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BA7022 MERCHANT BANKING AND FINANCIAL SERVICES

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Department of Management Studies

QUESTION BANK WITH ANSWER KEY

TWO MARK QUESTIONS WITH ANSWER KEY

UNIT-I

1. What do you mean by financial system?

A financial system or financial sector functions as an intermediary and facilitates the flow of funds from the
areas of surplus to the areas of deficit. It is a composition of various institutions, markets, regulations and laws,
practices, money manager, analysts, transactions, claims and liabilities.

2. Give meaning the meaning of unorganised market.

In unorganised markets, there are a number of money lenders, indigenous bankers, traders, etc. who lend
money to the public. Indigenous bankers also collect deposits from the public. There are also private finance
companies, chit funds, etc. whose activities are not controlled by the RBI. The RBI has already taken some steps to
bring unorganised sector under the organised fold.

3. What is primary market?

Primary market also known as New Issues Market (NIM) is a market for raising fresh capital in the form of
shares and debentures. Corporate enterprises, which are desirous of raising capital funds through the issue of
securities, approach the primary market. Issuers exchange financial securities for long-term funds.

4. What do you understand by financial deepening and broadening?

Financial deepening refers to an increase of financial assets as percentage of the Gross Domestic Product
(GDP). Financial broadening refers to building an increasing number and a variety of participants and instruments.

5. Who is a merchant banker?

Merchant banker means any person who is engaged in the business of issue management either by making
arrangements regarding selling, buying or subscribing to securities as manager-consultant, advisor or rendering
corporate advisory services in relation to such issue management.

6. Give the meaning of portfolio managers.

Portfolio managers are defined as persons who, in pursuance of a contract with clients,
advise/direct/undertake, the management/administration of portfolio of securities/funds of clients on behalf of the
latter. The term portfolio means the total holdings of securities belonging to any person.

7. What do you mean by project counselling?

Project counselling is a part of corporate counselling and relates to project finance. It broadly covers the study of the project, offering advisory assistance on the viability and procedural steps for its implementation.

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8. Define loan syndication.

It refers to a loan arranged by a bank for a borrower who is likely to be a large company, a local authority,
or a government department. So the merchant banker first finalizes the cost of the project before approaching to
financial institutions for term loans.

9. Expand SEBI and FEMA.

SEBI-Security and Exchange Board of India
FEMA - Foreign Exchange Management Act.

10. What are stock exchanges?

Stock Exchanges are a structured market place for the proper conduct of trading in company stocks and
other securities. The main services of the Indian Stock Exchanges all over the country are to provide nation-wide
services to investors and to facilitate the issue and redemption of securities and other financial instruments.

11. Name two stock exchanges of India.

The two most important exchange houses of the Indian stock market are
(i) The National Stock Exchange and
(ii) The Bombay Stock Exchange.

UNIT-II

1. What is issue management?

Public issue management involves marketing of corporate securities by offering the securities to the public,
procuring private subscription to the securities and offering securities to existing shareholders of the company.

2. Define project appraisal.

Project appraisal is a process of investigation, review and evaluation undertaken as the project or alternative concepts of the project are defined. This study is designed to assist the client to reach informed and
rational choices concerning the nature and scale of investment in the project and to provide the brief for subsequent
implementation.

3. What is capital structure?

Capital Structure of a company refers to the composition or make-up of its capitalization and it includes all
long-term capital resources viz. loans, reserves, shares and bonds.

4. Define equity shares.

Equity shareholders are the real owners of the company as they have the voting rights and enjoy decision-

making authority on important matters, related to the company. The shareholders‟ return is in the form of dividend,
which is dependent on the profits of the company and capital gain/loss, at the time of their sale.

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5. What are participating preference shares?
The holders of these shares participate in surplus profits of the company. They are firstly paid a fixed rate of
dividend and then a reasonable rate of dividend is paid on equity shares. If some profits remain after paying both
these dividends, then preference shareholders participate in the surplus profits.

6. What is meant by debentures?
It is type of debt instrument that is not secured by physical asset or collateral. Debentures are backed only
by the general credit worthiness and reputation of the issuer. Both corporations and governments frequently issue
this type of bond in order to secure capital. Like other types of bonds, debentures are documented in an indenture.

7. Define Red Hiring Prospectus.
It is a prospectus which does not have details of either price or number of shares being offered or the
amount of issue. This means that in case price is not disclosed, the number of shares and the upper and lower price
bands are disclosed.

8. Give the meaning of Bought out Deals (BOD).
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.

9. What is green shoe option?
Green shoe option means an option of allocating shares in excess of the shares included in the public issue
and operating a post-listing price stabilizing mechanism for a period not exceeding 30 days in accordance with the
provisions of Chapter VIII A of DIP Guidelines, which is granted to a company to be exercised through a Stabilizing
Agent.

10. What is Book-Building?
Book building is actually a price discovery method. In this method, the company does not fix up a particular
price for the shares, but instead gives a price range, eg. Rs.80-100.

UNIT-III

1. Define merger.

A merger is a combination of two or more companies into one company. It may be in the form of one or more
companies being merged into an existing company or a new company may be formed to merge two or more existing
companies. The Income Tax Act, 1961 of India uses the term „amalgamation‟ for merger.

2. Explain absorption.

A Combination of two or more companies into an existing company is known as „absorption‟. In a merger
through absorption all companies except one go into liquidation and lose their separate identities.

3. What is congeneric merger?

It occurs where two merging firms are in the same general industry, but they have to mutual
buyer/customer or supplier relationship, such as a merger between a bank and a leasing company. For example,
Prudential‟s acquisition of Bache and Company.

4. Who is a portfolio manager?

Portfolio manager means any person who pursuant to a contract or arrangement with a client, advises or
directs or undertakes on behalf of the client (whether as a discretionary portfolio manager or otherwise) the
management or administration of a portfolio of securities or the funds of the client, as the case may be.

5. What is an underwritten deal?

An underwritten deal is one for which the arrangers guarantee the entire commitment, and then syndicate
the loan. If the arrangers cannot fully subscribe the loan, they are forced to absorb the difference, which they may
later try to sell to investors.

6. What is novation?

Novation is the only way in which a lender can effectively „transfer‟ all its rights and obligations under the
Loan Agreement. The process of transfer effectively cancels the existing lender‟s obligations and rights under the
loan, while the new lender assumes identical new rights and obligations in their place. The documentation required to
affect a novation of a participation in a syndicated loan depends on the provisions in the Loan Agreement.

7. Define credit rating.

Credit rating is an assessment of the credit worthiness of individuals and corporations. It is based upon the
history of borrowing and repayment as well as the availability of assets and extent of liabilities. A credit rating tells a
lender or investors the probability of the subject being able to pay back a loan.

8. Expand CRISIL and ICRA.

CRISIL – Credit Rating Information Services of India Limited
ICRA – Investment Information and Credit Rating Agencies of India

9. What do you understand by mutual fund?

A mutual fund is a professionally-managed form of collective investments that pools money from many
investors and invests it in stocks, bonds, short-term money market instruments, and/or other securities. In a mutual

fund, the fund manager, who is also known as the portfolio manager, trades the fund‟s underlying securities, realizing
capital gains or losses, and collects the dividend or interest income.

10. Who are trustees?

Persons who hold the property of the mutual fund in trust for the benefit of the unit holders are called
„trustees‟. Trustees look after the mutual fund, which is constituted as a trust under the provisions of the Indian Trust
Act.

11. What is meant by asset Management Company?

The investment manager of a mutual fund is technically known as the „Asset Management Company‟, and is
appointed by the sponsor or the trustees. The AMC manages the affairs of the mutual fund. It is responsible for
operating all the schemes of the fund, and can act as the AMC of only one mutual fund.

12. What are Gilt funds?

Gift funds are also known as Government Securities in India, Gift Funds invest in government papers
(named dated securities) having medium to long-term maturity period. Issued by the Government of India, these
investments have little credit risk (risk of default) and provide safety of principal to the investors.

13. What is business valuation?

Business valuation is a process and a set of procedures used to estimate the economic value of an owner‟s
interest in a business. Valuation is used by financial market participants to determine the price they are willing to pay
or receive to consummate a sale of a business.

UNIT-IV

1. Define Leasing.

A lease may be defined as a contractual arrangement/transaction in which a party owning an
asset/equipment (lessor) provides the asset for use to another/transfer the right to use the equipment to the user
(lessee) over a certain/for an agreed period of time for consideration in form of/in return for periodic payment
(rentals) with or without a further payment (premium).

2. Write the elements of leasing.

Parties to the contract
Asset
Ownership Separated from user
Term of lease
Lease Rentals

Modes of terminating lease

3. Define Angel Finance.

Angel investors are private investors, typically wealthy individuals who provide financial support in return for an equity stake. Angel investors have personal interest in the venture and offer advice, and support to promoters for achieving success.

4. Write the entities of Direct Lease.

In direct lease, the lessee and the owner of the equipment are two different entities. A direct lease can be of two types:

Bipartite and
Tripartite lease.

5. Mention the six players of leasing.

Independent Leasing Companies
Other finance companies
Manufacturer-Lessors
Financial Institutions
In-house Lessors
Commercial Banks

6. Write any four advantages of lease financing.

The advantages of leasing are as follows:

To the Lessee:

Lease financing has following advantages to the lessee:

Financing of Capital Goods
Additional Source of Finance
Less Costly
Obsolescence Risk is Averted

To the Lessor:

A lessor has the following advantages:

Full Security
Tax Benefit
High Profitability
Trading on Equity

7. List out the types of leasing.

Leasing can be classified into the following types:

- Finance lease and Operating Lease,
- Sales and lease back and Direct lease,
- Single investor lease and Leveraged lease and
- Domestic lease and International lease.

8. Give the meaning of hire purchasing.

Hire-purchase is a mode of financing the price of the goods to be sold on a future date. In a hire-purchase transaction, the goods are let on hire, the purchase price is to be paid in installments and the hirer is allowed an option to purchase the goods by paying all the installments.

9. Write any two characteristics of hire purchase.

- Payment to be made in instalments over a specified period.
- The possession is delivered to the hirer at the time of entering into the contract.

10. Define Contract of Sales of Goods.

A contract of sales of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price. It includes both an actual „sale" and an „agreement to sell" which vastly differ from each other.

UNIT-V

1. Define venture capital.

Venture capital is defined as providing seed, start up and first stage financing and also funding expansion of companies that have already demonstrated their business potential but do not yet have access to the public securities market or to credit-oriented institutional funding sources.

2. What is last stage financing?

This stage of venture capital financing involves established businesses which require additional financial support. At this stage, the firm is not ripe enough to go for a public offer as it has not reached the profit-earning stage.

3. Mention any two venture capital industry of India.

Two venture capital industry of India are

(i) Risk Capital and Technology Finance Corporation Limited

(ii) Technology Development and Information Company of India Limited (TDICI).

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4. What is foreign venture capital?

Foreign Venture Capital Investors (FVCIs) are those funds that are not constituted in India but make
investments in Indian capital market.

5. Define bill of exchange.

According to the Indian Negotiable Instruments Act, 1881: "The bill of exchange is an instrument in writing
containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only
to, or to the order of, a certain person, or to the bearer of that instrument."

6. Write a note on consumer credit.

Consumer credit includes all asset-based financing plans offered to primarily individuals to acquire durable
consumer goods. Typically, in a consumer credit transaction the individual-consumer-buyer pays a fraction of the
cash purchase price at the time of the delivery of the asset and pays the balance with interest over a specified period
of time.

7. What is the meaning of 'factoring'?

"Factoring means an arrangement between a factor and his client which includes at least two of the following
service to be provided by the factor:
(i)
Finance,
(ii)
Maintenance of accounts,
(iii)
Collection of debts and
(iv)
Protection against credit risk".

8. What is the meaning of 'Forfaiting'?

Forfaiting is a form of financing of receivables pertaining to international trade. It denotes the purchase of
trade bills/promissory notes by a bank/financial institution without recourse to the seller. The purchase is in the
form of discounting the documents covering the entire risk of non-payment in collection.

9. What do you mean by real estate financing?

A set of all financial arrangements that are made available by housing finance institutions to meet the
requirements of housing is called real estate financing.
Housing finance institutions includes banks, housing finance companies, special housing finance institutions,
etc.

10. What are the factors of real estate finance assistance?

- Loan Amount
- Tenure

Administrative & Processing Cost
Prepayment charges
Services
Value addition
Sources of finance like HFCs and banks
EMI calculation method.

SIXTEEN MARK QUESTIONS WITH ANSWER KEY

UNIT-I

1. Briefly explain the three tier system of stock exchange of India.

The three-tier stock market system as follows:

(i) Principal Stock Exchanges comprising of five major exchanges currently functioning in the metropolitan
centres of Mumbai, Delhi, Kolkata, Chennai and Ahmedabad.

(ii) Regional Stock Exchanges comprising of exchanges established in smaller metros and urban centres, i.e.,
comprising of all other existing Stock Exchange.

(iii) Additional Trading Floors (ATFs) sponsored and managed by either a principal or a Regional Stock Exchange.

2. Describe about the SEBI Regulations on Merchant Banking.

Following are the SEBI regulations on merchant banking:

Registration of Merchant Banker‟s
Requirements for Granting of Certificate
Capital Adequacy Requirements
Procedure for Registration
Renewal of Certificate

3. List out the important functions of merchant banking and explain it.

Some of the most important functions of investment banking are as follows:

Underwriter
Banker
Broker
Registrar
Debenture Trustee
Portfolio Manager

4. Give the meaning and definition of financial system. What are the functions of it?

A good financial system serves in the following ways:

Link between Savers and Investors
Helps in Projects Selection

□□Allocation of Risk
□□Information Available
□□Minimizes Situations of Asymmetric Information
□□Reduce Cost of Transaction and Borrowing
□□Promotion of Liquidity
□□Financial Deepening and Broadening

5. Write about the institutional structure of merchant banking and explain its elements.

The main elements of the re-organization of the institutional structure are briefly outlined below:
□□Development/Public Financial Institutions (DFIs/PFIs)
□□Commercial banks
□□Non-Banking Financial Companies (NBFCs)
□□Mutual Funds
□□Securities/Capital Market
(i)
Primary Market
(ii)
Secondary Market
□□Money Market

UNIT-II

1. Explain capital structure and its instruments.

There are four basic instruments of capital structure, viz.,
□□Equity Shares
□□Preference Shares
□□Retained Earnings/Ploughing Back of Profits
□□Debenture

2. Describe placement of the issues

□□Initial Public Offer (IPO)
□□Follow on Public Offer (FPO)
□□Rights Issue
□□Offer for Sale

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□□Green Shoe Option
□□E-IPO
□□Private Placement/Placement with FIs, MFs, FIIs, etc.
□□Bought Out Deal
□□Off-Shore Issues

3. Explain about the post-issue management.

After closing the public issue the next task of the merchant bankers is post issue management. It includes
□□Collection of Application Forms,
□□Screening of Applications,
□□Deciding Allotment Procedure,

Mailing of Allotment Letters and
Share Certificates and Refund Orders.

4. Give some details about SEBI Guidelines for Post-Issue Management.

The Post-issue obligations/requirements of lead managers/merchant bankers to an issue are discussed below.

Post-Issue Monitoring Reports
Redressal of Investors‟ Grievances
Co-ordination with Intermediaries
Finalization of Basis of Allotment
Dispatch of Share Certificates.

5. Explain issue marketing and its steps.

Following are the steps involved in the marketing of the issue of securities to be undertaken by the lead manager:

Target Market
Target Concentration
Pricing
Mobilizing Intermediaries
Information Contents
Launching Advertisement Campaign
Brokers‟ and Investors Conferences
Timing of the Issue

UNIT-III

1. What are the types of Mergers and also explain the process of mergers.

The following are the types of mergers:

Horizontal Merger
Vertical Merger
Conglomerate Merger
Congeneric Mergers
Reverse Merger

The process of merger or the steps involved in merger are as follows:

Defining the Corporate Strategy
Implementing the Corporate Strategy
Target Identification
Valuation of the Merger
Merger Implementation
Post-Merger Integration

2. Explain the details about Business Valuation.

Business valuation is a process and a set of procedures used to estimate the economic value of an owner‟s
interest in a business.

Valuation is just to estimate:

What (cash flow) +When (time period) + How (risk), we receive in future out of a subject property.
(i) Approaches for Valuation

- Asset-Based Approaches
- Earning Value Approaches
- Market Value Approaches

(ii) Reasons for Business Valuation
(iii) Valuation Procedures
(iv) Common Errors in Business Valuation
(v) Advantages of Business Valuation Methods
(vi) Disadvantages of Business Valuation Methods

3. What are all the techniques of Investment Analysis/Performance Evaluation of Mutual funds?

Performance evaluation methods generally fall into four categories:
(i) Sharpe‟s Ratio
(ii) Treynor‟s Measure

(iii) Jensen Measure
(iv) Modigliani and Modigliani Measure

4. What are the types of mutual funds?

Mutual funds can be classified under two different categories:
(i) General Classification

- Open-Ended Schemes
- Close-Ended Schemes
- Interval Scheme
- Load Funds
- Non-Load funds
- Tax-Exempt Funds
- Non-Tax-Exempt Funds

(ii) Broad Classification

- Equity Funds
-

Money Marker/Liquid Funds
□
Hybrid Funds
□
Debt/Income Funds
□
Gilt Funds
□
Commodity Funds
□
Real Estate Funds
□
Exchange Traded Funds(ETF)
□
Fund of Funds

5. Explain the functions of Credit Rating Agency.

A credit rating agency serves following functions:
(i) Provides Unbiased Opinion
(ii) Provides Quality and Dependable Information
(iii) Provides Information at Low
(iv) Provide Easy to Understand Information
(v) Provide Basis for Investment
(vi) Healthy Discipline on Corporate Borrowers
(vii) Formation of Public Policy

UNIT-IV

1. Difference between Leasing and Hire purchase financing.

These two modes of financing differ in the following respects:
□□Ownership
□□Depreciation
□□Magnitude
□□Extent
□□Maintenance
□□Tax Benefits

2. What are all the income tax considerations for the lessees?

The income tax considerations for the lessees are
□□Allowability of lessee rentals
□□Deduction of Incidental Expenses and
□□Tax Planning
o
Flexible structuring of lease rentals
o
Transfer of unabsorbed capital allowance to the lessor.

3. What are the limitations of lease financing?
Lease financing suffers from certain limitations too:
□□Restrictions on Use of Equipment
□□Limitations of Financial Lease
□□Loss of Residual Value
□□Consequences of Default
□□Understatement of Lessee‟s Asset
□□Double Sales-Tax.
4. What are the types of leasing?
Leasing can be classified into the following types:
□□Finance lease and Operating Lease,
□□Sales and lease back and Direct lease,
□□Single investor lease and Leveraged lease and
□□Domestic lease and International lease.
5. What are the advantages of leasing?
The advantages of leasing are as follows:

To the Lessee:
Lease financing has following advantages to the lessee:
□□Financing of Capital Goods
□□Additional Source of Finance
□□Less Costly
□□Ownership Preserved
□□Avoids Conditionalities
□□Flexibility in Structuring of Rentals
□□Simplicity
□□Tax Benefits
□□Obsolescence Risk is Averted
To the Lessor:
A lessor has the following advantages:
□□Full Security
□□Tax Benefit
□□High Profitability
□□Trading on Equity
□□High Growth Potential

UNIT-V

1. What are the characteristics of Venture Capital?
Following are the characteristics of venture capital.
a. New Ventures
b. Continuous Involvement
c. Mode of Investment
d. Objective

e. Hands-On Approach
f. High Risk-Return Ventures
g. Nature Of Firms
h. Liquidity

2. What are the features of Consumer Credit?

The features of Consumer Credit are as follows:
(i) Parties to the transaction
(ii) Structure of the transaction

(iii) Mode of Payment
(iv) Payment period and Rate of Interest
(v) Security

3. What are the functions of a factor?

Depending on the type/form of factoring, the main functions of a factor, in general terms, can be classified
into five categories:
(i) Maintenance/administration of sales ledger
(ii) Collection facility of accounts receivable
(iii) Financing facility/trade debts
(iv) Assumption of credit risk/credit control and credit protection and
(v) Provision of advisory services.

4. What are the types of bills?

There are various types of bills. They can be classified on the basis of when they are due for payment,
whether the documents of title of goods accompany such bills or not, the type of activity they finance, and so on.
Some of these bills are:
(i) Demand Bill
(ii) Usance Bills
(iii) Documentary Bills
(iv) D/A Bills
(v) D/P Bills
(vi) Clean Bills

5. What are the types of factoring?

The important forms/types of factoring are as follows:
(i) Recourse and Non-recourse Factoring
(ii) Advance and Maturity Factoring
(iii) Full Factoring
(iv) Disclosed and Undisclosed Factoring
(v) Domestic and Export/Cross-Border/International Factoring.