1. (a) Consider one-year Treasury bill.

\[ 91,500 = \frac{100,000}{1+r_1} \]

\[ 1+r_1 = \frac{100,000}{91,500} = 1.092896 \]

\[ r_1 = 0.0929 \text{ or } 0.093 \]

Consider two-year Government Security

\[ 98,500 = \frac{10,000}{1.093} + \frac{110,000}{1.093(1+r_2)} \]

\[ 98,500 = 91,491.31 + \frac{110,000}{1.093(1+r_2)} \]

\[ \Rightarrow 89,350.87 = \frac{100,640.4}{1+r_2} \]

\[ \Rightarrow 1+r_2 = 1.126351 \]

\[ \Rightarrow r_2 = 0.12635 \]

\[ \Rightarrow r_2 = 0.1263 \]

Consider three-year Government Securities:

\[ 99,000 = \frac{10,500}{1.093} + \frac{10,500}{1.093 \times 1.1263} + \frac{110,500}{1.093 \times 1.1263(1+r_3)} \]

\[ \Rightarrow 99,000 = 9,606.587 + 8,529.65 + \frac{89,761.07}{1+r_3} \]

\[ \Rightarrow 80,863.763 = \frac{89,761.07}{1+r_3} \]

\[ \Rightarrow 1+r_3 = 1.1100284 \]

\[ \Rightarrow r_3 = 0.1100284 \text{ say } 11.003\% \]

(b) Forward Rate = \[ \frac{2.50(1+0.075)}{(1+0.060)} = \text{Can$ 2.535/£} \]

(i) If spot rate decline by 2%

\[ \text{Spot Rate} = \text{Can$ 2.50 \times 1.02 = Can$ 2.55/£} \]
£ receipt as per Forward Rate (Can $ 5,00,000/ Can$ 2.535) | 1,97,239
£ receipt as per Spot Rate (Can $ 5,00,000/ Can$ 2.55) | 1,96,078
Gain due to forward contract | 1,161

(ii) If spot rate gains by 4%
Spot Rate = Can$ 2.50 x 0.96 = Can$ 2.40/£

£ receipt as per Forward Rate (Can $ 5,00,000/ Can$ 2.535) | 1,97,239
£ receipt as per Spot Rate (Can $ 5,00,000/ Can$ 2.40) | 2,08,333
Loss due to forward contract | 11,094

(iii) If spot rate remains unchanged

£ receipt as per Forward Rate (Can $ 5,00,000/ Can$ 2.535) | 1,97,239
£ receipt as per Spot Rate (Can $ 5,00,000/ Can$ 2.50) | 2,00,000
Loss due to forward contract | 2,761

(c) (in lakhs)

<table>
<thead>
<tr>
<th>Calculation of Present Value (PV) of cash payments:</th>
<th>Quote A</th>
<th>Quote B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial lease rent (PV)</td>
<td>5.00</td>
<td>1.00</td>
</tr>
<tr>
<td>Less: PV of tax benefit on initial payment of lease rent</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rs. 5.00 lakh x 0.30 x 0.91</td>
<td>(1.365)</td>
<td>-</td>
</tr>
<tr>
<td>Rs. 1.00 lakh x 0.30 x 0.91</td>
<td>-</td>
<td>(0.273)</td>
</tr>
<tr>
<td>PV of Annual lease rents</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rs. 21.06 lakh x 0.7 x 2.49</td>
<td>36.71</td>
<td>-</td>
</tr>
<tr>
<td>Rs. 19.66 lakh x 0.7 x 3.17</td>
<td>-</td>
<td>43.63</td>
</tr>
<tr>
<td><strong>Total payments in PV</strong></td>
<td><strong>40.345</strong></td>
<td><strong>44.357</strong></td>
</tr>
<tr>
<td>Capital Recovery Factor (reciprocal of Annuity Factor)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1/2.49</td>
<td>0.402</td>
<td>-</td>
</tr>
<tr>
<td>1/3.17</td>
<td>-</td>
<td>0.315</td>
</tr>
<tr>
<td><strong>Equated Annual Payment or cash outflow (Rs. lakhs)</strong></td>
<td><strong>16.20</strong></td>
<td><strong>13.979</strong></td>
</tr>
</tbody>
</table>

**Conclusion:** Since Quote B implies lesser equated annual cash outflow, it is better.

(d) (i) Pre-tax Income required on investment of Rs. 20,00,000
Let the period of Investment be ‘P’ and return required on investment Rs. 1,00,000 (Rs. 20,00,000 x 5%)
Accordingly,
(Rs. 20,00,000 x \(\frac{9}{100} \times \frac{P}{12}\) – Rs. 50,000 = Rs. 1,00,000)

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\[ P = 10 \text{ months} \]

(ii) Break-Even its investment expenditure

\[ (Rs. \ 20,00,000 \times \frac{9}{100} \times \frac{1}{12}) - Rs. 50,000 = 0 \]

\[ P = 3.33 \text{ months} \]

2. (a) A When dividend is paid

(a) Price per share at the end of year 1

\[ 100 = \frac{1}{1.10} (Rs. 5 + P_1) \]

\[ 110 = Rs. 5 + P_1 \]

\[ P_1 = 105 \]

(b) Amount required to be raised from issue of new shares

Rs. 10,00,000 – (Rs. 5,00,000 – Rs. 2,50,000)

Rs. 10,00,000 – Rs. 2,50,000 = Rs. 7,50,000

(c) Number of additional shares to be issued

\[ \frac{7,50,000}{105} = \frac{1,50,000}{21} \text{ shares or say 7143 shares} \]

(d) Value of ABC Ltd.

\[ \text{(Number of shares } \times \text{ Expected Price per share)} \]

\[ i.e., (50,000 + 7,143) \times Rs. \ 105 = Rs. 60,00,015 \]

B When dividend is not paid

(a) Price per share at the end of year 1

\[ 100 = \frac{P_1}{1.10} \]

\[ P_1 = 110 \]

(b) Amount required to be raised from issue of new shares

Rs. 10,00,000 – Rs. 5,00,000 = Rs. 5,00,000

(c) Number of additional shares to be issued

\[ \frac{5,00,000}{110} = \frac{50,000}{11} \text{ shares or say 4545 shares.} \]

(d) Value of ABC Ltd.,

\[ (50,000 + 4,545) \times Rs. \ 110 \]

\[ = Rs. 59,99,950 \]

Thus, as per M.M. approach the value of firm in both situations will be the same.
(b)  

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Adjusted Value Rs. lakhs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity Shares</td>
<td>63.920</td>
</tr>
<tr>
<td>Cash in hand</td>
<td>2.760</td>
</tr>
<tr>
<td>Bonds and debentures not listed</td>
<td>2.125</td>
</tr>
<tr>
<td>Bonds and debentures listed</td>
<td>7.500</td>
</tr>
<tr>
<td>Dividends accrued</td>
<td>1.950</td>
</tr>
<tr>
<td>Fixed income securities</td>
<td>9.409</td>
</tr>
<tr>
<td>Sub total assets (A)</td>
<td>87.664</td>
</tr>
<tr>
<td>Less: Liabilities</td>
<td></td>
</tr>
<tr>
<td>Amount payable on shares</td>
<td>13.54</td>
</tr>
<tr>
<td>Expenditure accrued</td>
<td>1.76</td>
</tr>
<tr>
<td>Sub total liabilities (B)</td>
<td>15.30</td>
</tr>
<tr>
<td>Net Assets Value (A) – (B)</td>
<td>72.364</td>
</tr>
<tr>
<td>No. of units</td>
<td>2,75,000</td>
</tr>
<tr>
<td>Net Assets Value per unit (Rs. 72.364 lakhs / 2,75,000)</td>
<td>Rs. 26.3142</td>
</tr>
</tbody>
</table>

3. (a) Working Notes:  
   (i) Computation of Forward Rates

<table>
<thead>
<tr>
<th>End of Year</th>
<th>NC</th>
<th>NC/Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>NC1.60 x (\frac{1+0.09}{1+0.08})</td>
<td>1.615</td>
</tr>
<tr>
<td>2</td>
<td>NC1.615 x (\frac{1+0.09}{1+0.08})</td>
<td>1.630</td>
</tr>
<tr>
<td>3</td>
<td>NC1.630 x (\frac{1+0.09}{1+0.08})</td>
<td>1.645</td>
</tr>
</tbody>
</table>

(ii) NC Cash Flows converted in Indian Rupees

<table>
<thead>
<tr>
<th>Year</th>
<th>NC (Million)</th>
<th>Conversion Rate</th>
<th>Rs. (Million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>-25.00</td>
<td>1.600</td>
<td>-15.625</td>
</tr>
<tr>
<td>1</td>
<td>2.60</td>
<td>1.615</td>
<td>1.61</td>
</tr>
<tr>
<td>2</td>
<td>3.80</td>
<td>1.630</td>
<td>2.33</td>
</tr>
<tr>
<td>3</td>
<td>4.10</td>
<td>1.645</td>
<td>2.49</td>
</tr>
</tbody>
</table>

Net Present Value

<table>
<thead>
<tr>
<th>Year</th>
<th>Cash Flow in India</th>
<th>Cash Flow in Nepal</th>
<th>Total</th>
<th>PVF @ 9%</th>
<th>PV</th>
<th>(Rs. Million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>---</td>
<td>-15.625</td>
<td>-15.625</td>
<td>1.000</td>
<td>-15.625</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>2.869</td>
<td>1.61</td>
<td>4.479</td>
<td>0.917</td>
<td>4.107</td>
<td></td>
</tr>
</tbody>
</table>
Modified Internal Rate of Return

<table>
<thead>
<tr>
<th></th>
<th>Year</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>0</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>Cash Flow (Rs. Million)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Year 1 Cash Inflow reinvested for 2 years (1.188 x 4.479)</td>
<td>-15.625</td>
<td>4.479</td>
<td>6.53</td>
<td>7.09</td>
<td></td>
</tr>
<tr>
<td>Year 2 Cash Inflow reinvested for 1 years (1.090 x 6.53)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>19.53</td>
</tr>
</tbody>
</table>

\[
\text{MIRR} = \left( \frac{\text{Terminal Cash Flow}}{\text{Initial Outlay}} \right)^{1/n} - 1 = \left( \frac{19.53}{15.625} \right)^{1/3} - 1 = 0.0772 \text{ say 7.72%}
\]

(b) (i) The contract is to be cancelled on 30-10-2010 at the spot buying rate of US$ 1 = Rs. 41.5000

Less: Margin Money 0.075%

= Rs. 0.0311

= Rs. 41.4689 or Rs. 41.47

US$ 20,000 @ Rs. 41.47

= Rs. 8,29,400

US$ 20,000 @ Rs. 42.32

= Rs. 8,46,400

The difference in favour of the Bank/Cost to the importer

Rs. 17,000

(ii) The Rate of New Forward Contract

Spot Selling Rate US$ 1 = Rs. 41.5200

Add: Premium @ 0.93%

= Rs. 0.3861

= Rs. 41.9061

Add: Margin Money 0.20%

= Rs. 0.0838

= Rs. 41.9899 or Rs. 41.99

4. (a) Conversion Value of Debenture

= Market Price of one Equity Share X Conversion Ratio

= Rs. 25 x 30 = Rs. 750

(b) Market Conversion Price

= Market Price of Convertible Debenture

\[
\text{Conversion Ratio}
\]

= \text{Rs. } 900 \over 30 = \text{Rs. 30}

(c) Conversion Premium per share

Market Conversion Price – Market Price of Equity Share

= Rs. 30 – Rs. 25 = Rs. 5

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(d) Ratio of Conversion Premium

\[
\text{Conversion premium per share} = \frac{\text{Rs. 5}}{\text{Rs. 25}} = 20\%
\]

(e) Premium over Straight Value of Debenture

\[
\frac{\text{Market Price of Convertible Bond}}{\text{Straight Value of Bond}} - 1 = \frac{\text{Rs. 900}}{\text{Rs. 700}} - 1 = 28.6\%
\]

(f) Favourable income differential per share

\[
\text{Coupon Interest from Debenture - Conversion Ratio \times Dividend Per Share \over Conversion Ratio}
\]

\[
\text{Rs. 85 - 30 \times 1 \over 30} = \text{Rs. 1.833}
\]

(g) Premium pay back period

\[
\frac{\text{Conversion premium per share}}{\text{Favourable Income Differential Per Share}} = \frac{\text{Rs. 5}}{\text{Rs. 1.833}} = 2.73 \text{ years}
\]

(b) (i) The Betas of two stocks:

Aggressive stock - 40% - 4% - 25% - 7% = 2

Defensive stock - 18% - 9% - 25% - 7% = 0.50

Alternatively, it can also be solved by using the Characteristic Line Relationship as follows:

\[
R_s = \alpha + \beta R_m
\]

Where

\[
\alpha = \text{Alpha} \quad \beta = \text{Beta} \quad R_m = \text{Market Return}
\]

For Aggressive Stock

4% = \alpha + \beta(7%)

40% = \alpha + \beta(25%)

36% = \beta(18%)

\beta = 2

For Defensive Stock

9% = \alpha + \beta(7%)

18% = \alpha + \beta(25%)

9% = \beta(18%)

\beta = 0.50

(ii) Expected returns of the two stocks:

Aggressive stock - 0.5 \times 4% + 0.5 \times 40\% = 22\%

Defensive stock - 0.5 \times 9% + 0.5 \times 18\% = 13.5\%

(iii) Expected return of market portfolio = 0.5 \times 7\% + 0.5 \times 25\% = 16\%

\therefore \text{Market risk prem.} = 16\% - 7.5\% = 8.5\%
\[ \text{SML is, required return} = 7.5\% + \beta \times 8.5\% \]

(iv) \( R_s = \alpha + \beta R_m \)

For Aggressive Stock
\[ 22\% = \alpha_A + 2(16\%) \]
\[ \alpha_A = -10\% \]

For Defensive Stock
\[ 13.5\% = \alpha_D + 0.50(16\%) \]
\[ \alpha_D = 5.5\% \]

5. (a) The annual change in cash flows through entering into a factoring agreement is:

<table>
<thead>
<tr>
<th>Savings</th>
<th>(Amount in Rs.)</th>
<th>(Amount in Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Administration cost saved</td>
<td></td>
<td>1,00,000</td>
</tr>
<tr>
<td>Existing average debtors</td>
<td>21,91,781</td>
<td></td>
</tr>
<tr>
<td>[Rs. 1,00,00,000/365) x 80 days]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average New Debtors</td>
<td>16,43,836</td>
<td></td>
</tr>
<tr>
<td>[(Rs. 1,00,00,000/365) x 60 days]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reduction in debtors</td>
<td>5,47,945</td>
<td></td>
</tr>
<tr>
<td>Cost there of @80%</td>
<td>4,38,356</td>
<td></td>
</tr>
<tr>
<td>Add: Interest saving @15% p.a. on</td>
<td>Rs. 4,38,356</td>
<td>65,753</td>
</tr>
<tr>
<td>Add: Bad Debts saved @.005 of</td>
<td>Rs. 1,00,00,000</td>
<td>50,000</td>
</tr>
<tr>
<td>Rs. 1,00,00,000</td>
<td></td>
<td>Total 2,15,753</td>
</tr>
<tr>
<td>Less: Annual charges @2% of</td>
<td>Rs. 1,00,00,000</td>
<td>2,00,000</td>
</tr>
<tr>
<td>Net annual benefits of factoring</td>
<td></td>
<td>15,753</td>
</tr>
</tbody>
</table>

Therefore, the factoring agreement is worthwhile and should be undertaken.

(b) (i) To compute perfect hedge we shall compute Hedge Ratio (\( \Delta \)) as follows:

\[ \Delta = \frac{C_1 - C_2}{S_1 - S_2} = \frac{150 - 0}{780 - 480} = \frac{150}{300} = 0.50 \]

Mr. Dayal should purchase 0.50 share for every 1 call option.

(ii) Value of Option today

If price of share comes out to be Rs.780 then value of purchased share will be:

\[
\begin{align*}
\text{Sale Proceeds of Investment (0.50 x Rs. 780)} & \quad \text{Rs. 390} \\
\text{Loss on account of Short Position (Rs. 780 – Rs. 630)} & \quad \text{Rs. 150} \\
\quad & \quad \text{Rs. 240}
\end{align*}
\]

If price of share comes out to be Rs. 480 then value of purchased share will be:

\[
\begin{align*}
\text{Sale Proceeds of Investment (0.50 x Rs. 480)} & \quad \text{Rs. 240} \\
\text{Accordingly, Premium say P shall be computed as follows:} & \\
(Rs. 300 – P) 1.025 & = \text{Rs. 240} \\
P & = \text{Rs.65.85}
\end{align*}
\]
(iii) Expected Return on the Option

Expected Option Value = (Rs. 780 – Rs. 630) × 0.60 + Rs. 0 × 0.40 = Rs. 90

Expected Rate of Return = \frac{90 - 65.85}{65.85} \times 100 = 36.67%  

6. (a) Working Notes

Calculation of Interest Payment on 9% Debentures

PVAF (9%,6) = 4.486

Annual Installment = \frac{Rs. 22.50 crore}{4.486} = Rs. 5.0156 crore

<table>
<thead>
<tr>
<th>Year</th>
<th>Balance Outstanding (Rs. Crore)</th>
<th>Interest (Rs. Crore)</th>
<th>Installment (Rs. Crore)</th>
<th>Principal Repayment (Rs. Crore)</th>
<th>Balance (Rs. Crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>22.5000</td>
<td>2.025</td>
<td>5.0156</td>
<td>2.9906</td>
<td>19.5094</td>
</tr>
<tr>
<td>2</td>
<td>19.5094</td>
<td>1.756</td>
<td>5.0156</td>
<td>3.2596</td>
<td>16.2498</td>
</tr>
<tr>
<td>3</td>
<td>16.2498</td>
<td>1.462</td>
<td>5.0156</td>
<td>3.5536</td>
<td>12.6962</td>
</tr>
<tr>
<td>4</td>
<td>12.6962</td>
<td>1.143</td>
<td>5.0156</td>
<td>3.8726</td>
<td>8.8236</td>
</tr>
</tbody>
</table>

Statement showing Value of Equity

<table>
<thead>
<tr>
<th>Particulars</th>
<th>2013-14 (Rs. Crore)</th>
<th>2014-15 (Rs. Crore)</th>
<th>2015-16 (Rs. Crore)</th>
<th>2016-17 (Rs. Crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>EBIT</td>
<td>48.0000</td>
<td>57.0000</td>
<td>68.0000</td>
<td>82.0000</td>
</tr>
<tr>
<td>Interest on 9% Debentures</td>
<td>2.025</td>
<td>1.7560</td>
<td>1.4620</td>
<td>1.1430</td>
</tr>
<tr>
<td>Interest on 8% Loan</td>
<td>12.8000</td>
<td>12.8000</td>
<td>12.8000</td>
<td>12.8000</td>
</tr>
<tr>
<td>EBT</td>
<td>33.1750</td>
<td>42.4440</td>
<td>53.7380</td>
<td>68.0570</td>
</tr>
<tr>
<td>Tax* @35%</td>
<td>11.6110</td>
<td>14.8550</td>
<td>18.8080</td>
<td>23.8200</td>
</tr>
<tr>
<td>EAT</td>
<td>21.5640</td>
<td>27.5890</td>
<td>34.9300</td>
<td>44.2370</td>
</tr>
<tr>
<td>Dividend @12.5% of EAT*</td>
<td>2.6955</td>
<td>3.4490</td>
<td>4.3660</td>
<td>5.5300</td>
</tr>
<tr>
<td>Balance b/f</td>
<td>18.8685</td>
<td>24.1400</td>
<td>30.5640</td>
<td>38.7070</td>
</tr>
<tr>
<td>Balance c/f</td>
<td>18.8685</td>
<td>43.0085</td>
<td>73.5725</td>
<td>112.2795</td>
</tr>
<tr>
<td>Share Capital</td>
<td>82.5000</td>
<td>82.5000</td>
<td>82.5000</td>
<td>82.5000</td>
</tr>
</tbody>
</table>

*Figures have been rounded off.

In the beginning of 2013-14 equity was Rs. 82.5000 crore which has been grown to Rs. 194.7795 over a period of 4 years. In such case the compounded growth rate shall be as follows:

(194.7795/82.5000)^{1/4} - 1 = 23.96%

This growth rate is slightly higher than 20% as projected by Mr. Smith.

If the condition of VenCap for 18 shares is accepted the expected share holding after 4 years shall be as follows:

<table>
<thead>
<tr>
<th>No. of shares held by Management</th>
<th>6.00 crore</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. of shares held by VenCap at the starting stage</td>
<td>2.25 crore</td>
</tr>
<tr>
<td>No. of shares held by VenCap after 4 years</td>
<td>4.05 crore</td>
</tr>
<tr>
<td>Total holding</td>
<td>6.30 crore</td>
</tr>
</tbody>
</table>
Thus, it is likely that Mr. Smith may not accept this condition of VenCap as this may result in losing their majority ownership and control to VenCap. Mr. Smith may accept their condition if management has further opportunity to increase their ownership through other forms.

(b) CAPM formula for calculation of Expected Rate of Return is:
\[ ER = R_f + \beta (R_m - R_f) \]
\[ = 8 + 1.5 (12 - 8) \]
\[ = 8 + 1.5 (4) \]
\[ = 8 + 6 \]
\[ = 14\% \text{ or } 0.14 \]

Applying Dividend Growth Model for the calculation of per share equilibrium price:
\[ ER = \frac{D_1}{P_0} + g \]
\[ 0.14 = \frac{3 (1.10)}{P_0} + 0.10 \]
\[ 0.14 - 0.10 = \frac{3.30}{P_0} \]
\[ 0.04 P_0 = 3.30 \]
\[ P_0 = \frac{3.30}{0.04} = \text{Rs. 82.50} \]

Per share equilibrium price will be Rs. 82.50.

7. (a) Salient features of Financial Lease
(i) It is an intermediate term to long-term arrangement.
(ii) During the primary lease period, the lease cannot be cancelled.
(iii) The lease is more or less fully amortized during the primary lease period.
(iv) The costs of maintenance, taxes, insurance etc., are to be incurred by the lessee unless the contract provides otherwise.
(v) The lessee is required to take the risk of obsolescence.
(vi) The lessor is only the Financier and is not interested in the asset.

(b) Financial restructuring, is carried out internally in the firm with the consent of its various stakeholders. Financial restructuring is a suitable mode of restructuring of corporate firms that have incurred accumulated sizable losses for over a number of years. As a sequel, the share capital of such firms, in many cases, gets substantially eroded / lost; in fact, in some cases, accumulated losses over the years may be more than share capital, causing negative net worth. Given such a dismal state of financial affairs, a vast majority of such firms are likely to have a dubious potential for liquidation. Can some of these firms be revived? Financial restructuring is one such a measure for the revival of only those firms that hold promise/prospects for better financial performance in the years to come. To achieve the desired objective, such firms warrant / merit a restart with a fresh balance sheet, which does not contain past accumulated losses and fictitious assets and shows share capital at its real/true worth.

(c) Credit rating is a very important indicator for prudence but it suffers from certain limitations. Some of the limitations are:
(i) **Conflict of Interest** – The rating agency collects fees from the entity it rates leading to a
conflict of interest. Since the rating market is very competitive, there is a distant possibility of such conflict entering into the rating system.

(ii) Industry Specific rather than Company Specific – Downgrades are linked to industry rather than company performance. Agencies give importance to macro aspects and not to micro ones; overreact to existing conditions which come from optimistic / pessimistic views arising out of up / down turns. At times, value judgments are not ruled out.

(iii) Rating Changes – Ratings given to instruments can change over a period of time. They have to be kept under constant watch. Downgrading of an instrument may not be timely enough to keep investors educated over such matters.

(iv) Corporate Governance Issues – Special attention is paid to:
   (a) Rating agencies getting more of their revenues from a single service or group.
   (b) Rating agencies enjoying a dominant market position. They may engage in aggressive competitive practices by refusing to rate a collateralized / securitized instrument or compel an issuer to pay for services rendered.
   (c) Greater transparency in the rating process viz. in the disclosure of assumptions leading to a specific public rating.

(v) Basis of Rating – Ratings are based on ‘point of time’ concept rather than on ‘period of time’ concept and thus do not provide a dynamic assessment. Investors relying on the credit rating of a debt instrument may not be aware that the rating pertaining to that instrument might be outdated and obsolete.

(vi) Cost Benefit Analysis – Since rating is mandatory, it becomes essential for entities to get themselves rated without carrying out cost benefit analysis. Rating should be left optional and the corporate should be free to decide that in the event of self-rating, nothing has been left out.

(d) Some of the techniques used for economic analysis are:

(i) Anticipatory Surveys: They help investors to form an opinion about the future state of the economy. It incorporates expert opinion on construction activities, expenditure on plant and machinery, levels of inventory – all having a definite bearing on economic activities. Also future spending habits of consumers are taken into account.

(ii) Barometer/Indicator Approach: Various indicators are used to find out how the economy shall perform in the future. The indicators have been classified as under:
   (1) Leading Indicators: They lead the economic activity in terms of their outcome. They relate to the time series data of the variables that reach high/low points in advance of economic activity.
   (2) Roughly Coincidental Indicators: They reach their peaks and troughs at approximately the same in the economy.
   (3) Lagging Indicators: They are time series data of variables that lag behind in their consequences vis-a-vis the economy. They reach their turning points after the economy has reached its own already.

All these approaches suggest direction of change in the aggregate economic activity but nothing about its magnitude.

(iii) Economic Model Building Approach: In this approach, a precise and clear relationship between dependent and independent variables is determined. GNP model building or sectoral analysis is used in practice through the use of national accounting framework.
The success of any business is measured in financial terms. Maximizing value to the shareholders is the ultimate objective. For this to happen, at every stage of its operations including policy-making, the firm should be taking strategic steps with value-maximization objective. This is the basis of financial policy being linked to strategic management.

The linkage can be clearly seen in respect of many business decisions. For example:

(i) Manner of raising capital as source of finance and capital structure are the most important dimensions of strategic plan.

(ii) Cut-off rate (opportunity cost of capital) for acceptance of investment decisions.

(iii) Investment and fund allocation is another important dimension of interface of strategic management and financial policy.

(iv) Foreign Exchange exposure and risk management.

(v) Liquidity management

(vi) A dividend policy decision deals with the extent of earnings to be distributed and a close interface is needed to frame the policy so that the policy should be beneficial for all.

(vii) Issue of bonus share is another dimension involving the strategic decision.

Thus from above discussions it can be said that financial policy of a company cannot be worked out in isolation to other functional policies. It has a wider appeal and closer link with the overall organizational performance and direction of growth.