

Test Series: May 2020

MOCK TEST PAPER 1**FINAL (NEW) COURSE: GROUP – II****PAPER – 6B: FINANCIAL SERVICES AND CAPITAL MARKETS**

*The question Paper comprises **five** case study questions. The candidates are required to answer any **four** case study questions out of five.*

CASE STUDY: 1

A large infrastructural conglomerate (let us call it India Infrastructure Investment Corporation Ltd - shortly IIIC), whose shareholders include large institutional investors both from India (including PSUs) and abroad had invested in several infrastructural projects — all of which are having long gestation periods (minimum and maximum spans of 20 years and 30 years) respectively, through several subsidiary companies formed as SPVs numbering about 250, for specific projects. Though a significant portion of the shareholdings are by corporations like LIC and public financial institutions like SBI (around 40%), technically IIIC is not a Government company.

For making such investments, IIIC sourced funds through debt instruments like Non-Convertible Debentures and Commercial Papers with coupon rates that were best at the market at relevant points of time. Several Indian financial institutions like banks, insurance companies, mutual funds and pension funds (in effect, savings of the public at large) had invested in such NCDs and CPs to the extent of about Rs. 90,000 crores. IIIC's application of funds were through equity and debt investments in hundreds of subsidiary companies and associates, all of which had taken up projects like construction of roads, expressways, airports, seaports, waterways, power & energy sectors, maritime infrastructure etc. Though the operations of many of these subsidiary companies and associates were progressing but slowly, some of them had hit roadblocks in terms of local body approvals, land acquisition issues, litigations etc. In any case, as mentioned earlier, even to generate revenues and cash flows enough to service its debts, IIC knew that it would take a minimum of 10 to 15 years from even its fastest projects.

However, as there were big names in the shareholders list and the company could get support from various Governments and State Agencies that accorded projects after projects, IIIC was also able to obtain good, why, even great ratings from the various credit rating agencies (CRAs). Such good ratings were the comfort bells for the above mentioned institutional investors, the AUM (Assets under Management) of which comprised of public money as deposits or NCD investments of mutual fund investments or insurance savings.

Though much of the CPs and NCDs issued by IIIC were for the maximum permitted 10 years, in order to have better marketability of the debt instruments, IIIC also issued short term CPs - the redemptions of which became difficult in view of cash flow situations.

At first, two subsidiaries reported having trouble paying back loans and inter corporate deposits to other banks and lenders. In a few weeks, there was another report that another subsidiary failed to repay a short term loan of Rs. 1,000 crores from another leading public financial institution, resulting in turmoil and resignations of senior officials in that institution. Successive news items kept coming about defaults in loan repayments and non-servicing of loans on committed dates by one or the other subsidiary. Amidst the melee, the rating agency which had reaffirmed a rating of A1 Plus, within the next 40 days made two successive rating actions which saw the downgrading to D for specific commercial papers, citing reasons of "recent irregularities in debt servicing driven by the material weakening of the company's liquidity profile".

It was widely believed that the CRA acted more reactively than proactively possibly because they have always had zero accountability and even at their worst performing scenarios, the maximum rebuke they used to get were something like this : "Rating agencies need better market intelligence and surveillance rather than

depending upon historical data and some structure based on past estimates.” Even in this case, the fact that IIC’s short term borrowings increased by 30% in one year, has not rung any alarm bells. In a nation that is very quick to blame the lenders who trusted the ratings and the auditors for not doing a perfect post mortem, no blame lies on those whose recommendations are held sacrosanct as in most case they are mandated by regulators even.

The founder CEO, who was later accused of having given himself a very fat remuneration all along, suddenly resigned citing ill-health as pressures started mounting. The Government, realizing that the impending fall-out was already causing tremors in the financial markets, moved to take control and replaced the entire Board. Serious Fraud Investigation Office (SFIO) started investigation as there were huge procedural lapses. Though there is no fraudulent motives imputed or alleged as of now on the company, the findings that the company has had multiple layers of holding and subsidiary companies and has had a complicated web of inter-corporate relationships, have made the new management to go on record that the erstwhile board had indulged in ‘massive mismanagement of public funds’. The issue has caught the eye of MCA, SEBI, NCLT etc. and developed as a major worry in the financial market horizon of the country.

Several institutions and mutual funds who have invested in CPs and debt securities, due to the strict NPA norms they are subjected to, began classifying their investments as Non-performing and have also taken haircuts of their investments in installments. An intense discussion also started among the financial market players on the role of rating agencies. The market value of quoted mutual funds got a severe beating, resulting in erosion of invested values for ordinary investors.

Descriptive Questions

- 1.1 In your opinion, should Credit Rating Agencies be better monitored and regulated to be made more accountable. **(5 Marks)**
- 1.2 What, in your view, is the fundamental reason for the financial mess that was created in the above case study and how could it have been better addressed? **(5 Marks)**
- 1.3 What is the CAMEL model in rating methodology? Is it sufficient in case of large public offerings of debt securities? **(5 Marks)**

Multiple Choice Questions

Choose the most appropriate answer from the answer options.

- 1.4 Normally the role of Credit Rating Agencies (CRA) is
 - (A) Financial due diligence of an enterprise
 - (B) Limited to giving opinion on any specific instrument
 - (C) Giving investment recommendation
 - (D) Opining on the holding or subsidiary companies as well
- 1.5 The regulatory authority of CRAs is
 - (A) Ministry of Corporate Affairs
 - (B) SEBI
 - (C) Credit Rating Regulatory Authority of India
 - (D) None of the above
- 1.6 Once a rating has been assigned, when can the next revision happen?
 - (A) Next financial year

- (B) On the happening of an event such as default of interest payment
- (C) Regular monitoring triggers
- (D) Again, at the request of the rated entity

1.7 The Credit Rating process is not mandatory for

- (A) Listed Non-Convertible Debentures
- (B) Initial Public Offerings of companies that are getting listed
- (C) All Public Deposits by NBFCs
- (D) Commercial Papers by Corporates

1.8 Which one of the following is not a Credit Rating Agency?

- (A) Fitch
- (B) Credit Analysis & Research Ltd.
- (C) CIBIL
- (D) Standard & Poor

(5 x 2 Marks = 10 Marks)

CASE STUDY: 2

There are nearly 12 Lakh students who aspire to get in to one of the Indian Institutes of Technology which number over 20 all over India. There are many private coaching academies which train aspiring students to take on the challenging entrance tests, popularly known as IIT-JEE, as only about 11,000 students would finally make it to one of the IITs. JEET Academy (Pvt. Ltd. Co.) headquartered in a tier-II city in the Northern India, is a cult name in the field of coaching for IIT aspirants, right through their 9th grade up to class-XII. It is predominantly owned by one Mr. Ashwath Gupta, who, himself an IITan, started this academy in a small scale after a stint of employment abroad.

Of course, there are many such coaching academies and JEET has been doing fairly well among stiff competition, presently training around 22,000 students annually, with the numbers growing steadily. JEET has been sending nearly 1400 to 1600 students annually to various IITs and its success rate @ 6 to 7.5% has been consistently better than the overall success rate of IITs, which has been less than 1%. The professors, numbering around 300 of the academy, a good number of them from IITs themselves, were enthusiastic to develop the institution further.

There was, of course, a good scope for JEET to expand as Ashwath knew that in cities like Hyderabad, Kolkata, Chennai, Bengaluru and even a few centres abroad, there were untapped potential. There were technological advancements like remote classes through Skype, online interactions, mobile phone apps, prometric type of testing etc. that needed to be taken advantage of. Ashwath needed to invest heavily in infrastructure facilities also, besides opening centres in various cities, hiring teaching talents etc.

Not wanting to go through the debt or IPO routes, he slowly explored the options of Private Equity investments. His ambitions were funneled by two Private Equity firms -one a big ticket firm from UK called Blue Diamond and one mid-size PE fund by name Aquarius based out of Mumbai. Though Ashwath was not keen to divest any of his holdings in the Academy, as he became aware that it would not be possible for him to expand his business horizon without additional infusing of funds and as was more averse to debt, he mentally decided that he would divest a 'portion of his stake in favour of a new PE investor but was keen to get a good valuation for his business.

Both the PE funds sent him term sheets, on the basis of the financial projections given by JEET, as below (post PE infusion):

PROJECTED FINANCIALS		(Rs. in crores)			
	2016-17	2017-18	2018 -19	2019-20	2020-21
Income					
Tuition Fees	133.70	180.50	243.60	304.50	380.60
Study Material sales	6.60	9.90	14.80	22.20	33.40
Exam Fees	3.40	4.60	6.10	8.30	11.20
	143.70	195.00	264.50	335.00	425.20
Expenses					
HR Expenses	59.20	74.00	92.50	115.60	144.80
Rentals	9.80	12.30	15.30	19.30	24.00
Marketing	14.40	17.30	20.70	24.90	29.90
Admn & Operating Exp	9.00	10.70	13.10	15.50	18.60
	92.40	114.30	141.60	175.30	217.30
Net Operating Revenue	51.30	80.70	122.90	159.70	207.90
Interest Earned	5.20	5.80	7.20	8.40	9.50
PBT	56.50	86.50	130.10	168.10	217.40
Taxes	19.78	30.28	45.54	58.80	76.09
PAT	36.72	56.22	84.56	109.30	141.31

The salient features of Term Sheets sent by Aquarius and Blue Diamond UK are as below:

AQUARIUS (MUMBAI) TERM SHEET: PROPOSAL 'A'

A. The investment amount is the aggregate of the following:

1. Compulsorily Convertible Preference Shares ("CCPS") each to be issued by the company to the Investors at face value (total subscription amount being Rs.22 crores). These CCPS are required to be compulsorily converted (along with CCPS obtained post conversion as mentioned in sub-clause 4 below), at the option of the Investors, into so many Equity Shares of the Company based on the valuation determined in accordance with Clause 2 below;
2. Such number of Equity Shares of the Company to be purchased from the Promoters by the Investors for a consideration of Rs.11 crores at a price per share which is 20% lower than the price per share determined for conversion of CCPS into Equity Shares in accordance with Clause 2 below;
3. The "Warrant(s)" to be issued by the Company to the Investors free of cost, at the time of issue of CCPS (as mentioned in preceding sub- clause 2) entitling the Investors to subscribe to CCPS at face value for the total consideration of Rs.11 crores. Such option to subscribe to CCPS will have to be exercised from July, 1, 2017 to December 31, 2018.

B. Pre-Money Valuation and Post-Money Valuation and ESOP

The actual post-money equity valuation will be at 12 times multiple of the audited consolidated FY 2016-17 Profit After Tax, adjusted for any extraordinary items, etc. This is subject to a maximum post-money valuation of Rs. 440 crores and a minimum valuation of Rs.340 crores. Accordingly, the minimum pre-money valuation will be Rs.296 crores and maximum pre money valuation will be Rs. 396 crores.

At maximum post-money valuation, Investor Securities (assuming the CCPS on an as-converted basis) will represent 8 percent of the post issued and paid up capital of the Company immediately after the closure of the round and post exercise of the warrants they will represent 12 percent of post issued and paid up Capital assuming all the Warrants have been converted.

The current equity (prior to current funding round) is 100 percent held by Promoters. On or before June 30, 2018, the Promoter will transfer, at a price decided by the Promoter, such number of equity shares to Employees / close associates / friends / relatives such that post investment of Rs. 22 Crores by Investors, and after the above-mentioned transfer, the percentage stake held by Employees/close associates / friends/ relatives is a maximum of 10 percent and by the Investors is 8 percent (all assuming conversion happens at Rs.440 Crores post-money).

C. Board of Directors

The Investors will have the right to nominate a Director (“Investor Director”) on the Board of the Company and in the select Board Committees

D. Exit Provisions

The Company and Promoters shall endeavor to list its common shares on ‘recognized stock exchanges in India, by way of an IPO/Offer for Sale, no later than four (4) years from the date of initial investment by the Investors. In case of Offer for Sale, the Investors shall be entitled to participate in the offer by offering Investor Securities on pro-rata (fully diluted) basis. The Company shall undertake to bear all the expenses related to the listing of the equity shares. The IPO shall be considered as a “Qualified IPO” for the purpose of the clauses below, only if the following conditions are satisfied.

- (a) The floor price per share in IPO is such that it gets an IRR of at least 15 percent on purchase price (subject to adjustments for stock dividends, splits, combinations, and similar events).
- (b) The gross proceeds of the offer to the public by means of a fresh issue of shares are not less than Rs.150 Crores.

In the event that the Company is unable to provide the Investors with an exit via a Qualified IPO, the Investors will have following alternatives.

E. Sale to Third-Party Buyers

If the Investors exit has not happened in the manner contemplated above, within 5 years from the date of initial investment by the Investors, Promoters shall be required to enter into an agreement with the Investors to sell up to a maximum of same number of shares as are held by the Investors at that point in time, along with all of the Investors’ shareholding, to a third- party buyer. It is clarified that for the purpose of this Clause, the Investors shall be entitled to sell to any third party including Competitors.

F. Brand Equity:

The Brand value which has been the exclusive ownership of the owner Mr. Ashwath has to be transferred to the Company, at no cost.

G. Others

Besides the above, there are usual terms and conditions regarding end-use of investment funds, anti-dilution rights, minimum holding period of investment, investors’ rights to future rounds of funding, non-compete, non-disclosure, exclusivity etc.

BLUE DIAMOND, UK's TERM SHEET: PROPOSAL 'B'

Issuer	: JEET Academy, a Company Incorporated in India.
Securities	: Series A Preferred Stock (the "Series A Preferred")
Company Valuation	: Rs. 600 crores post-money, i.e., 16x of the audited FY 2016-17 PAT (R/a to nearest hundred)
Present Offering	: Rs. 150 crores
Consideration	: Cash
Number of securities	: 5,00,000 shares
Price per share	: Rs. 300
Dividends	: Dividend rate. 8% Noncumulative
Dividends (continued)	: Priority. Senior to Common Equity
Liquidation preference	: Amount. Original purchase price plus accrued dividends
Priority	: Senior to common
Participation	: After payment of preferential liquidation proceeds, the Series A Preferred does not participate in further liquidation proceeds.

Redemption: Outstanding shares of Series A Preferred will be redeemed on March 31, 2021. at purchase price plus declared dividends from the closing date plus 4% p.a. If the Series A Preferred is not redeemed on the date or dates set for redemption, the redemption price will increase to the purchase price plus declared dividends plus 10% per annum from the date originally set for redemption.

Conversion: The Series A Preferred may be converted at any time, at the option of the holder, into shares of common stock. The conversion rate will initially be 1:1, subject to anti-dilution and other customary adjustments.

Automatic conversion: Each share of preferred stock will automatically convert into common stock, at the then applicable conversion rate, 'upon (i) the closing of a firmly underwritten public offering of common stock (a "Qualified Public Offering"), or (ii) the consent of the holders of a majority of the then outstanding shares of the preferred stock.

Anti-dilution Adjustment: The conversion price of the Series A Preferred will be subject to adjustment, on a broad-based weighted-average basis, if the Company issues additional securities at a price per share less than the then applicable conversion price, except in specified circumstances.

(Not necessary for this case study)

General voting rights: Each share of preferred stock will have the right to a number of votes equal to the number of shares of common stock issuable upon conversion of each such share of preferred stock. The preferred stock will vote with the common stock on all matters except as specifically provided in the articles of incorporation or as otherwise required by law.

Voting for directors: The holders of Series A Preferred will be entitled to elect two directors. Any additional directors will be elected by the holders of preferred stock and common stock voting together.

Right of first refusal; If the Promoter proposes to transfer any common stock or other securities convertible into or exercisable for common stock, the holders of Series A Preferred will have a right of first refusal (on a pro rata basis based on the Company's outstanding securities (on an as converted and as-exercised basis)

with respect to the proposed transfer. The rights of first refusal will be subject to customary exceptions and will terminate on a Qualified Public Offering.

In the background of the Private Equity investments scenario in India and with reference to the case study given and the Term sheets, the questions need to be answered.

Descriptive Questions

- 2.1** You are the CFO of the Company who has been given the task of choosing one of the 2 proposals and you choose the proposal from Blue Diamond over that of Aquarius. Prepare a brief note providing at least 4 reasons (each not exceeding 50 words) for your choice. **(4 Marks)**
- 2.2** After much deliberations the Board of the Company has chosen to consider Proposal Aquarius over Proposal Blue Diamond. What in your view would the Board have found compelling merits in proposal Aquarius? (each reasoning may not exceed 50 words) **(6 Marks)**
- 2.3** If you were Ashwath, now with a feel of your company's worth, will you contemplate postponing the PE idea for 2 more years? (The projected financials as given herein are pre-expansion plans - with a regular growth rate). Evaluate this in the background of the need to obtain better market share, changing environment in the area of such tutorial education, ceding some managerial control to outsiders etc. **(5 Marks)**

Multiple Choice Questions:

Choose the most appropriate answer from the answer options.

- 2.4** The most important thing that a Private Equity Investor looks for, during a Private Equity Investment Deal is
- (A) No. of Directorships in the Board (leaning towards Majority of the Board)
 - (B) Control of the Company
 - (C) Business Model and Promoter qualities
 - (D) Duration & Mode of Exit offered by the Promoter
- 2.5** The Key difference between Private Equity Investor & Venture Capital Investor is
- (A) Size / Extent of Investment
 - (B) Intent of Control / Takeover of Investee Company Age & growth of Investee Company
 - (C) Stage of Investment
 - (D) All of the above
- 2.6** The term Sheet in a Private Equity Deal is
- (A) of utmost importance to Investor & binding on Promoter
 - (B) of utmost importance to Promoter & binding on Investor
 - (C) of no importance to Promoter & Investor and Companies Act will prevail
 - (D) of importance' only where the Investor chooses to exit via an IPO
- 2.7** The right by which the majority of the shareholders bind the minority shareholders in the event of sale / transfer of shares is known as
- (A) Pre-emptive
 - (B) Predatory
 - (C) Democratic
 - (D) Drag along

2.8 Who is an angel investor?

- (A) One who provides the seed capital
- (B) One who accepts the maximum valuation
- (C) One who is prepared to take the risk of zero return
- (D) One who has a domain experience in the field in which the investee company operates

(5 x 2 Marks = 10 Marks)**CASE STUDY: 3**

The details relating to repo/reverse repo transactions are given in Tables 1 and 2.

Table 1:

Details	7.5% 2025 G-Sec	GoI 91 day T Bill maturing on 31-01-2019	9% Corporate Bond maturing on 8 th July, 2020
	I	II	III
Market value per security on 15/11/2018 (Rs.)	96.9000	98.6000	99.5000
Market value per security on reversal date (Rs.)	96.9485	98.6493	99.5498

Table 2:

Common Parameters	
Repo Period	7 days
Repo Commencement Date	16th November, 2018
Coupon Dates	8th January and 8th July every year
Face Value of security	Rs. 100
Day Count Convention	30/360 for coupons and actual/365 for repos
Repo Interest Rate	6.5%
Value of securities	To be calculated to four decimal places
Number of securities	To be rounded off to the next higher integer

Assume all entities in this case study are Indian entities.

Answer the following:

Multiple Choice Questions

Choose the most appropriate from the answer options:

3.1 The following is true:

- (A) Repos can be traded on a recognized stock exchange.
- (B) Repos are solely privately traded transactions between a borrower and a lender and are reversed between the parties at a pre-determined date.
- (C) Repos are entered into between two parties, one of whom should be a banking entity.
- (D) Repos must have RBI as one entity.

- 3.2** In India, repos shall be undertaken for
- (A) a minimum period of three days
 - (B) a minimum period of one day
 - (C) a maximum period of 270 days
 - (D) for a maximum period of one month, subject to renewal every month, upto 270 days.
- 3.3** Suppose entity 'E' is an eligible entity and wants to enter into a repo transaction with Bank 'B' for market value of T bills and CDs of Rs. 500 crores and Rs. 200 crores respectively, then, the amount of borrowing can be (in Rs. Crores)
- (A) 98% of 500 + 98% of 200
 - (B) 500 + 98% of 200
 - (C) 98% of 500 + 200
 - (D) 500 + 200
- 3.4** Suppose that 'E' had made a bid for a term repo of 14-day tenor under the LAF through a variable rate auction mechanism, then
- (A) 'E' can be any entity that accepts deposits.
 - (B) 'E' can be any entity, provided it is regulated by SEBI
 - (C) E has to be a scheduled commercial bank
 - (D) E can be an NBFC, RRB or a commercial bank, provided RBI regulates it.
- 3.5** The following is in ascending order:
- (A) Bank rate, reverse repo rate, repo rate.
 - (B) Bank rate, repo rate, reverse repo rate
 - (C) Repo rate, reverse repo rate, bank rate
 - (D) Reverse repo rate, repo rate, bank rate
- (5 x 2 Marks = 10 Marks)**

Descriptive Questions

- 3.6** Suppose entity 'E' wants to raise funds based on the above securities (in table 1), under a ready forward agreement by selling and simultaneously agreeing to repurchase after 7 days and that 'E' wants your computations on a per security basis for each of the given securities, show the following values: consideration for the first leg of the transaction and the consideration for the second leg showing clearly in your tabulation, who pays what amounts to whom on which dates under the repo deal based on a per security basis. Assume that 'E' has adequate number of each type of security for the purpose. Consider 'K' as the other party. **(10 Marks)**
- 3.7** Discuss the impact of the above transaction on the coupon interests on the securities on the due dates and in the intervening period of the repo/reverse repo. What happens if the coupon date falls in the repo period? **(5 Marks)**

CASE STUDY: 4

Arjun and Lakshman are students who have enrolled themselves for Graduation in Financial Services and Capital Markets in the University of Chicago. As part of this curriculum, both Arjun and Lakshman will be covering various aspects including Global financial markets, policy making and impact of policies, role of capital markets, institutions and intermediaries in capital markets, commodity markets, banking operations etc. amongst other things.

Whilst their focus during the study is largely global, Mr. Derek, their professor presents a paper for discussions amongst the professor community and fellow students. Mr. Derek mentioned that, India, as a country is going

through a significant development in recent years and a number of new initiatives and policies have been undertaken currently. He also mentioned that, the economy in India is also seeing a slowdown currently and there could be an impact on the overall growth and output from industries.

Given the above, Mr. Derek mentioned to Arjun and Lakshman that, it will be of great interest and a source of knowledge for the students to understand the way the Indian financial services and capital markets are structured, in what way are the aspects fundamentally different from some of the global markets and their high level views on some of the policies and happenings in the market.

Both Arjun and Lakshman were super excited with this opportunity and realized that this is also a great opportunity to understand the Indian financial system in a better manner. As they started to prepare for the same, some of the aspects Mr. Derek wanted them to consider included the below items:

Global trends in capital markets - He particularly mentioned that technology plays an important role in evolution of the global capital markets recently.

Regulators in the financial markets and how those are different when compared to the regulators in India. For this purpose,

- Mr. Derek wanted both Arjun and Lakshman to focus on two of the main regulators in India in comparison to the Securities Exchange Commission (SEC) and the Fed in the US and why their operation strategies are different.
- In one of the conversations during the discussions which Arjun had with Mr. Derek, Arjun mentioned that he sees no reason why the Reserve Bank of India (RBI) should be any different when it comes to its approach as the Central Bank, in comparison to the approach of Fed. He said the Indian policy-makers need to just replicate the Fed in terms of its approach rather than customizing their decisions for India.
- Mr. Derek listened to Arjun but prompted Lakshman to look into the views of Arjun and share his thoughts with Mr. Derek.

Credit policy: Mr. Derek wanted both Arjun and Lakshman to look into what credit policy means in the context of the Indian economy, what would be the main objectives and analyze the same in greater detail.

- He said that for the purposes of the discussion, they should also analyze the credit policies adopted by some of the other emerging economies such as Brazil and South Africa and include the same in their overall analysis as this will help the students understand the concepts better.
- He was also prompting Arjun to look into the tools and policy objectives of Fed in the above context and how is that different when it comes to the overall elements of credit policy.

Computation of following indexes: Mr. Derek wanted Arjun and Lakshman to look into:

- Cost inflation index and how is the same to be computed.
- Consumer price index and how is this to be arrived at.
- Wholesale price index and how is that used.

Determination of interest rates: Mr. Derek was very particular that Arjun and Lakshman understand and analyze the determination of interest rates in greater detail. He was keen for them to let the larger student community know, how in India the interest rates are regulated & how interest rates are determined. He said it would be great if both of them can also look at the regulation of interest rates in some of the comparable global economies and how is that different when it comes to India. Specifically, few of the aspects to be considered included:

- Libor

- Mibor
- T Bills of Government
- G-Sec etc.

Arjun was also keen that during this analysis, he wanted to analyze and cover some of the developments in the last few years in the form of **debt securitization** and **money market mutual funds**. He said securitization is the buzz word in some of the recent money market evolution and this would be of huge value to the student community to understand.

Institutions and intermediaries : Lakshman normally shows keen interest in understanding the role played by various institutions and intermediaries in the functioning of the capital markets and he did not want to let go of this chance to deep dive in understanding this better in the context of India. In particular, he told Arjun that he will take the lead in analyzing and presenting the following:

- Depository system
- Stock and commodity exchanges
- Intermediaries
- Institutional investors such as the merchant bankers, registrars to an issue, underwriters, bankers and debenture trustees
- FPIs
- Custodians
- Clearing houses

Arjun for his part mentioned that his interest in **commodity markets** is known to everyone and he will, accordingly take lead in analyzing the commodity markets in India and compare the same with the Global Practices. He said he will look into the key Indian commodity markets such as the MCX and NCDEX which comprise the trading platforms in India and also analyze how they operate.

- Arjun also indicated that he will look at the problems associated with the Indian commodity markets and understand the application of derivatives in commodities. In particular, he mentioned that the Indian commodity market is plagued by :
 - High speculation and fly by night operators
 - Trading without underlying
 - Lack of exponential growth that is required for the platforms to sustain it
 - Lack of connect of the farmers to the market
 - Political ramifications
- He said that whilst a future trading is exciting, it comes with certain specific conditions such as durability, homogeneity, free from control and frequent trading and this isn't always the case in a market such as India for all the key products.

Both Arjun and Lakshman held a discussion with Mr. Derek outlining the various aspects that they will be covering during the presentation. Mr. Derek was very impressed with the aspects identified though he mentioned that many of these aspects were arising out of the discussions they had with Mr. Derek himself.

Mr. Derek indicated to both Arjun and Lakshman that he will have a short discussion with them where he will ask them a few questions for them to respond to and also provide them with his additional thoughts questions

so that they are better prepared for the final discussions and presentation. They are as follows :

- 4.1** Which technology is deployed to remove inefficiencies in the current international capital market structure by enabling capital market firms to create digital assets for private securities which will help in direct and immediate access by regulatory bodies ?
- (A) Private Securities Blockchain Solution
 - (B) Robotic process automation
 - (C) Blockchain and Robotic process automation
 - (D) SAP
- 4.2** Liquidity is controlled in the economic system by:
- (A) The RBI by resorting to sale of securities at times of excess liquidity
 - (B) The RBI by resorting to purchase of securities at times of excess liquidity
 - (C) The RBI through buying securities at times of tight liquidity
 - (D) The Government through buying securities at times of tight liquidity
- 4.3** Quantum channel relating to money supply and credit comprise of:
- (A) Bank lending channel and balance sheet channel
 - (B) Bank lending channel and credit channel
 - (C) Bank lending channel and exchange rate channel
 - (D) Bank lending channel and asset price channel
- 4.4** Repo and Reverse Repo instruments used by RBI for:
- (A) Under Repo, the RBI borrows from the commercial banks and under Reverse Repo, commercial banks borrow from RBI
 - (B) Under Repo, the RBI lends to commercial banks and under Reverse Repo, RBI borrows from commercial banks
 - (C) Under Repo, the RBI borrows from the commercial banks and under Reverse Repo, commercial banks lend to RBI
 - (D) Under Repo and under Reverse Repo, commercial banks borrow from the RBI
- 4.5** The regulation of commodity derivatives market is by:
- (A) Securities and Exchange Board of India under Securities Contracts Regulation Act (SCRA), 1956
 - (B) Securities and Exchange Board of India under Forward Contracts Regulation Act (FCRA)1952
 - (C) Reserve bank of India
 - (D) Forward Markets Commission under Forward Contracts Regulation Act
- (5 x 2 Marks = 10 Marks)**
- 4.6** Please write a Note for Students in the University of Chicago, explaining the following:
- (A) The key elements of financial markets and what are the main functions of financial markets in India? **(2 Marks)**
 - (B) What are the various instruments of credit policy prevalent? **(2 Marks)**

(C) What are the basic differences between Wholesale price index and consumer price index ?
Elaborate on the same with examples. **(3 Marks)**

4.7 Is Arjun right in his view on the approach adopted by RBI in comparison to Fed? What do you think should be the response that Lakshman provide to Mr. Derek? **(3 Marks)**

4.8 Do you agree with Arjun's view on the problems in commodity markets in India? What do you think is the required solution for the same? **(2 Marks)**

4.9 Analyze whether futures trading on a commodity exchange is possible for the below products - explain stating why?

- Petrol
- Zinc
- Pulses

(3 Marks)

CASE STUDY: 5

You are a Partner in M/s. Advisor & Co., a firm of Chartered Accountants which specializes in providing advisory services to its clients on investments in mutual funds and also provides advice on fund raising etc.

Recently, Innovate Limited, promoted as a tech startup, has approached you in providing some advice in respect of its investments as well as its funding requirements. You had a meeting with Mr. Satya Prakash, the MD of the Company who has provided the below facts to you:

- The Company is involved in providing niche solutions in the customer management space for its customers through innovative solutions and technologies.
- The company has grown exponentially in the recent past and many of its customers are based out of the US and China. It also has further plans to grow and also to raise some funds by attracting potential investors.
- The Company has a huge cash balance in its Indian bank account and has retained the same as part of its current account balance and fixed deposits for a considerable period of time. The MD mentioned that he has heard about mutual funds, but is not sure if corporate entities can invest in mutual funds. He is also not too sure on which types of funds to choose, both from a risk and a return perspective.
- On the Mutual funds, the MD mentioned that he has heard some experiences of few of his start-up friends in other entities who have lost a considerable amount due to the effect of some large infrastructure companies failing and as such, wanted to avoid that scenario. He, therefore, wanted some inputs on factors to consider in selection of mutual funds.
 - The MD wanted advice regarding venture capital funding for Innovate and also the types of funding that would be available and its suitability.
 - The MD mentioned that the Company is currently in the stage of enhancing its market and expanding further as it has been a year since it has broken-even.
 - He is also exploring options for a long term loan from banks, but since that may take a while, a temporary option of funding from a venture capital is also being explored.
 - He does not prefer a mode where the venture capitalist has a say in the affairs of the company nor does he want them to acquire any stake in the entity.
 - He has seen some of his fellow startups obtain mezzanine funding from the VCs, and he is keenly evaluating that as a possibility, he could consider.

- The MD was also keen in knowing whether they can issue debt instruments such as debentures for the purpose of raising funds. He mentioned that he is keen in exploring this option and also get the debenture listed in a stock exchange.

But he wanted to understand what the additional compliance requirements on account of listings are.

- One of the aspects that the MD is evaluating is also to scale up its support activities such as finance, administration; HR etc., as it is currently run by a few individuals. .He was curious to know if, there is a mandatory law which forces them to recruit qualified professionals or they can continue to run the company the way it is currently being managed.
- The MD provided you with additional facts of the business :
 - The company has about 600 employees currently
 - It operates from 3 locations in India and has sales offices abroad
 - The Company's ERP is a home grown ERP and they plan to move to a cloud based solution
 - The finance team is currently only 4 people and they follow cash basis of accounting
 - As much as the MD wants to scale up operations, he is also cost conscious and does not want to unnecessarily incur additional costs in manpower.
 - He also wanted to check if outsourcing of the finance, treasury and accounts operations is an option.
 - Since a major portion of revenues come from abroad, he was keen in knowing applicability of those regulations to the entity.

The MD mentioned, given the above information, he would like you to prepare a brief report addressing some of his questions and meet up with him in a week's time.

- 5.1** The maximum cost that mutual funds can incur is____and any extra cost is borne by
- (A) 2.5% of the portfolio and extra cost is borne by the investor
 - (B) 2.5% of the portfolio extra cost is borne by the underlying companies in which mutual funds invest
 - (C) 2.5% of the portfolio and extra cost is borne by the asset management company
 - (D) 3% and extra cost is borne by the investors
- 5.2** Which of the below ratios is an appropriate measure of performance for an overall portfolio particularly when it is compared to another portfolio or another index such as S&P 500, Small Cap Index etc.
- (A) Treynor Ratio
 - (B) Jensen's Alpha
 - (C) Sharpe Ratio
 - (D) Net asset value
- 5.3** A financing mode which is typically a hybrid of debt and preferred stock finance is known as :
- (A) Early stage funding
 - (B) Working capital loan
 - (C) Mezzanine funding
 - (D) Expansion funding

- 5.4 Since they need to bear extremely high risks, their rate of returns are the highest. Which category is this?
- (A) Angel investors
 - (B) Venture capital funds
 - (C) Mutual funds
 - (D) Investment banks
- 5.5 Credit ratings once issued:
- (A) Need not be revised as this is given at a point in time
 - (B) Needs to be revised periodically irrespective of whether the rating has changed
 - (C) Rating agency shall during the lifetime of the securities rated by us, continuously monitor the rating of such securities and carry out periodic reviews of all published ratings
 - (D) Rating agencies will need to revise it on a quarterly basis.
- (5 x 2 Marks = 10 Marks)**
- 5.6 Please prepare a detailed Note for MD of Innovate Limited., summarizing the following:
- (A) The advantages of investing in a mutual fund. **(2 Marks)**
 - (B) What would be the factors you would advise the MD before selecting the right mutual funds to invest in for short term tenor of Investments as well for Long Term tenor of Investments?
(3 Marks)
 - (C) Provide your inputs on the various types of funding by a venture capitalist. And which mode will be best suitable to Innovate Limited?
(6 Marks)
- 5.7 Please advise if Innovate Limited, can issue debt rather than raise further capital. And what additional regulations are to be considered for listing and is Innovate Limited currently geared up to meet the requirements?
(4 Marks)