<PGDM-IBM, 2016-18>

<Investment Management>

<INS-503>

Trimester – V, End-Term Examination: December-2017

Time allowed: 2 Hrs 30 Min
Max Marks: 50

Roll No: ____________

Instruction: Students are required to write Roll No on every page of the question paper, writing anything except the Roll No will be treated as **Unfair Means.** All other instructions on the reverse of Admit Card should be followed meticulously.

Sections	No. of Questions to attempt	Marks	Marks
A	3 out of 5 (Short Questions)	5 Marks each	3*5 = 15
B	2 out of 3 (Long Questions)	10 Marks each	2*10 = 20
C	Compulsory Case Study	15 Marks	15
		Total Marks	**50**

Section-A

Answer any 3 out 5 questions. **5 Marks Each**

A1. Identify important interactions of noninvestment functions with investment functions

A2. Describe how companies can proactively manage the risk of changing regulatory requirements and standards.

A3. Define rate of return and identify potential source of investment returns

A4. Differentiate between types of mortgages and describe various aspects of mortgage operations.

A5. Describe the primary characteristics of alternative investments.

Section-B

Answer any 2 out 3 questions. **10 Marks Each**

B1. Describe types of common stock dividends and the process for declaring, paying, and controlling dividend payments.

B2. Describe how life insurance companies are required to apply risk capital charges to bond investments.

B3. Describe the characteristics of the financial obligations of a life insurance company, including how asset risk and credit risk can affect a company's liabilities, assets, and capital.

Section-C

Case Study Compulsory: **15 Marks**

Buyback of Shares by MNCs in India In the financial year 2001-2002, twenty MNCs made buyback offers. Some of the wellknown MNCs which offered to buy back their shares were Philips India Limited (Philips), Cadbury India Limited (Cadbury), Britannia Industries Limited (Britannia), Carrier Aircon (Carrier) and Otis Elevators (Otis). All these companies made open offers for the non-promoter shareholding in their Indian subsidiaries. To buy back shares, Cadbury paid 9 billion, Philips 2 billion, and Carrier, Otis and Reckitt Benkiser all paid over 1 billion. According to analysts, the increased buyback activity by MNCs was due to three reasons. They felt that the share prices of most MNCs were under priced and did not reflect the true value of the company. Moreover, the buyback of shares allowed MNCs to convert their Indian ventures into Wholly Owned Subsidiaries (WOS). It also allowed them to delist the shares of these ventures from the stock markets and thus protect them from the volatility of the stock markets (caused by scams and other market manipulations). Analysts also felt that MNCs had used the buyback of shares as a method for distributing surplus cash to their shareholders. Buyback also acted as a tool for creating wealth for the shareholders. The buyback of shares improved a company's return on equity (ROE), and this improvement would ultimately be reflected in a higher price earning ratio. Buyback by the company usually indicated that the management felt that the stock was undervalued. It resulted in an increase in stock price, bringing it closer to the intrinsic value. For example, when Philips announced its first buyback offer at a maximum price of 105 in October 2000, its shares were trading at around 60. The buyback announcement resulted in an increase in the share price to 90 even before the buyback offer opened on November 13, 2000. Hence, the buyback offer gave shareholders an exit option that paid them a premium over the pre-buyback share price. However, in spite of the benefits of buyback, a section of analysts and investors felt that it was being misused by MNCs. Analysts felt that the buyback option may be misused by MNCs to increase their equity stakes in their Indian ventures, escape public scrutiny and accountability and prevent them from the Indian regulatory environment. Moreover, the option to convert their Indian ventures into wholly owned subsidiaries and delist their shares from the stock markets provided MNCs with complete control over their Indian ventures, allowed them to repatriate profits and make more independent investment decisions. A section of investors felt that government regulations must have provided them with a choice. However, minority shareholders claimed that they had no option and were forced to sell their shares once MNCs bought back shares from the majority shareholders. For example, because Life Insurance Corporation (LIC) and the General Insurance Corporation (GIC), who together held a 21% stake in Philips, surrendered their shares when Philips made its first buyback offer, the minority shareholders were forced to surrender the remaining shares when Philips made a second offer in November 2001. Reportedly, investors feared losing an exit option in case the shares get delisted. Moreover, during the second offer, the trading volume of shares fell to less than (on an average) 500 shares per day since December 2001. Similarly, when Cadbury made a buyback offer, public shareholding fell from 26.67% to just 7.32% within six months after the majority shareholders surrendered their shares. Moreover, in this case, investors felt that the premium offered by Cadbury Schweppes, the UK based parent company of Cadbury, was low. The offer was priced at 500, which represented a premium of 24% on the average high and low prices over the past 26 weeks prior to the offer. However, Cadbury's stock had been

trading at prices in excess of 500 in 1999 and 2000, with an average P/E multiple of 60 in 1999 and 54 in March 2000. Moreover, Cadbury's third quarter (October to December 2001) sales had increased by 11.2% compared to the same period in 2000, while its profits had increased by 5.2%. Hence, investors felt that the price offered for the buyback had not taken into consideration the future potential profits of the company and was not attractive to shareholders who had been holding their shares for a longer term. As a result of depressed stock market conditions, investors (in most cases) received a low buyback price. The price at which the open offers were made by MNCs caused great concern to both investors and regulators. Analysts argued that like China and Indonesia, India must revert back to a system that prevented multinationals from delisting their shares from the stock exchange by prescribing a minimum amount of floating stock. The buyback by MNCs not only affected the small shareholders, it also had an impact on the stock exchanges. The buyback of floating stock resulted in a decline in the trading volumes. For example, the Delhi Stock Exchange was badly affected as MNCs accounted for more than 90% of the volume traded and 85% of the listing fees earned by the exchange before the buyback act was introduced. Given the negative impact of the Buyback Act, market observers felt that the act had failed to revive the capital markets. The dilemma that faced small investors in India was whether the buyback option, along with the SEBI guidelines, actually protected their interests and offered them an exit option at a fair price or was it a tool that provided them with no options allowing large MNCs to gain complete control of their subsidiaries. Investors felt that the regulations framed by SEBI did not have provisions for preventing good stocks from delisting. Moreover, the buyback price, which was determined using the parameters specified in the SEBI Takeover Code, did not consider the future potential of the stock (Refer Exhibit III for details of pricing parameters of open offers). They felt that SEBI should have looked at various financial parameters such as future cash flows, value of brands and the value of fixed assets to determine a pricing formula for open offers which ensured that investors who had been holding the stock for several years received a fair price for their investment.

Questions 1. What were the objectives of the buyback ordinance issued by the Government of India in 1998? Describe the salient features of the buyback ordinance. Why did MNCs want to buy back the shares of their Indian ventures? Explain

Question 2 The depressed stock markets in India are being utilized by several large MNCs to increase their stake in their Indian subsidiaries through the buyback of shares. Explain in detail the different methods of buyback available to an organization.

Question 3. According to minority shareholders, MNCs had misused the buyback option. Explain the various grievances of minority shareholders regarding the buyback of shares

Question 4. Do you think stringent measures should be introduced to protect the interests of small investors? What should SEBI do to safeguard small investors' interests and resolve their grievances?