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Syllabus 2008- CAPITAL MARKET ANALYSIS & Advanced Financial Management

Syllabus 2012 Paper- 14 Advanced Financial Management

CAPITAL MARKET & FINANCIAL MANAGEMENT

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Part I

Objectives

1) The financial goal of public sector firm fully owned by the government is to
   a. Maximum the book value per share
   b. Maximum the profit earned by the firm
   c. Maximize the present value of stream of equity returns
   d. Maximize the return on equity
   e. Both (a) and (d) above
2) Which of the following is not an objective of financial management?
   a. Maximization of wealth of shareholders
   b. Maximization of profits.
   c. Mobilization of funds at an acceptable cost.
   d. Efficient allocation of funds.
   e. Ensuring discipline in the organization.
3) Which of the following is not a function of a finance manager?
   a. Mobilization of fund
   b. Deployment of funds
   c. Control over use of funds.
   d. Manipulate share price of the company.
   e. Maintain a balance between risk and return.
4) The market value of the firm is the result of
   a. Dividend decisions
   b. Working capital decisions
   c. Capital budgeting decision
   d. Trade-off between cost and risk
   e. Trade-off between risk and return.
5) Which of the following is related to the control function of the financial manager?
   a. Interaction with the bankers for arranging a short-term loan.
   b. Comparing the costs and benefits of different sources of finance.
   c. Analysis of variance between the targeted costs and actual acts incurred.
   d. Assessing the costs and benefits of a project under consideration.
   e. Deciding the optimum quantity of raw materials to be ordered for procurement.
6) The minimum number of persons required to form a private limited company and a public limited company respectively are
   a. 2 and 5
   b. 5 and 7
   c. 2 and 7
   d. 7 and 2
   e. None of the above
7) Which of the following is an advantage of a sole proprietorship?
   a. Life of firm is limited to the life of the owner.
   b. Fund raising form outside is easy.
   c. Limited personal liabilities.

d. Easy and inexpensive to set-up
e. Expansion of Business is possible.

8) Which of the following is an advantage of partnership firms?
a. The life of the firm is perpetual
b. Personal liabilities of the partners are limited
c. Its ability to raise funds is virtually unlimited
d. It is relatively free form Governmental regulations as compared to joint stock companies.
e. None of the above.

9) The objective of financial management is to
a. Generate the maximum Net Profit
b. Generate the maximum retained earnings
c. Generate the maximum wealth for the shareholders
d. Generate maximum funds for the firm at the least cost
e. All of the above.

10) Which of the following statements represents the financing decision of a company?
a. Procuring new machineries for the R&D activities.
b. Spending heavily for the advertisement of the product of the company.
c. Adopting state of the art technology to reduce the cost of production.
d. Purchasing a new building at Delhi to open a regional office.
e. Designing an optimal capital structure by using suitable financial instruments.

11) The amount that can be realized by a company when it sells its business as an operating one is teamed as
a. Going concern value
b. Market value
c. Book value
d. Replacement value
e. Liquidation value

12) Which of the following functions of the financial system facilitates conversion of investments in stocks, bonds, debentures etc. into money?
a. Savings function.
b. Liquidity function.
c. Payment function.
d. Risk function.
e. Policy function.

13) The objective of financial management to increase the wealth of the shareholders means to
a. Increase the physical assets owned by the firm
b. Increase the market value of the share of the firm
c. Increase the current assets of the firm
d. Increase the cash balance of the company
e. Increase the total number of outstanding shares of the company.

14) Which of the following is a function of the finance manager?
a. Mobilizing funds.
b. Risk return trade off.
c. Deployment of funds.
d. Control over the uses of funds.
e. All of the above.

15) A financial asset should necessarily have
a. A claim to a payment in the form of an instrument
b. An underlying asset, with a charge over it
c. Parting of money today with an expectation that it will be returned in future with some addition to it.
d. Both (a) and (c) above
e. All of (a), (b) and (c) above.

16) Which is/are the essential feature(s) of a Call Money Market?
a. Maturity periods of 1-15 days.
b. Market determined interest rates.
c. Low liquidity.
d. High agency costs.
e. Both (a) and (b) above

17) The apex fanatical institution in India that promotes housing finance is
a. Housing and Urban Development Corporation (HUDCO)
b. Housing Development Finance Corporation Ltd. (HDFC)
c. Cooperative Housing Finance Society

d. National Housing Bank (NHB)
e. LIC Housing Finance Limited

18) "Single Window Lending" refers to
a. An arrangement by which the lead bank in a consortium of banks releases the initial requirements of the borrower
b. Loans given by commercial banks to the agricultural sector, which are subject to finance from NABARD
c. A specialized cell set up in scheduled banks exclusively for the purpose of industrial loans
d. Priority sector lending by nationalized banks
e. Loans given by NBFCs to some sectors to which nationalized bans are not allowed to give.

19) The difference(s) between Commercial Paper (CP) and Certificate of Deposit (CD) is/are
a. CP is secured while C.D. is unsecured
b. CPs can be issued by private sector companies while CDs can be issued by scheduled banks.
c. CP is sold at a discount and redeemed at face value whereas for C.D. the principal and interest are payable upon maturity
d. Both (b) and (c) above
e. All of (a), (b) and (c) above.

20) The money lent in money market for a period of 2 to 15 days is referred to as
a. Call money
b. Demand loan
c. Term loan
d. Notice money
e. None of the above.

21) Which of the following are feature(s) of Gift-edged securities?
a. Only repayment of principal is secured.
b. They are issued by non-government service organizations.
c. They are issued by government entitles.
d. The repayment of both principal and interest are secured
e. Both (c) and (d) above.

22) Which of the following provides liquidity to money market instruments by creating a secondary market where they can be traded?
a. Discount and Finance House of India.
b. National Securities Depository Limited.
c. State Bank of India.
d. Reserve Bank on India.
e. Over the Counter Exchange of India.

23) Which of the following is an example of non-fund based activity of an NBFC?
a. Bill discounting.
b. Leasing.
c. Issue management.
d. Hire purchase.
e. Inter-corporate loans.

24) The minimum maturity period for a Certificate of Deposit is
a. Fifteen days
b. One month
c. Three months
d. Six months
e. No specific time limit is prescribed.

25) Statutory Liquidity Ratio (SLR) refers to the
a. Percentage of secret reserves which acts as a cushion for nationalized banks
b. Percentage of reserves banks are required to park with instruments approved by RBI.
c. Ratio between current account and fixed account deposits of banks.
d. Percentage of reserves banks are required to utilize only for forex transactions
e. Percentage of reserves meant for priority sector lending.

26) Public debt in the Indian economy is being managed by
a. SBI on behalf of Government of India.
b. Ministry of Finance
c. RBI
d. All nationalized banks and term lending institutions
e. Ministry of Commerce and Trade.

27) In which of the following instances bought-out deal is more appropriate?
a. Companies do not wish to disclose information by way of public issue.

b. Promoters do not wants to dilute their stake by going public.
c. Small projects require funds but costs of public issue are substantially high.
d. Foreign institutional investors offload their shares when market is down.
e. Board for industrial and Financial Reconstruction (BIFR) offers a sick unit to existing blue chips in that industry.

28) Which of the following is/are not a feature(s) of National Stock Exchange?
a. NSE was promoted by FIs at the bentest of GOI.
b. The trading is non-line in national network.
c. The volume of trading in it is less than that of BSE.
d. It has a debt market segment.
e. The weights to the stocks on NIFTY are based on total share holding.

29) Which of the following is/are not true in respect of PSU bonds?
a. There is no secondary market.
b. Market lot for trading purposes is minimum of Rs. 10 crore.
c. They come under "approved investments" by RBI.
d. Both (a) and (c) above
e. All of (a), (b) and (c) above.

30) Unit banking refers to the system
a. With a single bank having units at different places
b. With the overall operations of a bank conducted from a single office
c. Which deals with the units of UTI
d. Which deals with the units in small-scale sector
e. Either (a) or (b) above.

31) Which of the following is not a function performed by a financial system?
a. Saving function
b. Liquidity function.
c. Risk function.
d. Special function
e. Policy function.

32) The maturity period of a Certificate of Deposit (C.D.) issued by a bank is
a. Not less than 1 months and not more than 6 months
b. Not less than 2 months and not more than 9 months
c. Not less than 15 months and not more than 12 months
d. Not less than 4 months and not more than 12 months
e. Not less than 1 months and not more than 12 months

33) If in an order to buy/sell shares from a stock exchange is limited by a fixed price it is called
a. Limit order
b. Limited discretionary order
c. Stop loss order
d. Best rte order
e. None of the above.

34) Gift edged securities are the bonds issued by
a. Big corporate
b. Multinational corporate
c. Global corporations
d. Central Government
e. Financial institutions.

35) Medium dated government securities have maturities ranging from
a. 1 to 3 years
b. 1 to 5 years
c. 3 to 5 years
d. 3 to 10 years
e. 5 to 10 years

36) Which of the following maturity of T-Bills does not have a provision?
a. 30-day.
b. 91-day.
c. 182-day.
d. 364-day.
e. None of the above.

37) In secondary spot capital market, the delivery and payment is completed
a. On the same day of the date of contract
b. On the next day of the date of contract
c. Within four days from the date of contract

d. Within 2 days from the date of contract
e. Beyond fourteen days form the date of contract

38) The primary capital market
a. Imparts liquidity and marketability to long term financial instruments.
b. Helps companies to raise funds to finance their projects
c. Provides an auction market for long term securities
d. Operates through the medium of stock exchanges
e. Both (a) and (c) above

39) In a private company maximum number of members permissible is
a. 5
b. 10
c. 25
d. 50
e. 100.

40) Banks borrow in call money market to
a. Give loans
b. Invest in high yielding securities
c. Meet the Cash Reserve Ratio (CRR)
d. Meet sudden demand for funds arising due to large payments and remittances
e. Both (c) and (d) above.

41) Which of the following s not a feature of Commercial Paper (CP)?
a. Purely secured instrument.
b. Maturity varies between 15 days and a year.
c. Buy-back facilities are available.
d. Negotiable by endorsement and delivery.
e. None of the above.

42) Which of the following is not a money market instrument?
a. Treasury bills
b. Certificate of deposits.
c. Debentures.
d. Call money.
e. None of the above.

43) Private placement of share can be made out of
a. Mutual funds quota
b. Promoters quota
c. Public quota
d. Financial institutions quota
e. All of the above.

44) An order to sell shares, where brokers are given a particular limit for sustenance of loss is known as
a. Limited discretionary order
b. Limit order
c. Cancel order
d. Stop loss order
e. Best rate order.

45) Which of the following is not true with regard to commercial paper?
a. It is issued in multiples of Rs. 5 lakhs.
b. The minimum amount to be invested by a single investor is Rs. 20 lakhs.
c. The maturity period cannot exceeded 1 year.
d. These are unsecured promissory notes.
e. The issuing company must have a high credit rating.

46) Which of the following enables a company to increase its paid-up share capital without receiving any payment from the recipients of the shares?
a. Public issue
b. Bonus issue.
c. Private placement.
d. Bought-out deal.
e. Rights issue.

47) In which of the following types of orders the members of stock exchange are not given any price or time limit by the client for execution of order?
a. Limit order.
b. Best rate order.
c. Immediate or cancel order.

d. Limited discretionary order.
e. Open order.

48) Which of the following statements is false?
a. All scheduled banks except co-operative banks and regional rural banks are eligible to issue CDs.
b. CDs can be issued to individuals.
c. CDs are issued at a discount to face value.
d. The maturity period of CDs issued by banks varies form 15 days to one year.
e. CDs are issued in multiples of one lakhs subject to the minimum size of each issue of Rs. 50 lakhs.

49) Which of the following methods of issuing additional shares does not result in an increase in the net worth of the company?
a. Public issue.
b. Rights issue.
c. Bonus issue.
d. Private placement.
e. Bought-Out Deal.

50) The major categories of investors in primary market of government securities include
a. Reserve Bank of India
b. Financial institutions
c. Foreign fanatical institutions
d. Commercial banks.
e. All of the above.

51) Which of the following is an asset of a bank?
a. Balances with other banks.
b. Saving deposits.
c. Demand and time deposits form other banks.
d. Refinance form NABARD.
e. None of the above.

52) The National Housing Bank extends refinance on housing loans to
a. Scheduled commercial banks
b. Co-operative banks
c. Housing finance companies
d. Apex cooperative housing finance societies
e. All of the above.

53) According to the guidelines of Money Market Mutual Funds, the minimum lock in period of an investor's investment is
a. Nil
b. 15 days
c. 30 days
d. 45 days
e. 60 days.

54) One of the important functions of a well developed money market is to channel savings into productive investments like working capital. Which of the following is not a money market instrument?
a. Corporate debentures.
b. Call money.
c. Treasury bills.
d. Commercial paper.
e. Certificate of deposits.

55) Which of the following is not a feature of a commercial paper?
a. They are transferable by endorsement and delivery.
b. They are issued in multiples of one lakhs.
c. Their maturity varies form 15 days to one year.
d. They are unsecured in nature.
e. They normally have buy-back facility.

56) Which of the following is not an advantage of a bought out deal?
a. The promoters are assured of immediate funds.
b. The time consuming and costly public issue can be avoided.
c. It is easier to convince the wholesale investor rather than the general public.
d. The shares issued via bought out deal can be bought back by the company at any time.
e. It is the cheapest and quickest source of finance for small to medium sized companies.

57) If a company wants to raise funds through commercial paper market, the minimum fund based working capital limit should be
   a. Rs. 1 crore
   b. Rs. 2 crore
   c. Rs. 3 crore
   d. Rs. 4 crore
   e. Rs. 5 crore.

58) In a Bought-Out Deal
   a. Companies issue share to the public
   b. Companies issue share to the existing shareholders
   c. Mutual funds buy out a part of promoter's share
   d. A part of the equity of a unlisted company is bought by a sponsor/merchant banker
   e. Financial constitutions buy out a significant portion of share capital of a listed company.

59) Which of the following is not a financial asset?
   a. Secured premium notes.
   b. National defense gold bon.
   c. Capital investment bon.
   d. Bullion.
   e. Special bearer bond.

60) Bills rediscounting facility is offered by
   a. All public sector banks
   b. Some co-operative banks
   c. IDBI
   d. All SFCs
   e. Both (c) and (d) above.

61) Which of the following statement is/are true? i) A cash credit is a running account
   ii) Cash credits may become long-term loans due to repeated roll-overs
   iii) Overdrafts are allowed only against the security of inventories.
   b. Only (i) above
   c. Only (ii) above
   d. Only (iii) above
   e. Both (i) and (ii) above.
   f. All of (i), (ii) and (iii) above.

62) Which of the following is not a money market instrument?
   a. Treasury bill
   b. Commercial paper.
   c. Convertible debenture.
   d. Certificate of deposit.
   e. Both (b) and (c) above.

63) Which of the following statements is true regarding insurance of Commercial Paper (CP)?
   a. Corporate need prior approval of RBI for CP issue.
   b. Underwriting of a CP issue outstanding not mandatory.
   c. Minimum size of a CP issue is Rs. 10 lakhs.
   d. CPs have to be backed by a bank guarantee.
   e. CPs are issued in multiples of Rs. 1 lakhs.

64) Which of the following statements is/are true regarding the call money market?
   a. Surplus funds of banks constitute a major component.
   b. Major Corporates participate as lenders.
   c. Banks often borrow form it for maintenance of SLR and CRR.
   d. Both (a) and (b) above
   e. All of (a), (b) and (c) above.

65) Which of the following statements is/are true regarding 91-day Treasury Bills?
   a. They are also referred to as PSU bonds.
   b. They are issued through auctions conducted by RBI.
   c. They are risky instruments as their interest rtes fluctuate widely.
   d. They cannot be rediscounted with RBI.
   e. None of the above.

66) CRISIL
   a. Rates, Debentures and fixed deposits.
   b. Was set up by the Industrial Development Bank of India.
   c. Gives the highest rating of "P1" to short-term instruments.
   d. Does not consider non-financial factors while valuing a company's securities.

e. None of the above.

67) Which of the following is not a money market instrument?
a. Call loans
b. Commercial papers.
c. Certificates of deposit.
d. Treasury bills
e. None of the above.

68) Which of the following is a form of direct assistance by All India Financial Institutions?
a. Underwriting.
b. Subscribing to a company's shares.
c. Bills rediscounting.
d. All of the above.
e. Both (a) and (b) above.

69) Which of the following statements is not true?
a. The industrial Credit and Investment Corporation of India has merged with ICICI bank.
b. The industrial development bank of India is the apex term lending financial institution.
c. The industrial finance corporation of India is an all India term lending financial institution.
d. The industrial reconstruction bank of India is the central agency for rehabilitation of industrial units declared sick by BIFR only.
e. None of the above.

70) Which of the following was not an objective of Nationalization and greater governmental control over major banks?
a. Achieving wider spread of bank credit.
b. Preventing misuse of resources of banks.
c. Reducing the influence of business houses on banks.
d. Bringing larger income to the government.
e. None of the above.

71) Private Banks
a. Should not be registered as public limited companies
b. Need not adhere to capital adequacy norms determined by RBI.
c. Are covered by banking regulation Act, 1949
d. Should not be listed on any stock exchanges
e. Both (a) and (d) above.

72) Which of the following are the reasons for low profitability of the Commercial Banks?
a. High incidence of bad debt.
b. Inefficient procedures.
c. Overstaffing.
d. Priority sector lending.
e. All of the above.

73) Gilt-edged securities
a. Have fairly active secondary market
b. Have low interest rates
c. Are subscribed mainly by commercial banks, provident funds and other institutional investors
d. Are held by bans to satisfy their SLR requirements
e. All of the above.

74) Which of the following is not true?
a. There has been a general down trend in the nominal interest rates in the past few years.
b. Term finance rates have been higher than the working capital finance rates.
c. Interest rates in the organized sector in India are fixed by the government.
d. Interest rate policy of the government is designed to mobilize substantial savings.
e. Interest rate policy of the government is designed to facilitate government borrowing cheaply.

75) Certificates of deposits (CDs)
a. Are freely transferable by endorsement and deliver
b. Are issued at a discount stipulated by RBI.
c. Are issued by RRBs
d. Have no fixed maturity
e. Have an active secondary market.

76) Which of the following statements is true?
a. IDBI's deep discount bonds are zero coupon bonds.
b. When a company wants to raise a given amount of capital through a rights issue, the subscription price should ideally be higher than the current market price.

c. Regional stock exchanges are unrecognized
d. The rupee is convertible on the capita account.
e. The alpha (α) of a security measures the return on the market portfolio.

77) The changes in the banking structure through nationalization has resulted in
a. Deeper penetration into rural areas
b. Increase in deposits
c. Channelization of bank credit
d. Lower operational autonomy for banks
e. All of the above.

78) The following indirect financial assistance is extended by the financial institutions to help the industrial units.
a. Underwriting
b. Guarantee for foreign currency loans
c. Deferred payment guarantee
d. All of the above
e. None of the above.

79) Money market deals with
a. Mortgage loans
b. Certificate of deposits
c. Deposits with RBI under CRR
d. Fixed Deposit receipts
e. Both (a) and (b) above.

80) In a well-functioning capital market, shareholders will vote for the goal of
a. Modifying the investment plan of the firm to help shareholders achieve a particular time pattern of investment
b. Making shareholders as wealthy as possible by investing in real assets with positive net present values
c. Inviting shareholders and giving them costly articles in annual general meetings
d. Having employees as shareholders
e. Choosing high or low risk projects to match shareholders risk preferences.

81) Capita markets differ form money market in that
a. Capital markets are regulated while money markets are not
b. The maturity of securities in the capital are long term while in the money market it is short-term
c. Limited companies which operate in capital markets cannot operate in money markets
d. Unorganized money markets are larger than unorganized capital market
e. Both (a) and (d) above.

82) Which of the following members would you not find in the secondary stock market?
a. Investors.
b. Stock exchanges.
c. Stock brokers.
d. Companies.
e. Underwriters.

83) In terms of the maturity of assets issued, which of the following markets have the shortest maturity period?
a. Call Money market
b. Commercial paper market
c. Treasury bills market.
d. Certificates of deposit market.
e. All of the above.

84) Which of the following is true regarding the issuance of commercial paper?
a. The minimum net worth of Rs. 10 crore is required.
b. The maximum discount rate is 16%.
c. The minimum credit rating required is P1.
d. Prior approval of RBI for the issue is required.
e. Minimum investment by an individual is Rs. 5 lakhs.

85) The minimum maturity of treasury bills is
a. 14 days
b. 28 days
c. 45 days
d. 60 days
e. 90 days.

86) Which of the following statements is/are true regarding call money market?

i) Financial institutions and mutual funds can participate only as lenders in this market.
ii) The interest on call loan is regulated by RBI.
iii) The maximum maturity of notice money is 3 days.
b. Only (i) above
c. Only (ii) above
d. Both (i) and (iii) above
e. Both (i) and (iii) above
f. Both (ii) and (iii0 above

87) Which of the following outstanding true regarding a Bought-Out Deal?
a. It involves direct selling of securities to a limited number of institutional or high net worth individuals.
b. The costs involved in a bought-out deal are generally higher than the costs of a public issue.
c. The company proposing to place its securities through this route can price its securities to reflect the intrinsic value.
d. The procedural complexities are very high.
e. New companies cannot make bought-out deals.

88) The maximum number of persons in a private limited company is
a. 1
b. 2
c. 3
d. 7
e. 50.

89) The service of which of the following entities is generally not useful to the retail investors for raising funds?
a. Merchant banks.
b. Commercial banks.
c. Hire purchase finance companies.
d. Housing finance companies.
e. Nidhis.

90) Which of the following is not traded in the money market?
a. Commercial papers.
b. Certificate of deposits.
c. Treasury bills.
d. 6 months term deposits.
e. None of the above.

91) Which of the following is a function of the primary capital market?
a. To allow the Foreign institutional investors (FIIs) to invest in the Indian capital markets.
b. To allow the companies to raise funds to meet their short term funds requirements through new securities.
c. To provide a market for trading with the outstanding long term securities.
d. To provide a market for trading with the existing short term securities.
e. None of the above.

92) In which of the following types of issue, new securities are offered to the existing shareholders of the company on a pro rata basis?
a. Public issue
b. Rights issue
c. Bonus issue
d. Private placement
e. Both (b) and (c) above.

93) Which of the following is a disadvantage of Bought-Out Deals?
a. It is difficult to convince a wholesale investor.
b. The promoters of the company do not get the funds immediately.
c. It is a very time consuming procedure.
d. The issue expenses are more than that of a public issue.
e. Sponsor may exploit the situation.

94) Which of the following companies generally provide risk capital to the technology oriented and high-risk business entities?
a. Lease finance companies.
b. Venture capital funding companies.
c. Commercial banks.
d. Hire purchase finance companies.
e. Insurance companies.

95) Which of the following is/are the characteristics of the money market instruments?
   a. Long term maturity
   b. High liquidity
   c. Highly secured
   d. Issued by the Governments only.
   e. Both (b) and (d) above.

96) Which of the following situations leads to the greatest increase in volatility in the call money market?
   a. Reduction in cash reserve ratio.
   b. Prepayment of term loans by a large number of borrowers
   c. Entry of he fanatical institutions (FIs) into the market
   d. Payment of large amount of advance taxes by the banks and FIs.
   e. Decrease in the demand for loanable funds in the economy.

97) Which of the following is/are correct wit respect to the act(s) of the arbitrageurs in the derivatives market?
   a. To protect owns position in the spot by taking suitable instrument(s) in the derivatives market.
   b. To protect one's anticipated position in the spot by taking suitable instrument(s) in the derivatives market.
   c. To make profit form the subsequent price movements of any particular instrument in the derivatives market.
   d. To make risk free profits by simultaneously buying and selling different instruments in different markets.
   e. Both (a) and (b) above.

98) Which of the following results in a public limited company to have a significant advantage over a proprietorship firm?
   a. Limited liability.
   b. Difficulty of transfer of ownership interest.
   c. Limited life.
   d. Inability to mobilize a lot of funds.
   e. None of the above.

99) Which of the following is not a marketable instrument?
   a. Commercial paper.
   b. Certificate of deposit
   c. Inter corporate deposit
   d. Preference shares.
   e. Treasury bills.

100) Which of the following functions is/are served by the primary capital market of an economy?
   a. It allows the corporate houses to raise the long tem capital by suing new securities.
   b. To offers a market to trade for the outstanding long term securities.
   c. It offers a market to trade for the outstanding short term securities.
   d. If offers an excellent exit route for the venture capital funding companies.
   e. Both (a) and (d) above.

101) Which of the following function of the financial system channelises the savings from the savers to the producers in the economy?
   a. Financial intermediation function.
   b. Liquidity function.
   c. Payment function
   d. Risk function
   e. Policy function

102) In which of the following markets, are the outstanding long term financial instruments traded?
   a. Money market
   b. Forex market
   c. Primary capital market
   d. Secondary capital market
   e. Call money market.

103) Corporate investment and financing decisions are limited by a governmental regulatory framework which seeks to
   a. Define avenues of investment available to business enterprises in different categories, ownership and size-wise.
   b. Induce investment along certain lines by providing incentives, concessions and relief specify the procedures for raising funds form financial markets.
   c. Specify the procedures for raising funds form financial markets

d. Both (a) and (c) above.
e. All of (a), (b) and (c) above.

104) Which of the following entities issues the "Gilt edged" securities?
a. Multinational companies.
b. Reputed domestic companies.
c. Private sector enterprises
d. Small scale companies.
e. Central and State Government.

105) Long dated government securities have maturities ranging form
a. Up to 1 year
b. 1 to 5 years
c. 5 to 8 years
d. 8 to 10 years
e. 10 to 30 years

106) What is the maximum limit on the number of members in a private limited company?
a. 5
b. 8
c. 15
d. 50
e. Unlimited.

107) Which of the following regulations no more relevant in today's business environment?
a. Foreign exchange regulation Act, 1973.
b. Monopolies and Restrictive trade practices Act, 1969.
c. Companies Act, 1956.
d. Income tax Act, 1961.
e. SEBI Act, 1992.

108) Which of the following statement(s) is/are true for given value of 'i' and 'n'?
a. Present value interest factor is the reciprocal of future value interest factor.
b. Future value interest factor Annuity is the reciprocal of Present value interest factor annuity.
c. Capital recovery factor is a product of future value interest factor and reciprocal of future value annuity factor.
d. Both (a) and (c) above.
e. Both (b) and (c) above.

109) The product of PVIF, FVIF, FVIFA and Capital Recovery Factor is
a. FVIF
b. PVIFA
c. PVIF
d. FVIFA
e. None of the above.

110) The nominal rate of interest is equal to
a. Real Rate + Risk Premium - Inflation
b. Real Rate + Risk Premium + Inflation
c. Real Rate - Risk Premium + Inflation
d. Real Rate - Risk Premium - Inflation
e. Real Rate.

111) The accurate doubling period n given a rate of return R can be calculated by
a. $(1 + R)^n = 2$
b. 72/R
c. 0.35 + 69/R
d. All of the above
e. None of the above.

112) The inverse of sinking fund factor is given by
a. $\frac{1-(1+k)^n}{k}$
b. $\frac{1}{k} - (1+k)^n$
c. $\frac{\frac{(1+k)^n}{k} - \frac{1}{k}}{k}$
d. $(1+k)^n - 1$

e. $\frac{(1+k)^n -}{1\ k}$

113) If P=principal amount, i-interest rate per annum, m=frequency of compounding per year, n=number of years and A=accumulation at the end of the year n, then which of the following expressions is correct?
a. $A = P(1 + i/n)^{mn}$ b.
$P = A(1 + i/m)^{mn}$
c. $A = [P(1 + i/m)^{m}]^{n}$
d. $A = P(1 + i/m)^{mn}$
e. None of the above.

114) If 'k' is the rate of interest and 'n' the number of years, then the capital recovery factor is given as ********

115) Which of the following statement is not true?
a. The more frequent the compounding, he higher the future value, other things being equal.
b. For a given amount, the greater the discount rate, the less is the present value.
c. Capital recover is the inverse of FVIFA.
d. PVIFA = $\frac{(1+k)^n - 1}{k(1+k)^n}$
e. All of the above.

116) An interest rate that has been annualized using compounded interest is termed as a. Simple interest rate
b. Annual interest rate
c. Discounted interest rate
d. Effective annual interest rate
e. Compounded interest rate.

117) When an investment pays only simple interest rate, this means a. The interest rate is lower than on comparable investments b. The future value of investment will be low
c. The interest earned is non-table to the investor d. Interest is earned only on the original investment. e. Interest is earned on previously earned interest.

118) Cash flows occurring in different periods should not be compared unless a. Interest rates are expected to be stable
b. The flows occur no more than one year form each other
c. High rate of interest can be earned on the flows
d. The flows have been discounted to a common date
e. Interest rates are expected to increase over a period of time.

119) Sinking fund factor is the reciprocal of
a. Future value interest factor
b. Present value interest factor
c. Future value interest factor of annuity
d. Present value interest factor of annuity
e. Capital recovery factor.

120) The present value interest factor of annuity is equal to
a. $\frac{(1+k)^n - 1}{k(1+k)^n}$
b. $\frac{\text{FVIFA}(\ ,n)}{\text{FVIF}(\ ,n)}$
c. FVIFA(k,n) x PVIF(k,n)
d. Reciprocal of sinking fund factor for k% and n years x PVIF (k,n)
e. All of the above.

121) Which of the following statements is true?
a. Increased frequency of compounding reduces the effective rate of interest.
b. According to Rule of 72, the period within which the amount will be doubled can be obtained by dividing 72 by the interest rate and adding 0.35 to the value arrived at.
c. Effective interest rate is always more than or equal to the nominal interest rate.
d. An annuity is a lump sum payment.
e. A project s financially viable if the present value of the future cash inflows is positive.

122) The money has time value because
a. The individuals prefer future consumption to present consumption

b. A rupee today is worth more than a rupee tomorrow in terms of its purchasing power.
c. A rupee today can be productively deployed to generate real returns tomorrow the nominal return on investments are always more than inflation thereby ensuring real returns to the investors
d. Both (b) and (c) above.

123) Which of the following equations is correct?
a. PV = FV_n x FVIF(k, n)
b. PV = FV_n / (1+k)n
c. PV = FV_n x PVIF(k,n)
d. FV_n = PV x $(1+k)^n$
e. FVA_n = $\{(1+k)^n-1\}$ / k

124) Which of the following statements is not true?
a. The Present value interest factor for an annuity (PVIFA) is equal to the product of the future value interest factor for annuity and he present value interest factor.
b. The inverse of PVIFA factor is called the capital recovery factor.
c. The nominal rate of interest is equal to the effective rate of interest when the interest is compounded annually.
d. The present value of cash flow stream of any periodicity can be calculated using FVIFA tables.
e. The sinking fund factor is used to determine the amount that must be deposited periodically to accumulate a specified sum at the do of a given time period.

125) Which of the following is not true?
a. The inverse of PVIFA factor is called the capital recovery factor
b. The nominal rate of interest is equal to the effective rate of interest when the interest is compounded annually.
c. The present value of interest factor for annuity is equal to the product of the inverse of future value interest factor for annuity and the present value interest factor.
d. The present value of any cash flow stream can be clauculated using PVIFA tables.
e. The sinking fund factor is used to determine the amount that must be deposited periodically to accumulate a specified sum at the end of a given period at a given rate of interest.

126) With an increase in the frequency of compounding
a. The nominal rate of interest becomes greater than the effective rate
b. The nominal rate of interest increase at an increasing rate
c. The nominal rate of interest becomes equal to the effective rate of interest
d. The effective rate of interest increase at a decreasing rate
e. Both (a) and (d) above.

127) Skinking fund explains
a. The maturity value in year 't' for an amount deposited in year '1'
b. The amount to be deposited annually to accumulate a predetermined sum in year 't'
c. He discounted value in year zero for an uneven series occurring in several years in future
d. The amount to be deposited in year zero for a periodical withdrawal in future for a specified period
e. The effective rate of interest.

128) Which of the following statements is/are true?
a. All (i), (ii) and (iii) of all above
b. Both (i) and (ii) of the above
c. Only (i) of the above
d. Only (ii) of the above
e. Only (iii) of the above

129) The nominal rate of interest
a. Is lesser than the effective rate of interest under inflationary conditions
b. Is equal to the effective rate of interest minus inflation
c. Does not consider risk premium
d. Is the real rate of interest plus inflation plus risk premium
e. Is al referred to as the prime lending rate.

130) When compounding of interests is done at intervals which are less than a year
a. The effective rate of interest will be the same as the nominal rate of interest
b. The effective rate of interest will be lesser than the nominal rate
c. The nominal rate of interest will be lesser than the effective rate
d. There is no difference between the effective and nominal rtes in the first year
e. It cannot be ascertained as to which rate is more unless the frequency of compounding is know.

131) If any investment (P) has to be doubled at an interest rate of k, then the doubling period 'n' is exactly equal to
a. 72/k
b. 0.35+69/k
c. Log2/log (1+k)
d. 2
e. Both a and b above.

132) Which of the following is/a true?
a. Inverse of FVIF is PVIF
b. Inverse of FVIFA is PVIFA
c. Inverse of capital recover factor is FVIFA.
d. PVIFA is the product of inverse of FVIFA and PVIF
e. Both (a) and (d) above

133) The relationship between effective rate of interest ® and nominal rate of interest (i) is best represented by
a. $i = 1+ \frac{R}{M}^{m} - 1$
b. $r = 1+ \frac{i}{m}^{m} - 1$
c. $i = 1+ \frac{r}{N}^{n} - 1$
d. $r = (1+m)^{i} - 1$
e. $I = (1+r)^{m} - 1$.

134) If compounding is done twice in a year, the effective rate of interest is equal to
a. 2 x nominal rate of interest
b. Nominal rate of interest/2
c. $(1+ \text{nominal rate of interest}/2)^{2} - 1$
d. $((1+\text{nominal rate of interest}/2)^{2}$
e. (1+nominal rate of interest/2)x2

135) Which of the following is/are true?
a. FVIF is the reciprocal of PVIF.
b. Product of fvif and PVIFA is equal to FVIFA.
c. FVIFA is the reciprocal of PVIFA.
d. Both a and b above
e. Both a and c above

136) Time value of money considers
a. The preference outstanding the individuals for future consumption to present consumption
b. Increase in purchasing power of rupee with the passage of time
c. The uncertainty of the future
d. The productivity of money to earn real returns over time
e. Both c and above

137) Which of the following statement is/are true with respect to present value interest factor of annuity (PVIFA)?
i) The cash flow is assumed to occurred the end of the period under consideration
ii) The cash flow is assumed to occurred the start of the period under consideration
iii) It is reciprocal to capital recovery factor.
b. Only I above.
c. Only ii above
d. Only iii above
e. Both ii and iii above
f. Both I and iii above

138) Which of the following may be considered as the correct reason for money having time value?
a. It is the legal tender for carrying out any type of transaction.
b. In Indian it is guaranteed by the union government.
c. Its purchasing power increase with the passage of time due to inflation.
d. Money can be productively invested to generate real returns over a period of time.
e. None of the above.

139) A risk-free stock has a beta of
a. -1
b. Zero
c. 0.5

d. 1
e. Infinity.

140) Which of the following is not an assumption under CAPM?
a. Investors make their investment decisions on a single period horizon
b. If the perceived risk is high a risk averse investor expects higher return
c. The investor is not limited by his wealth and price of the asset
d. Assets can be bought at the going market price
e. CAPM is based on all the above assumptions.

141) If the slope of the security market line is zero, which of the following is/are true?
a. Risk free return = market return
b. Market return = expected return
c. Expected return = risk free return
d. Both a and c above
e. All of a, b and c above

142) Which of the following is not a non-diversifiable risk
a. Lock out in a company due to workers demanding a wage hike
b. Slump in the industry lack of strategy for the management in a company
c. A change in the tax structure for corporates in the union budget
d. Both a and c above

143) The amount of risk refection depends on
a. Degree of correlation
b. Number of stocks in the prrtfolio
c. The market index movement
d. Both (a) and (b) above
e. All of (a) b and c above

144) Which of the following is diversifiablr risk
a. Inflation risk
b. Interest rate risk
c. Market risk
d. Business risk
e. Both (b) and (d) above

145) If a person holds a diversified portfolio the risk a security adds would be
a. Specific risk
b. Systematic risk
c. Portfolio risk
d. Liquidity risk
e. Diversifiable risk.

146) Portfolio Beta
a. Is the risk of a diversified portfolio
b. Is the weighted average on individual security betas, weights being the proportion of individual returns
c. Is the weighted average of individual security beta, weights being the proportions of the investments in the respective securities
d. Both (a) and (b) above
e. Both (a) and (c) above

147) Which is true regarding $k_j = r_r + \beta(k_m - r_r)$?
a. r_f can be he rate of return earned on gilt-edged securities.
b. β Will be > 1 if the security is volatile
c. Lower β would give a low risk premium
d. There is a possibility that a zero bets exists.
e. All of the above.

148) The slope of the security market line denotes
a. The expected return by the investors
b. The market volatility
c. Bea of he security
d. The influence of unsystematic risk
e. He risk premium required.

149) If the security return plots below e SML, then, it can be said hat
a. It overpriced
b. The required rate of return is much lower than the actual rate of return
c. The investors would try to buy more of the security
d. It is a defensive security
e. Both a and b above

150) A security is said to be aggressive when it
  a. Has a beta of >1
  b. Plots on the upper part of SML
  c. Gives below average returns
  d. Both a and b above
  e. Both b and c above

151) Which of the following is not a non-diversifiable risk
  a. Interest rate risk
  b. Purchasing power risk
  c. Operating risk
  d. Market risk
  e. Political risk

152) Risk-return trade-off implies
  a. Increasing the profit of the firm through increased production
  b. Not taking any loans which increase the risk of the firm
  c. Not granting credit to risky customers
  d. Taking decisions in such a way which optimizes the balance between risk and return
  e. Minimum all risks.

153) Which of the following is a specific risk factor
  a. Market risk
  b. Inflation risk
  c. Interest rate risk
  d. Financial risk
  e. None of the above

154) Security risk premium in the capital asset pricing model (CAPM) is given by
  a. R_r
  b. K_m-R_r
  c. $\beta(k_m - R_r)$
  d. βK_m
  e. $\beta(R_r - k_m)$

155) The risk arising due to uncertainty about the time element and the price concession is selling a security is called.
  a. Price risk
  b. Market risk
  c. Trading risk
  d. Liquidity risk
  e. Financial risk

156) Standard deviation as a measure of risk is preferred because
  a. Standard deviation considers every possible event and assigns each event equal weight
  b. Standard deviation is a measure of dispersion around the median value
  c. Standard deviation is a familiar concept and may calculators and computes are programmed to calculate it
  d. Standard deviation considers every possible even an assigns eac event a weight equal to its probability.
  e. Both c and d above.

157) Which of the following is not a diversifiable or specific risk factor
  a. Company strike.
  b. Bankruptcy of a major supplier.
  c. Death of a key company officer
  d. Unexpected entry of new competitor into the market
  e. Industrial recession.

158) Which of the following statement is true of beta
  a. Beta a security is the slope of the security market line (SML)
  b. Beta a security is a measure of the diversifiable risk of a security.
  c. High beta of a security assures high return.
  d. Beta of a security can never be negative.
  e. Beta of a security is a measure of systematic risk of a security.

159) Which of the following is not an assumption of capital asset model (CAPM)?
  a. Investors are risk-averse and use the expected rate of return and standard deviation of return as appropriate measure of return and risk respectively.
  b. Investors make their investment decisions based on a single period horizon i.e. the next immediate time period.

c. Transaction costs in financial markets are low enough to ignore and assets can be bought and sold in any unit desired.
d. Taxes do not affect the choice of buying assets.
e. Investors make their investment decisions based on multi-period horizon.

160) Ceter is paribus, a security is to be bought if.
a. The required rate of return is less than expected rate of return
b. The required rate of return is greater than the expected rate of return
c. Security has a beta greater than one
d. The security has beta of less than one
e. The security has a large amount of floating stocks in the market.

161) Which of the following statements is true
a. If one portfolio variance excess that of another portfolio, its standard deviation will also be grater than that of the other portfolio.
b. For investment horizons greater than 20 years long term corporate bonds will outperform common stocks.
c. Due to their short maturity the average real rate of return for treasury bills approximately equals their average nominal rate of return.
d. When inflation is expected to be low, the nominal risk premium on common stocks is expected to be low.
e. Market risk can be eliminated in a stock portfolio through diversification.

162) Real rates of return are typically less than nominal rates of return due to
a. Inflation
b. Capital gains
c. Dividend payments
d. Deflation
e. Recession

163) Real rates of return will be positive as loan as
a. The nominal return is positive
b. The inflation rate is positive
c. The nominal return exceeds inflation rate
d. Inflation rate exceeds the real return
e. None of the above

164) The major benefit of diversification is to
a. Increase the expected return
b. Increase the size of he investment portfolio
c. Reduce brokerage commissions
d. Reduce the expected risk
e. Increase the expected return over and above the risk free rate of return.

165) Which of the following is not true
a. Interest rate risk is the variability in a security return resulting form changes in interest rates.
b. Market risk refers to the variability of return due to a wide rage of factors exogenous to the securities themselves
c. Inflation risk is the loss of purchasing power due to inflation.
d. As inflation rate increase the interest rate risk decreases
e. Business risk is the risk of doing business in a particular industry.

166) What is the cost of a debenture if it is issued at face value of Rs. 100. the coupon is 13% the maturity is 6 years, redemption is at 6% premium and realizable amount is Rs. 97.50 and Tax = Rs. 38%.
a. 9.25%
b. 9.56%
c. 9.13%
d. 9.31%
e. 9.49%

167) Which of the following statements is true
a. Interest rate risk refers to the variability of returns due to fluctuations in the securities market.
b. Market risk refers to the reduction in purchasing power
c. The interest rates on securities tend to go up with inflation
d. Business risk refers to the risk due to debt financing.
e. Financial risk is associated wit the secondary market in which a particular security is traded.

168) Financial risk arises due to the

a. Reduction in purchasing power of the assets employed by the firm
b. Variability of returns due to fluctuations in the securities market
c. Changes in prevailing interest rte in eh market
d. Leverage used by the company
e. Liquidity of the assets of the company

169) The diversifiable risk includes the risk due to
a. Inflation
b. Industrial recession or slow down
c. Natural calamities
d. Strike in the company
e. Changes in economic policy

170) Which of the following would reduce the applicability of capital asset pricing model (CAMP)
a. Investors having different time horizons for investments.
b. The presence of high transaction cost I the market
c. The influence of taxes on the choice of assets
d. The different expectations of the investors regarding the risk and retun associated with various securities.
e. All of the above.

171) Which of the following is a diversifiable risk factor?
a. An increase in inflation rate.
b. Unexpected entry of a new competitor in the market
c. A change in economic policy of government.
d. Industrial recession
e. Increase in international oil prices.

172) If a security is less risky than the market portfolio, then its beta would be
a. Negative
b. More than market beta
c. Equal to zero
d. Less than 1
e. More than 1.

173) Which of the following statements is true
a. Expected return and ex post returns are same
b. There are only two types of returns i.e. realized returns and historical returns.
c. Risk is a motivating force for an investor
d. The objective of any investor is to maximize his returns as well as risk
e. The investor compensates for the uncertainty in returns by requiring an expected return that in sufficiently high to offset the risk of uncertainty.

174) Which of the following types of risks is
a. Credit risk
b. Interest rate risk
c. Purchasing power risk
d. Market risk
e. Both a and d above

175) The security market line shows the relationship between the
a. Expected rate of return and diversifiable risk
b. Realized rate of return and beta
c. Required rate of return and unsystematic risk
d. Expected rate of return and beta
e. Realized rate of return and systematic risk.

176) The risk that arises due to change in the purchasing power is called
a. Financial risk
b. Interest rate risk
c. Business risk
d. Market risk
e. Inflation risk

177) The risk aversion of an investor can be measured by
a. Risk free rate of return
b. Market rate of return
c. Variance of the return from a security
d. The difference between the market rate of return and the risk free rate of return
e. None of the above

178) The risk of a portfolio of two securities increases if there is .... between their returns.
a. Perfect positive correlation

b. Perfect negative correlation
c. Moderate positive correlation
d. Moderate positive correlation
e. Moderate negative correlation
f. Both a and c of the above

179) Which of the following types of risk is not a diversifiable risk
a. Business risk
b. Financial risk
c. Credit risk
d. Purchasing power risk
e. Technology risk.

180) Market portfolio contains
a. Frequently traded securities in the stock market
b. All the securities in proportion to their market capitalization
c. All securities listed in the specified group of a stock exchange
d. The securities having large volume in tems of number of transactions and market capitalization
e. None of the above

181) Security market line shows the relationship between return on the stock and
a. Return on market portfolio
b. Risk free rate of retune
c. Standard deviation of the stock returns
d. Beta of the stock
e. Variance of the stock returns.

182) If a security return plots above the security market line it means
a. Security is overpriced
b. Security is under priced
c. Security's beta is more than one
d. Security's beta is less than one
e. Security's bets is equal to zero

183) Which of the following statements is true
a. The CAPM establishes the relationship between an assets return and its systematic risk.
b. The above relationship can be graphically plotted as the security market line.
c. An undervalue security is a very desirable asset to own.
d. All of the above.
e. Both a and b above.

184) Characteristic line is the relationship between return on stock and
a. Return on market portfolio
b. Risk free rate of return
c. Return on government bond
d. Both b and c above
e. None of the above

185) In booming (share) market, the companies are to be selected with Beta (β)
a. $\beta = 0$
b. $\beta > 1$
c. $\beta < 1$
d. $\beta = 1$
e. Beta is not relevant

186) Which of the following is not an assumption of CAPM
a. Capital markets are perfect
b. Lending rate is more than borrowing rate
c. No individual is capable of affecting market
d. Homogenous expectations.
e. All the above are assumptions.

187) Systematic risk factor involved in investing in bonds
a. Purchase power risk
b. Interest rate risk
c. Yield risk
d. Both a and b above
e. Both b and c above

188) The low of the security market line changes with
a. Change in risk free rate of retune
b. Change in risk attitude of investors

c. Change in inflation
d. All of the above
e. Both a and c above

189) The relationship between beta of a security and required rate of return is represented by
a. Characteristic line
b. Security market line
c. Capital market line
d. All of the above
e. None of the above

190) If investors expect the inflation rate to fall in future and they expect themselves to become less risk averse then
a. SML shifts up and the slope increase
b. SML shifts up and the slope decrease
c. SML shifts down and the slope increase
d. SML shifts down and the slope decrease
e. SML does not change as the above changes offset each other.

191) The return from an investment is calculated by using the formula
a. $\frac{d_t + (P_t - P_{t-1})}{}$ Where d_t = dividend in year true; P_{t-1} and d_t = prices in the year true and true-1 respectively
b. $\sum_{i=1}^{n} k_j p_i$ Where k_i = ith possible rate of return; p_i = Probability associated with the occurrence of the ith rate of return
c. $R_f = \beta (R_m - R_f)$ where R_f = Risk free rate of return; β = Beta coefficient of the security; R_m = Return form the market portfolio
d. Both a and b above
e. All of the a, b and c above.

192) The required rate of return calculated as per capital asset pricing mode
a. Is the minimum return required by the investor
b. Is the same as expected rate of return under equilibrium conditions
c. Depends on retunes of market portfolio and risk free rate of return
d. All of the above
e. CAPM does not define required rate of return.

193) Which of the following does not contribute to systematic risk?
a. Change in the interest rates
b. Change in the level of government spending
c. Emergence of a new competitor
d. Change in the industrial policy
e. Both b and d above

194) Security market line cuts the Y-axis at
a. Expected rate of return on the market portfolio
b. Expected rate of return on individual security
c. Expected rate of inflation
d. Real rate of return on risk free securities
e. nominal rate of return on risk free securities

195) An equity share with beta greater than unity would be called
a. A defensive stock because it is expected to decrease more than the market increases
b. An aggressive stock because it is expected to increase more than the market increase
c. A defensive stock because it is expected to increase more than the market decreases
d. An aggressive stock because it is expected to decrease more than the market decreases
e. A stock moving against the market.

196) Risk ness of a portfolio is a function of
a. Proportions invested in the components
b. Riskiness of the components
c. Correlation of he returns on the component securities
d. All of the above
e. Only b and c of the above

197) Which of the following will cause an increase in the required rate of return
a. Decrease in inflation
b. Decrease in risk-free rate
c. Increase in interest rate

d. Decrease in risk aversion
e. All of a, b and c above

198) The security market line
a. Is also referred to as the characteristic line
b. Is a graphical representation of the capital asset pricing model
c. Has beta as its slope
d. Manifests the relationship between returns on the market and returns on he security
e. Measures the behavior of returns overtime.

199) If the slope of security market line = 0, Which of the following is/are true
a. Expected rate of return is more than the market return.
b. Expected return is equal to risk free rate of return.
c. Risk free rate of return is equal to zero
d. Expected return shall be beta times of the risk aversion.
e. Both a and b of the above.

200) Diversification can eliminate risk if the securities of a portfolio are
a. Perfectly positively correlated
b. Perfectly negatively correlated
c. Weakly positively correlated
d. Weakly negatively correlated
e. Not correlated.

201) Systematic risk of a security is measured by
a. Standard deviation
b. Variance
c. Covariance
d. Beta
e. Correlation coefficient.

202) Which of the following instances relating to ABC Ltd. do not represent unsystematic risk
a. An open offer for takeover of the company.
b. Workers declare strike in the company
c. Company makes a breakthrough in process innovation
d. Introduction of minimum alternative tax
e. Raid on he company for tax evasion.

203) If there is zero correlation among the securities in a portfolio, eh resulting graph will be a(n)
a. Straight line with a slope of 45 degrees
b. Straight line with a negative slope of 45 degrees
c. Scattered
d. Ellipse
e. hyperbola

204) Which of the following is an example of systematic risk?
a. Risk of non availability of a major raw material to a company amking aluminium bars.
b. Death of the finance manger of a company providing financial services
c. Unexpected entry of a multi national company in the tea industry.
d. Reduction of tax rate by the government
e. Sudden strike called by the workers of a jute manufacturing company demanding for the wage revision.

205) Which of the following statements does not involve risk return trade off decision
a. Of increase the sales revenue through an aggressive advertisement campaign.
b. To improve the paying habit of the customers by framing an attractive credit terms.
c. To maximize profits by ensuring he maximum usage of the production facilities.
d. To maximize he profit by resorting to debt financing.
e. None of the above

206) If a security return is plotted above the security market line then
a. The risk free rate is equal to the required rate of return on the security
b. The security rate of return is more that the return on the market portfolio
c. The security beta is less than one and hence a conservative security
d. The security is said to be overvalued
e. The security is to be bought immediately.

207) Which of the following is/are an assumption of CAPM?
a. Investors use the expected return and standard deviation of returns as the appropriate measure of return and risk of eh portfolio
b. Investors are risk averse
c. Investors agree with each other on the nature of return and the risk associated wit each instrument where investment may be made.

d. The assets can be bought and sold in any unit as desired by the investor.
e. All of the above.

208) If the rates of return form a security move perfectly in tandem with respect other market returns then the beta for he security will be
a. Equal to 1
b. 0
c. Between 0 and 1
d. Greater than 1
e. Less than -1

209) Which of the following is an example of non systematic risk to a firm
a. Volatility of interest rates
b. Sudden increase in the rate of inflation
c. The possibility of the imposition of surcharges by the government to reduce fiscal deficit.
d. Sudden scarcity of cement in the market
e. Non availability of sufficient power supply to overall business sector.

210) If the return on a security lies below the security market line then
a. The security is conservative security
b. The security is aggressive security
c. The risk free rate of return is more than the sxpected return form tha security
d. The security is over priced
e. The security is under priced.

211) Which of the following relationships is represented by the Characteristic Regression Line (CRL)
a. The return from an equity share and the variance of its returns.
b. The return from an equity share and the return form the market index.
c. The return from an equity share and its beta
d. The return from an equity share and the risk free rate of return
e. The return from an equity share and the market risk premium.

212) What is the significance of the beta coefficient with respect to the risk of a security
a. It indicates the unsystematic risk of he security.
b. It indicates the systematic risk of the security.
c. It indicates the total risk of the security
d. It indicates the operating risk of he company that has issued the security.
e. It indicates the financial risk of the company that has issued the security.

213) Which of the following is an assumption of CAPM
a. The investors are risk loves.
b. The assets can be sold or bought in the lots of 100 units.
c. Transactions costs and taxes are of a significant amount
d. Expectation of one investor is not same s that of the another in relation to the expected returns from a security and the risks associated with it.
e. The investors considers the expected return and the standard deviation of returns as the criteria for making investment.

Valuation of Securities

214) Which of the following is/are not feature of bonds issued by above agency
a. They are secured
b. They are issued at discount and redeemed at he face value
c. The interest rate can be changed before the maturity of he bond if government wishes so
d. Both a and c above
e. Both b and c above

215) If a 2 year redeemable bond is purchase and held till maturity the rate of return earned is called
a. Coupon rate
b. Required rate of return
c. Yield to maturity
d. Current yield
e. Either b or d above

216) When the required rate of return is equal to the coupon rate, value of the redeemable bond is equal to its.
a. Market value
b. Face value
c. Present value of he stream of interest inflows
d. Average of pare value and maturity value
e. None of the above

217) When the coupon rate is less than the required rate of return the discount on the bond .... as maturity approaches
   a. Decreases
   b. Increase
   c. Does not change
   d. First decreases and then increases
   e. First increases and then decreases.

218) Given the maturity an increase in bond yield causes a price decrease that is .... the price increase caused by a equal size decrease in yields.
   a. Higher than
   b. Smaller than
   c. Equal to
   d. Greater than or equal to
   e. Smaller than or equal to

219) A change in YTM .... it affects bonds with a lower YTM
   a. Less than
   b. More than
   c. Same as
   d. Either of a or c above
   e. Either of b or c above

220) An investor would buy a bond if
   a. The intrinsic value is lower that the market value
   b. The intrinsic value is higher then the market value
   c. The current market value is lower than the redemption value
   d. The current market value is less than the face value
   e. He required rate of return is equal to coupon rate of interest.

221) Nadir shah purchases a bond today and sells 6 months before its maturity. Yield realized is known as
   a. Holding period return
   b. Current yield of coupon interest is received
   c. yield to maturity
   d. Both a and b above
   e. All of a, b and c above

222) For a bond held to maturity, YTM is not affected by
   a. Annual interest payment
   b. Discount rat
   c. Redemption value
   d. Number of years to maturity
   e. Current market price of the bond.

223) Which of the following statements is false
   a. The required rate of return determines the premium or discount on the bond value.
   b. If the YTM increase the bonds market price decreases
   c. The coupon rate affects the YTM
   d. If the market price and face value are equal then coupon rate is more than YTM
   e. All of the above.

224) If the coupon rate of bond X is grater that bond Y with the same YTM and maturity
   a. The bond X's price will change more than Y for a change in YTM
   b. The market price of bond Y is more than that of X
   c. The current yield of both the bonds would be same
   d. The bond Y's price would change more than that of X for a change in YTM
   e. Both b and d above

225) The price of he share will increase if
   a. The dividend decreases
   b. The required rate of return increases
   c. The growth rate increases
   d. Both b and c above
   e. All of a, b and c above.

226) Prabhasa Constructions Ltd. is showing a low dividend yield and high price earnings ratio. then,
   a. Price of its share is high
   b. There is growth in the company
   c. The investors in this share can expect capital gains
   d. Both a and b above

e. All of a, b and c above

227) The book value approach is criticized because
a. It can be established easily
b. It values the firm's share without any future projections
c. It is based on accounting figures which can be manipulated
d. Both a and b above
e. Both b and c above

228) The factor(s) which affect (s) P/E ratio is/are
a. Growth rat
b. Debt proportion
c. Retention ratio
d. Quality of management
e. All of a, c and d above

229) The coupon rate on a bond is set equal to
a. Its yield to maturity
b. A percentage of its market price
c. A percentage of its maturity value
d. A percentage of its par value
e. A percentage of its issue price.

230) The amount a company can realize if it sold its business as an operating one is called
a. Market value
b. Book value
c. Replacement value
d. Liquidation value
e. Going concern value

231) Which of the following statements is not true
a. Ceteris paribus, as the expected growth in dividend increases, the expected return depends more on the capital gain yields, and less on dividend yield.
b. Ceteris paribus, he price earnings ratio increases as the expected growth rate in dividend increases.
c. High dividend yield and low price earnings ratio imply listed growth prospects.
d. Low dividend yield and high price earnings ratio imply low growth prospects.
e. Low dividend yield and high price earnings ratio imply considerable growth prospects.

232) Which of the following statement is false
a. When required rate of return (kd) is equal to coupon rat (kc), the value of bond (V) is equal to its par value (F).
b. When k_d is greater then k_c, V is less than F
c. When k_d is greater than k_c, eh discount on bond delines as maturity increase.
d. When k_d is less than k_c, the premium on th4 bond declines as maturity approaches.
e. None of the above

233) Which of the following statements is false
a. Market value is he amount that a company could realize if it sold its assets after terminating its business.
b. Replacement value is the amount required to replace its existing assets in the current conditions.
c. Going concern value is he amount that a company could realize if it sold its business as an operating one.
d. Book value is an accounting concept.
e. The difference between the book value of assets and liabilities is equal to shareholder's funds.

234) Which of the following is true
a. The book value of a company is equal to the historic value of its assets.
b. Intangible assets cannot form part of the book value of a company
c. The book value of debt is equal to the outstanding amount of debt.
d. The difference between book value of shareholders funds and the liabilities is equal to the book value of the firm.
e. Book value is also know as liquidation value.

235) Which of the following statement is false
a. A change in YTM affects a bond with a higher YTM
b. For a given difference between YTM and coupon rate, bonds with longer term to maturity will have greater price change.
c. A bonds price moves inversely proportional to YTM

d. For any change in YTM, he percentage price change in case of bonds of gigh coupon rate will be smaller that bonds wit low coupon rate.
e. None of the above

236) If the maturity of a bond increase, the
a. Volatility of the bond decreases
b. Volatility of the bond increase
c. Volatility remains unaffected
d. Change in volatility depends on the required rate of retain
e. None of the above

237) When the required rate of return on a bond is less than the coupon rate, then
a. The value of the bond is equal to its par value
b. The discount on the bond declines as maturity approaches
c. The premium on the bond increase as maturity approaches
d. The value of the bond is greater than its par value
e. The value of the bond is less then its par value.

238) Which of the following statements is true
a. The intrinsic value of a stock is equal to the discounted value of the stream of future earnings per share.
b. The intrinsic value of a stock is equal to the present value of earnings per share plus the net present value of future growth opportunities.
c. The intrinsic value of a stock is equal to the present market price per share less the purchase
d. The intrinsic value of a stock is equal to th discounted value of te stream of future dividends per share.
e. The intrinsic value of a stock is equal to the market capitalization divided by the number of outstanding shares.

239) Which of the following statements is/are true regarding changes in bond prices
a. The shorter the term to maturity the grater would be the price change with change in yield to maturity.
b. With a change in YTM he percentage change in bond prices would be lower in case of high coupon bonds than in the case of low coupon bonds.
c. The changes in bond prices move inversely to change in yield to maturity
d. Both b and c above
e. All of a, b and c above

240) If maturity of bond lengthens, what happens to the validity of bond?
a. Volatility increases
b. Volatility decrease
c. Volatility sometimes increase, sometimes decreases
d. Volatility remains unchanged.
e. None of the above

241) Which of the following is true
a. When the expected price earnings ratio exceeds the actual price earnings ratio of a stock, the stock is overpriced.
b. When the expected rate of return is equal to the required rate of return, the stock is correctly priced.
c. An overpriced stock should be purchased as it is undervalued.
d. All of the above
e. Both a and b above.

242) When the required rate of return on a bond is greater than the coupon rate
a. The premium on the bond declines as maturity approaches
b. The discount on the bond declines as maturity approaches
c. Te value of the bond is greater than its par value
d. The greater is its price change, in response to a given change in the required rate of return
e. None of the above

243) In an ever changing scenario of interest rate in the bond market, if discount bonds and premium bonds re sold at the same price, it indicate that
a. The bonds have approached maturity
b. The YTM = Coupon rate
c. The bonds are giving the same coupon rate, same maturity value and same face value
d. The investors cost of funds are approximately equal
e. All of the above

244) Coupon yield is equal to current yield, if any only if
a. The market interest rates are regulated

b. The market price of the bond is equal to the face value of he bond
c. The bonds are highly volatile
d. The market price is more than the par value
e. The face value is more than the market value.

245) What is the value of beta when the required rate of return is 21.4% the risk free rate is 6% and the market return is 17%
a. 1.2
b. 0.8
c. 1.3
d. 1.4
e. 1.5

246) Which of the following is true regarding the value of a share?
a. The value of a share equals the discount stream of future earnings per share.
b. The value of a share equals the present value of earnings per share less the purchase price per share.
c. The value of a share equals the discounted stream of future dividends per share.
d. The value of a share equal the market capitalization divided by the number of outstanding shares.

247) Which of the following is false regarding the value of a bond
a. The value of a bond varies inversely with the interest rate.
b. Bonds of short maturity have less interest rate risk compared to the bonds of long maturity.
c. Bonds of high coupon have high interest rate risk compared to small coupon bonds.
d. The value of the bond will be equal to face value if the coupon rate is equal to the YTM.

248) Yield to maturity of a perpetual bond is equal to
a. Interest/face value
b. Interest/market value
c. Interest/Average of face value and market price
d. Interest rate
e. (Interest + Annual Redemption)/Average investment.

249) Which of the following statement is/are true regarding bond value theorems
i) When the required rate of return is greater than the coupon rate, the premium on the bond increases as maturity approaches.
ii) For a given difference between yield to maturity and coupon rate, he longer the term to maturity, greater will be the change in price with the change in yield to maturity.
iii) The effect of a change in yield to maturity on the price of he bond is more in case of lower yield bonds than in bonds with higher yields.
b. Only I above
c. Only ii above
d. Both I and ii above
e. Both I and iii above.
f. Both ii and iii

250) Which of the following is most likely to result in a higher P/E ratio for a firm, other things being equal?
a. Lower growth rate in dividends.
b. Reduction in the stock required rate of return
c. Lower dividend yield
d. Lower stock price
e. Higher cost of insolvency

251) Which of the following statement is correct regarding cash dividends on common stocks
a. Dividend payment are guaranteed
b. Dividends are he only form of return on investment
c. Low dividend yields indicate out of favor stocks
d. Dividend yields are based on current stock price
e. None of the above

252) The value of common stock is likely to decrease if
a. Investment horizon decrease
b. The growth rate of dividends increase
c. The discount rate increase
d. Dividend are discounted back to present
e. Dividends pay out ratio remains constant.

253) The g is the constant growth dividend discount model refers to
a. Only I above

b. Only ii above
c. Both I and ii above
d. Both I and iii above
e. Both ii and iii above

254) Which risk is associated with a particular security traded on the secondary market
a. Interest rate risk
b. Market risk
c. Liquidity risk
d. Financial risk
e. Both b and c above

255) Given the difference between YTM and coupon rate
a. The longer the term to maturity the lesser will be the change in price with change in YTM.
b. The shorter the term to maturity the lesser will be the change in price with change in YTM.
c. The longer the term to maturity the grater will be the change in price with change in YTM.
d. The term to maturity does not influence the change in price for any change in YTM.
e. The term to maturity influences the change in price for any change in YTM in an unpredictable manner.

256) Which of the following is an external factor that influences the intrinsic value of stock
a. Earning power and profitability of the operations.
b. Dividends paid and payable in future
c. Growth in earnings over time and expectations of the same in future
d. Quality of management
e. Growth rate of the industry to which the company belongs.

257) Current yield of a bond equals
a. Coupon rate when the price of the bond is grater than face value of the bond
b. Coupon rate when the price of the bond is less than face value of the bond
c. Coupon rate when price of the bond is equal to the face value of the bond
d. Yield to maturity (YTM) when the price of the bond equals the face value of the bond
e. Both c and d above

258) Other things being equal, Which of the following will cause an increase in the value of a bond
a. Decrease in the term to maturity
b. Increase in the required rate of return on maturity
c. Decrease in the discount on the bond on issue
d. Increase in the premium on maturity of the bond
e. Decrease in the coupon rate of the bond.

259) Which of the following is/are false when the required rate of return on a bond is more than the coupon rate
i) The discount on the bond decreases as the maturity approaches
ii) The market value of the bond is less than its par value
iii) The premium on the bond decreases as the maturity approaches b. Only I above
c. Only ii above
d. Only iii above
e. Both I and ii above
f. Both ii and iii above

260) Which of the following is not true with regard to the warrants issued by a company
a. It is a call option to buy certain number are of shares of the company that issued the same.
b. The warrant holder is entitled to receive dividends.
c. The warrant holder may sell the warrant at any point of time prior to the exercise date.
d. Warrants are generally issued with an objective to sweeten the public offer.
e. All are the above.

261) Which of the following is not true with regard to the multi period valuation model of equity shares?
a. There is pre specified maturity period
b. The value of an equity share is equal to the present value of its entire dividend stream
c. The model can be applied to the instances of constant dividends and constant growth in dividends.
d. The model can also be applied in case of variable growth in dividends.
e. The cost of equity of the company can vary form time to time.

262) Which of the following factors, other things remaining the same will decrease the bond value? a. Increase in coupon rate
b. Decrease in the yield of the bond

c. Increase maturity premium
d. Increasing the term of the bond
e. Increase in the yield of the bond.

263) The amount that a company may realize if it sells it business after having terminated the same is called
a. Going concern value
b. Book value
c. Market value
d. Liquidation value
e. Replacement value.

264) Which of the following statement is true if the required rate of return form a bond is more than the coupon rate
a. In intrinsic value of the bond is more than the par value of the bond.
b. In intrinsic value of the bond is less than the par value of the bond.
c. The discount on the bond increase as the maturity approaches
d. The discount on the bond decrease as the term to maturity increase
e. The premium on the bond decrease as the maturity approaches.

265) Which of the following factors are to be considered in the valuation of the equity shares of a company through price earning ratio approach
a. Book value of the assets of the company
b. Liquidation value of the assets of the company
c. Growth rate of the earnings
d. Number of equity shareholders
e. Whether preference share have been issued by the company.

266) Long term solvency is indicated by
a. Liquidity ratio
b. Debt equity ratio
c. Interest coverage ratio
d. Return on capital employed
e. Both b and d above.

267) Current ratio is chiefly used to assess the
a. Effective utilization of capital
b. Application of debt
c. Liquidity position
d. Levels of inventory piled up in different forms
e. Prompt payment of long term liabilities.

268) Which of the following indicates the debt service coverage ratio of 1.5 of a firm
a. The total obligation (i.e. interest plus repayment on the long term lone) of the firm are 1.5 times its PBDIT.
b. The total obligations re 1.5 times its PAT
c. The post tax cash earning are 1.5 times its total obligations.
d. The post tax earning after depreciation are 1.5 times its total obligations
e. The total obligations are 1.5 times the equity earnings.

269) Which of the following is/are false statements regarding common size analysis
a. It is used for comparing performance of a company in one year with that of another year.
b. The industry average is compared with the performance of a company.
c. All items in the financial statements are expressed as percentages of the respective totals.
d. Both a and c above
e. Both b and c above

270) A fixed chares coverage ratio of 4 signifies
a. Pre-tax operating income is 4 times all fixed financial obligations
b. Post tax income plus depreciation is 4 times all financial obligations
c. Pre tax income before lease rental is 4 times all fixed financial obligations
d. Post tax income less preference dividends is 4 times all fixed financial obligations
e. Post tax income plus debt interest and lease rental is 4 time all fixed financial obligations.

271) Which of the following statements is/are true
a. Average collection period evaluates all aspects of credit policy.
b. All other thing remaining the same, issue of new share for cash will improve the current ratio.
c. Ratio analysis is technique of planning and control
d. Both a and c above
e. All of a, b and c above

272) If a firm has realized its debtors and has paid off its creditors to the same extent then

a. The current ratio will increase if it was less than 1 previously
b. The current ratio will decrease if it was more than 1 previously
c. The current ratio will increase if it was equals to 1 previously
d. Both a and c above
e. Both a, b and c above

273) Receivables turnover ratio of 10 means
a. The net credit sales for the year are 10 times the average receivables
b. Receivables are generated 10 times during the year
c. It takes 36 days to collect credit sales on an average
d. Both a and c above
e. All of a, b and c above

274) If the realized collection period is more than the terms of trade, it can be said that
a. The collection job is poor
b. The quality of debtors is poor
c. The average daily sale are low
d. Both a and b above
e. All of a, b and c above

275) Low assets turnover may indicate
a. Low assets
b. High costs of maintenance
c. Idle assets
d. Higher sales
e. Both b and c above.

276) A gross profit margin ratio may not indicate
a. Earning power
b. The efficiency of production
c. The efficiency of pricing
d. The gap between net sale and cost of goods sold
e. Eh balance left to meet the administration and financing expenses.

277) The long term solvency positions are measured by
a. Coverage ratios
b. Earnings ratios
c. Structural ratios
d. Both a and c above
e. Both a and b above

278) Dividend pay out ratio is
a. A ratio between dividend paid and the number of equity shares
b. DPS divided by EPS
c. A ratio between PAT and the dividend paid
d. The percentage of equity earnings over EBIT
e. EPS divided by DPS.

279) Which of the following would affect the dividend yield directly
a. Retention ratio
b. Book value per share
c. Face value of a share
d. The cost of equity capital
e. Debt equity ratio

280) Which doing the time series analysis you found that the ROE is decreasing. Which of the following may be a probable reason
a. The Net Profit margin is increasing
b. Assets turnover is decreasing
c. The debt assets ratio is decreasing
d. Both a and b above
e. Both b and c above

281) Which of the following is/are the problem encountered financial statement analysis
a. Development of benchmarks.
b. Window dressing
c. Price level changes
d. Interpretation of results
e. All of the above

282) Equity multiplier in Du Pont Analysis as
a. EPS/Market price of shares
b. EPS/Book value of shares

c. PAT/net worth
d. Average assets / average equity
e. None of the above

283) Which of the following statement is true
a. The income statement of a firm shows the value of its assets and liabilities over a specified period of time
b. The difference between the current and quick ratio is that inventory has been subtracted form current liabilities.
c. The net working capital of a firm will increase when accrued wages are paid with cash.
d. The lower the times interest coverage ratio, the lower is the interest expense.
e. Other things being equal, a decrease in average accounts receivable will increase the firm's return on assets.

284) A common size Balance Sheet portrays the firm accounts as a percent of the
a. Industry assets
b. Firms net income
c. Firms total assets
d. Strongest competitor assets
e. Current assets

285) As assets liquidity measures
a. Its potential for generating a profit
b. Its usefulness to the corporation
c. Its ease and cost of being converted into cash
d. Its proportion of equity financing
e. Its proportion of debt financing.

286) The current ratio is the ratio of
a. Current asset to total asset
b. Current liabilities to total liabilities
c. Current assets to current liabilities
d. Current liabilities to equity
e. Current assets to fixed assets.

287) If the current ratio is less than 1 then it can be definitely said that.
a. The net working capital is negative
b. The net working capital is positive
c. The inventories are inadequate
d. The current assets other than inventories are inadequate
e. Cash in hand is inadequate.

288) 1 year = 365 days. The expression $\frac{\text{Average Re ceivable x 365}}{\text{annual Credit Sales}}$ is known as

289) If the debt-equity ratio of a company is 2:1 then it can be understood that for every
290) Which of the following statement is true?
291) How does financial statement analysis help in understanding financial statement?
292) Working capital gap
293) Which of the following is an efficiency ratio
294) Capitalization rate is calculated a
a. Total assets to debt ratio
b. Market price of the share to eanings per share
c. Earning per share to book value of the shares
d. Earning per share to market price of the shaer
e. Total assets to equity ratio.

295) An interest coverage ratio of 2.25 indicates that
a. Ebit is 2.25 times the interest payable
b. Ebt is 2.2.5 times the interest payable
c. Eat is 2.25 times the interest payable
d. Retained earnings are 2.25 times the interest payable
e. None of the above

296) Which of the following s a liquidity ratio
a. Debt equity ratio
b. Dividend pay out ratio
c. Net Profit margin
d. Interest coverage ratio
e. Acid test ratio.

297) Which of the following is/are not a liquidity ratio
a. Current ratio

b. Quick ratio
c. Average collection period
d. Bank finance to working capital gap ratio
e. Both c and d of the above

298) Earnings per share (EPS) is equal to
a. Profit before tax/No. of outstanding shares.
b. Profit after tax/No. of outstanding shares
c. Profit after tax/amount of equity share capital
d. Profit after tax/ net worth
e. Profit after tax les equity dividends/No. of outstanding shares.

299) Current ratio indicates
a. Amount of cash with the company
b. Amount of current assets out of total assets of the company
c. Capacity to meet current liabilities
d. Ability to repay debt installments
e. None of the above

300) Which of the following is not considered while determining the appropriate P/E ratio for a firm
a. Industry growth rate
b. Book value to earnings per share ratio
c. Stability of earnings
d. Size of the company
e. Dividend pay out ratio.

301) Which of the following is/are true regarding common size analysis?
a. It states items in the Balance Sheet as percentage of total assets
b. It expresses items in Balance Sheet as an index relative to the base year
c. It is the safe as time series analysis
d. It is done to find the intrinsic value of the company stock
e. Both a and c above

302) Day's Sales Outstanding
a. Is the ratio of receivable outstanding to average daily sales
b. Is similar to the average collection period.
c. If higher, indicates an efficient credit policy
d. Both a and b above
e. Both a and c above

303) A high inventory turnover ratio
a. Could mean that inventory could have increased even when net sales remained constant
b. Is generally an indicator of efficient inventory management
c. Could also be an indicator of over trading
d. All of the above

304) When current assets and current liabilities increase by the same amount
a. The current ratio remains the same
b. The current ratio increases, if it is greater than 1
c. The current ratio decrease, if it is greater than 1
d. The current ratio becomes 1:1
e. None of the above

305) The basic ratio for measuring the firm's ability to meet its interest charge is the
a. Cash flow coverage ratio
b. Interest coverage ratio
c. Debt service coverage ratio
d. Acid test ratio
e. None of the above

306) The starting pint of Du Pont chart is
a. Return on equity
b. Return on investment
c. Return on total asset
d. Return on fixed assets
e. None of the above

307) Return on investment and return on equity are exactly 0.25. this indicates that
a. ROE has been calculated wrongly
b. RIO pertains to the previous year
c. The firm has no debt in their capital structure
d. The firm does not pay income taxes
e. Both c and d of the above.

308) The market value of book value ratio is 2. this indicates that
   a. The book value is understated
   b. There is head by speculating in the market
   c. The firm has doubled the wealth of the shareholder
   d. The net wealth of shareholder is reduced to half
   e. Accounts are not being maintained properly.
309) In the Du Pont chart the left apex term is
   a. Earning per share
   b. Return on equity
   c. Net Profit to total assets
   d. Operating profit before interest and taxes to total assets
310) The use of debt in a project increase ROE if the firm
   a. Has more outside liabilities than equity
   b. Hs more assets than equity
   c. Pays more taxes than interest
   d. Has an asset turnover more than 2
   e. Earns higher return than the rate of interest on debt.
311) Interest coverage ratio of 6 indicates
   a. Sales are 6 times of interest
   b. Profit after tax is 6 times
   c. Profit before tax is 6 times of interest
   d. Earning before interest and taxes is 6 times of interest
   e. Profit after tax is equal to $1/6^{th}$ of interest.
312) In the context of financial statements analysis, cross sectional analysis involves comparison between
   a. Two division of a company
   b. Historical and current data
   c. A company and its competitor
   d. A company and the industry
   e. None of the above
313) Earning power measures the
   a. Profitability of equity funds invested in the firm
   b. Operating performance of the firm
   c. Efficiency of production as well as pricing
   d. Efficiency of fixed assets employed
   e. Efficiency of total assets employed.
314) The current ratio and quick ratio of BCC Ltd. nearly the same, this suggests that
   a. The company has got a sizeable investment in inventory
   b. The liquidity position of the company is unclear
   c. The company has got a low investment I inventory
   d. The quick assets of the company are low
   e. The company is ahighly profitable one.
315) The leverage ratio used in ROE analysis is
   a. Sales ratio
   b. Profit margin
   c. Total assets to net worth
   d. Tangible net worth total assets
   e. Long term debt to equity ratio.
316) Which of the following statement is/are true with respect to earning power?
   a. It measures operating profitability of the firm
   b. It measures the efficiency of the capital employed
   c. It is not influenced by the financial structure of the firm
   d. All of a, b and c above
   e. Both a and c above
317) Earnings per share divided by book value is equal to
   a. Net worth
   b. Return on equity
   c. Net Profit
   d. Net worth / Net Profit
   e. Reciprocal of return on equity.
318) For assessing the future market value of accompany, it is best to depend on
   a. Turnover ratios
   b. Earnings ratios

c. Efficiency ratios
d. Profitability ratios
e. Liquidity ratios

319) Dividend yield is equal to
a. Dividend rate
b. Dividend per share face value of the share
c. Dividend per share / earnings per share
d. Dividend per share / retained earnings per share
e. Dividend per share / market value per share.

320) Which of the following is a liquidity ratio
a. Return on equity
b. Return on investment
c. Acid test ratio
d. Debt equity ratio
e. Debt asset ratio

321) In common size analysis the items in the income statement are expressed as percentage of
a. Total asset
b. Net sales
c. Total expenses
d. Gross sales
e. Total fixed assets.

322) Which of the following ratios indicates the capital structure
a. Debt assets ratio
b. Inventory turnover ratio
c. Total asset turnover ratio
d. Return on equity
e. Return on assets

323) Which of the following ratios indicates the ability of affirm to service the financial charges.
a. Dividend pay to ratio
b. Fixed charges coverage ratio
c. Net Profit margin ratio
d. Inventory turnover ratio
e. Acid test ratio

324) In Which of the following situations price earnings ratio is applied
a. To determine the financial risk of a business entity
b. To determine the expected market value of the share of a company
c. To assess the earning potential of a company in the near future
d. To examine the operations efficiency of a company.
e. To check how efficiently the assets are utilized by a firm.

325) How can a company lower its debt to total assets ratio in its capital structure
a. Borrowing more funds form the market by issuing debentures.
b. Using short term funds against he fixed assets of long life
c. Using long term funds against the current assets of the company.
d. Planning for a rights issue
e. Borrowing more funds from the financial institutions.

326) The serves and surplus at the base year is set at 100% whereas for the subsequent years, it may be less than or more than 100%. Which types of analysis is supposed to be carried out.
a. Cross sectional analysis
b. Year to year change analysis
c. Index number trend analysis
d. Common size analysis
e. Expected annual income analysis.

327) A cement manufacturing company has a debt to equity ratio of 1.6 compared with the industry average of 1.4. this means that the company.
a. Will never experience any difficulty with its creditors
b. Has more borrowing capacity than the other companies in the industry
c. Will be viewed as having high creditworthiness
d. Has greater than average financial risk when compared to companies in the same industry
e. Has a better ability to met its financial commitments towards its stakeholders.

328) High asset turnover ratio indicates
a. Large amount of investment in the fixed assets
b. large amount of investment in the current assets
c. large amount of sale value in comparison to total assets

d. inefficient utilization of the assets
e. high debt equity ratio.

329) A 15% debenture of face value Rs. 100 of 8 years to maturity is trading at a premium of 9%. Realized amounts. 95 and tax rate is 40%. What is eh yield?
a. 10.21%
b. 10.44%
c. 10.76%
d. 10.54%
e. 10.12%

330) Which of the following methods of financial statements analysis is based on the interrelationship among various components of the financial statements
a. Common size analysis.
b. Tie series analysis
c. Index analysis
d. Du Pont analysis
e. Cross sectional analysis.

331) In which of the following methods of financial statement analysis, the items in the income statement are expressed as percentages of total sales.
a. Common size analysis
b. Time series analysis
c. Index number tread analysis
d. Du Pont analysis.
e. Cross sectional analysis.

Funds Flow Analysis

332) The meaning of "fund" in fund flow statement is
a. Cash
b. Net working capital
c. Gross working capital
d. Profit
e. Either a or b above

333) Which of the following change(s) does/do not appear in a Cash Flow Statement
a. Issue of equity shares
b. Conversion of all FCDs into equity shares
c. Bonus issue of equity shares
d. Both b and c above
e. All of a, b and c above

334) Which of the following statement is true with respect to sources and uses of funds
a. Depreciation and decrease in NWC are sources of funds.
b. Depreciation and decrease in NWC are uses of funds.
c. Depreciation is a source of fund but decrease in NWC is a use of fund.
d. Depreciation is a use of fund but decrease in NWC is a source of fund.
e. Depreciation and increase in NWC are uses of funds.

335) Which of the following statement is true?
a. Depreciation is a use of funds.
b. Increase in liability is a source
c. Decrease in an asset, other than cash is a use
d. Increase in bills pyable is a use
e. Increase in equity is a use.

336) Which of the following items represent potential use of funds
a. Sale of land and building at loss
b. Dividend proposed and not yet declared
c. Sale of trade marks and patent rights.
d. Net loss form operations
e. Amortization of goodwill

337) Which of the following represent s cash form operations
a. Net Profit + non cash expense
b. Net Profit + decrease in current liabilities
c. Net Profit + increase in current assets
d. Net Profit
e. Earnings before interest, depreciation and tax + decrease in current assets.

338) Which of the following is/are true regarding funds flow statement
a. Amortization of preliminary expenses is a use of fund
b. Increase in provision for taxation decreases working capital

c. Cash or credit sales at a profit increase the working capital
d. Both a and b above
e. Both b and c above

339) Which of the following is a source of fund
a. Increase in cash
b. Increase in accrued expenses
c. Decrease in reserve
d. Dividend payment
e. All of the above

340) Which of the following is not a use of funds
a. Increase in fixed asset
b. Buy back of shares
c. Decrease in working capital
d. Increase in depreciation
e. Both c and d only

341) Which of the following is not benefit of funds flow statement analysis for an organization
a. Detection of imbalances
b. Divisional performance appraisal
c. Evaluation of firm financing
d. Evaluation of the quality of firm stop management'
e. Planning of future financing.

342) Which of the following is not a method of sales forecasting
a. Jury of executive opinion
b. Sales forces mate
c. Trend analysis via extrapolation
d. Ratio analysis
e. Regression analysis.

343) Which of the following assumptions is true while calculating the external funds requirements?
a. The assets of the firm will increase proportionately to cost of goods sold
b. Net Profit marking will increase at a constant rate
c. Dividend pay out ratio and debt equity ratio will remain constant
d. External issue of equity will be resorted to
e. Net Profit margin will in create at an increasing rate.

344) Which of the following is a source of working capital in a funds flow statement drawn on working capital basis
a. Net income
b. Dividends
c. Taxes
d. Increase in short term loans
e. Decrease in receivables.

345) Which of the following is a source of cash in a funds flow statement drawn on cash basis
a. Dividend payment
b. Increase in fixed assets
c. Increase in receivables
d. Repayment of short term bank loan
e. depreciation

346) Which of the following is not an item of current liabilities
a. Sundry creditors
b. Hire purchase dues
c. Fixed deposit made for 18 months
d. Unclaimed dividends
e. Advances form customers.

347) Which of the following is not a source of funds
a. Increase in owner's equity
b. Decrease in Plant and Machinery
c. Payment of dividends
d. Decrease in debtors
e. Sale of investments.

348) Which of the following will not result in an increase in net working capital
a. Increase in cash
b. Decrease in creditors
c. Decrease in bank borrowings
d. decrease in inventory

e. decrease in bills payable.

349) Which of the following is not a source of fund
a. Increase in share capital
b. Increase in working capital
c. Increase in a long term liability
d. Increase in profits
e. Increase in depreciation.

350) An increase in Which of the following is considered as a source of funds while preparing funds flow statement on a working capital basis.
a. Issue of share capital
b. Increase in working capital
c. Repayment of a terms loans
d. Purchase of fixed assets
e. None of the above

351) Which of the following appears as a use in a funds flow statement
a. Taxes
b. Increase in equity
c. Increase in long term loans
d. Decrease in fixed assets
e. Decrease in working capital

352) Which of the following is a use of fund
a. Decrease in current liabilities
b. Increase in current assets
c. Increase in cash
d. All of the above
e. Both a and c of the above

353) Which of the following is not a source of fund
a. Increase in profits.
b. Increase in liabilities
c. Increase in share capital
d. Increase in assets
e. increase in depreciation.

354) Which of the following sources/uses of funds is not considered while preparing funds flow statement on a working capital basis?
a. Issue of share capital
b. Payment of dividend
c. Depreciation
d. Purchase of fixed assets
e. Purchase of raw materials

355) Which of the following increases the cash flow form operations
a. Increase in debtors
b. Increase in inventory
c. Decrease in prepaid expenses
d. Decrease in income ax paid in advance
e. Both c and d above.

356) Which of the following alternatives result in an increase in working capital
a. Issue of bonus shares
b. Issue of equity share
c. Conversion of debentures to equity
d. Both a and c above
e. All of a, b and c above

357) Which of the following can be considered as a use of cash?
a. Increase in provision
b. Increase in prepaid expenses
c. Increase in taxes due but not paid
d. Decrease in investment
e. Decrease in current assets.

358) Which of the following is not shown by a funds flow statement on cash basis
a. The source of cash
b. The uses of cash
c. Decrease in cash
d. The net change in working capital
e. Increase in cash

359) Which of the following is true with respect to funds flow statement of a company
   a. It helps to judge the quality of management
   b. It show whether the ownership pattern of the business entity has been change.
   c. It cannot be manipulated by the unscrupulous promoters
   d. It fails to identify the operational ineffectiveness in a business entity.
   e. It identifies whether short terms fund is used for the procurement of long term asset
360) Which of the following statements shows the source of funds while making funds flow analysis on total resources basis?
   a. Retirement of high cost debt
   b. Installation of a capital asset
   c. Conversion of debentures into equity shares
   d. Selling an old car today in order to buy a new one after three months
   e. Buying back the equity share
361) Which of the following is not a source of fund in a funds flow statement on cash basis
   a. A gross decrease in fixed assets
   b. A gross increase in fixed assets
   c. A net increase in current liabilities.
   d. Sale of any fixed asset
   e. Funds from the operations.
362) Which of the following is not a use c funds flow analysis for an organization
   a. Planning for the future financing strategy
   b. Identification of imbalances with respect to the sources and uses of funds.
   c. Divisions performance appraisal
   d. Assessment of the firm financing.
   e. Assessment of the market leadership for the products of the company.
363) Which of the following statement is/are true with respect to funds flow statement
   a. It shown the changes in the ownership patterns of the company
   b. It shown the sources and uses of funds at any particular date in a year
   c. It can be considered as a snapshot picture for the operation of the business.
   d. It cannot be manipulated by means of window dressing
   e. It indicates how the business financed its fixed assets.
364) A funds flow statement is also known as
   a. Balance Sheet
   b. Profit and loss statement
   c. Income statement
   d. Proforma statement
   e. Statement for the changes in financial position.
365) Degree of total leverage can be applied in measuring change in
   a. EBIT to a percentage change in quantity
   b. EBIT to a percentage change in EBIT.
   c. EBIT to a percentage change in quantity
   d. DFL to a percentage change in DOL
   e. quantity to a percentage change in EBIT
366) DFL becomes zero when
   a. The firm doe not have to pay any tax
   b. EBIT is just equal to the sum of interest and dividend components
   c. The firm does not are any operating profit
   d. Eh interest component equals the preferred dividend
   e. Dfl will never become zero.
367) The firm is now operating at the EBP.
   a. The DTL will increase if the quantity produced increase
   b. The DTL will be negative if he quantity increase
   c. The DTL will start decreasing as the quantity increase
   d. The DTL will not be affected by quantity unless the fixed costs also change
   e. the DTL at the help is undefined.
368) The measure of business risk is
   a. Operating leverage
   b. Financial leverage
   c. Total leverage
   d. Working capital leverage
   e. Debt equity ratio
369) The value of debit at which EPS is equal to zero is know as
   a. Break even point

b. Financial break even point
c. Operating break even point
d. Overall break even into
e. None of the above

370) Which of the following is not a leverage ratio
a. Debt-asset ratio
b. Deb equity ratio
c. Debt service coverage ratio
d. Fixed charges coverage ratio
e. Bank finance to working capital gap ratio.

371) Degree of financial leverage is a measure of relationship between
a. EPS and debit
b. EBIT and quantity produced
c. EPS and quantity produced
d. EPS and sales
e. EPS and interest payment.

372) Operating leverage examines
a. The effect of the change in the quantity of EBIT
b. The effect of the change in EBIT one the EPS of the company
c. The effect of the change in output to the EPS of the company
d. The effect of the change in EPS on the output of the company
e. The effect of the change in EPS on the EBIT of the company.

373) Which of the following statements is not true
a. Each level of EBIT has a distinct DFL.
b. DFL is undefined at financial breakeven point
c. DFL will be negative when the EBIT level goes below the financial breakeven point.
d. DFL will be positive for all values of EBIT that are above he financial breakeven point
e. DOL (Degree of Operating leverage) is undefined at level of output below the financial breakeven point.

374) Which of the following is the expression for operating leverage
a. Contribution / EBIT
b. EBT / Contribution
c. Contribution/EAT
d. Quantity / EBIT
e. Contribution / quantity.

375) Which of the following statements regarding degree of financial leverage is false
a. Each level of EBIT has a distinct dfl.
b. DFL is undefined at financial break even point
c. DFL is negative when EBIT is below financial break even point
d. DFL starts declining as EBIT increases.
e. With the help of DFL one can understand the impact of the change in output on EBIT of the company.

376) Which of the following statement is true?
a. Degree to total leverage measures he changes in EPS to a unit percentage change in EBIT.
b. DTL measures the total risk of the company
c. DTL measures the variability of EBIT for a given error in forecasting the total quantity sold.
d. The sum of operating and financial leverage is called total leverage.
e. The DTL is equal to open at the overall break even point of output

377) If the degree of operating leverage is 2 and the degree of financial leverage is 1.5 it means that
a. 1% change in sales will result in 1.5 percent change in EBIT
b. 1% change in EBIT will result in 2% change in EPS
c. 1% change in EPS will be caused by 3.5% change in sale
d. 1% change in EPS will be caused by 3% change in sale
e. 1%change in sale will result in 3% change in EPS.

378) If DOL represent degree of operating leverage and DFL represent degree of financial leverage, degree of total leverage can be defined as
a. DOL + DFL
b. DOL – DFL
c. DOL x DFL
d. DOL/DFL
e. None of the above

379) Which of the following statement is false about financial leverage

a. It measures the effect of the change in EBIT on the EPS.
b. Each level of EBIT has distinct DFL.
c. At financial break even point DFL is zero.
d. If EBIT is less then financial break even point ,DFL will be negative
e. If EBIT is more then financial break even point ,DFL will be positive

380) Which of the following statement sis true if the Degree of financial leverage (DFL) of a firm is zero
a. The firm does not pay preference dividend.
b. The firm does not pay taxes
c. The firm does not pay interest
d. The EBIT of the firm is zero
e. None of the above

381) Which of the following is/are true regarding the Degree of operating leverage (DOL)
a. Each level of output has a unique DOL
b. DOL is undefined at operating breakeven point
c. DOL is positive beyond the operating break even point
d. Both a and b above
e. Both a and c above

382) If we observe the behaviour of dol, in general we find the following
a. Unique DOL for each level of output
b. DOL is well defined at operating break even point
c. DOL is positive beyond the operating break even point
d. Both a and b above
e. Both a and c above

383) Operating leverage is the response of changes in
a. EBIT to the change in sale
b. EBIT to the changes in selling price
c. EPS to the change in EBIT
d. Production to the change in sales
e. None of the above

384) Operating leverage
a. Exists because of the present of fixed expenses like interest payment
b. Measure the responsiveness of earnings per share to variability in earnings before interest and taxes
c. Is undefined at the operating break even point
d. All of the above
e. None of the above

385) The operating break even point
a. Is that point below which the degree of financial leverage is negative
b. Is that quantity produced and sold at which the profit after tax is zero
c. Is that value of earnings before interest and taxes at which earnings per share is zero
d. Is that quantity produced and sold at which the profit before interest and taxes is zero
e. Both a and d above.

386) The use of preference share capital as against debt finance
a. Reduces DFL
b. Increases DFL
c. Increases financial risk
d. Has no effect on either financial risks or financial leverage
e. Both a and c above

387) Which of the following is true of ht Degree of Operating leverage

a.

388) When the firm changes the technology leading to increase in fixed costs it
a. Increase dol
b. Decreases dol
c. Decreased operating break even point
d. Loses all abandonment value
e. Decrease DFL

389) The degree of financial leverage
a. Measures financial risk of the firm
b. Is zero at financial break even point
c. Increases at EBIT increases
d. Is undefined below financial break even point level
e. Both a and d above

390) Operating leverage measures the sensitivity of the .... to changes in quantity.
a. Earnings per share
b. Profit after tax
c. Earnings before interest and taxes
d. Profit before tax
e. Dividend per share.

391) If degree of financial leverage becomes zero, then
a. The firm does not pay preference dividend
b. The firm does not pay taxes
c. The firm does not pay interest
d. The firm does not earn any operating profit
e. Both b and d above

392) The degree of operating leverage below the operating break even point will be
a. 1
b. 0
c. Less than zero
d. Either b or c
e. Undefined.

393) If the output isles than the operating break even point, then the degree of operating leverage will be
a. Greater than 1
b. Less than -1
c. Equal to zero
d. Less than zero
e. None of the above

394) Which of the following is true with regard to the degree of operating leverage for a company
a. Irrespective of the level of output DOL of a company remains same.
b. DOL of a company is positive above the operating by real even point.
c. DOL of a company is positive below the operating by real even point.
d. Dol of a company is negative above the operating break even point
e. Dol is zero at the operating break even point.

395) Which of the following is true with regard to the degree of financial leverage
a. DFL helps to measure the business risk of any corporate entity
b. DFL can be used to analyze the implications of retiring debrts by using the proceeds of preference capital
c. DFL is applied by a corporate house for its production and sales planning
d. DFL is used to estimate the revised EPS following a change in sales volume
e. DFL is used assess the change in EBIT owing to any change in sales volume

396) At operating breakeven point which of the following statement is true?
a. Sales revenue just covers the fixed cost.
b. Sales revenue is just equal to the variable cost
c. Fixed cost is same as that of the variable cost
d. EBIT is zero
e. EBIT is positive

397) Other things remain the same, what will be the impact on the degree of operating leverage of a firm, if it issues equity shares in lieu of debentures.
a. DOL will increase
b. DOL will decrease
c. DOL will remain the same
d. DOL will become zero
e. Cannot be predicted

398) Which of the following results form the early repayment of the debenture capital by a firm?
a. The degree of operating leverage increase
b. The degree of operating leverage decrease
c. The degree of financial leverage increase
d. The degree of financial leverage decrease
e. The degree of total leverage remains unchanged.

399) If the degree of total leverage of a firm is zero, the Which of the following statements will always be valid?
a. The firm does not produce and sale any output.
b. The firm does not have any interest burden in a strict sense the firm has never issued any reference share
c. The firm doe sent bear any fixed cost burden

d. The contribution is zero.

400) Which of the following is true with respect to the degree of operating leverage
a. DOL is same for any level of output of the firm
b. DOL is well defined at the operating break eve pint
c. DOL measures he business risk of a company.
d. DOL assesses eh impact on the profitability of he company against the changes in the interest rate.
e. Using the concept of DOL, one may judge the possibility of committing default by a company with respect to the payment of interest.

401) If a company appoints a number of skilled mangers with a very high mount of compensation package, Which of the following conditions may occur immediately after the appointment
a. The operating break even point of he company will come down
b. The company will be above to reach the financial break even point easily
c. The degree of operating leverage will be zero
d. The degree of total leverage will reduce to zero
e. Te degree of total leverage will increase.

402) What will be impact on the operating leverage of a firm, if it proceeds for addition borrowing
a. It will increase
b. It will decrease
c. It will remain unchanged
d. It will increase or decrease depends on the cost of borrowings.
e. Cannot be analyzed.

403) The major assumption in trend analysis via extrapolation is
a. The erratic movements which occurred in the previous years will reoccur in the coming years
b. Sales for the coming period will increase by the average growth rate of the concerned industry
c. Sales for the coming period will change true the same degree as sales changed form the prior period to the current period
d. Sales in the coming period will increase by the general economic growth rate, after adjusting for the erratic events
e. Both a and c above.

404) Sustainable growth rate refers to the rate
a. Which can be maintained without resorting to external finance
b. The firm uses for its internal purposes like project appraisal, etc.
c. Which can be maintained only with external borrowing
d. By which the firm expects its sales to increase in he coming years
e. By which the assets of the firm have been increasing in he past several years.

405) The credit extended by the suppliers of goods and services is
a. Long term sources of finance
b. Short term sources of finance
c. Spontaneous source of finance
d. Both a and c above
e. Both b and c above

406) The starting point of ht financial forecast in exercise is the
a. Sales forecast
b. Forecast of labor cost
c. Forecast of material cost
d. Forecast of operating expenses
e. Cash flow statement.

407) The percent of sales method of financial forecasting assumes that

408) The starting point in the preparation of pro form income statement is the projection of
a. The amount of sales for the next year
b. The amount of raw material to be purchased in the next year
c. The quantum of product to be manufactured in the next year
d. Anticipated EPS for the next year
e. None of the above

409) Which of the following is not an objective method of sales forecasting
a. Sales force estimates
b. Extrapolation and trend analysis
c. Regression analysis
d. Sustainable growth rate
e. None of the above

410) Which of the following is/are objective methods of sales forecasting
a. Jury of executive opinion
b. Sales force estimate
c. market survey
d. regression analysis
e. both b and d above

411) Given that all the other factors are constant, the external funds requirement is
a. Directly related to growth rate of sales
b. Inversely related to growth rate of sale
c. Inversely relate to dividend pay out ratio.
d. Directly related to Net Profit marking ratio
e. Cannot be determined with certainty

412) The basic assumption in percent of sales method for preparation of pro form income statement is
a. Similar relationship between future costs and sales to their historical relationship exists
b. Cost elements are unchanged
c. Sales increases by ten percent
d. Both a and b above
e. Both b and c above

413) Which of the following methods is preferred to prepare pro forma income statement
a. Percent of sales method.
b. Budgeted expense method
c. Combination of above two methods
d. Time series projection method
e. None of the above

414) Which of the following is not a subjective model of sales forecasting
a. Trend analysis
b. Sales force estimates
c. Regression analysis
d. A and c only
e. All of a, b and c above

415) Growth with internal equity will increase with the
a. Increase in debt ratio
b. Decrease in dividend pay out ratio
c. Decrease in profit making
d. Increase in assets to sales ratio
e. Both a and d above

416) The growth rate of sales that can be sustained by a firm without raising external equity increases with
a. An increase in Net Profit margin
b. A decrease in the debt to equity ratio
c. A decrease in the retention ratio
d. An increase in the asset to sales ratio
e. Both a and b above

417) Which of the following is not an assumption for estimating the sustainable growth rate
a. The assets of the firm will increase proportionately with the increase in sales
b. The company will maintain the same capital structure
c. The profitability of the company will remain same
d. The company will pay the same amount of dividend.
e. None of the above

418) While preparing proforma financial statement by using budgeted expense method,
a. The method of extrapolation is applied to assess the total expenses of he company in proportion to increase in sales
b. The items related to various expenses are projected on the basis of the anticipated changes
c. The future cost sales ratio is assumed to be prevailed as per historical relationship
d. A regression equation may be framed to project the costs during the future years
e. All the expenses are increased by a fixed percentage.

419) Which of the following is/are subjective method of sales forecasting
a. Jury of executive opinion
b. Sales force estimate
c. Regression method.
d. Time series projection method

e. Both a and b above

420) Calculate the DTIL form the following information

Quantity sold	= 6,000 units
S.P. unit	= Rs. 500
Variable cost unit	= Rs. 200
Fixed expenses	= Rs. 8,00,000
Interest	= Rs. 80,000
Preference dividend	= Rs. 60,000
Tax rate	= 40%

a. 2.119
b. 3.416
c. 2.195
d. 2.519
e. 2.159

421) In relation to the preparation of the proforma income statement by using budgeted expense method,

a. The future relationship between various costs to sales is assumed to follow historical relationship
b. The estimation of the various items are made on the basis of the expected developments
c. A extrapolation using trend analysis is always made to assess the total expenses of the company
d. A regression equation is always modeled to project the amount of future expenses
e. None of the above

Part- II
Distinguish

Q 1 Explain the difference between forward contract and future contract.

ANS: Forward contracts are private bilateral contract and have well established commercial usage. Future contracts are standardized tradable contracts, fixed in terms of size, contract date and all other features. The differences between forward and future contracts are given below

Forward Contract	Future Contract
The contract price is not privately disclosed and hence not transparent	The contract price is transparent
The contract is exposed to default risk by counter party.	The contract has effective safeguards against defaults in the form of clearing corporation and guarantees for trades and daily mark to market adjustments to the accounts of trading members based on daily price change.
Each contract is unique in terms of size, expiration date and asset type / quality	Contracts are standardized in terms of size, expiration date and all other features.
The contract is exposed to the problem of liquidity	There is no liquidity problem in the contract
Settlement of the contract is done by delivery of the asset on the expiration date.	Settlement of the contract is done on cash basis.

Q 2. Explain the difference between Fixed Price vs. Book-building.

ANS:

Fixed Price	Book-Building
1. Offer price is known to investor in advance.	1. Only the floor price and price range is known.
2. Demand for the securities known after issue closure.	2. Demand for the securities is visible online as the book is built.
3. Application money credited to issuer Account.	3. Application money is credited to an escrow account.

Q 3 Primary Market vs. Secondary Market :

ANS:

Primary Market	Secondary Market
1. The primary is that part of the capital markets that deals with the issuance of new securities. Thus, it is called as the new issues Market. This is the market for new Long term capital.	1. The secondary market is the financial market for trading of Securities that have already been issued.
2. In a primary issue securities are issued by the company directly to the investors.	2. The market that exists just after the new issue is often refer to after market.
3. Primary issues are used by companies for the purpose of setting up new business or for expanding or modernizing the existing business.	3. Once a newly issued stock is listed on a stock exchange investors and speculators can easily trade on the exchange, as market makers provide bids and offers in the new stock.
4. The primary market performs the crucial function of facilitating capital formation in the economy.	4. Secondary market can refer to the market for any kind of already issued goods.

Q 4 What are the differences between merchant banks and commercial banks?

ANS:

Merchant Banks	Commercial Banks
The area of activities of merchant bankers is "equity and equity related". They deal with mainly funds raised through money market and capital market.	Basically deal and debt related finance and their activities are appropriately arrayed around credit proposal, credit appraisal and loan sanctions.
The merchant bankers are management oriented. They are willing to accept risk of business.	Commercial banks are asset oriented and their lending decisions are based on detailed credit analysis of loan proposals and the value of security offered against loans. They generally avoid risks.
The activities of merchant bankers include project counselling, corporate counselling in areas of capital restructuring, amalgamations, mergers, takeover etc, discounting and rediscounting of short term paper in money markets, managing, underwriting and supporting public issues in new issue market and acting as brokers and advisers on portfolio management in stocks exchange. Merchant banking activities have impact on growth, stability and liquidity of money markets.	Commercial bankers are merely financiers.

Q 5. Money market vs. Capital market.

ANS:

Money market	Capital market
Money market is that segment of financial market where short-term financial assets are dealt with. In this type of market the funds can be raised as well invested from short-term point of view.	Capital market is that segment of financial market where long-term as well as medium term financial assets are dealt with. In this market the funds can be invested as well as raised from medium/ long-term time horizon.
The instruments of the money market are commercial papers, factoring, bills discounting, call money etc.	The instruments of capital market are shares, debentures and loans.
There are no segments of money market.	There are two segments of capital market (i) Primary market and (ii) secondary market.
RBI is the main regulator of this market.	SEBI is the main regulator of this market.

Q 6 State the important distinction between a futures and option contract.

ANS: The important distinction between a futures contract and an options contract is that the futures contract is an obligation. When an investor purchases or sells a futures contract, the investor has an obligation to accept or deliver, respectively, the underlying commodity on the expiration date. In contrast, the buyer of an option contract is not obligated to accept or deliver the underlying commodity but instead has the right, or choice, to accept delivery (for call holders) or make delivery (for put holders) of the underlying commodity anytime during the life of the contract.

Futures and options modify a portfolio's risk in different ways. Buying or selling a futures contract affects a portfolio's upside risk and downside risk by a similar magnitude. This is commonly referred to as symmetrical impact. On the other hand, the addition of a call or put option to a portfolio does not affect a portfolio's upside risk and downside risk to a similar magnitude. Unlike futures contracts, the impact of options on the risk profile of a portfolio is asymmetrical.

Q 7. What are the differences between merchant banks and commercial banks?

ANS: The differences between merchant banks and commercial banks are summarized below:

1. Commercial banks basically deal in debt related finance and their activities are appropriately arrayed around credit proposal, credit appraisal and loan sanctions. On the other hand, the area of activities of merchant bankers is "equity and equity related". They deal with mainly funds raised through money market and capital market.

2. Commercial banks are asset oriented and their lending decisions are based on detailed credit analysis of loan proposals and the value of security offered against loans. They generally avoid risks. The merchant bankers are management oriented. They are willing to accept risk of business.

3. Commercial bankers are merely financiers. The activities of merchant bankers include project counselling, corporate counselling in areas of capital restructuring, amalgamations, mergers, takeover etc, discounting and rediscounting of short term paper in money markets, managing, underwriting and supporting public issues in new issue market and acting as brokers and advisers on portfolio management in stocks exchange. Merchant banking activities have impact on growth, stability and liquidity of money markets

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Q 8 What is difference between Primary market and Secondary market?

ANS Primary Market vs. Secondary Market :

In the primary market, securities are offered to public for subscription for the purpose of raising capital or fund. Secondary market is an equity trading avenue in which already existing/pre- issued securities are traded amongst investors. Secondary market could be either auction or dealer market. While stock exchange is the part of an auction market, Over-the-Counter (OTC) is a part of the dealer market.

The SEBI is the regulatory authority established under Section 3 of SEBI Act 1992 to protect the interests of the investors in securities and to promote the development of, and to regulate, the securities market and for matters connected therewith and incidental thereto.

Part- III

Descriptive and short notes

Q1. GREEN SHOE OPTION

ANS: Green shoe option denote an option of allocating shares in excess of the shares included in the public issue. It is an option that allows the underwriting of an IPO to sell additional shares if the demand is high. It can be understood as an option that allows the underwriter for a new issue to buy and resell additional shares up to a certain pre-determined quantity. Lo0king to the exceptional interest of investors in terms of over subscription of the issue, certain provisions are made to issue additional shares or bonds to underwriters for distribution. The issuer authorizes for additional shares or bonds.

In common parlance, it is retention of over subscription to a certain extent. It is a special feature of EURO issues. In the Indian context, Green shoe option has a limited connotation. In the SEBI guidelines governing public issue, certain appropriate provisions for accepting over-subscription subject to a ceiling, say 15% of the offer made to public is provided. In certain cases, the Green shoe option can be even more than 15%. The Green shoe option facility would bring in price stability of initial public offering.

Q2. QUALIFIED INSTITUTIONAL BUYERS (QIB)

ANS: Qualified Institutional Buyers are those institutional investors who are generally perceived to possess expertise and the financial muscle to evaluate and invest in the capital market. As per the SEBI guidelines, QIBs shall mean the following:

- Public Financial Institution as defined in section 4A of the Companies Act of 1956,
- Scheduled Commercial Banks,
- Mutual Funds,
- Foreign Institutional Investors registered with SEBI,
- Multilateral and Bilateral Development Financial Institutions,
- Venture Capital Funds registered with SEBI,
- State Industrial Development Corporations,
- Insurance Companies registered with the Insurance Regulatory and Development Authority (IRDA),
- Provident Funds with minimum corpus of Rs 25 crores,
- Pension Funds with minimum corpus of Rs 25 crores.

Q 3. Stock invest

ANS: In case of over subscription of issue, there have been inordinate delay in refund of excess application money and large amounts of investors' funds remain locked up in companies for long periods affecting the liquidity of the investing public. To overcome the said problem a new instrument called 'stock invest' is introduced.

The stock invest is a non-negotiable bank instrument issued by the bank in different denominations. The investor who has a savings or current account with the bank will obtain the stock invest in required denominations and will have to enclose it with share / debenture application. On the face of the instrument provides for space for the investor to indicate the name of the issues, the number and amount of shares/ debentures applied for and the signature of the investor. The stock invests issued by the bank will be signed by it and the date of issue will also be indicated on the instruments. Simultaneously, with the issue of stock invest, the bank will mark a lien for the amounts of stock invest issued in the deposit account of the investor. On full or partial allotment of shares to the investor, the Registrar to issue will fill the columns of stock invest indicating the entitlement for allotment of shares / debentures, in terms of number, amount and application number and send it for clearing.

The investors' bank account would get debited only after the shares / debentures allotted. In respect of unsuccessful applicants, the funds continue to remain in their account and earn interest if the account is a savings or a term deposit. The excess application money of partly successful applicants also, will remain in their accounts.

There will be lien on the funds for a maximum of four months period. The stock invest is intended to be utilized only by the account holders and the stock invest should not be handed over to any third party for use. In case the cancelled / partly utilized stock invest is not received by the issuing branch on expiry of four months from the date of issue against an indemnity bond from the investor.

Q 4. CERTIFICATE OF DEPOSIT

ANS: Certificates of Deposit (CDs) is a negotiable money market instrument issued in dematerialized form or as a usuance Promissory Note, for funds deposited at a bank or other eligible financial institution for a specified time period. Guidelines for issue of CDs are presently governed by various directives issued by the Reserve Bank of India, as amended from time to time. CDs can be issued by ;

- scheduled commercial banks excluding Regional Rural Banks (RRBs) and Local Area Banks (LABs); and
- select all-India Financial Institutions that have been permitted by RBI to raise short-term resources within the umbrella limit fixed by RBI.
- Banks have the freedom to issue CDs depending on their requirements. An FI may issue CDs within the overall umbrella limit fixed by RBI, i.e., issue of CD together with other instruments viz., term money, term deposits, commercial papers and inter-corporate deposits should not exceed 100 per cent of its net owned funds, as per the latest audited balance sheet.

Q 5. FRINGE MARKET

ANS: The fringe market is a disorganised money market, deemed to include everything that is outside the scope of the money market (i.e., the institutional money market). The fringe market includes activities like the Inter-Corporate Deposit (ICD) market, small scale trade financing, financing of investments in the stock market, discounting and lending against IOUs or promissory notes, etc. The ICDs market is the most visible feature of the fringe market. As its name indicates it essentially involves short term borrowing and lending of funds amongst the corporations. Generally the fringe market exist, wherever the main borrowers and lenders of the funds are based, i.e., at the location of the industrial, corporate and trading establishments. The interest rates at which the funds can be lent in the fringe market are generally higher than those operating in the money market. The risk level of the fringe market is higher too - the people who borrow at exorbitant rates are the ones who are most likely to default.

Q 6. ELLIOT WAVE PRINCIPLE

ANS: One theory that attempts to develop a rationale for a long-term pattern in the stock price movements is the Eliott Wave Principle (EWP), established in the 1930s by R.N. Eliott and later popularized by Hamilton Bolton. The EWP states that major moves take place in five successive steps resembling tidal waves. In a major bull market, the first move is upward, the second downward, the third upward, the fourth downward and the fifth and final phase upward. The waves have a reverse flow in a bear market.

Q 7. CREDIT WRAPPING

ANS: Credit wrapping is a technique by which bonds are issued by a company with a poor rating can be shored up with the assistance of an institution with a strong credit rating. It involves the institution agreeing to underwrite a proportion of the amount payable in the event of default at the time of redemption. In many cases it is the only way in which poorly rated companies can issue bonds.

Q 8. Stale Prices

ANS: Supposing, we look at the closing price of an index. It is reflecting the state of the stock market at 3:30 pm on NSE and say, an illiquid stock is in the index. The last traded price (LTP) of the stock might be an hour, or a day, or a week old! The index is supposed to show how the stock market perceives the future of the corporate sector at 3:30 pm. When an illiquid stock injects these 'stale prices' into the calculation of an index, it makes the index more stale. It reduces the accuracy with which the index reflects information

Q 9. Enumerate the main features of Venture Capital Financing

ANS: Venture capital is long term risk capital to finance high technology project which involves risk but at the same time has strong potential for growth.

Some of the features of venture capital financing are :

(i) Venture capital is usually used in the form of equity participation. It may also take the form of convertible debt or long term loan.

(ii) Investment is made only in high risk but growth potential projects.

(iii) Venture capital is available only in high risk but high growth potential projects.

(iv) Venture capital joins the entrepreneurs as a co-promoter in project and shares the risk and rewards of the enterprise.

(v) There is continuous involvement in business after making an investment by the investor.

(vi) Once the venture has reached the full potential the venture capitalist disinvests his holdings either to the promoters or in the market.

(vii) Venture capital; is not just injection of money but also an input needed to set to the firm design its marketing strategy and organize and manage it.

(viii) Investment is usually made in small and medium scale enterprises.

Q10. WHAT IS INVESTOR PROTECTION FUND (IPF) AT STOCK EXCHANGES?

ANS: Investor Protection Fund is the fund set up by the Stock Exchanges to meet the legitimate investment claim7s of the clients of the defaulting members that are not of speculative nature.

SEBI has prescribed guidelines for utilization of IPF at the Stock Exchanges. The Stock Exchanges have been permitted to fix suitable compensation limits, in consultation with the IPF / CPF Trust. It has been perceived that the amount of compensation available against a single claim of an investor arising out of default by a member broker of a Stock Exchange shall not be less than Rs 1 Lakh in case of major Stock Exchages viz; BSE and NSE and Rs 50,000 in case of other stock exchanges.

Q 11. What are the principle weaknesses of Indian Stock Market?

ANS: The principle weakness of Indian Stock Market are enumerated below:

A) **Scarcity of floating stock;** Financial institutions, banks and insurance companies own 80% of the equity capital of the private sector,
B) **Speculation;** 85% of the transactions on the NSE and BSE are speculative in nature,
C) **Price rigging**; Evident in relatively unknown and low quality scripts causes short term fluctuations in the price,
D) **Insider trading**; Obtaining market sensitive information to make money in the markets.

Q 12. Explain how a trader who has bought an option can exit the trade.

ANS: Liquidating Option Positions :

When a trader buys an option, he can exit the trade in two ways :

- Sell the option and collect whatever the premium is – If the premium is more than what is initially cost plus commission, there's a profit. If the premium is less, it's a loss, but keeping some money is better than losing all the money.
- Exercise the option, covering it into a future position-The broker must be notified before options expire. Not all options have an automatic exercise provision. Therefore, an in-the-money option that expires without any action taken, loses the buyer money (a seller somewhere will be very happy). An option can be exercised if the trader feels the market will continue to move favourable to the trader's position or an option can be exercised if the trading in the option is not very liquid. The trader, in this case feels he can exercise and then liquidate the futures more economically than selling his option position.
- Ride the option into the dust- Let it expire worthless, especially if getting out will cost more than the premium is worth.

When a trader sells an option, he or she can exit the trade by buying the option back. If the premium is higher, the option seller has lost money. The option seller cannot exercise his or her option.

Q 13. What is a load fund? How are Net Asset Values, public offer price and redemption price calculated?

ANS: Load Fund : A Load Fund is one that charges from the investor a percentage of NAV for entry or exit. This means that, each time one buys or sells units in the fund, a charge will be payable. This charge is used by the mutual fund for marketing and distribution expenses.
Net Asset Value (NAV):
NAV is calculated as follows;

NAV = (Fair Market Value of scheme's investments + Receivables + Accrued Income + Other assets – Accrued expenses – Payable – Other liabilities) / Number of units outstanding
Calculation of Public Offer Price (POP):
Public Offer Price = Net Asset Value / 1-Front –End load
Calculation of Redemption price:
Redemption = Net Asset Value /1- Back-end Load.

Q 14. Janak Constructions Ltd. had received an e- from Hiroshi Ltd. emanating from the company's official website, accepting the former's offer. Later on, Hiroshi Ltd. failed to fulfil their promise. Can Janak Construction Ltd. launch proceedings against Hiroshi Ltd. on the strength of the e-mai?
What precaution should Janak Constructions Ltd. have taken in this regard?

ANS: The Information Technology Act, would come to the rescue of Janak Constructions Ltd. Section 4 and 5 of the said Act may be referred to in this context. Section 4 accords legal recognition of electronic records. As per this section, where any law provides that information or any other matter shall be in writing or in the typewritten or printed form, then, notwithstanding anything contained in such law, such requirement shall be deemed to have been satisfied if such information or matter is;
(i) Rendered or made available in an electronic form, and
(ii) Accessible so as to be for a subsequent reference.

Section 5 speaks of legal recognition of digital signatures. Accordingly, where any law provides that information or any other matter shall be authenticated by affixing the signature or any document shall be signed or bear the signature of any person then, notwithstanding anything contained therein in such law, such requirement shall be deemed to have been satisfied, if such information or matter is authenticated by means of digital signature affixed in such manner as may be prescribed by the Central Government. The Explanation to this section states that for the purposes of this section, "signed", with its grammatical variations an cognate expressions, shall, with reference to a person, mean affixing of his hand written Janak Constructions Ltd. can proceed against Hiroshi Ltd. on the strength of these provisions.

Janak Constructions Ltd should ensure that in respect of important e- s / e-documents / e-records, the sender affixes his digital signature. A digitally signed document is a perfect piece of legal evidence as to its timing, contents, integrity and authenticity.

Q 15. Under what circumstances can a company registered as a collective investment management company raise funds from the public.

ANS: A registered Collective Investment Management Company is eligible to raise funds from the public by launching schemes, Such schemes have to be compulsorily credit rated as well as appraised by an appraising agency, The schemes also have to be approved by the Trustee and contain disclosures, as provided in the regulations, which would enable the investors to make informed decision,

A copy of the offer document of the scheme has to be filed with SEBI and if no modifications are suggested by SEBI within 21 days from the date of filing then the collective investment Management Company is entitled to issue the offer document to the public for raising funds from them.

Q 16. When does a market-wise circuit breaker system apply?

ANS: The index-based market wise circuit breakers were implemented in compulsory rolling settlement with effect from July 02, 2001.

The index-based market-wide system applies at 3 stages of the index movement, either way viz; at 10%, 15% and 20%. These circuit breakers when triggered, bring about a coordinated trading halt in all equity and equity derivative markets nationwide.

The market-wide circuit breakers are triggered by movement of either the BSE Sensex or the NSE S & P CNX Nifty, whichever is breached earlier. The percentage movement of the index and the time frame of the trading halt is given below :

10% movement – a one-hour market half if the movement takes place before 1.00 p.m.

– at or after 1.00 p.m. but before 2.30 p.m., a trading halt for ½ hour

– at or after 2.30 p.m. there will be no trading halt and market shall continue trading

15% movement-a two-hour halt if the movement takes place before 1 p.m.

– on or after 1.00 p.m., but before 2.00 p.m.., a trading halt of one hour

– on or after 2.00 p.m. the trading shall halt for remainder of the day.

20% movement- trading shall be halted for the remainder of the day.

Q 17 Explain the term 'Beta' as a systematic risk of a security.

ANS: "Beta' as a measure of the systematic risk of a security :

Beta is a measure of systematic risk of security that cannot be avoided through diversification. Beta is a relative measure of risk of an individual stock relative to the market portfolio of all stocks. If the security's return move more (less) than the market's return as the latter changes, the security's return's have more (less) volatility (fluctuation in price) than those of the market. It is important to note that beta measures a security's volatility or fluctuations in price, relative to a benchmark, the market portfolio of all stocks.

Securities with different slopes have different sensitivities to the returns of the market index. If the slope of this relationship for a particular security is a 45 degree angle, the beta is 1.0.This means that for every one per cent change in the market's return, on average this security's return change 1 per cent. The market portfolio has a beta of 1.0.

A security with beta of 1.5 indicates that, on average, security returns are 1.5 times as volatile as market returns, both up and down. This would be considered an aggressive security because when the overall market return rises or falls 10 per cent, this security, on average, would rise or fall 15 per cent. Stocks having a beta of less than 1.0 would be considered more conservative investments than the overall market.

Beta is useful for comparing the relative systematic risk of different stocks and in practice, is used by investors to judge a stock's riskiness. Stocks can be ranked by their betas. Because the variance of the market is constant across all securities for a particular period, ranking stocks by beta is the same as ranking them by their absolute systematic risk. Stocks with high betas are said to be high-risk securities.

Q 18 What do you mean by "Impact Cost"?

ANS: Market impact cost is the best measure or the liquidity of a stock. It accurately reflects the costs faced when actually trading an index. Supposing a stock trades at bid 99 and ask 101. We say the 'ideal' price is Rs. 100. Now, supposing, a buy order for 1000 shares goes through at Rs. 102. Then it can be said that the market impact cost at 1000 shares is 2.

Likewise, if a buy order for 2000 shares goes through at Rs. 104, it is said that the market impact cost at 2000 shares is 4%. For a stock to qualify, for possible inclusion into the S&P CNX Nifty, it has to reliably have market impact cost or below 0.75% when doing S&P CNX Nifty trades of half a crore rupees.

Q 19 What should a stock market index be?

ANS: A stock market index should capture the behavior of the overall equity market. Returns obtained by distinctive portfolios in the country, will be indicated by the movements of the index. An Index is used to give information about the price movements of products in the financial, commodities or any other markets.

A stock market index is created by selecting a group of stocks that are representative of the whole market or a specified sector or segment of the market. An Index is calculated with reference to a base period and a base index value. Stock market indexes are useful for a variety of reasons, some of them are:

- It is a lead indicator of the performance of the overall economy or a sector of the economy,
- Stock indexes reflect highly up to date information,
- They provide a historical comparison of returns on money invested in the stock market against other forms of investments such as gold or debt,
- They can be used as a standard against which to compare the performance of an equity fund,
- Modern financial applications such as Index Funds, Index Futures, Index Options play an important role in financial investments and risk management.

Q 20 Why are indices important?

ANS: By looking at an index we know how the market is faring. The index is a lead indicator of how the overall portfolio will fare. Owing to direct applications in finance, in the form of index funds and index derivatives, in recent years, indices have gained more popularity. Index funds are funds which passively 'invest in the index'. Index derivatives allow people to cheaply alter their risk exposure to an index (which is called hedging) and to implement forecasts about index movements (which are called speculation). Using index derivatives, as hedging, has become a central part of risk management in the modern economy. These applications are now a multi-trillion dollar industry worldwide, and they are critically linked up to market indices. Finally, indices serve as a benchmark for measuring the performance of fund managers.

For e.g., an all-equity fund, should obtain returns like the overall stock market index. A 50:50 debt: equity fund should obtain returns close to those obtained by an investment of 50% in the index and 50% in fixed income.

Q21 What is the portfolio interpretation of index movements?

ANS: It is easy to create a portfolio, which will reliably get the same returns as the index. i.e. if the index goes up by 4%, this portfolio will also go up by 4%. Suppose an index is made of two stocks, one with a market cap of Rs. 1000 crore and another with a market cap of Rs.3000 crore. Then the index portfolio will assign a weight of 25% to the first and 75% weight to the second. If we form a portfolio of the two stocks, with a weight of 25% on the first and 75% on the second, then the portfolio returns will equal the index returns.

So, if anybody want to buy Rs. 1 lakh of this two-stock index, the person would buy Rs.25,000 of the first and Rs.75,000 stock index. A stock market index is hence just like other price indices in showing what is happening on the overall indices, the wholesale price index is a comparable example. Additionally, the stock market index is attainable as a portfolio.

Q22 What do you mean by ETF (Exchange Traded Funds) State in brief the applications of it.

ANS: Exchange Traded Funds (ETFs) are just what their name implies, baskets of securities that are traded like individual stocks, on an exchange. Unlike regular open-end mutual funds, ETFs can be bought and sold throughout the trading days, like any stock.

The concept of ETF first came into existence in the USA in 1993. It took several years to attract public interest.

But once it was done, the volumes took off with a retaliation . Most ETFs charge lower annual expenses than index mutual funds. However, as with stocks, one must pay a brokerage to buy and sell ETF units, which can be a significant drawback for those who trade frequently or invest regular sums of money.

The funds rely on an arbitrage mechanism to keep the prices at which they trade roughly in line with the net asset values of their underlying portfolios. For the mechanism to work, potential arbitragers need to have full and timely knowledge of a fund's holdings.

Applications of ETF are :

• Managing Cash Flows — Investment and fund managers, who see regular inflows and outflows, may use ETFs because of their liquidity and their capability to represent the market.

• Diversifying Exposure — If an investor is not aware about the market mechanism and does not know which particular stock to buy but likes the overall sector, investing in shares tied to an index or basket of stocks, provides diversified exposure and reduces risk.

• Efficient Trading — ETFs provide investors a convenient way to gain market exposure index that trades like a stock. In comparison to a stock, an investment in an ETF index product provides a diversified exposure to the market.

• Shorting or Hedging — Investors who have a negative view on a market segment or specific sector may want to establish a short position to capitalize on that view. ETFs may be sold short against long stock holdings as a hedge against a decline in the market or specific sector.

• Filling Gaps — ETFs tied to a sector or industry may be used to gain exposure to new and important sectors. Such strategies may also be used to reduce an overweight or increase an underweight sector.

• Equalizing Cash — Investors having idle cash in their portfolios, may want to invest in a product tied to a market benchmark. An ETF, is a temporary investment before deciding which stocks to buy or waiting for the right price.

Q23 What is Investor Protection Fund (IPF) at Stock Exchanges?

ANS: Investor Protection Fund is the fund set up by the Stock Exchanges to meet the legitimate investment claims of the clients of the defaulting members that are not of speculative nature. SEBI has prescribed guidelines for utilisation of IPF at the Stock Exchanges. The Stock Exchanges have been permitted to fix suitable compensation limits, in consultation with the IPF/CPF Trust. It has been provided that the amount of compensation available against a single claim of an investor arising out of default by a member broker of a Stock Exchange shall not be less than Rs. 1 lakh in case of major Stock Exchanges viz., BSE and NSE, and Rs. 50,000/- in case of other Stock Exchanges.

Q24 What is Arbitration? What is the process for preferring arbitration?

ANS: Arbitration is an alternative dispute resolution mechanism provided by a stock exchange for resolving disputes between the trading members and their clients in respect of trades done on the exchange.

Process for preferring arbitration :

The byelaws of the exchange provide the procedure for Arbitration. One can procure a form for filing arbitration from the concerned stock exchange. The arbitral tribunal has to make the arbitral award within 3 months from the date of entering upon the reference. The time taken to make an award cannot be extended beyond a maximum period of 6 months from the date of entering upon the reference.

Q25 Is there any difference between investing in a mutual fund in an initial public offering (IPO) of a company?

ANS: Yes, there is a difference. IPOs of companies may open at lower or higher price than the issue price depending on market sentiment and perception of investors. However, in the case of mutual funds, the par value of the units may not rise or fall immediately after allotment. A mutual fund scheme takes some time to make investment in securities. NAV of the scheme depends on the value of securities in which the funds have been deployed.

Q 26 What are advantages of share repurchase over dividends?

ANS: The advantages of share repurchase over dividends are as follows :

(i) Cash dividend implies a commitment on the part of company to continue payments in future, as investors keep expecting them. However, share repurchase is an one time affair.

(ii) The decision to repurchase the shares offers a company more flexibility as to number of shares, the period etc.

(iii) Share repurchase are more focused in terms of paying out cash only to those shareholders who need it. However, dividends are paid to all.

(iv) Share buy back provide a way of increasing control in the firm. If only outsiders tender their shares, automatically insiders control increases.

Q27 Is share buyback is a financing decision or an investment decision?

ANS: When the shares are undervalued in the market and the firm does not have an alternate business opportunity, then the excess cash is returned to shareholders and thus the management prefers to invest in its own business by buying back their shares. In this case, the management has more faith in its own business. Thus it can be argued as an investment decision even though excess cash with the firm is given to shareholders in a different form.

Secondly, share buy back reduces the equity portion of the firm, thereby increasing the debt portion in the overall capital structure. Moreover, for further expansion the firm may borrow thereby further increasing the leverage and risk. Thus share repurchase is a kind of financing decision too.

Q 28 What is clientele effect?

ANS: Investors have diverse preferences. Some want more dividend income; others want more capital gains; still others want a balanced mix of dividend income and capital gains. Over a period of time, investors naturally migrate to firms which have a dividend policy that matches their preferences. The concentration of investors in companies with dividend policies that are matched to their preferences is called the clientele effect. The existence of a clientele effect implies that

(a) firms get investors they deserve and

(b) it will be difficult for a firm to change an established dividend policy.

Q 29 what are the risks relevant while investing?

ANS: The relevant risks are as follows:
(i) Interest rate risk – Interest rates and prices vary inversely
(ii) Purchasing power risk – Inflation tend to reduce the returns generated.
(iii) Business Risk – Change in business cycles & bull/bear market phase affect
(iv) Financial risk – Decision of company to alter the capital structure etc. affect.

Q30 Define a Portfolio Manager as per SEBI Rules & state the functions of a portfolio manager.

ANS: As defined under SEBI (Portfolio Managers) Rules 1993, a portfolio manager is a person who pursuant to a contract or arrangement with a client, advises or directs or undertakes on behalf of a client the management or administration of a portfolio of securities of the funds of the client as the case may be.
Functions of a Portfolio Manager:

(i) Study Economic Environment
(ii) Study Securities Market
(iii) Maintain complete data of top companies
(iv) Keep track of latest policies and guidelines of GOI
(v) Study problems of Industry affecting securities market
(vi) Study attitude of investors
(vii) Study the financial behaviour of major players in the market
(viii) Counsel prospective investor on share market
(ix) Carry out investment in securities to attain maximum profit at lesser risk.

Q31 What is the provision for lock-in period of pre-issue share capital of an unlisted company?

ANS: Lock-in of Pre-issue Share Capital of an Unlisted Company

• The entire pre-issue share capital, other than that locked in as promoters contribution, shall be locked-in for a period of one year from the date of commencement of commercial production or the date of allotment in the public issue, whichever is later.

• The above provision is not applicable to the pre-issue share capital held by venture capital funds and foreign venture capital investors.

• The above provision is also not applicable if shares are held for a period of at least one year at the time of filing draft offer document with SEBI and being offered to the public through offer for sale.

Q 32 What is Technical Analysis ? What are the basic assumptions regarding technical analysis?

ANS: Technical analysis is a method of evaluating securities by analyzing the statistics generated by market activity, such as past prices and volume. Technical analysts do not attempt to measure a security's intrinsic value, but instead use charts and other tools to identify patterns that can suggest future activity. Just as there are many investment styles on the fundamental side, there are also many different types of technical traders. Some rely on chart patterns, others use technical indicators and oscillators, and most use some combination of the two. In any case, technical analysts' exclusive use of historical price and volume data is what separates them from their fundamental counterparts. Unlike fundamental analysts, technical analysts don't care whether a stock is undervalued - the only thing that matters is a security's past trading data and what information this data can provide about where the security might move in the future.
The basic and necessary assumptions regarding the technical analysis :

1. The Market Discounts Everything
2. Price Moves in trends
3. History tends to repeat itself

Q 33 What are the provisions regarding e- and digital signature as per IT Act, 2000?

ANS: The IT Act 2000, the cyber law of India legalizes the e- and gives it the status of being valid form of carrying out communication in India. This implies that e- s can be duly produced and approved in a court of law, thus can be regarded as substantial document to carry out legal proceedings.

The act also talks about digital signatures and digital records . These have been also awarded the status of being legal and valid means that can form strong basis for launching litigation in a court of law. It invites the corporate companies in the business of being Certifying Authorities for issuing secure Digital Signatures Certificates.

Q 34 What are the features of option contracts?

ANS: The important features of options contracts are as follows :

- The option is exercisable only by the owner, namely the buyer of the option.
- The owner has limited liability.
- Owners of options have no right affordable to shareholders such as voting right and dividend right.
- Options have high degree of risk to the option writers.
- Options are popular because they allow the buyer profits from favorable movements in exchange rate.
- Options involve buying counter positions by the option sellers.
- Flexibility in investors needs.
- No certificates are issued by the company.
- An investor who writes a call option against stock held in his portfolio is said to be selling 'covered options'. Options sold without the stock to back them up are called 'naked options'.

Q35 What are the different phases of portfolio management?

ANS: Phases of portfolio management :

1. Specification of investment objectives and constraints
2. Choice of asset mix
3. Formulation of portfolio strategy
4. Selection of securities
5. Portfolio execution
6. Portfolio revision
7. Portfolio evaluation

Q 36 What are zero coupon bonds?

ANS: Zero coupon bonds are issued at a discount and redeemed at par. No interest is paid on such bonds before maturity. Zero coupon bonds are issued by means of auction, with a face value of say Rs. 100. The bidders need to clearly specify the purchase price expressed upto two decimal points in the application. An applicant needs to submit more than one bid at different prices through separate applications for each bid (but the aggregate amount of bids submitted by a person should not exceed the aggregate amount of bonds offered for sale).

The RBI will determine the cut-off price at which it tenders for purchase of zero coupon bonds will be accepted at the auction. All the bids at prices higher than the cut-off price will receive full allotment, while the bids at prices lower than the cut-off price will be rejected. The bids at the cut-off price may receive full or partial allotment depending on the total amount of bids and the notified amount.

Q37 What is yield to maturity?

ANS: The yield or the return on the instrument is held till its maturity is known as the Yield-to-maturity (YTM). It basically measures the total income earned by the investor over the entire life of the Security. The total income consists of the following :

(i) Coupon income: The fixed rate of return that accrues from the instrument.

(ii) Interest-on-interest at the coupon rate: Compound interest earned on the coupon income

(iii) Capital gains/ losses: The profit or loss arising on account of the difference between the price paid for the security and the proceeds received on redemption/ maturity.

Q 38 How to estimate the equity beta of a private firm?

ANS: To obtain an estimate for the cost of equity of a private firm, we can use the CAPM. To do so, we need an estimate of the company's equity beta. Since this is not available, given that the firm is not publicly traded, we can use information from comparable firms. Obtaining a sample of comparable firms, we can use each firm's equity beta and un-lever it to obtain the firm's asset beta. We use the average asset beta of the comparable firms as an estimate of the asset beta for the private firm. To take into account the impact of financial leverage, we re-lever the asset beta using the private firm's debt-equity ratio. The re-levered beta is the estimate of the private firm's equity beta. In order to obtain an estimate of the cost of debt, given that the firm has no publicly –traded debt, we could either examine the firm's borrowing history or obtain a synthetic rating by comparing the private firm's financial ratios to those of comparable firms that are rated.

Q 39 What are the criticism of DOW theory?

ANS: Several criticisms are levelled against the Dow theory.

1. It is not a theory but an interpretation of known data. A theory should be able to explain why a phenomenon occurs. No attempt was made by Dow or his followers to explain why the two averages Should be able to forecast future stock prices.

2. It is not acceptable in its forecast. There was considerable lag between the actual turning points and those indicated by the forecast.

3. It has poor predictive power. According to Rosenberg, the Dow theory could not forecast the bull market which had preceded the 1929 crash. It gave bearish indication in early 1926. The 31/2 years which followed the forecast of Hamilton's editorials for the 26-year period, from 1904 to 1929. Of the 90 recommendations Hamilton made for a change in attitude towards the market (55% were bullish, 18% bearish and 29% doubtful) only 45 were correct. Such a result an investor may get by flipping a coin).

Q 40 What are risks of an option holder?

ANS: Risk of Option holders

1. An option holder runs the risk of losing the entire amount paid for the option in a relatively short period of time. This risk reflects the nature of an option as a wasting asset which becomes worthless when it expires. An option holder who neither sells his option in the secondary market nor exercises it prior to its expiration will necessarily lose his entire investment in the option. If the price of the underlying asset does not change in the anticipated direction before the option expires to an extent sufficient to cover the cost of the option, the investor may lose all or a significant part of his investment in the option.

2. The Exchange may impose exercise restrictions and have authority to restrict the exercise of options at certain times in specified circumstances.

Q 41. What is SEBI's role in a right issue of a listed company?

ANS: A listed company making a rights issue of value of more than Rs 50 lakh is required to file a draft offer document with SEBI for its observations. The company can proceed further on the issue only after getting observations from SEBI. The validity period of SEBI's observation letter is three months only i.e. the company has to open its issue within three months period. SEBI does not recommend any issue nor does take any responsibility either for the financial soundness of any scheme or the project for which the issue is proposed for or for the correctness of the statements made or opinions expressed in the offer document.

It is to be distinctly understood that submission of offer document to SEBI should not in any way be deemed or construed that the same has been cleared or approved by SEBI. The Lead manager certifies that the disclosures made in the offer document are generally adequate and are in conformity with SEBI guidelines for disclosures and investor protection in force for the time being. This requirement is to facilitate investors to take an informed decision for making investment in the proposed issue.

Q 42. What are the rules regarding payment of dividend?

ANS: The power to pay dividend is subject to the following two fundamental rules :

(1) Dividend must not be paid out of capital.

(2) Dividend should be paid out of profits. Company law provisions regarding dividend Section 205 of the Act provides as under

No dividend shall be declared or paid by a company for any financial year except :

(1) Out of the profits for that year arrived at after providing for depreciation in accordance with subsection (2) ; or

(2) Out of the profits of the company for any previous year or years arrived at after providing depreciation in the prescribed manner and remaining undistributed or out of both;

(3) Out of (1) and (2) above ;

(4) Out of moneys provided by the Central or State Government for this purpose in pursuance of a guarantee given by that Government.

Q 43. What is an Index and Index Future?

ANS: An Index is a number used to represent the changes in a set of values between a base time period and the current time. A stock index represents change in the value of a set of stocks which constitute the index over a base year.

An index future is a derivative whose value is dependent on the value of the underlying asset (e.g. BSE Sensex, S&P CNX NIFTY). While trading on index futures, an investor is basically buying and selling the basket of securities comprising an index in their relative weights. Unlike commodity and other futures contracts, Index Future contracts are settled in cash.

Q44. What is At-The-Money, In-The-Money and Out-Of-The-Money?

ANS: There are three different terms for describing where an option is trading in relation to the price of the underlying security. These terms are 'at-the-money', 'in-the-money', and 'out-of-the-money'. An option is in-the-money if the exercising of option will bring about gain and an option is out-of-the-money if the exercising of option will bring about loss.

The following summarizes the relationship between an option's strike price and the market price of the underlying asset

Market scenario	Call option	Put option
Market price > Strike price	In-the-money	Out-of-the-money
Market price < Strike price	Out-of-the-money	In-the-money
Market price = Strike price	At-the-money	At-the-money

Q 45. What is a futures contract?

ANS: A futures contract enables an investor to buy the cash equivalent of an asset at the expiration date. The purchase price is specified on the day of purchase but settlement is deferred. Thus, at first glance, the futures price represents the market estimate of the asset value at expiration. The asset value is arrived at by incorporating the cost of carry into the spot value. On the other hand, since futures are marked to market, settlement of the purchase price is not exactly made in one lump sum at the expiration date; it is made in successive daily installments called margin variation payments.

The difference between the cash and the futures index prices hinges on the difference in dividend payments and on the fact that the spot value is a present value while the futures price is value derived for the future by calculating the cost of carry.

Q 46. What are the drawbacks of Mutual Funds?

ANS: Mutual funds have their drawbacks and may not be for everyone :

• **No Guarantees:** No investment is risk free. If the entire stock market declines in value, the value of mutual fund shares will go down as well, no matter how balanced the portfolio. Investors encounter fewer risks when they invest in mutual funds than when they buy and sell stocks on their own. However, anyone who invests through a mutual fund runs the risk of losing money.

• **Fees and commissions:** All funds charge administrative fees to cover their day-to-day expenses. Some funds also charge sales commissions or "loads" to compensate brokers, financial consultants, or financial planners. Even if you don't use a broker or other financial adviser, you will pay a sales commission if you buy shares in a Load Fund.

• **Taxes:** During a typical year, most actively managed mutual funds sell anywhere from 20 to 70 percent of the securities in their portfolios. If your fund makes a profit on its sales, you will pay taxes on the income you receive, even if you reinvest the money you made.

• **Management risk:** When you invest in a mutual fund, you depend on the fund's manager to make the right decisions regarding the fund's portfolio. If the manager does not perform as well as you had hoped, you might not make as much money on your investment as you expected. Of course, if you invest in Index Funds, you forego management risk, because these funds do not employ managers.

Q 46 Junk Bond.

ANS: Junk bonds are corporate bonds with low ratings from a major credit rating agencies. High rated Bonds are called investment grade bonds, low rated bonds are called speculative-grade bonds or less formally called as 'Junk bonds'. A bond may receive a low rating for a number of reasons. If the financial condition or business outlook of the company is poor, bonds are rated speculative grade.

Bonds are also rated speculative-grade if the issuing company' already has large amounts of debt outstanding. Some bonds are rated speculative-grade; because they are subordinated to other debt i.e. their legal claim on the firm's assets in the event of default stands behind the other claim, so called senior debt. Junk bonds are traded in a dealer market rather than being traded in stock exchanges. Institutional investors hold the largest share of junk bonds. Firms with low credit ratings are willing to pay 3 to 5 percent more than the investment grade corporate debt to compensate for greater risk. Junk bonds are a high yield security, because of this reason junk bonds are widely used as a source of finance in takeovers and leveraged buy-outs. Junk bonds lie between conventional investment as equities and investment-grade bonds. Junk bonds are riskier than investment-grade bonds but less risky than equity. Junk bonds may have cost or tax advantage that allow for some marginal increase in debt. But these advantages are not likely to induce bondholders to invest in junk bonds more recklessly than other safer debt instruments.

Q 47. Convertible debenture

ANS: In Convertible Debentures (CDs) an option is given to the debenture holders to convert them into Equity or preference shares at stated rates of exchange, after a certain period. Such debentures once converted into shares cannot be reconverted into debentures. CDs may be fully or partly convertible. In case of fully convertible debentures, the entire face value is converted into shares at the expiry of specified period(s). In case of partly convertible debentures only the convertible portion is converted into shares at the end of the specified period and non-convertible portion is redeemed at the end of certain specified period. Non-convertible debentures do not confer any option on the holder to convert the debentures into shares and are redeemed at the expiry of specified period(s). CDs, whether fully or partly convertible, may be converted into shares at the end of specified period or periods in one or more stages. The company should get a credit rating of debentures done by credit rating agency. CDs are listed on stock exchanges. The Partly Convertible Debentures (PCDs) offers more flexibility to both companies and investors. It has been claimed to be better than fully convertible debentures as it does not automatically entail a large equity base, particularly in case of new companies. Experience shows that servicing of a large base of capital is not easy in case of new projects, especially if the company runs into rough weather due to marketing difficulties.

Q 48 Exchange rate risk

ANS: All investors who invest internationally in today's increasingly global investment arena face the prospect of uncertainty in the returns after they convert the foreign gains back to their own currency. Unlike the past when most U.S. investors ignored international investing alternatives, investors today must recognize and understand exchange rate risk, which can be defined as the variability in returns on securities caused by currency fluctuations. Exchange rate risk is sometimes called currency risk. For example, a U.S. investor who buys a German stock denominated in marks must ultimately convert the returns from this stock back to dollars. If the exchange rate has moved against the investor, losses from these exchange rate movements can partially or totally negate the original return earned. Obviously, U.S. investors who invest only in U.S. stocks on U.S. markets do not face this risk, but in today's global environment where investors increasingly consider alternatives from other countries, this factor has become important. Currency risk affects international mutual funds, global mutual funds, closed-end single country funds, American Depository Receipts, foreign stocks, and foreign bonds.

Q 49 What are factors that affect a value of a call option?

ANS: The factors that affect the value of a Call option are:
(i) An increase in stock price causes an increase in the value of a call option.
(ii) An increase in exercise price causes a decrease in the value of a call option.
(iii) An increase in the time to expiration causes an increase in the value of a call option.
(iv) An increase in the risk-free rate causes an increase in the value of a call option.
(v) An increase in variance of stock return causes an increase in the value of a call option.

Q 50. What is mark to market margin?

ANS: The mark-to-market (MTM) margin is collected by the stock exchange in addition to the daily margin. While calculating MTM all notional profits of the members are ignored and all notional losses are collected on a daily basis. The members are, thus, required to pay the higher of daily margin or MTM margin. By introducing MTM margin, the management of risk on the outstanding position of the members has considerably improved. The margins are debited to the members bank accounts on the next day of the trade (i.e.,T+1). In case of delay in payment of daily margin, a late fee @ 1% of the amount involved is imposed. Mark to market margin is calculated by marking each transaction in a scrip to the closing price of the scrip at the end of trading. In case the security has not been traded on a particular day, the latest available closing price at the NSE is considered as the closing price. In the event of the net outstanding position of a member in any security being nil, the difference between the buy and sell values would be considered as notional loss for the purpose of calculating the mark to market margin payable. In case of a net loss, the same is collected as the MTM margin over and above the daily VaR margin and if there is a profit the same is ignored for the purpose of computing the MTM margin.

Q 51. What is exactly meant by the term secured redeemable debenture?

ANS: Secured refers to the security given by the issuer for the loan transaction represented by the debenture. This is usually in the form of a first mortgage or charge on the fixed assets of the company on a pari passu basis with other first charge holders like financial institutions etc. Sometimes, the charge can also be a second charge instead of a first charge.

Most of the times the charge is created on behalf of the entire pool of debenture holders by a trustee specifically appointed for the purpose. Redeemable refers to the process whereby the debenture is extinguished on payment of all the obligations due to the holder after the repayment of the last installment of the principal amount of the debenture.

Q 52. "Investment is well grounded and carefully planned speculation".

In the light of the above statement, explain and differentiate between 'investment' and 'speculation'. How do they differ from 'gambling'?

ANS: Investment usually involves putting money into an asset which is not necessarily marketable in the short run in order to enjoy a series of returns the investment is expected to yield. On the other hand, speculation is usually a more short-run phenomenon. Speculators tend to buy assets with the expectation that a profit can be earned from a subsequent price change and sale. Accordingly, they buy marketable assets which they do not plan to own for very long.

Probably the best way to make a distinction between investment and speculation is by considering the role of expectations. Investments are usually made the expectation that a certain stream of income or a certain price which has existed will not change in the future. Speculation, on the other hand, are usually based on the expectation that some change will occur. An expected change is a basis for speculation but not for an investment.

A gamble is usually a very short-term investment in a game of chance. Speculation typically lasts longer than gambles but are briefer than investment. There is no precise dividing line with respect to the length of investment holding periods that could be used to separate gambles from speculations and speculations from investments. At its best, investment is well grounded and carefully planned speculation where as it is an ostrich-like form of involuntary and unconscious speculation at its worst.

Q 53. Write short note on – Secured Debenture.

ANS: When any particular or specified property of the company is offered as security to the debenture holders and when the company can deal with it only subject to the prior right of the debenture holders, fixed charge is said to have been created. On the other hand, when the debenture holders have a charge on the undertaking of the company i.e., on the whole of the property of the company, both present and future, and when it can deal with the property in the ordinary course of business until the charge crystallises i.e., when the company goes into liquidation or when a receiver is appointed, the charge is said to be a floating charge. When the floating charge crystallises, the debenture holders have a right to be paid out of the sale proceeds of the assets subject to the right of the preferential creditor but prior to making any payment to unsecured creditors

Q 53. Explain briefly the operations of Indian stock market. What are the principal weaknesses of Indian stock market?

ANS: The history of stock exchanges shows that the development of joint stock enterprise would never have reached its present stage but for the facilities which the stock exchanges provide for dealing with the securities. Stock exchanges have a very important function to fulfill in the country's economy.

The stock exchange is really an essential pillar of the private sector corporate economy. It discharges essential functions in the process of capital formation and in raising resources for the corporate sector. Briefly, the operations of Indian stock market can be analysed as:

First the stock exchange provides a market place for purchase and sale of securities viz., shares, bonds, debentures etc. It, therefore, ensures the free transferability of securities which is the essential basis for the stock enterprise system. The private sector economy cannot function without the assurance provided by the exchange to the owners of shares and bonds that they can be sold in the market at any time. At the same time, those who invest their surplus funds in securities for long-term capital appreciation or for speculative purpose can also buy scripts of their choice in the market.

Secondly, the stock exchange provides the linkage between the savings in the household sector and investment in corporate economy. It mobilizes savings, and channelize them in the form of securities into those enterprises which are favored by the investors on the basis of such criteria as future growth prospects, good returns and appreciation of capital.

Thirdly, by providing a market quotation of the prices of shares and bonds – a sort of collective judgment simultaneously reached by many buyers and sellers in the market-the stock exchange serves the role of barometer, not only of the state of health of individual companies, but also of the nation's economy. The changes in share prices are brought about by a complex set of factors, all operating in the market simultaneously. Share values as a whole are subject to secular trends set by the economic programme of the nation, and governed by factors like general economic situation, financial and monetary policies, tax changes, political environment, international – economic and financial development, etc.

Shortcoming of Stock Markets:

- **Scarcity of floating stocks:** Financial institutions, banks and insurance companies own 80 percent of the equity capital of the private sector.
- **Speculation:** 85 percent of the transactions on the NSE and BSE are speculative in nature.
- **Price rigging:** evident in relatively unknown and low quality scripts. Causes short term fluctuations in the prices.
- **Insider trading:** Obtaining market sensitive information to make money in the markets.

Q 54. Demutualization of stock exchanges

ANS: Demutualization of stock exchanges: Historically stock exchanges were formed as 'mutual' organisations, which were considered beneficial in terms of tax benefits and matters of compliance. They are generally 'not-for profit' and tax exempted entities. The trading members who provide broking services, also own, control and manage such exchanges for their common benefit, but do not distribute the profits among themselves. The ownership rights and trading rights are clubbed together

in a membership card which is not freely transferable and hence this card at times carries a premium. In contrast, in a 'demutual' exchange, three separate sets of people own the exchange, manage it and use its services. The owners usually vest in management constituting a board of directors which is assisted by a professional team. A completely different set of people use trading platform of the exchange. These are generally 'for-profit' and tax paying entities.

The ownership rights are freely transferable. Trading rights are acquired/surrendered in terms of transparent rules. Membership cards do not exist. These two models of exchanges are generally referred to as 'club' and 'institution' respectively.

There are 23 recognised exchanges in the country. Three of them are 'Association of Persons', while the balance 20 are companies, either limited by guarantee or by shares. Except one ex- change (NSE), all exchanges, whether corporates or association of persons, are not-for profit making organisations. Except for two (OTCEI and NSE), all exchanges are 'mutual' organisations. An expert committee appointed by SEBI has recently recommended demutualisation of stock exchanges since stock exchanges, brokers, associations and investors association have overwhelmingly felt that such a measure was desirable. The committee has accordingly suggested the steps for such demutualisation.

The most important development in the capital market is concerning the demutualisation of the stock exchanges. Demutualisation of exchanges means segregating the ownership from management. This move was necessitated by the fact that brokers in the management of the stock exchange were misusing their position for personal gains. Demutualisation would bring in transparency and prevent conflict of interest in the functioning of the stock exchanges.

Now, all the stock exchanges in India are demutualised entities.

Q 55. Certificate of deposit

ANS: Certificates of Deposit (CDs) is a negotiable money market instrument issued in dematerialized form or as a usuance Promissory Note, for funds deposited at a bank or other eligible financial institution for a specified time period. Guidelines for issue of CDs are presently governed by various directives issued by the Reserve Bank of India, as amended from time to time. CDs can be issued by (i) scheduled commercial banks excluding Regional Rural Banks (RRBs) and Local Area Banks (LABs); and (ii) select all-India Financial Institutions that have been permitted by RBI to raise short-term resources within the umbrella limit fixed by RBI. Banks have the freedom to issue CDs depending on their requirements. An FI may issue CDs within the overall umbrella limit fixed by RBI, i.e., issue of CD together with other instruments viz., term money, term deposits, commercial papers and inter-corporate deposits should not exceed 100 per cent of its net owned funds, as per the latest audited balance sheet.

Q 56. Inter-connected stock exchange of India :

ANS: Inter-connected Stock Exchange of India Limited (ISE), has been promoted by 15 Regional stock exchanges to provide trading linkage/connectivity to all the participating exchanges to widen their market. Thus, ISE is a national level exchange providing trading, clearing, settlement, risk management and surveillance support to the Inter-Connected Market System (ICMS). ISE aims to address the needs of small companies and retail investors with the guiding principle of optimising the infrastructure and harnessing the potential of regional markets to transform these into a liquid and vibrant market through the use of technology and networking. The participating exchange in ISE have in all about 4500 traders. In order to leverage its infrastructure as also to expand its nation-wide reach, ISE has also appointed dealers across various cities other than the participating exchange centers. These dealers are administratively supported through strategically located regional offices at Delhi, Calcutta, Chennai and Nagpur.

ISE, thus expects to emerge as a low cost national level exchange in the country for retail investors and small intermediaries. ISE has also floated a wholly-owned subsidiary namely, ISE Securities and Services Limited (ISS) to take membership of NSE and other premier exchanges, so that traders and dealers of ISE can access other markets in addition to the local market and ISE. This will provide the investors in smaller cities with a solution for costeffective and efficient trading in securities.

Core objectives of the Inter-connected Stock Exchange include creation of single integrated national level solution with access to multiple markets for providing high quality, low cost services to millions of investors across the country, a liquid and vibrant national level market for all listed companies in general and small capital companies in particular and providing trading, clearing and settlement facilities to the traders and dealers across the country at their doorstep with decentralised support system. Some of the features which make ISE a new age stock exchange are as follows :

- ISE is a national level recognised stock exchange having moderate listing fees and granting listing and trading permission to small and medium sized companies having a post public issue paid-up capital of Rs. 3 crore to Rs. 5 crore (subject to the appointment of market makers) besides companies with a capital of above Rs. 5 crore.
- All traders and dealers of ISE have access to NSE through ISE Securities and Services Ltd. (ISS), which ensures continuous attention of investors.
- Proposing to introduce the 'IPO Distribution System' for offering primary market issue.
- ISE has set up an 'Investors Grievance and Service Cell' which looks after all types of complaints of investors located across the country and provides decentralised support.
- Listing of stocks with ISE would give the company an advantage of being identified as a technology-savvy and Investor-friendly company.

Q57. Bought Out Deal

ANS: Bought Out Deal (BOD) is a process of investment by a sponsor or a syndicate of investors/ sponsors directly in a company. Such direct investment is being made with an understanding between the company and the sponsor to go for public offering in a mutually agreed time.

Bought out deal, as the very name suggests is a type of wholesale offer of equities by a company. A company allots shares in full or in lots to a sponsors at a price negotiated between the company and the sponsor(s). After a particular period of agreed upon between the sponsorer and the company the shares are issued to the public by the sponsorer with a premium. The holding cost of such shares by the sponsor may either be reimbursed by the company or the sponsor may absorb the profit in part or full as per the agreement, arising out of the public offering at a premium. After the public offering the shares are listed in one or more stock exchanges.

Advantages Bought out deal is not only advantageous to the company going for it but also to the sponsors and common investors.

- The company has the advantage of using the fund immediately without waiting as in the case of direct public issue. In case of BOD the company instantly gets funds and is able to focus its attention on project implementation without worrying for source of investment. Bought out deals are ideally suited in circumstances when money needs to be arranged fast without which the project may suffer. Lowering or eliminating issue cost from the preliminary expenses is another advantage to the company.
- The time taken to raise money in the capital market by a company takes as much as six months and this time is very high for a company in an infancy stage. The waste of time in the initial stage can be avoided by going for BOD.
- In case of a new and untried product it is easier to convince an investment banker for an investment in the company rather than the general public. Hence BOD is an innovative method of financing for such companies.
- When the market sentiment is low and the secondary market is undergoing a bear phase, a company may not like to come to the market with a public issue. In such case BOD is a superior process to get fund for the company.
- The merchant bankers also gain handsomely from a BOD. The merchant banks expect a return of around 30% from a BOD whereas private financing institutions expect a return of 40% to 60% from a BOD. The gains can be tremendous provided the sponsors select proper issues and price it attractively to the investors.
- The investors also gain from the BOD in a way that they get good issues where some merchant banker has already invested in it. The common investors do not have enough scope and information for proper evaluation of a company. The merchant bankers are professionals and can make proper appraisal of a company.

Q 58 Qualified Institutional Buyers (QIBs)

ANS: Qualified Institutional Buyers are those institutional investors who are generally perceived to possess expertise and the financial muscle to evaluate and invest in the capital market.

As per the SEBI guidelines QIBs shall mean the following :

- Public Financial Institution as defined in section 4A of the Companies Act, 1956
- Scheduled Commercial Banks
- Mutual Funds
- Foreign Institutional Investors registered with SEBI
- Multilateral and Bilateral Development Financial Institutions
- Venture Capital Funds registered with SEBI
- Foreign Venture Capital Investors registered with SEBI
- State Industrial Development Corporations
- Insurance Companies registered with the Insurance Regulatory and Development Authority (IRDA)
- Provident Funds with minimum corpus of Rs. 25 crores
- Pension Funds with minimum corpus of Rs. 25 crores.

These entities are not required to register with SEBI as QIBs. Any entities falling under the categories specified above are considered as QIBs for the purpose of participating in primary issuance process.

Q 60. Stock invest

ANS: In case of oversubscription of issue, there have been inordinate delay in refund of excess application money and large amounts of investors' funds remain locked up in companies for long periods affecting the liquidity of the investing public. To overcome the said problem a new instrument called 'stock invest' is introduced. The Stock invest is a non-negotiable bank instrument issued by the bank in different denominations. The investor who has a savings or current account with the bank will obtain the stock invest in required denominations and will have to enclose it with the share/debenture application. On the face of the instrument provides for space for the investor to indicate the name of the issues, the number and amount of shares/ debentures applied for and the signature of the investor. The stock invests issued by the bank will be signed by it and the date of issue will also be indicated on the instruments. Simultaneously with the issue of stock invest, the bank will mark a lien for the amounts of stock invest issued in the deposit account of the investor. On full or partial allotment of shares to the investor, the Registrar to issue will fill the columns of stock invest indicating the entitlement for allotment of shares/debentures, in terms of number, amount and application number and send it for clearing.

The investor's bank account would get debited only after the shares/debentures allotted. In respect of unsuccessful applicants, the funds continue to remain in their account and earn interest if the account is a savings or a term deposit. The excess application money of partly successful applicants also, will remain in their accounts. There will be lien on the funds for a maximum of four months period. The stock invest is intended to be utilised only by the account holders and the stock invest should not be handed over to any third party for use.

In case the cancelled/partly utilised stock invest is not received by an investor from the registrar, lien will be lifted by the issuing branch on expiry of four months from the date of issue against an indemnity bond from the investor.

Q 61. Fringe Market

ANS: The fringe market is a disorganised money market, deemed to include everything that is outside the scope of the money market (i.e., the institutional money market). The fringe market includes activities like the Inter-Corporate Deposit (ICD) market, small scale trade financing, financing of investments in the stock market, discounting and lending against lOUs or promissory notes, etc. The ICDs market is the most visible feature of the fringemarket.

As its name indicates it essentially involves short-term borrowing and lending of funds amongst the corporations. Generally the fringe market exist, wherever the main borrowers and lenders of the funds are based, i.e., at the location of the industrial, corporate and trading establishments. The interest rates at which the funds can be lent in the fringe fringe market is higher too - the people who borrow at exorbitant rates are the ones who are most likely to default.

Q 62. Rolling Settlement

ANS: The rolling settlement was introduced by SEBI on January 10, 2000. Ten stocks were selected initially and SEBI has announced a list of 156 stocks which was included in rolling settlement made by the first fortnight of May 2000. In a rolling settlement of a T+5 period trades are settled 5 days from the date of transaction. If an investor purchases 500 shares of RIL and sells 400 shares on Monday he would be asked to settle the net outstanding of 100 shares on the following Monday. This means all open positions are squared up on the fifth or sixth day from the trading date.

In the T+2 rolling settlement, trades are settled on the second working day. For example, trades taking place on Monday are settled on Wednesday, etc.

In a Rolling Settlement, trades executed during the day are settled based on the net obligations for the day. Say for example, if the trades pertaining to the rolling settlement are settled on a T+2 day basis where T stands for the trade day. Hence, trades executed on a Monday are typically settled on the following Wednesday (considering 2 working days from the trade day). The funds and securities pay-in and pay-out are carried out on T+2 day.

Q 63. Circuit Breakers

ANS: The index-based market-wide circuit breakers were implemented in compulsory rolling settlement with effect from July 02, 2001.

The index-based market-wide circuit breaker system applies at 3 stages of the index movement, either way viz. at 10%, 15% and 20%. These circuit breakers when triggered bring about a coordinated trading halt in all equity and equity derivative markets nationwide.

The marketwide circuit breakers are triggered by movement of either the BSE Sensex or the NSE S&P CNX Nifty, whichever is breached earlier. The % movement of the index and the time frame of the trading halt is given below:

- 10% movement - a one-hour market halt if the movement takes place before 1:00 p.m.
  – at or after 1:00 p.m. but before 2:30 p.m., a trading halt for ½ hour.
  – at or after 2:30 p.m. there will be no trading halt and market shall continue trading.
- 15% movement - a two-hour halt if the movement takes place before 1 p.m.
  – on or after 1:00 p.m., but before 2:00 p.m., a trading halt of one hour
  – on or after 2:00 p.m. the trading shall halt for remainder of the day.
- 20% movement - trading shall be halted for the remainder of the day.

Q 64. Fibonacci Numbers :

ANS: Fibonnacci numbers have intrigued mathematicians and scientists for hundreds of years. Leonardo Fionacci (1170-1240) was a medieval mathematician who discovered the series of numbers while studying the reproductive behaviour of rabbits. The beginning of the Fibonacci series is shown below : 1,1,2,3,5,8,13,21,34,55,89,144,233,……. Fibonacci ratios are core knowledge for the stock and commodities trader. The market's Rules of Grammar. Every swing is related in both price and time by certain Fibonacci ratios to what has happened before. Professional traders with the money to move the market know all the Fibonacci levels that are coming up in the current move.

Q 65. Elliot Wave Principle :

ANS: One theory that attempts to develop a rationale for a long-term pattern in the stock price movements is the Eliott Wave Principle (EWP), established in the 1930s by R.N. Eliott and later popularized by Hamilton Bolton. The EWP states that major moves take place in five successive steps resembling tidal waves. In a major bull market, the first move is upward, the second downward, the third upward, the fourth downward and the fifth and final phase upward. The waves have a reverse flow in a bear market.

Q 66. Debt for Equity Swap :

ANS: This instrument is an offer from an issuer of debt securities to its debt holders lo exchange the debt for the issuer common or preferred stock. The issuer who wishes to offer debt for equity swaps does so with a view to increasing equity capital for the purposes of improving its debt equity ratio and also enhance its debt raising capacity. It also helps issuers to reduce their interest expenses and enables them to replace it with dividends on stock that are payable at their discretion. Investors get attracted because of the potential appreciation in the value of the stock. There are risk considerations in view of the fact swaps may dilute earnings per share of issuer. In addition, dividends are not tax deductible while interest on tax securities is taxable.

Q 67 Credit Wrapping:

Credit wrapping is a technique by which bonds are issued by a company with a poor rating can be shored up with the assistance of an institution with a strong credit rating. It involves the institution agreeing to underwrite a proportion of the amount payable in the event of default at the time of redemption. In many cases it is the only way in which poorly rated companies can issue bonds.

Q 68 Callable Bond

ANS: A callable bond is a bond which the issuer has the right to call in and pay off at a price stipulated in the bond contract. The price the issuer must pay to retire a callable bond when it is called is termed as 'call price'. The main advantage in callable bond is the issuers have an incentive to call their existing bonds if the current interest rate in the market is sufficiently lower than the bond's coupon rate. Usually the issuer cannot call the bond for a certain period after issue.

Q 69 Junk Bonds

ANS: Junk bonds are corporate bonds with low ratings from a major credit rating agencies. High rated bonds are called investment grade bonds, low rated bonds are called speculative grade bonds or less formally called as 'Junk bonds'. A bond may receive a low rating for a number of reasons. If the financial condition or business outlook of the company is poor, bonds are rated speculative-grade. Bonds are also rated speculative-grade if the issuing company' already has large amounts of debt outstanding. Some bonds are rated speculativegrade;

because they are subordinated to other debt i.e. their legal claim on the firm's assets in the event of default stands behind the other claim, so called senior debt. Junk bonds are traded in a dealer market rather than being traded in stock exchanges. Institutional investors hold the largest share of junk bonds. Firms with low credit ratings are willing to pay 3 to 5 percent more than the investment grade corporate debt to compensate for greater risk.

Junk bonds are a high yield security, because of this reason junk bonds are widely used as a source of finance in takeovers and leveraged buy-outs. Junk bonds lie between conventional investment as equities and investment- grade bonds. Junk bonds are riskier than investment grade bonds but less risky than equity. Junk bonds may have cost or tax advantage that allow for some marginal increase in debt. But these advantages are not likely to induce bondholders to invest in junk bonds more recklessly than other safer debt instruments.

Q 70 Who is Standard & Poor's, and why does their name appear with the S&P CNX Nifty?

ANS: S&P owns the most important index in the world. By the name of the S&P 500 index, which

is the foundation of the largest index funds and most liquid index futures markets in the world, S &P has become a familiar name in the world. When S&P came to India to look at market indices, they paid attention towards the S&P CNX Nifty as opposed to alternative indices. They now stand behind the S&P CNX Nifty, as is evidenced by the name "S&P CNX Nifty". This is a unique occasion; S&P has never endorsed a market index before.

Q 71. We sometimes hear the term 'nifty fifty' used in the US to denote a certain set of growth stocks. Is there any connection?

ANS: No. It's purely coincidental. It was research that led to the choice of 50 stocks as the optimal size of an index in the Indian equity market. One day, a clever leap was made from NSE-50 to 'S&P CNX Nifty'.

Q 72. What is 'bid-ask bounce' ?

ANS: Supposing a stock trades at bid 1440 ask 1490. Let us consider that no news appears for ten minutes. But, over this period, say a buy order first comes in (at Rs.1490) followed by a sell order (at Rs. 1440). This sequence of events makes it seem that the stock price has dropped by Rs.50. This is a totally false price movement! Even when no news is breaking, when a stock price is not changing, the 'bid-ask bounce' is about prices bouncing up and down between bid and ask. These changes are fake. This problem is the greatest with illiquid stocks where the bid-ask spread is wide. When an index component shows such price changes it contaminates the index.

Q 73. What is 'stale prices'?

ANS: Suppose we look at the closing price of an index. It is supposed to reflect the state of the stock market at 3:30 PM on NSE. Suppose an illiquid stock is in the index. The last traded price (LTP) of the stock might be an hour, or a day, or a week old! The index is supposed to show how the stock market perceives the future of the corporate sector at 3:30 PM. When an illiquid stock injects these 'stale prices' into the calculation of an index, it makes the index more stale. It reduces the accuracy with which the index reflects information.

Q 74 What about market manipulation - how would manipulation of an index take place, and how would an index be made less vulnerable to manipulation?

ANS: The index is a large entity and is intrinsically harder to manipulate when compared to individual stocks. Obviously, larger indices are harder to manipulate than smaller indices. The weak links in an index are the large, illiquid stocks. These are the achilles heel where a manipulator obtains maximum impact upon the index at minimum cost. Optimal index manipulation consists of attacking these stocks. This is one more reason why illiquid stocks should be excluded from a market index; indeed this aspect requires that the liquidity of a stock in an index should be proportional to its market capitalization.

Q75 What is 'impact cost'?

ANS: Market impact cost is the best measure of the liquidity of a stock. It accurately reflects the costs faced when actually trading an index. Supposing a stock trades at bid 99 and ask 101. We say the 'ideal' price is Rs. 100. Now, supposing, a buy order for 1000 shares goes through at Rs.102. Then it can be said that the market impact cost at 1000 shares is 2%.

Likewise, if a buy order for 2000 shares goes through at Rs.104, it is said that the market impact cost at 2000 shares is 4%. For a stock to qualify, for possible inclusion into the S&P CNX Nifty, it has to reliably have market impact cost of below 0.75 % when doing S&P CNX Nifty trades of half a crore rupees.

Q 76 Is the 'zero coupon' yield curve only useful for talking about zero coupon bonds?

ANS: No. Besides zero coupon instruments, the ZCYC (Zero Coupon Yield Curve) can be used to price a wide range of securities including coupon paying bonds, derivatives, interest rate forwards and swaps. In arriving at the ZCYC for a coupon bearing instrument ,what can be simply done , is stripped the 'n' cash flows into 'n' zero coupon instruments, the first 'n-1' being coupon payments and the 'n'th being the terminal coupon plus redemption amount.

Q 77. What are the different types of fixed income instruments available to an investor?

ANS: Fixed income instruments can be categorized by type of payments. Most fixed income instruments pay to the holder a periodic interest payment, commonly known as the coupon, and an amount due at maturity, the redemption value. There exists some instruments that do not make periodic interest payments; the principal amount together with the entire outstanding amount of interest on the instrument is paid as a lump sum amount at maturity.

These instruments are also known as 'zero coupon' instruments (Treasury Bills provide an example of such an instrument). These are sold at a discount to the redemption value, the discounted value being determined by the interest rate payable (yield) on the instrument.

Fixed income instruments can also be categorized by type of issuer. The rate of interest offered by the issuer depends on its credit-worthiness. Sovereign securities issued by the Government of any country, with minimal default risk, usually offer lower rates of interest than a non-sovereign entity with some default risk. The 'credit spread' that has to be added by a non-sovereign entity with non-zero probability of default risk, over and above the interest rates offered by a sovereign body, is directly related to the default risk of the issuer - higher the default risk, higher is the spread.

Q 78 Is the 'term structure' the only factor influencing the price of a bond?

ANS: No, there are other factors besides the term structure, that influence the pricing of a bond. These include, for instance, tax regulations (differential tax rates for income and capital gains) that affect the relative valuations of bonds with different cash flows. Again, illiquid bonds trade at a premium relative to liquid bonds of the same residual maturity. Some other characteristics also influence bond valuation. For trades in the same bond conducted on the same day, dispersion in prices could be attributed to transaction costs that vary with the size of the trade, an example of which could be an intra-day effect on account of new developments during the day and expectations about the directionality of the term structure risk, higher is the spread.

Q 79 Write about myths and realities of derivatives.

ANS:

Myths and Realities about Derivatives:

Derivatives increase speculation and do not serve any economic purpose. Numerous studies of derivatives activity have led to a broad consensus, both in the private and public sectors that derivatives provide numerous and substantial benefits to the users. Derivatives are a low-cost, effective method for users to hedge and manage their exposures to interest rates, commodity prices, or exchange rates. The need for derivatives as hedging tool was felt first in the commodities market. Agricultural futures and options helped farmers and processors hedge against commodity price risk. After the fallout of Bretton wood agreement, the financial markets in the world started undergoing radical changes. This period is marked by remarkable innovations in the financial markets such as introduction of floating rates for the currencies, increased trading in variety of derivatives instruments, on-line trading in the capital markets, etc. As the complexity of instruments increased many folds, the accompanying risk factors grew in gigantic proportions. This situation led to development derivatives as effective risk management tools for the market participants. Looking at the equity market, derivatives allow corporations and institutional investors to effectively manage their portfolios of assets and liabilities through instruments like stock index futures and options. An equity fund, for example, can reduce its exposure to the stock market quickly and at a relatively low cost without selling off part of its equity assets by using stock index futures or index options. By providing investors and issuers with a wider array of tools for managing risks and raisingcapital, derivatives improve the allocation of credit and the sharing of risk in the global economy, lowering the cost of capital formation and stimulating economic growth. Now that world markets for trade and finance have become more integrated, derivatives have strengthened these important linkages between global markets, increasing market liquidity and efficiency and facilitating the flow of trade and finance.

Q 80. LEAPS

ANS: Long-term stock options or index options, with expiration dates up to three years away. LEAPs are very similar to standard options except for the fact that they expire much further in the future. LEAPS are available in two forms, calls and puts. Options were originally created with expiry cycles of 3, 6, and 9 months, with no option term lasting more than a year. Options of this form, for such terms, still constitute the vast majority of options activity. LEAPS were created relatively recently and typically extend for terms of 2 years out. Equity LEAPS always expire in January. For example, if today were November 2005, one could buy a Microsoft January call option that would expire in 2006, 2007, or 2008.

(The further out the expiration date, the more expensive the option.) They can be safer than traditional options because it is somewhat easier to predict stock movement over longer periods. Like options, they allow an investor to lock in a fixed price for the underlying security. Therefore, like options, they can be effective for both leverage and insurance purposes. Expiration generally occurs 36 months after purchase, and LEAPs are American style, so they can be exercised at any time before expiration. Strike prices usually range around 25% above or below the price of the underlying stock when the LEAP is first offered.

Q 81 Basket Trade,

ANS: It is an order to purchase or to sell a set of 15 or more securities. This type of trade is utilized to invest large amounts of money into a specific portfolio or index. For many types of investors, basket trades are a helpful investment strategy. They can assist fund managers who want to rework a portfolio of investments. They can also assist individual investors that want to address specific areas of interest. To limit the monetary risk because of movements by the index, investors may choose to purchase or sell all the constituents of an index by utilizing a basket trade. One advantage of basket trading includes the ability for investors to create baskets of stocks according to specific investment needs.

Q 82 Mezzanine Finance

ANS: Mezzanine finance is unsecured debt (or preference shares) offering a high return with a high risk. This type of debt generally offers interest rates two to five percentage points more than that on senior debt and frequently gives the lenders some right to a share in equity values should the firm perform well. Mezzanine finance tends to be used when bank borrowing limits are reached and the firm cannot or will not issue more equity. The finance it provides is cheaper (in terms of required return) than would be available on the equity market and it allows the owners of a business to raise large sums of money without sacrificing control. It is a form of finance which permits the firm to move beyond what is normally considered acceptable debt/equity ratios (gearing or leverage levels).

Q 83 Write short note on Chaos Theory.

ANS: At recent finance conferences, a few researchers have presented papers on chaos theory and its application to the stock market. In physics, chaos theory is growing field of study examining instances in which apparently random behaviour is, in fact, quite systematic or even deterministic. Scientists apply this theory to weather prediction, population growth estimates, and fisheries biology.

- As an example of the latter application, a given volume of ocean water, left free from human interference, will not necessarily reach an equilibrium population of the various species that inhibit it. As fish grow, they consume the smaller fry (of their own or a different species) in increasing numbers. Fewer younger fishes are left to mature; this, coupled with the natural death of the older fish, eventually results in a sudden drastic reduction in fish population, causing dismay to fishermen and excitement in the local media. At the same time, it results in reduced predation and food competition by the surviving fry, so the population begins to grow dramatically, and the cycle continues. Interactions between species add complexity to the process.
- Investment analysts have sought a pattern in stock market behavior since the origin of the exchanges. Much remains unknown about how security prices are determined, and chaos theory may eventually provide some potential answers. If the apparent randomness of security price changes, can be shown to be nonrandom, much of the theory of finance would need revision.

Q 84 Write short note on Exchange Rate Risk.

ANS: All investors who invest internationally in today's increasingly global investment arena face the prospect of uncertainty in the returns after they convert the foreign gains back to their own currency. Unlike the past when most U.S. investors ignored international investing alternatives, investors today must recognize and understand exchange rate risk, which can be defined as the variability in returns on securities caused by currency fluctuations. Exchange rate risk is sometimes called currency risk. For example, a U.S. investor who buys a German stock denominated in marks must ultimately convert the returns from this stock back to dollars.

If the exchange rate has moved against the investor, losses from these exchange rate movements

can partially or totally negate the original return earned. Obviously, U.S. investors who invest only in U.S. stocks on U.S. markets do not face this risk, but in today's global environment where investors increasingly consider alternatives from other countries, this factor has become important. Currency risk affects international mutual funds, global mutual funds, closed-end single country funds, American Depository Receipts, foreign stocks, and foreign bonds.

Q 85 Write short note on diffusion index.

ANS: Diffusion Index : It is a measure of the percentage of stocks that have advanced in price or are showing a positive momentum over a defined period. It is used in the technical analysis of stocks.

It can also be said as a measure of the breadth of a move in any of the Conference Boards Business Cycle Indicators (BCI), showing how many of an indicators components are moving together with the overall indicator index.

It is one of the many different tools used by technical analysts to increase the probability of picking-winning stocks. The diffusion index can help an economist or trader interpret any of the composite indexes of the

BCI more accurately - the diffusion index breaks down the indexes and analyzes the components separately, exhibiting the degree to which they are moving in agreement with the dominant direction of the index.

Q 86. Write Short notes on Rolling Settlement.

ANS: The rolling settlement was introduced by SEBI on January 10, 2000. Ten stocks were selected initially and SEBI has announced a list of 156 stocks which was included in rolling settlement made by the first fortnight of May 2000. In a rolling settlement of a T+5 period trades are settled 5 days from the date of transaction. If an investor purchases 500 shares of RIL and sells 400 shares on Monday he would be asked to settle the net outstanding of 100 shares on the following Monday. This means all open positions are squared up on the fifth or sixth day from the trading date.

In the T+2 rolling settlement, trades are settled on the second working day. For example, trades taking place on Monday are settled on Wednesday, etc. In a Rolling Settlement, trades executed during the day are settled based on the net obligations for the day. Say for example, if the trades pertaining to the rolling settlement are settled on a T+2 day basis where T stands for the trade day. Hence, trades executed on a Monday are typically settled on the following Wednesday (considering 2 working days from the trade day). The funds and securities pay-in and pay-out are carried out on T+2 day.

Q 89 Write a brief note on Book Building and Reverse Book Building.

ANS: Book Building :

(i) It is a method of Initial Public Offer (IPO) to raise capital, whereby the Company offers its shares for subscription at an indicative price range.

(ii) The investors are to subscribe at a price within the range offered by the Company.

(iii) The price at which shares will finally be allotted will be based on criterion under law.

Reverse Book Building :

(i) It is method of buy-back of securities. It is an efficient price discovery process adopted when the Company aims to buy the shares from the public and other shareholders.

(ii) This is generally done when the Company wishes to delist itself from the trading exchanges.

Q 90 Write short note on Alpha.

ANS: Meaning :

(i) The difference between the investment's actual expected return and its fair return (as per CAPM) is known as the investment alpha (i.e. a).

(ii) Alpha is an absolute measure, which is the return on the Portfolio in excess of the CAPM predicted return.

(iii) It measures the relative value addition provided by an Asset Manager compared to a market index, given a Portfolio's market risk.

(iv) Alpha can also be interpreted as the deviation from the SML in the CAPM.

Features:

(i) Alpha is appropriate, when the investment represents one of the many investments held by a client.

(ii) Alpha enables to evaluate how well a Manager has performed, when accounting for the level of risk undertaken on to achieve their returns.

Value:

(i) **Positive Alpha :** A positive alpha indicates that the expected return from this stock is higher than the return under CAPM, to the extent of the Alpha value. Hence stocks with positive alpha should be considered as under-valued stocks and hence should be bought.

(ii) **Negative Alpha :** A negative Alpha value indicates that expected return from the stock is less than the return under CAPM, to the extent of the alpha value. Hence stocks with negative alpha should be considered as over-valued stocks and should be sold.

Q 91. "Ratings measure performance and recommend investment." Comment.

ANS: Credit rating do not measure the following –

(i) **Investment recommendation** – Credit Rating does not make any recommendation on whether to invest or not.

(ii) **Investment decision** – They do not take into account the aspects that influence an investment decision.

(iii) **Issue Price** – Credit Rating does not evaluate the reasonableness of the issue price, possibilities for capital gains or liquidity in the secondary market.

(iv) **Risk or Repayment** – Ratings do not take into account the risk of prepayment by issuer, or interest or exchange risks.

(v) **Statutory Compliance** – Credit Rating does not imply that there is absolute compliance of statutory requirements in relation to Audit, Taxation, etc. by the issuing Company.

Q 91 What do you mean by Bull Spread ? What are its variants?

ANS: Bull Spread is the act of buying and selling options with different strike prices with the same expiry dates. Call Option purchased has a Lower Exercise Price than Call Option written. Similarly, put Option purchased has a higher exercise price than Put Option sold.

Basis :

(i) Investor expects that the price of the underlying asset will rise, i.e. outlook is bullish.

(ii) Investor does not want to take undue risks on such expectation.

Types : There two types of Bull Spreads, Bull Call spread and Bull Put Spread –

Areas	**Bull Call spread**	**Bull Put Spread**
Situation	Buy and write a Call Option, with different exercise prices, but same expiry date.	Buy and write a Put Option, with different exercise prices, but same expiry date.
Condition	Exercise price of Call Option bought is Lower than exercise price of Call Option sold	Exercise price of Put Option bought is Higher than exercise price of Put Option sold.
Maximum profit	Ability to make profit is limited to the difference between the exercise prices, and difference between the option premium.	Maximum gain is limited to difference between the premium collected and paid.
Maximum loss	Loss is limited to difference between the premium paid and collected.	Maximum loss is limited to the difference between the exercise prices, and difference between the Option Premium.

Q 92. State briefly the powers of RBI to control advances made by Banking Companies.

ANS: Where RBI is satisfied that it is necessary or expedient in the public interest or in the interest of depositories or Banking policy so to do, it may determine the policy in relation to advances to be followed by Banking Companies generally or by any Banking Company in particular. The policy so determined is binding upon the Banking Companies concerned.

The RBI may also give directions to Banking Companies, either generally or to any Banking Company or group of Banking Companies in particular, as to –

(i) Purposes for which advances may or may not be made.

(ii) Margins to be maintained in respect of secured advances.

(iii) Maximum amount of advances or other financial accommodation which may be made by a Banking Company to any one Company, Firm, Association of Persons or Individual, having regard to the paid-up capital, reserves and deposits of that Banking Company, and other relevant considerations. [This is called Exposure Norms.]

(iv) Maximum amount upto which guarantees may be given by a Banking Company on behalf of any one Company, firm, Association of Persons or Individual [with regard to the considerations given above].

(v) Rate of interest and other terms and conditions on which advances or other financial accommodation may be made or guarantees may be given.

Q 93 what are the provisions in the Insurance Act relating to new place of Business?

ANS: Place of business includes a branch, a sub-branch, inspectorate, organization office and any other office by whatever name called.

Permission from IRDA :

(i) An insurer can open a new place of business in India or change otherwise than within the same city, town or village, the location of an existing place of business situated in India, only after obtaining the prior permission of IRDA.

(ii) IRDA may grant permission, subject to such conditions as it may think fit to impose either generally or with reference to any particular case.

Consequences of non-compliance :

(i) If IRDA is of the opinion that an insurer has at any time, failed to comply with any of the conditions imposed on him u/s 64VC, it may revoke the permission granted, by making an order in writing.

(ii) The insurer shall be provided a reasonable opportunity to show cause against the action proposed to be taken against him.

Q 94 Block deal

ANS: With reference to the stock exchanges in India, a trade, with a minimum quantity of 5,00,000 shares or minimum value of Rs. 5 crores executed through a single transaction is referred to as Block Deal. SEBI permits the stock exchanges to provide a separate trading window for this type of deal. BSE and NSE are operating these types of windows.

In this connection, the SEBI guidelines are as follows:

(a) The window shall remain operative from 9.00 a.m. to 9.35 a.m. (35 minutes)

(b) The orders may be placed in this window at a price not exceeding + 1% from the ruling market price/ previous day's closing price, as applicable.

(c) Every trade executed in this must result in delivery and shall not be squared off or reversed.

(d) The stock exchanges shall disseminate the information on block deals to the general public on the same day, after the market hours.

Q 95 Derivative Usance Promissory Notes is an innovative instruments issued by the RBI to eliminate movement of papers and facilitating easy rediscounting.

ANS: Features:

(a) DUPN is backed by up to 90 days Usance Commercial bills.

(b) Government has exempted stamp duty on DUPN to simplify and stream line the instrument and to make it an active instrument in the secondary market.

(c) The minimum rediscounting period is 15 days.

(d) DUPN is transferable by endorsement and delivery and hence is liquid.

(e) RBI has widened the entry regulation for bill market by selectively allowing, besides banks and PDs, Co-operative banks, Mutual funds and financial institutions.

DFHI trades in these instruments by rediscounting DUPNs drawn by commercial banks. DUPNs which are sold to investors may also be purchased by DFHI.

Q 96 What are Support levels and Resistance Levels? How do they affect the market behavior?

ANS:

Support Levels – When the Index/Price rebounds after reaching a trough subsequently, the lowest value reached becomes the support level.

Resistance Levels – Represents the peak value from which the index or price goes down. Applications and Market behavior:

Price band : Price is expected to move between these two levels.

Market behavior :

(i) If 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.

(ii) 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.

Prices outside the support level and resistance level: Breach of these levels indicates a distinct departure from status quo, and an attempt to set newer levels.

For further enquiry regarding capital market, financial management and business valuation.

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