Advice from embassies of home country in the host country.
4. Populatrity of current govt. & its stability.

Identify Political Risk

RIPE

1. Restriction on conversion of currency.
2. Insistence on resident investors or labour.
3. Price fixation of the products.
4. Expropriation of foreign assets by local govt.

Minimize / Mitigate PR

Local ही Local

1. Local raw material and labour.
2. Local financing.
3. Local business partners i.e. Enter into joint venture.
4. Local govt. - Prior negotiations.

3.3 CURRENCY RISK

Risk that the cash flows of an entity may be adversely affected due to fluctuations in foreign exchange (Fx).

PARAMETERS TO IDENTIFY CURRENCY RISK

i) Nominal Interest rate - as per IRPT, it affects exchange rate.
ii) Inflation rate - As per PPPT, it affects exchange rate.
iii) Govt. Actions or Change in Govt. - can have a deep impact on the currency of a country. Eg: Govt. attitude towards foreign investment.
iv) Natural calamity
v) War, Coup, rebellion etc.

3.4 INTEREST RATE RISK

What is Interest rate risk?	How to Identify Interest rate risk?
Risk that Interest rate may change which may affect the value of asset & liability of an entity. This risk is more important for banking companies as their balance sheet's items are more interest sensitive and their base of earning is spread between borrowing and lending rates.	i) Monetary Policy of the Government. ii) Any action by Government such as demonetization iii) Economic Growth iv) Release of Industrial Data v) Investment by foreign investors vi) Stock market changes

3.5 Liquidity Risk

Risk that an entity to meet it liabilities whenever they become due. This risk mainly arises when organization is unable to generate adequate cash or there may be some mismatch in period of cash flow generation.

This type of risk is more prevalent in banking business where there may be mismatch in maturities

4. VAR

Value at Risk

VAR is a measure of risk of investment. It tells us about how much loss may be incurred on an investment under normal market conditions, in a particular period, say 1 day.

It answers two basic questions :-

(i) What is worst case scenario? (ii) What will be loss?

FEATURES OF VAR

Chandigarh To Shimla via Private Road

i) Components: VAR calculation is based on 3 components:

(a) Time Period (b) Confidence Level (c) Loss (in % or Rs.)

(ii) Time Horizon: VAR can be calculated for different time horizons. Eg: 1-day, 10-days etc.

(iii) Statistical Method: VaR is a statistical tool based on SD.

(iv) Probability: Assuming the values are normally distributed, probability of maximum loss can be predicted.

(v) Risk Control: Risk can be controlled by setting VaR limits.

(vi) Z Score: Z Score when is multiplied with SD provides VaR.

APPLICATION / USES OF VAR

Maximum LATE

VaR can be applied -

(a) to measure the maximum possible loss on any portfolio.

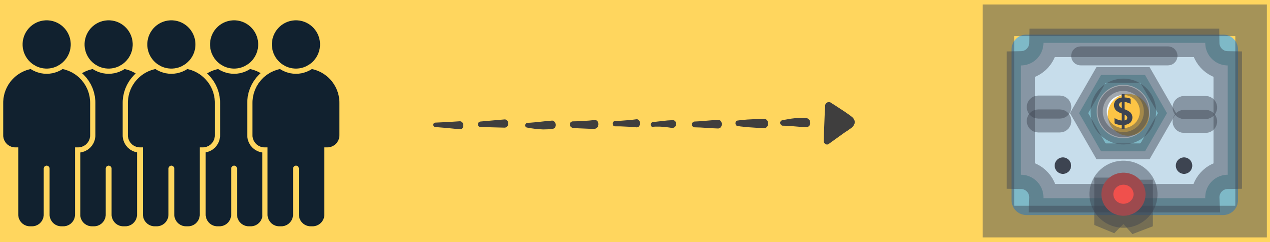
(b) Limits - to fix limits for individuals dealing in front office of a treasury department.

(c) ALM - as a tool for Asset & Liability Management especially in banks.

(d) Trading strategy - management can decide the trading strategies using VaR.

(e) Evaluate performance of any operation.

3. Securitization



Illiquid Assets (Debtors) → Liquid Assets (Securities)

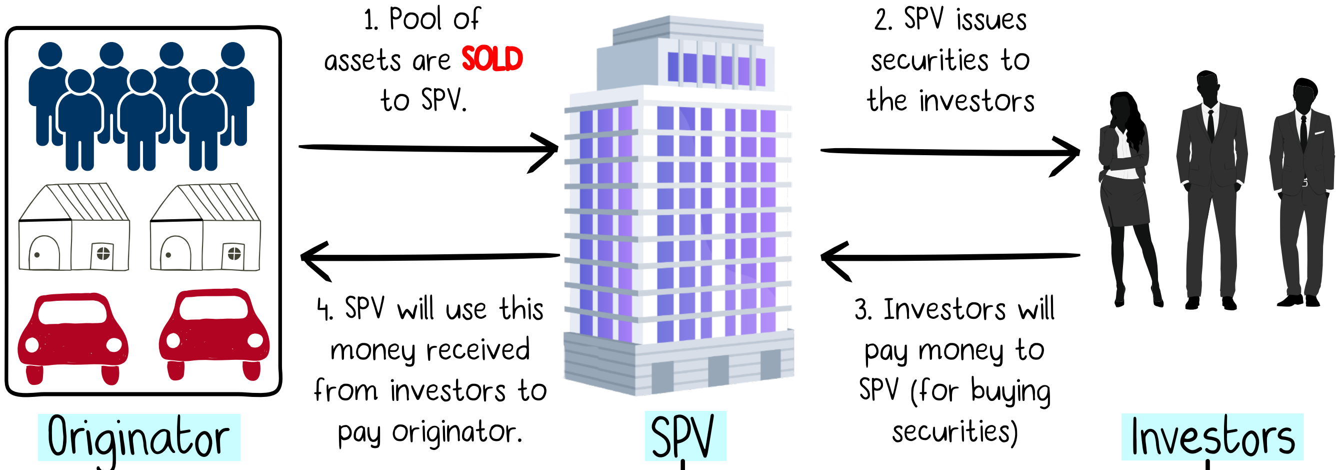
CHAPTER JOURNEY

Securitization (Definition)

Securitization is the process of rebundling of illiquid assets into marketable securities. These assets can be automobile loans, credit card receivables, residential mortgages or any other form of future receivables.

As per RBI, Securitization = Transactions where credit risks in assets are redistributed by repackaging them into tradable securities.

SECURITIZATION BASIC



Originator: It is the entity which gave the loan (assets). It sells these assets to SPV & receives money from SPV.

SPV is specially made for:
1) Buying loans & holding them as assets
2) Issuing securities backed by these loans

Investors can be
1) retail investors or
2) institutional investors (mutual funds, provident funds etc.)

1. MECHANICS OF SECURITIZATION

Process of securitization / Steps involved in securitization.

1. CREATION OF POOL OF ASSETS	Segregating assets backed by similar types of mortgages.
2. TRANSFER TO SPV	The pooled assets are transferred to SPV.
3. SALE OF SECURITIZED PAPERS	SPV designs instruments from the pool of assets. These can be PTS (Pass Through Securities) or PTC (Pay Through Certificates).
4. ADMINISTRATION OF ASSETS	It may be subcontracted back to originator, which collects principal & interest and transfers it to SPV.
5. REPAYMENT OF FUNDS	SPV will pay interest & repay principal to the investors.
6. CREDIT RATING OF INSTRUMENTS	Credit rating may be done to assess the risk of issuer.
7. RECOURSE TO ORIGINATOR	If assets are securitized on recourse basis, assets will go back to originator in case of default.

2. PARTICIPANTS IN SECURITIZATION

PRIMARY PARTICIPANTS

(A) ORIGINATOR / INITIATOR / SECURITIZER:
i) It sells its assets books to SPV.
ii) It receives the funds generated through the sale of such assets.

(B) SPECIAL PURPOSE VEHICLE (SPV):
i) It is created especially for securitization only.
ii) SPV **BUYS** the assets from originator and hence it holds the **LEGAL TITLE** of these assets.
iii) Main objective of creating SPV is to remove the asset from the Balance Sheet of Originator.
iv) It issues securities (called Asset Based Securities or Mortgage Based Securities) to the investors.
v) It can be in form of co., firm, society or trust.

(C) INVESTORS: Buyers of securitized papers.
ii) Investors can be RETAIL investors or INSTITUTIONAL investors (mutual funds, provident funds etc.)
iii) They receive their money back in the form of interest and principal as per the terms agreed.

SECONDARY PARTICIPANTS (other parties)

RC - Obligor STARE

(A) OBLIGORS: They are the parties who owe money to the Co. & are assets in Balance Sheet of Originator.
ii) The amount due from the obligor is transferred to SPV

(B) STRUCTURER / ARRANGER: It brings together the originator, investors, other parties to securitization deal.
ii) Normally, these are investment bankers.
iii) Ensures that deal meets all legal, regulatory etc. requirements.

(C) TRUSTEE OR AGENT: They oversee that all parties to the deal perform in the true spirit of terms of agreement.
ii) Normally, it takes care of interest of investors.

(D) ADMINISTRATOR/RECEIVING & PAYING AGENT(RPA)/SERVICER: It collects the payment due from obligor(s) and passes it to SPV.
ii) It also follow up with defaulting borrower.
iii) Generally, originator or its affiliates acts as servicer.

(E) RATING AGENCY: Assets have to be assessed in terms of its credit quality. Rating agency assesses:
- Credit quality of obligors.
- Mechanism for timely payment of interest & principle
- Strength of legal framework.

(F) CREDIT ENHANCER: i) Investors are directly exposed to the performance of underlying assets. So, they seek credit enhancement.
ii) It may be provided by originator (eg: over collateralization or cash collateral) or by a 3rd party like bank (eg: letter of credit).

3. Pricing of Securitized Instruments

FROM ORIGINATOR'S POINT

Instruments can be priced at a rate at which originator has to incur an outflow and if that outflow can be amortized over a period of time by investing the amount raised through securitization.

FROM INVESTOR'S POINT OF VIEW

Student note only -> Price = PV of expected future cash flows
Yield = Yield of comparable security with same credit quality & maturity.
Alternatively, yield = yield of marketable securities, but some adjustment to spread is needed in this case because of difference in credit quality.

4. INSTRUMENTS CREATED OUT OF SECURITIZATION

4.1 PASS THROUGH CERTIFICATES (PTC)

- Originator transfers the entire receipt of cash in the form of interest or principal repayment from the assets sold.
- Thus, these securities represent direct claim of the investors on the securitized assets.
- Since it is a direct route, any prepayment of principal is also proportionately distributed among the securities holders.
- Due to these characteristics on completion of securitization by the final payment of assets, all the securities are terminated simultaneously.

4.2 PAY THROUGH SECURITIES (PTS)

In PTS, SPV can structure different tranches of debt securities which can carry different levels of risk & reward.

This structure permits the SPV to:

i) Issue several debt tranches with varying maturities.

ii) De-link the cash inflows (from underlying assets) from the cash outflows (on the issued securities).

iii) Reinvest surplus funds for short term in case of early retirement of receivables.

4.3 STRIPPED SECURITIES

The holder of IO securities receives only interest while PO security holder receives only principal. Being highly volatile in nature these securities are less preferred by investors.

WHEN INTEREST RATE INCREASES:

- Borrowers will prefer to postpone the payment on cheaper loans (i.e. Principal repayments will be received later than expected).

$\therefore$ PO will fall.

- But value of IO increases as more interest is collected on borrowings.

WHEN INTEREST RATE FALLS:

- Borrowers will repay existing loans faster & take new loans at reduced rate. (i.e. Principal repayments will be received earlier than expected.)

$\therefore$ Value of PO will rise.

- Due to faster principal repayments, lesser interest will be collected. $\therefore$ IO will fall.

Space for Student Notes

5.1 FEATURES OF SECURITIZATION

Retention Code - Bundled Tranche HITS

(i) Bundling and Unbundling	When all the assets are combined in one pool it is bundling and when these are broken into instruments of fixed denomination it is unbundling.
(ii) Trenching	Portfolio of different asset are split into several parts based on risk and return they carry called 'Tranche'. Each Trench carries a different level of risk & return.
(iii) Homogeneity	Under each tranche the securities issued are of homogenous nature.
(iv) Creation of Financial Instruments	The process of securities can be viewed as process of creation of additional financial product of securities in market.
(v) Tool of Risk Management	In case of assets are securitized on non-recourse basis, then securitization process acts as risk management as the risk of default is shifted.
(vi) Structured Finance	In the process of securitization, financial instruments are tailor structured to meet the risk return trade of profile of investor.

5.2 BENEFITS OF SECURITIZATION

From the point of view of originator & investors

RC - FORB	FROM THE ANGLE OF ORIGINATOR
(i) More Focus on main business	By transferring the assets the entity could concentrate more on core business as servicing of loan is transferred to SPV.
(ii) Off – Balance Sheet Financing	When receivables are securitized it releases a portion of capital tied up in these assets resulting in off Balance Sheet financing.
(iii) Helps to improve financial Ratios	Especially in case of Financial Institutions and Banks, it helps to manage Capital – To-Weighted Asset Ratio effectively.
(iv) Reduced Borrowing Cost	Credit rating of securitized instruments can be increased by using credit enhancement techniques. This results in lower borrowing cost for originator.
	FROM THE ANGLE OF INVESTORS
(i) Diversification of Risk	Purchase of securities backed by different types of assets results in diversification of portfolio leading to risk reduction.
(ii) Regulatory requirement	Acquisition of asset backed belonging to a particular industry say micro industry helps banks to meet regulatory requirement of investment in that industry.
(iii) Protection against default	In case of recourse arrangement if there is any default by any third party then originator shall make good the amount. Moreover, there can be insurance arrangement for compensation for any such default.

6. Securitization in INDIA

6.1 SHORT NOTE ON SECURITIZATION IN INDIA

INDUSTRY ACTIONS

- Citi Bank pioneered the concept of securitization in India by bundling auto loans into securitized instruments. After that many organizations securitized their receivables.
- Securitization in Indian Market is dominated by a few players e.g. ICICI Bank, HDFC Bank etc.
- CRISIL estimates that securitization market volume may reach Rs.1.9 Trillion.
- Securitization may become a key funding source for non-banks as well as for banks.

GOVT ACTIONS

- In order to encourage securitization, the Government has come out with Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002, to tackle menace of Non Performing Assets (NPAs) without approaching the Court.
- In order to further enhance the investor base in securitized debts, SEBI has allowed FPIs to invest in securitized debt of unlisted companies upto a certain limit.

6.2 PROBLEMS OF SECURITIZATION IN INDIA RC - Debt STALE

Inadequate Debt Market	Lack of existence of a well-developed debt market in India is another obstacle.
Stamp Duty	Under Transfer of Property Act, 1882, a mortgage debt stamp duty is charged. This even goes upto 12% in some states of India.
Taxation	In the absence of any specific provision relating to securitized instruments in Income Tax Act experts' opinion differ a lot. Some opine that SPV should be taxed IN REPRESENTATIVE CAPACITY. Others say that investors should be taxed on their share of income.
Accounting	Although securitization is slated to be an off-balance sheet instrument but in true sense receivables are removed from originator's balance sheet. Problem arises especially when assets are transferred without recourse.
Lack of standardization	Every originator following his own format for documentation and administration.
Not Effective Foreclosure laws	Foreclosure laws are not supportive to lending institutions. Lenders face difficulty in event of default by borrower. This makes securitized instruments less attractive.

7. RISKS IN SECURITIZATION

Credit / Counterparty risk	Risk of bankruptcy and non-performance of servicer is the prime risk of investor.
Legal risks	Securitization is a recently developed concept (in India) and there is an absence of statutory provisions or judicial precedents. So any legal dispute can result in uncertain cash flows for investors.
Market risks	It include risks due to market-related factors. It includes

Macroeconomic Risk

Macroeconomic factors, such as industry downturns or adverse price movements can affect loan performance.

Ex – If transport industry declines, then commercial vehicle (CV) owners may default on CV loans due to reduced earnings or If price of new CV falls substantially, then existing borrowers may wilfully default on the loan.

Prepayment Risk

Reduced interest rates increases prepayment of retail loans, resulting in reinvestment risk for investors.

- As investors may not be able to reinvest the received amount at the same yield.

Interest Rate risk

This risk is prominent where the loans are based on floating rate and investor pay-outs are based on a fixed rate or vice versa.

- It results in an interest rate mismatch where pool of cash inflow may not be sufficient to meet investor pay-outs.
- Interest rate swaps can be used to hedge this.

BlockChain (or DLT)

BLOCKCHAIN (DLT)

Blockchain or Distributed Ledger Technology (DLT) is a Peer-to- peer, decentralized open ledger of trnx system with no trusted 3rd parties in between. A block chain generally uses a chain of blocks, with each block representing the digital information stored in public database ("the chain").

'PAIN'

(i) Every entry in this database is **P**ermanent.
(ii) It is an **A**ppend-only database which cannot be changed or altered.
(iii) All transactions are fully **I**rreversible.
(iv) Any change in a transaction is recorded as a **N**ew transaction.

TOKENIZATION

Tokenization is a process of converting tangible and intangible assets into blockchain tokens. It can be effective in conventional industries like real estate, artwork etc.

Similarity b/w Securitization & Tokenization

Tokenization = Attempt to convert illiquid assets into a liquid and tradeable product. (Similar to Securitization).

(i) Liquidity - Both inject liquidity in the market for otherwise illiquid assets.
(ii) Diversification: - Both help investors to diversify their portfolio thus managing risk and optimizing returns.
(iii) Trading: - Both are tradable & helps to generate wealth.
(iv) New Opportunities - Both provide opportunities for financial institutions to earn income through fees.

Applications of Blockchain

(a) Financial Services	It can be used to provide a transaction log of any physical or digital asset such as laptops, automobiles, real estate, etc. (i.e. for Automated trade lifecycle).
(b) Healthcare	Blockchain provides secure sharing of data in healthcare industry by increasing the privacy and interoperability of the data by eliminating the interference of third party.
(c) Government	It can be used where technical decentralization is necessary along with governance of govt like land registration, vehicle registration, e-voting etc. Blockchain improves transparency & provides a better way to monitor and audit the transactions in these systems.
(d) Travel Industry	It can be used for money transactions, storing passports/other important documents, reservations, travel insurance etc.
(e) Economic Forecasts	We can use blockchain to make financial & economic forecasts based on decentralized prediction markets, decentralized voting, and stock trading.

Risks Associated with Blockchain / DLT (PURI)

Process Controls

Development and maintenance of process controls can be challenging due to absence of any central authority. So, users of public blockchains may find it difficult to understand the IT controls implemented and its effectiveness.

Updates

As blockchain involves humongous data updates, the risk of information overload could challenge the required monitoring. Further, finding competent people to design and perform effective monitoring controls may be difficult.

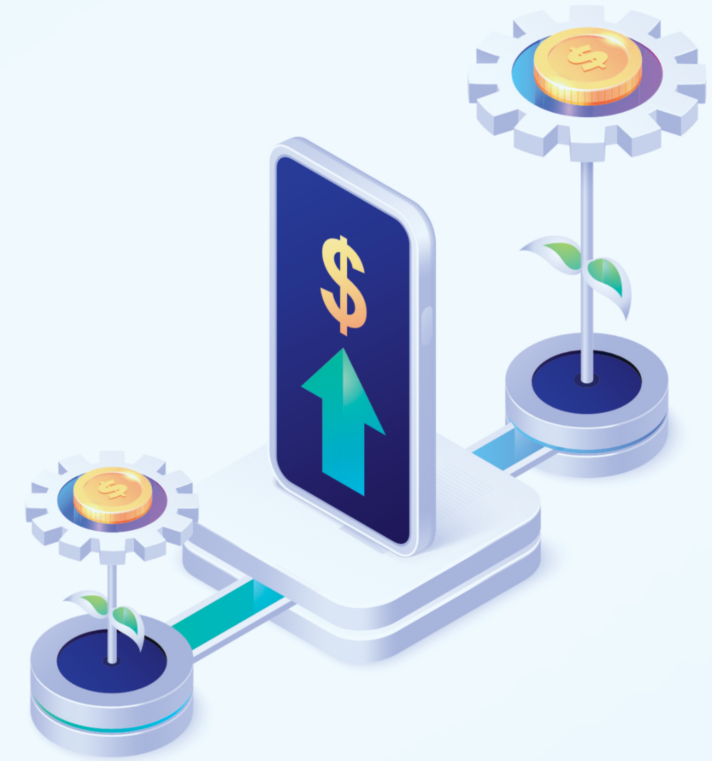
Reliability

Reliability of financial transactions is dependent on the underlying technology. If the underlying consensus mechanism is tampered with, then it could render the financial information to be inaccurate and unreliable.

In-Charge

Different members may have different risk appetite that may lead to conflict while designing monitoring controls. Since no one party is in charge, it needs to be defined who is responsible and accountable for managing risks in the blockchain.

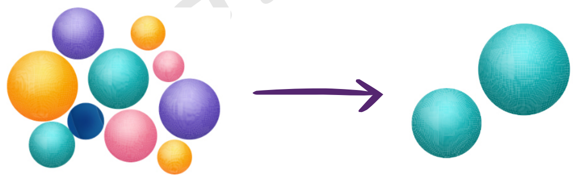
4. Financial Policy And Corporate Strategy



1.1 Functions of SFM

EXPLAIN THE FUNCTIONS OF STRATEGIC FINANCIAL MANAGEMENT. OR
WHAT ARE THE FUNCTIONS COVERED UNDER INVESTMENT & FINANCIAL DECISIONS?

1. **SEARCH** for best investment opportunity.
2. **SELECT** best opportunities.
3. Select **OPTIMAL MIX** for the investment
4. Establish **INTERNAL CONTROLS**
5. Analyse **RESULTS** for future decision making.



Bundle of all the available investment opportunities

Select the best opportunities & determine an optimum mix

1.2 WHAT ARE THE KEY DECISIONS FALLING WITHIN THE SCOPE OF FINANCIAL STRATEGY?

(i) Financing decisions	It deals with the mode of financing or mix of equity capital and debt capital.
(ii) Investment decisions	It involve profitable utilization of firm's funds especially in long-term projects. These projects are evaluated in relation to their expected return and risk.
(iii) Dividend decisions	It determine the division of earnings between payments to shareholders and reinvestment in the company
(iv) Portfolio decisions	It involves analysing how an investment will contribute to the aggregate performance of the entire corporation instead of merely analysing the standalone performance of that investment.

2. STRATEGY AT DIFFERENT HIERARCHY LEVELS

Corporate level

Corporate level strategy fundamentally is concerned with selection of businesses in which a company should compete.
IT ANSWERS 3 BASIC QUES:

SUITABILITY - Whether the strategy will help in accomplishing co.'s objective.
FEASIBILITY- Determines what resources are required to implement the strategy.
ACCEPTABILITY - It is concerned with the stakeholders' satisfaction.

Business unit level

At business unit level, strategic issues are:

1. Practical coordination of operating units
2. Developing & sustaining a competitive advantage for its products & services.

Functional level

1. Functional level strategies in R&D, operations, manufacturing, finance etc. involve development & coordination of resources through which business unit level strategies can be executed.
2. Functional unit translate higher level strategy into discrete action plans.
3. Among all the functions, finance assumes the highest importance.

3. QUES - EXPLAIN THE INTERFACE OF FINANCIAL POLICY AND STRATEGIC MANAGEMENT. OR HOW IS FINANCIAL POLICY LINKED TO STRATEGIC MANAGEMENT? OR STARTING POINT AND END POINT OF AN ORGANISATION IS MONEY. EXPLAIN.

Ans - The ultimate aim of the management of any co. is to maximize the shareholders' wealth. Therefore, the strategy as well as the financial policy of the co. Should be in line with this aim.

(i) SOURCES OF FUNDS	Funds may be sourced from : -- Owner's funds - Equity/preference share capital -- Borrowed funds - Debentures, Bank loan for Long term or Medium term. Overdraft, cash credit, trade credit for short term needs.
(ii) CAPITAL STRUCTURE	This includes deciding the desired mix of equity capital and debt capital. There are some norms for debt equity ratio. For eg: For PSU it is 1:1 and for pvt. Sector it may be 2:1 and so on.
(iii) INVESTMENT & FUND MANAGEMENT	Investment proposals can be divided into 3 groups. 1. Addition of new product. 2. Increase the level of operation of an existing product. 3. Cost reduction and efficient utilization of resources.
(iv) DIVIDEND DECISIONS	It deals with how much earnings should be distributed as dividends and how much should be retained. Various alternatives regarding dividend are: 1. Stable dividend payment every year. 2. Paying a Constant percentage of earnings dividend. 3. Pay a minimum dividend per share and additional dividend when earnings are higher than the normal earnings. 4. Whether to pay dividends in cash or as stock dividend.

Thus, the financial policy cannot be worked out in isolation of other functional policies.

4. FINANCIAL PLANNING

Ques - Write a short note on financial planning.

-- Financial planning is the backbone of the business planning and corporate planning.

-- Financial planning is a systematic approach whereby the financial planner helps the customer to maximize his existing financial resources by utilizing financial tools to achieve his financial goals.

-- There are 3 components of Financial planning:

(i) Financial Resources (FR)

(ii) Financial Tools (FT)

(iii) Financial Goals (FG)

Financial Planning = FR + FT + FG

Ques - What are the outcomes of financial planning?

(i) FINANCIAL OBJECTIVES - These are decided at the very outset so that rest of the decisions can be taken accordingly. The objectives need to be consistent with the corporate mission and corporate objectives.

(ii) FINANCIAL DECISION MAKING - It helps in analyzing the financial problems faced by the Co. and accordingly deciding the appropriate action.

(iii) FINANCIAL MEASURES - like ratio analysis, cash flow analysis are used to evaluate Co's performance. Selection of these measures again depends upon the corporate objectives.

5.1 SUSTAINABLE GROWTH

Write a short note on sustainable growth rate?

1. Concept of sustainable growth can be helpful for planning healthy corporate growth. This concept forces managers to consider the financial consequences of sales increases. A conflict can arise if growth objectives are not consistent with the value of the organization's sustainable growth.

2. Example - Fuel Industry

A DEMARKETING campaign was launched by fuel industry, which was focused on fuel conservation. This was done to ensure that the limited resources are used judicially.

This is an example of stable growth strategy adopted by the oil industry. Some other variants of stable growth strategy are incremental growth strategy, profit strategy and pause strategy.

3. Sustainable growth is important to enterprise long-term development. Too fast or too slow growth will go against enterprise growth and development, So, financial policy should ensure that the enterprise growth rate is close to the sustainable growth rate.

4. The sustainable growth rate of a firm is the maximum rate of growth in sales that can be achieved, given the firm's profitability, asset utilization, and desired dividend payout and debt (financial leverage) ratios.

→ SGR = ROE x (1- Dividend payment ratio)

5.2 ASSUMPTIONS OF SUSTAINABLE GROWTH MODEL

What are the assumptions of sustainable growth model?

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

→ Sustainable growth model assumes that asset to equity ratio is constant, therefore, new growth can only be funded by:
- Retained earnings or by Issuing additional debt that the retained earnings can support.
- Alternatively, a co. may also issue fresh equity to fund its growth. In such a case, there is no financial constraint on its growth rate. However, most of the companies are reluctant to issue fresh capital.

SOME SHORT QUESTIONS ON SUSTAINABLE GROWTH.

5.3 What makes an organisation sustainable?

RC = CLASS

Community support - get community support for its work.

Leverage financial resources - to create an impact

Administrative & financial infrastructure - should be adequate

Strategic direction - should be clear.

Staff - be able to attract, manage and retain competent staff.

5.4 What makes an organisation financially sustainable?

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

5.5 QUES - WRITE A SHORT NOTE ON GROWTH RATE IN CASE OF MATURE / CASH-RICH FIRMS.

These firms may have growth rate less than sustainable growth rate. In such cases management may:
1. Try to increase the growth rate through acquisition of rapidly growing companies.
2. Return the excess cash to shareholders through increased dividend, share buy back etc. This decreases the (required) sustainable growth rate of the company.

Growth can come from two sources: increased volume and inflation. Inflation increases the amount of external financing required and increases the debt-to-equity ratio when this ratio is measured on a historical cost basis. Thus, if creditors require that a firm's historical cost debt-to-equity ratio stay constant, inflation lowers the firm's sustainable growth rate.

Other Ques related to Strategy

Explain the processes of strategic decision making

- Investors want to maximize their wealth by selecting investments that will give maximum expected returns at minimum risk.
- This is the highest priority of management as well i.e. Wealth maximization.
- Capital is limiting factor. So, It should be allocated such tha it that sustain or increase investor returns.

Therefore, all businesses need to have the following three fundamental essential elements:

i. A clear and realistic strategy,
ii. The financial resources, controls and systems to see it through and
iii. The right management team and processes to make it happen.
We may summarise this by saying that: Strategy + Finance + Management = Fundamentals of Business

IMPORTANCE OF STRATEGIC MANAGEMENT IN TODAY'S SCENARIO

Strategic management intends to run an org in a systematized manner by developing a series of plans and policies.

It is concerned with where the org wants to reach and how it intends to reach there.

It tries to reduce uncertainty through continuous review of planning and implementation process.

It is therefore necessary for an org to go for strategic planning.

CHARACTERISTICS

Characteristics of strategy:
i) Long term in nature
ii) Strategy are complex
iii) Dynamic in nature
iv) Strategy are directed towards in goal of org
v) Strategy affects the whole organisation.

Role of CFO in various matters including value creation (AFM Additional Topic)

Traditional role = Concentrated to wealth maximisation by taking care of financial health & overseeing and implementing adequate financial controls.

Recent times = CFOs are also expected to contribute in strategic and operational decision making. Take a leadership role in long term sustainable value creation.

In post-pandemic time their role has been advanced in the following areas in addition to traditional role:

a) Risk Management – Look after the overall functioning of Risk Management framework.

b) Supply Chain – CFOs needs to consider the financial viability of the supply chain as it directly affects the financial health of the company.

c) Mergers, acquisitions, and Corporate Restructuring – Look after M&A decisions. Since these are strategic decision, any error here can lead to collapse of the whole business.

d) Environmental, Social and Governance (ESG) Financing – With the evolving of the concept of ESG their role has been shifted from traditional financing to sustainability financing.

1. INTRODUCTION

Let us say you want to invest in the shares. But there are thousands of stocks listed on stock market, how do you choose the stocks that are worth investing?

The simple answer is → You must **ANALYSE** the stocks and choose the best one as per your judgement.

But how to analyse the stocks?

This is the most basic question that faces when he/she starts investing in the stock market.

THERE ARE 2 DISCIPLINES OF ANALYSING THE STOCKS

	Fundamental analysis	Technical analysis
•	It assumes that the share price depends on the future dividends.	It assumes that all the relevant information is included in the price-volume chart of that stock.
•	The investor calculates the intrinsic value = PVCI	Investors believe that the price trends are repetitive.
•	If price > Value -> Over-valued (sell it) If price < Value -> under-valued (buy it)	Therefore, if something happened before, it is likely to happen again.
Method:	Prospects are measured by analyzing economy's macro factors such as Country's GDP, Inflation Rate, Interest Rate, Growth Rate etc. and company's micro factors like its Sales, Profitability, Solvency, Asset & Liabilities and Cash position etc.	Predicts future prices and their direction using purely historical market data and information such as their Price Movements, Volume, Open Interest etc.
Rule:	Prices of a share discounts everything.	Price captures everything
Use:	For Long-Term Investing	For Short-term Investing

Ques 1: How is decision taken by a fundamental analyst?

Ans: If price > Value -> Over-valued (sell it)

If price < Value -> under-valued (buy it)

Ques 2: What is fundamental analysis? What are the different approaches of fundamental analysis?

Ans: What is fundamental analysis -> Discussed in above table. Refer that.

Different approaches of fundamental analysis

a) Constant Dividend Approach: Under this approach company it is expected that the company will a constant dividend every year.

$$P0 = \frac{DPS}{(1+Ke)^1} + \frac{DPS}{(1+Ke)^2} + \frac{DPS}{(1+Ke)^3} + \text{-------------} \infty \quad \text{or} \quad P0 = \frac{DPS}{Ke}$$

b) Dividend Growth Approach : Practically, we observe that DPS changes due to change in company's earnings. This change in DPS can be captured by using Dividend growth model.

$$\text{Value as per Dividend growth approach} = \frac{DPS_1}{(1+Ke)^1} + \frac{DPS_1(1+g)}{(1+Ke)^2} + \frac{DPS_1(1+g)^2}{(1+Ke)^3} + \text{--------}\infty$$

or $$P0 = \frac{DPS_1}{Ke-g} \quad \text{or} \quad \frac{DPS0(1+g)}{Ke-g}$$

c) Earning Growth Model : $$P0 = \frac{EPS0(1+g)(1-b)}{Ke-g} \quad \text{or} \quad \frac{EPS_1(1-b)}{Ke-g}$$

2. FUNDAMENTAL ANALYSIS

Ques 3: What are the key areas / variables on which a fundamental analyst focus? or How to fundamentally analyse a security?

Ans: The 3 main areas are:

1. Economic analysis
2. Industry analysis
3. Company analysis

By analysing these three areas, an analyst can fundamentally analyse the share of a company.

Ques 4: What is economic analysis?

Ans: Economic analysis includes analysis of macro-economic factors such as

- Growth of different sectors of economy
- trends in people's income & expenditure
- Consumption patterns etc.

Ques 5: What are the factors affecting economic analysis?

Ans: (a) Growth Rates of National Income and Related Measures: The GDP growth rate of the economy affects industries and therefore affects the returns that an investor will earn from his investment.

(b) Growth Rates of Industrial Sector: GDP growth rate can be further broken down into growth rates of various industries based on estimated demand of the product in that industry.

(c) Inflation: The demand in some industries, particularly the consumer products industries, is significantly influenced by the inflation rate.

(d) Monsoon: Because of the strong forward and backward linkages, monsoon is of great concern to investors.

Ques 6: What are the techniques used for economic analysis?

(a) Anticipatory Surveys: They help investors to form an opinion about the future state of the economy. It incorporates expert opinion on construction activities, future spending habits of consumers etc.

(b) 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:

(i) 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.

(ii) Roughly Coincidental Indicators: They reach their peaks (high) and troughs (low) at approximately the same time in the economy.

(iii) Lagging Indicators: They are time series data of variables that lag behind in their consequences vis-à-vis the economy. They reach their turning points after the economy has reached its own already.

(c) Economic Model Building Approach: Modeling includes building a relationship between dependent & independent variables. A model can be build to estimate the future GNP. This modeling exercise can include:

i. Estimating the various components of the GNP such as consumption, govt. expenditure etc.

ii. Add the individual components to get GNP.

Ques: 7	What are the drawbacks of anticipatory surveys?
i.	Survey results do not guarantee that intentions surveyed would materialize.
ii.	They are not regarded as forecasts per se, as there can be a consensus approach by the investor for exercising his opinion.
Ques 8:	What is industry analysis?
Ans:	When an economy grows, the different industries in the economy will grow at different rates. So, we need industry analysis to analyse how well a particular industry is expected to perform in future.
Ques 9:	What are the factors affecting industry analysis?
Ans: a)	Product Life-Cycle: An industry usually exhibits high profitability in the initial and growth stages, medium but steady profitability in the maturity stage and a sharp decline in profitability in the last stage of growth.
(b)	Demand Supply Gap: Excess supply reduces the profitability of the industry because of the decline in the unit price, while insufficient supply tends to improve the profitability because of higher unit price.
(c)	Barriers to Entry: Any industry with high profitability would attract fresh investments. The potential entrants to the industry may face different types of barrier to entry such as technological barrier, legal barrier etc.
(d)	Government Attitude: The government attitude towards an industry is crucial determinants of its prospects.
(e)	State of Competition in the Industry: Competition depends on the
	- Type of products manufactured viz. homogeneous or highly differentiated,
	- Type of industry the firm is placed viz. growth, cyclical, defensive or decline.
(f)	Cost Conditions and Profitability: The price of a share depends on profitability of the firm. Profitability depends on the state of competition in the industry, cost control measures adopted by the units etc.
(g)	Technology and Research: Technology is subject to change very fast leading to obsolescence. Industries which update themselves have a competitive advantage over others in terms of quality price etc.
Ques 10:	What are the techniques used for industry analysis?
Ans:	Regression analysis: Regression can be used to forecast the demand. Various inputs such as per capita income, price elasticity of demand is used as input in the regression analysis.
	Input – output analysis: It reflects flow of goods & services as goods proceed through raw material stage through final consumption. This is used to detect changing trends indicating growth/decline of industries.

Ques 11: What is company analysis?

Economic and industry analysis provides investors the information about the industry in which investment should be done. At this stage it is important to identify a good company within the chosen industry. This requires careful examination of the company's quantitative and qualitative fundamentals.

Ques 12: What are the factors affecting company analysis?

Ans: (a) Net Worth & Book Value: Net worth = Equity share capital + free reserves – Intangible assets – c/f losses

Book value per share = Total net worth / Number of shares

(b) Analysis of Sources and Uses of Funds (Fund flow analysis): One of the major uses of funds flow analysis is to find out whether the firm has used short-term sources of funds to finance long-term investments.

(c) Cross-Sectional and Time Series Analysis: We Compare 2 firms, compare a firm against some benchmark figures for its industry. The techniques that are used are: common-sized statement, and financial ratio analysis.

(d) Size and Ranking: Measures used to calculate co.'s rank within its industry-> sales, net profits, ROI etc.

(e) Growth Record: Growth in sales, net income and EPS of the co. in the past few years should be examined.

(f) Financial Analysis: It includes calculating and analysing certain fundamental ratios. It helps in analysing the the financial solvency and liquidity of co., the efficiency with which the funds are used.

(g) Quality of Management: It has to be seen with reference to the experience, skills and integrity of management.

(h) Marketability of shares: Shares of the co. must be liquid so that they can be bought and sold easily.

Ques 13: What are the techniques used for company analysis?

Ans: (a) Correlation & regression Analysis: Simple regression is used when inter relationship covers two variables. For more than two variables, multiple regression analysis is followed. Here the inter relationship between variables belonging to economy, industry and company are found out.

(b) Trend Analysis: The relationship of one variable is tested over time using regression analysis. It gives an insight to the historical behaviour of the variable.

(c) Decision Tree Analysis: In decision tree analysis, the decision is taken sequentially with probabilities attached to each sequence. To obtain the probability of final outcome, various sequential decisions given along with probabilities, the probabilities of each sequence is to be multiplied and them summed up.

3. TECHNICAL ANALYSIS

Ques 14: What is technical analysis (TA)?

Ans: Technical analysis is a study of the share price movements by analysing the price charts.

-> It assumes that share price trends are repetitive that since investor psychology follows a certain pattern, what is seen to have happened before is likely to be repeated.

-> A technical analyst attempts to answer two basic questions:

i) Is there a discernible trend in the prices?

ii) If there is, then are there indications that the trend would reverse?

-> The methods used to answer these questions are visual and statistical. The visual methods are based on examination of a variety of charts to make out patterns, while the statistical procedures analyse price and return data to make trading decisions.

Ques 15: What are the assumptions of technical analysis?

(i) The market value of stock depends on the demand and supply for a stock.

(ii) The supply and demand are governed by several factors which can be rational or irrational.

(iii) Stock prices generally move in trends which continue for a substantial period.

(iv) Technical analysis relies upon chart analysis which shows the past trends in stock prices rather than the information in the financial statements like balance sheet or Profit & loss account.

Ques 16: What are the principals of technical analysis?

Ans: (a) The Market Discounts Everything: Technical analysts generally have the view that a company`s share price includes everything including the fundamentals of a company.

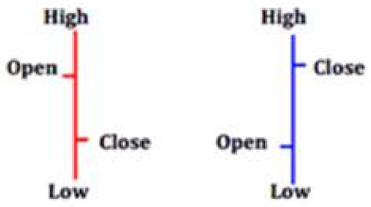
(b) Price Moves in Trends: Technical Analysts believe that prices move in trends. In other words, a stock price is more likely to continue a past trend than move in a different direction.

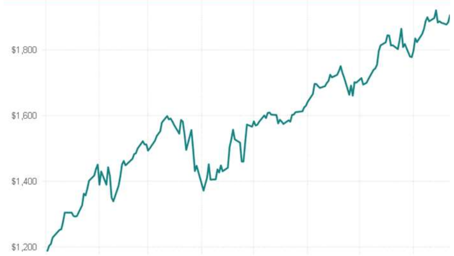
(c) History Tends to Repeat Itself: Technical Analysts believe that history tends to repeat itself. Technical analysis uses chart patterns to analyze subsequent market movements to understand trends.

Ques 17: Explain the types of charts used in technical analysis.

Ans: The type of charts used in technical analysis are:

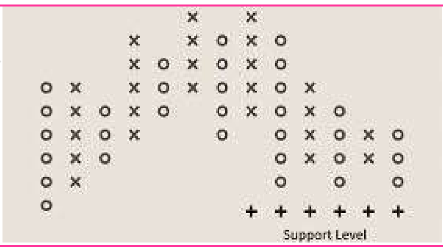
i. Bar chart – In a bar chart, a vertical line (bar) represents the lowest to highest price, with a short horizontal line indicating the closing price for the period.

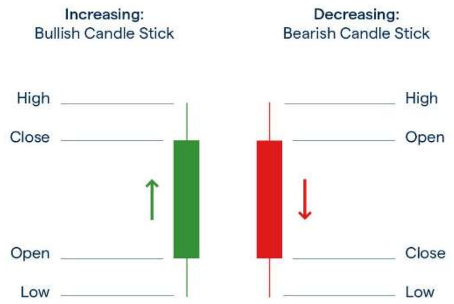


ii. 

Line chart – The closing price for each period is plotted as a point. These points are joined by a line to form a chart. The period may be a day, a week, a month.

iii. Point and figure chart – These are more complex than line or bar charts. They are used to detect reversals in trends. For plotting a point and figure chart, we have to first decide the box size and the reversal criterion. The box size is the value of each box on the chart, for example each box could be Rs.1, 2 or 0.50. The smaller the box size, the more sensitive would the chart be to price change.



iv. 

Japanese candlestick chart – Like Bar chart this chart also shows the same information i.e. Opening, Closing, Highest and Lowest prices of any stock on any day but this chart more visualizes the trend as change in the opening and closing prices is indicated by the colour of candlestick..

Ques 18: What are support and resistance levels?

Ans: i. When the index/price goes down from a peak, the peak becomes the resistance level.

ii. When it rebounds after reaching a trough subsequently, the lowest value reached becomes the support level.

iii. The price is then expected to move between these two levels. Whenever the price approaches the resistance level, there is a selling pressure because all investors who failed to sell at the high would be keen to liquidate, while whenever the price approaches the support level, there is a buying pressure as all those investors who failed to buy at the lowest price would like to purchase the share.

iv. A breach of these levels indicates a distinct departure from status quo, and an attempt to set newer levels.

Ques 19: Explain some of the market indicators.

Ans: I. Breath Index or Market breath – It is computed by dividing the net advances or declines in the market by the number of issues traded.

If breath index supports the Dow Jones averages -> This is a sign of technical strength.

If breath index does not support the Dow Jones averages -> This is a sign of technical weakness (i.e. an expectation that market may move into direction opposite to the Dow Jones averages.

II. Volume of Transactions – Volume plays a key role in the stock market.

- If the price of a share/index is rising along with an increased volume -> This means that a lot of people want to buy and there is unsatisfied demand in the market.
- Similarly, a falling market with increasing volume means -> A lot of people want to exit the security. Therefore, signalling bear market.
- Volume is best used along with some other indicator (as volume tells the strength of that indicator)

III. Confidence Index – CI = Ratio of High-grade bond yields to Low-grade bond yields.

Rising CI is expected to precede a rising stock market.

A fall in CI is expected to precede a fall stock market.

IV. Relative Strength Index (RSI) – The relative strength concept suggests that price of some securities rise relatively faster in a bull market or decline more slowly in a bear market than other securities i.e. some securities exhibit relative strength.

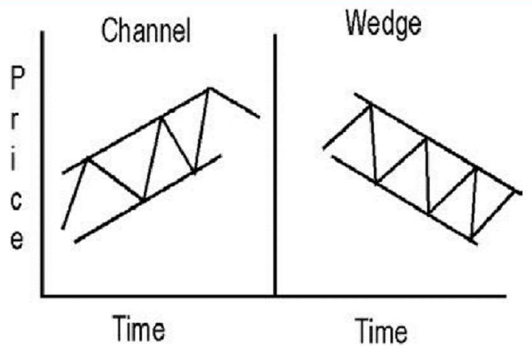
There are several ways to measure the RSI like using ratios.

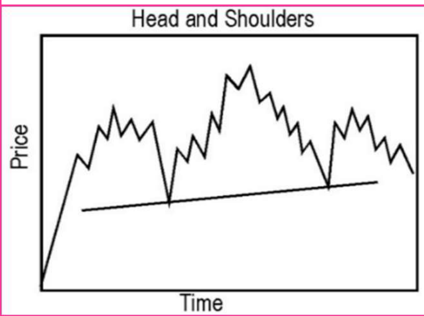
V. Odd-Lot theory – This theory is a contrary opinion theory. It assumes that the average person is usually wrong and that a wise course of action is to pursue strategies contrary to popular opinion. It is mainly used to predict tops in bull market and to predict reversals in individual securities.

Ques 20: Discuss some of the important price patterns used by technical analysts.

Ans: (a) **Channel:** A series of uniformly changing tops and bottoms gives rise to a channel formation. A downward sloping channel would indicate declining prices and an upward sloping channel would imply rising prices.

(b) **Wedge:** A wedge is formed when the tops (resistance levels) and bottoms (support levels) change in opposite direction (that is, if the tops, are decreasing then the bottoms are increasing and vice versa), or when they are changing in the same direction at different rates over time.



(c) 

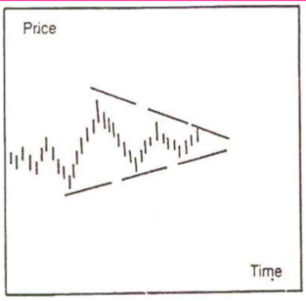
Head and Shoulders: It has a large lump (for head) in the middle of two smaller humps (for shoulders). The neckline of the pattern is formed by joining points where the head and the shoulders meet. The price movement after the formation of the second shoulder is crucial. If the price goes below the neckline, then a drop in price is indicated, with the drop expected to be equal to the distance between the top of the head and the neckline.

Head and Shoulder Top Pattern: This has a left shoulder, a head and a right shoulder. Such formation represents bearish development. If the price falls below the neck line (line drawn tangentially to the left and right shoulders) a price decline is expected. Hence it's a signal to sell.

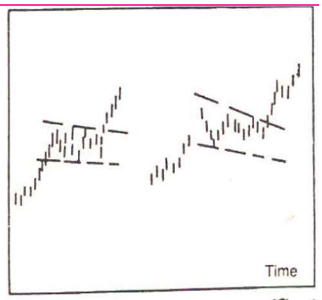
Inverse Head and Shoulder Pattern: As the name indicates this formation, it is an inverse of head and shoulder top formation. Hence it reflects a bullish development. The price rise to above the neck line suggests price rise is imminent and a signal to purchase.

(d) **Triangle or Coil Formation:** This formation represents a pattern of uncertainty and is difficult to predict in which way the price will break out.

Flags and Pennants Form: This form signifies a phase after which the previous price trend is likely to continue.



TRIANGLE OR COIL



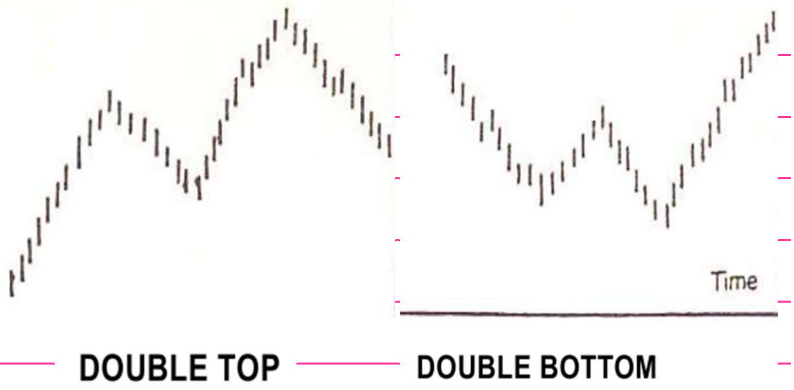
FLAG & PENNANT

(e) Double Top Form:

This form represents a bearish development, signals that price is expected to fall.

Double Bottom Form:

This form represents bullish development signalling price is expected to rise.



(f) Gap : A gap is the difference between the opening price on a trading day and the closing price of the previous trading day. The wider the gap the stronger the signal for a continuation of the observed trend. On a rising market, if the opening price is considerably higher than the previous closing price, it indicates that investors are willing to pay a much higher price to acquire the scrip. Similarly, a gap in a falling market is an indicator of extreme selling pressure.

Ques 21: What are the arguments in favour of & against technical analysis? Or Evaluate technical analysis.

Ans: IN FAVOUR:

(a) Under influence of crowed psychology, trend persist for some time. Tools of technical analysis help in identifying these trends early and help in investment decision making.

(b) Shift in demand and supply are gradual rather than instantaneous. Technical analysis helps in detecting this shift rather early and hence provides clues to future price movements.

(c) Fundamental information about a company is observed and assimilated by the market over a period of time. Hence price movement tends to continue more or less in same direction till the information is fully assimilated in the stock price.

AGAINST:

(a) Most technical analysts are not able to offer a convincing explanation for the tools employed by them.

(b) Empirical evidence in support of random walk hypothesis cast its shadow over usefulness of technical analysis.

(c) By the time an up trend or down trend maybe signalled by technical analysis it may already have taken place.

(d) Ultimately technical analysis must be self- defeating proposition. With more and more people employing it, the value of such analysis tends to decline.

4. DIFFERENT THEORIES ON TECHNICAL ANALYSIS

There are 3 theories under this topic.

- Elliot wave theory
- The Dow theory
- Random walk theory.

Ques 22: Explain the Elliot Wave Theory of technical analysis?

Ans:
- This theory was given by Ralph Elliot. He defined price movements in terms of waves.
- These waves are resulted from buying and selling impulses emerging from the demand and supply pressures on the market.

→ As per this theory, waves can be classified into Two Parts:

(a) IMPULSIVE PATTERNS (BASIC WAVES) - In this pattern there will be 3 or 5 waves in a given direction (going upward or downward) These waves shall move in the direction of the basic movement. This movement can indicate bull phase or bear phase.

(b) CORRECTIVE PATTERNS (REACTION WAVES) - These waves are against the basic direction of the basic movement. Correction involves fall in case of bull market and rise in case of bear market.

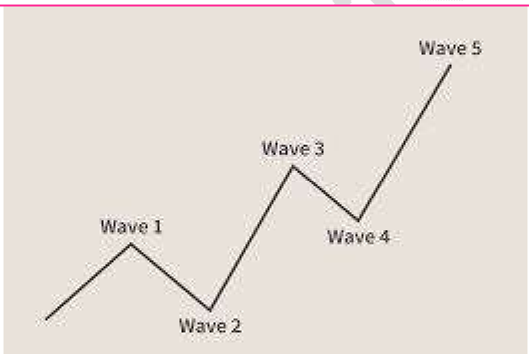
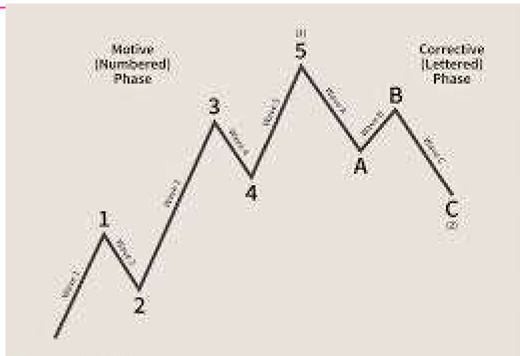


Fig: Waves 1, 3 and 5 are directional movements i.e the impulsive waves.
These are separated or corrected by wave 2 & 4, termed as corrective movements.



Complete Cycle - As shown in following figure five-wave impulses is following by a threewave correction (a,b & c) to form a complete cycle of eight waves

Ques 23: What is the Dow Jones Theory?

Ans: The Dow Theory (by Charles Dow) is one of the oldest and most famous technical theories.

- The Dow Theory is based upon the movements of two indices, constructed by Charles Dow,

  i) Dow Jones Industrial Average (DJIA) (ii) Dow Jones Transportation Average (DJTA).

- The movements of the market are divided into three classifications,

  Primary movement, Secondary movement, Daily fluctuations (not exactly a part of Dow theory)

  PRIMARY MOVEMENT- It is the main trend of the market, which lasts from one year to 36 months or longer. This trend is commonly called bear or bull market.

  SECONDARY MOVEMENT- It is shorter in duration than the primary movement, and is opposite in direction. It lasts from two weeks to a month or more.

  DAILY FLUCTUATIONS- These are the narrow movements from day-to-day.

- Purpose of Dow theory → The purpose is to determine where the market is and where is it going.

- What the theory states?

  - The theory states that if successively highs and the successive lows are higher, then the market trend is up and a bullish market exists. Contrarily, if the successive highs and successive lows are lower, then the direction of the market is down and a bearish market exists.

- The logic or the reason given by Charles Dow for the theory.

  Charles Dow proposed that the primary uptrend would have three moves up.

  1st Move - Caused by accumulation of shares by the far-sighted, knowledgeable investors.

  2nd Move - Caused by the arrival of the first reports of good earnings by corporations.

  3rd & the last move – Caused by widespread report of financial well-being of corporations.

  The third stage would also see rampant speculation in the market.

Ques 24: How should any investor time her investment decision as per Dow Jones theory.

Ans: Ideally, an investment manager would like to purchase shares when they have reached lowest trough and sell them when they reach highest peak. However, in practice it is extremely difficult to identify when a share has reached it's highest peak lowest trough. For this the investment manager should be able to identify exactly when the rising or falling trend has begun.

Dow Jones theory helps us in identification of this trend. It states that if successively highs and the successive lows are higher, then the market trend is up and a bullish market exists. Contrarily, if the successive highs and successive lows are lower, then the direction of the market is down and a bearish market exists.

Ques 25: Explain the Random Walk Theory?

Ans:
- This theory 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 i.e. these are independent of each other.
- 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:

(i) Prices of shares in stock market can never be predicted.

(ii) 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.

(iii) 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).

Ques 26: What is efficient market Hypothesis/theory (EMH)?

What conclusions from random walk theory led to evolution of Efficient market hypothesis?

Ans: As per this theory, at any given time, all available price sensitive information is fully reflected in securities' prices. This theory implies that as every stock is appropriately priced based on available information, it is impossible to outperform the overall market through expert stock selection or market timing and the only way an investor can possibly obtain higher returns is by purchasing riskier investments.

As per this theory:

- Information is freely and instantaneously available to all market participants.

- Keen competition among the market participants more or less ensures that market will reflect intrinsic values. This means that they will fully impound all available information.
- Price change only response to new information that is unrelated to previous information & ∴ unpredictable.

Ques 27: Explain the different levels or forms Efficient Market Theory?

Ans: (i) Weak form efficiency: Price reflect all information found in the record of past prices and volumes. This means that there is no relationship between the past and future price movements.

(ii) Semi-Strong efficiency: Price reflect not only all information found in the record of past prices and volumes but also, all other publicity available information.

(iii) Strong form efficiency: Price reflect all available information public as well as private.

Ques 28: Explain the Misconception about Efficient Market Theory?

Ans: Myth 1 – As per EMH investors cannot outperform the market.

EMH implies that market prices factor in all available information and as such it is not possible for any investor to earn consistent long term returns from market operations.

Myth 2: As per EMH market prices always reflect fair value.

Although price tends to fluctuate they cannot reflect fair value. This is because the future is uncertain. The market springs surprises continually and as prices reflect the surprises they fluctuate

Myth 3: The random movement of stock prices suggests that stock market is irrational.

Randomness and irrationality are two different things, if investors are rational and competitive, price changes are bound to be random.

Ques 29: Explain the different challenges to Efficient Market Theory?

Ans: (a) Information inadequacy – Information is neither freely available nor rapidly transmitted to all participants in the stock market. There is a calculated attempt by many companies to circulate misinformation.

(b) Limited information processing capabilities – Human information processing capabilities are sharply limited.

(c) Irrational Behaviour- The market participants can at times act irrationally. The effect of irrationality can be more profound when emotions enters into decision making.

(d) Monopolistic Influence – In theory, market is regarded as highly competitive. No single buyer or seller can have undue influence over prices. But in practice, powerful institutions and big operators yield great influence over the market. The monopolistic power enjoyed by them diminishes the competitiveness of the market.

Ques 30: Write a short note on Empirical Evidence on weak form of Efficient Market Theory

Ans: Three types of tests have been employed to empirically verify the weak form of Efficient Market Theory- Serial Correlation Test, Run Test and Filter Rule Test.

(i) Serial Correlation Test (to test randomness of stock price changes): Price change in one period is correlated with price change in some other period. Price changes are considered to be serially independent. Several serial correlation studies were conducted employing different stocks, different time lags etc. but no significant serial correlation was found. These studies were carried on short term trends viz. daily, weekly, fortnightly and monthly and not in long term trends in stock prices as in such cases stock prices tend to move upwards.

(ii) Run Test: Given a series of stock price changes each price change is designated + if it represents an increase and – if it represents a decrease. The resulting series may be -,+, - , -, - , +, +.

A run occurs when there is no difference between the sign of two changes. When the sign of change differs, the run ends and new run begins.

$$\frac{++}{1}/\frac{---}{2}/\frac{+}{3}/\frac{-}{4}/\frac{+}{5}/\frac{--}{6}\ \frac{++}{1}/\frac{---}{2}/\frac{+}{3}/\frac{-}{4}/\frac{+}{5}/\frac{--}{6}$$

To test a series of price change for independence, the number of runs in that series is compared with a number of runs in a purely random series of the size and in the process determines whether it is statistically different. By and large, the result of these studies strongly supports the Random Walk Model.

(iii) Filter Rules Test: If price of stock increases by at least N% buy and hold it until its price decreases by at least N% from a subsequent high. When the price decreases at least N% or more, sell it. If the behaviour of stock price changes is random, filter rules should not apply in such a buy and hold strategy. By and large, studies suggest that filter rules do not out perform a single buy and hold strategy particular after considering commission on transaction.

Ques 31: Write a short note on Empirical Evidence on Semi-Strong form of Efficient Market Theory

Ans: Semi-strong form efficient market theory holds that stock prices adjust rapidly to all publicly available information. By using publicly available information, investors will not be able to earn above normal rates of return after considering the risk factor.

- **Studies were conducted to test semi-strong form EMH, which lead to following queries:**

Whether it was possible to earn on the above normal rate of return after adjustment for risk, using only publicly available information and how rapidly prices adjust to public announcement with regard to earnings, dividends, mergers, acquisitions, stock-splits?

Several studies support the Semi-strong form Efficient Market Theory.

-- A study found that prior to the split, stock earns higher returns than predicted by any market model.

-- Another study divided the firms into two groups. First group consists of firms whose earnings increased in relation to the average corporate earnings while second group consists of firms whose earnings decreased in relation to the average corporate earnings. They found that before the announcement of earnings, stock in the first group earned positive abnormal returns while stock in the second group earned negative abnormal returns. After the announcement of earnings stock in both the groups earned normal returns.

Ques 32: Write a short note on Empirical Evidence on Strong form of Efficient Market Theory

Ans: To test this theory, the researcher analysed returns earned by certain groups viz. corporate insiders, specialists on stock exchanges, mutual fund managers who have access to internal information (not publicly available), or posses greater resource or ability to intensively analyse information in the public domain. They suggested that corporate insiders (having access to internal information) and stock exchange specialists (having monopolistic exposure) earn superior rate of return after adjustment of risk.

-- Mutual Fund managers do not on an average earn a superior rate of return. No scientific evidence has been formulated to indicate that investment performance of professionally managed portfolios as a group has been any better than that of randomly selected portfolios.

Ques 33: Write a short on equity research. **(AFM new addition)**

Ans: Equity Research = Analysing co.'s financial performance and other factors to determine whether the equity share of a company should be bought, sold or continued to be hold.

- It can also be applied in any M&A scenario to decide about swap ratio.
- Equity Research Analysts = People performing equity research.
- Earlier, equity research was paper based. But now analyst use various online tools.