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M0133/M0285 EQUITY & DEBT MARKET ANSWER KEY 2

BMS: FINANCE | Q.P.CODE

[Time: 2.5 Hours] | [Marks: 75]

Q1A.

1. IPO
2. Financial market
3. Debenture
4. SEBI
5. Treasury bill
6. Deep discount bonds
7. Authorized, Registered capital
8. Zero coupon bond
9. Statutory liquidity ratio
10. YTM, Interest rate method

Q1B.

True 2, 4, 6, 7, 8, 9, 10
False 1, 3, 5,

Q2.A. **Objectives of SEBI (2 marks)**

1) To protect the interest of investors
2) To bring professionalism in the working of intermediaries
3) To create good financial climate

Powers over Stock Exchange (5 marks)

1) To call periodical returns from recognised stock exchanges
2) To call any information or explanation from recognised stock exchange or its members
3) To order enquiries relating to affairs of stock exchanges or its members
4) To grant approval of Bye-laws of recognised stock exchanges
5) To make and amend any bye-laws
6) To control and to regulate stock exchanges

Q2. B . A merchant banker is defined as an organization that acts as an intermediary between the issuers and the ultimate purchaser of securities in the primary market.

Classified as Fee based merchant banking&Fund based merchant banking

Services offered by merchant bankers are:

- Consultancy services
- Government consent
- Project planning and feasibility study
- Raising financial resources
- Issue management
- Portfolio management
- Advice on expansion program

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- Loan syndication
- Corporate restructuring
- Revival of sick units

Q2.P. **<u>Ans.Following points to be covered with appropriate explanation.</u>**

A prospectus is any document described or issued as a prospectus and includes any kind of announcement inviting deposits or offers from public for the subscription or purchase of any shares or debentures of a corporate.

Types are

- Letter of offer prospectus
- Letter of rights
- Shelf prospectus
- Draft prospectus
- Red herring prospectus
- Abridged prospectus

Any two can be explained in detail.

Q2.Q. Preference shares

<u>Ans.Following points to be covered with appropriate explanation.</u>

- PS are those are those shares which enjoy preference rights over equity capital in terms of fixed annual dividends and return of capital in the event of winding up of the company.
- A company cannot issue irredeemable preference shares.
- Low capital appreciation.
- Cannot be traded on share market with exceptions.
- Less risk compared to equity shares.
- Normally issued for face value of Rs. 100.
- Not entitled for bonus shares and do not have voting rights.
- Types are cumulative, redemmable, convertible , participating and their opposites.

EQUITY SHARES

- An equity share also known as ordinary share, represents form of fractional ownership by means of which the shareholder undertakes maximum risk associated with the business venture.
- Asset – liability = equity
- It forms a part of liability side of balance sheet ie. Sources of funds.
- Equity shareholders have residual claim over the company and are known as virtual owners of the company.
- Equity capital is known as owned capital or risk capital or venture capital.
- They do not receive fixed dividend.
- They have voting rights.
  They are paid last at the time of winding up of the company

Q3A. **<u>Ans.Following points to be covered with appropriate explanation.</u>**

- Financial market consists of Capital & Money market
- Money market consists of organized & unorganized market with examples
- Capital market is divided into

3

- Industrial securities market ie. Primary & Secondary
- Government securities market
- Long term loans market ie. Term loan, Mortgage loan & Financial Guarantees loan
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Q3.B. IPO is a type of public offering in which shares of a company are sold for the first time to perspective investors comprising of retail, institutional clients, employees etc. It is a way to raise funds for future expansion and projects.

Steps in an IPO

- IPO approval from board.
- Selecting an investment banker.
- Letter of intent.
- Syndicate of underwriters.
- SEBI filing.
- Filing of prospectus with registrar of companies,
- Marketing of IPO
- Underwriting agreement
- Statutory announcement
- Collection and processing of applications
- Allotment of shares
- Listing of issue.

Q3.P. **Unorganised Money Market Sector**

- Money market refers to the dhole network of financial institutions dealing in short term funds which provides an outlet to lenders and a source of supply of funds to borrowers.
- The short period varies from a day to a year.
- Unorganised Sector of the money market consists of indigenous bankers and the money-lenders called mahajans, seths, shroffs, chettiars, etc., in different parts of the country.
- Many of the indigenous bankers combine banking business with trading and commission business, whereas others deal primarily in banking activities. The indigenous bankers deal in 'hundis' and 'promissory notes'.
- Nearly fifty per cent of the internal trade depends on finance from the unorganised sector
- The unorganised sector is largely outside the control of the Central Bank and is characterised by lack of uniformity in their business dealings.
- In India, the indigenous bankers and money lenders, traders, are important segment of unorganised money market.
- The only link that exists between the organised and unorganised sectors is through commercial banks. Indigenous bankers carry on their activities through the media of these commercial banks.
- Unorganized market has of late been strengthened with the addition of unaccounted or black money. A conservative estimate places this amount at between Rs. 2,500 and Rs. 10,000 crores. As a result of the income velocity of money, considerable savings will be accruing in the unaccounted income sector. These sectors seek outlets which again escape from the tax net and thus enlarge the un-accounted sector.

(9)

Q3.Q. Equity culture & issues in India

Ans.Following points to be covered with appropriate explanation.

Measures to develop equity culture in India

- SEBI
- Professional approach
- Guarantee and simplicity
- Market based pricing
- Disclosure and transparency
- Investor education
- Companies act

Development of equity culture in India

- Increase in working size of Indian population.
- Provision for tax incentives.
- Publicity & advertisement.
- Additional source of income.
- Capital appreciation, growth & liquidity.
- Increase in no. of registered companies

Q4.A. **Ans.Following points to be covered with appropriate explanation.**

- Nature
- Status (Creditors & owners)
- Issuer
- Profit sharing
- Earnings
- Claim
- Trading (OTC & Stock exchange)

Q4.B. **Ans.Following points to be covered with appropriate explanation.**

Primary market deals with

- It deals with issue of new securities.
- A company raises funds through IPO for various purposes.
- Transaction happens between issuer and investors.
- It generally happens through merchant bankers and underwriters.
- Important for capital formation.

Methods of raising funds in the primary market are

- Public issue
- Offer for sale or bought out deal
- Private placement
- Rights issue
- Electronic IPO
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Q4.P . $YTM = \frac{I + (RV - MP / N)}{RV + MP / 2} * 100$

Bond A = 17.65%

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Bond B = 20.84%

Bond B is better

Q4.Q.

Year	Interest	PVIF @ 15%	PV OF CASH INFLOW
1	140		121.8
2	140		105.84
3	140		92.12
4	140		80.08
5	140		69.58
6	140+1050		514.08

PV OF BOND = 983.5

Q5.A. RM = Total Earnings / Total cost *100

Total Earnings = Total dividend + Total capital appreciation

= 291/1105 *100 = 26.33%

CAPM , KE = RF + B(RM-RF)
C/O A = 23.86%
C/O B = 22.63%
C/O C = 20.17%
C/O D = 26.21%

Q5.B. D1= DO(1+G) = 2.5(1+0.1) = 2.75

V= D1/KE-G = 2.75/ 0.1344-0.10 = 79.9 = Hold on

V = D1/KE-G = 2.75/ 0.1344-0.12 = 190.9 = Sell

Or

Short notes

1. RBI

<u>Ans. A few of the Following points to be covered with appropriate explanation.</u>

RBI – Reserve bank of India , Central bank of India.
It started functioning from 1st April 1935

<u>TRADITIONAL FUNCTIONS</u>

- Issue of currency notes
- Banker to other banks
- Banker to government
- Exchange rate management
- Credit control function

PROMOTIONAL/DEVELOPMENTAL FUNCTIONS

- Development of the financial system
- Development of agriculture
- Provision of industrial finance
- Provision of training
- Collection of data and publication of reports
- Promotion of Export through refinance
- Encouragement of financial literacy

SUPERVISORY FUNCTIONS

- Granting license to banks
- Bank inspection
- CoOntrol over NBFI
- Implementation of various schemes

2. MMMFs

- It is a type of money market instruments where the investment companies like mutual fund pool the small savings for large number of investors and invest in short term liquid instruments like CD, CP, treasury bills etc.
- The MMMFs were introduced in 1992. The objective of the scheme was to provide an additional short term avenue to the individual investors.
- In 1995, RBI modified the scheme to allow private sector organisation to set up MMMFs.
- This is the best suited for the investors who have smaller money and do not have access to traditional money market instruments due to their size.
- The MMMFs are required to invest in call money, CDs, CPs, treasury bills etc with a maturity period of up to one year.
- The risk is relatively lower as the pooled moneys is invested in various instruments and hence leading to diversification.

3. Rights Issue : Existing equity shareholders, additional funds to be raised, Price lower than the market price
   Bonus Issue : Form of profit sharing, existing equity shareholders, free of cost, Ratio decided

4. **ESOP**

"Employees Stock Options Plans" is the generic term for a basket of instruments and incentive schemes provided to the employees of the company to motivate, reward, remunerate and to retain the employees. These are rather modern way of motivating employees as against the age old method of compensating the employees with salaries alone. It is now an accepted practice for large entities to remunerate their employees, apart from salary, by the way of granting options to the employees to acquire the shares, hence a portion of the ownership, of the company for which they work.

ESOP can be a one-time plan or an ongoing scheme depending upon the objectives that the company wants to achieve. ESOPs can be in the form of ESOS (Employee Stock Option Schemes), ESPP (Employee Stock Purchase Plans), Compensation Plans, Incentive Plans etc.

Advantages

1) Motivation to employees

2) Retention of work force
3) Tax Benefits
4) Easier financing

Disadvantages

1) Dilution of Equity
2) Negative effect on EPS
3) Cost of ESOPs have to be adjusted

5.

Basis	Primary market (New issue market)	Secondary market (stock exchange)
Securities traded	Sale of securities by new companies or new issues of securities by existing companies are sold to investors.	Trading of only existing securities takes place.
Buying/Selling	Only buying of securities takes place in the primary market. Securities cannot be sold there.	Both buying and selling of securities can take place on the stock exchange.
Purpose	Securities are issued by the company directly (or through an intermediary).	Ownership of existing securities is exchanged between investors. Company is not involved at all.
Capital formation	The flow of funds is from savers to investors, i.e. primary market directly promotes capital formation.	Enhances liquidity of securities, i.e. the secondary market indirectly promotes capital formation.
Price determination	Prices of securities are determined by the management of the company.	Prices are determined by demand and supply of the securities.
Location	There is no fixed geographical location.	Located at specified place.