GALGOTIAS UNIVERSITY

ADMISSION NUMBER

School of Business

Master of Business Administration MBA Dual Specialization
Semester End Examination - May 2024

Duration : 180 Minutes
Max Marks : 100

Sem IV - MBFI6015 - Managing Banks and Financial Institutions

General Instructions
Answer to the specific question asked
Draw neat, labelled diagrams wherever necessary
Approved data hand books are allowed subject to verification by the Invigilator

1) Classify the role of NABARD in India's rural development and agricultural financing? K3 (6)

2) Briefly analyze the concept of Operational Risk? Examine the types of Operational Risk as identified by Basel Committee. K4 (8)

3) Explain how government interventions during financial crises impact market behavior? K4 (8)

4) Classify Non-Banking Financial Companies (NBFCs) based on their activities and highlight the regulatory bodies overseeing each category K4 (4)

5) A technology startup is seeking advice on the most suitable financing option to fund its expansion plans. Analyze the company's growth prospects, cash flow projections, and risk profile to recommend whether the company should pursue venture capital funding, private equity investment, or a combination of debt and equity financing. K3 (9)

6) Explain the governance structure of NABARD and how it ensures transparency and accountability in its operations and decision-making processes? K5 (10)

7) A distressed company is exploring strategic alternatives, including a potential merger with a competitor to achieve operational synergies and improve its financial position. Develop a turnaround plan that may involve cost rationalization, asset divestitures, and debt restructuring to enhance the company's attractiveness to potential acquirers. K5 (10)

8) CASE OF NETWORK 18 MEDIA AND INVESTMENTS ISSUE K5 (15)

Network 35 mode a rights issue of Partly Convertible Cumulative Preference Shares (PCCPS) of ₹200 each for cash at par to its equity shansholders on a rights basis in the ratio of one PCCPS for every five equity shares held as on the Record Date Le. March 18, 2008. Each PCCPS had one detachable warrant and the warrant was proposed to be issued only after the PCCPS became fully paid up within 75 days of allotment. The POCPS were proposed to be listed and available for trading.

Each PCCPS consisted of two parts. Part A of the PCCPS had the convertible portion which was to be compulsorily and automatically converted into one equity share. From the Issue Price of 200 an amount of 250 (15 towards tace value and 145 towards share premium) was to be appropriated towards issuance of each Part A. Part B of the PCCPS consisted of the non-convertible portion. After conversion of Part A into equity, Part B was proposed to continue to be traded as a preference share for the balance amount of 150. The shareholders were required to accept the PCCPS as a whole, part acceptance of the Part A or Part B was not allowed. Part B had a coupon rate of 5% payable annually as dividend. Part B was proposed to be redeemed at the end of five years from the date of allotment at the balance amount of ₹150.

The detachable warrant was entitled to the right to apply for one equity share of 25 each at the exercise price which was fixed at a 50% discount to the average of the weekly high and low of the closing prices of the equity share of the company on the stock exchange with a higher aggregate trading volume during the 90 day period immediately preceding the week in which the Board of directors of the company would inform the stock exchanges about fixing the record date for the warrant exercise period. The warrant exercise price was payable in full on application for issue of the entitled shares. The warrant exercise period was fixed as the period commencing after 24 months from the date of allotment up to 48 months from the date of allotment. The date of allotment for the warrants was the same as that of the PCCPS.

1. Analyse the rationale behind Network 35 Media and Investments' decision to issue PCCPS with detachable warrants. Discuss the benefits and potential risks associated with including detachable warrants in the rights issue. (5 marks)
2. Assess the impact of the rights issue of PCCPS on Network 35 Media and Investments' capital structure and financial position. Discuss how the issuance of PCCPS may affect the company's leverage, cost of capital, and shareholder value. (5 marks)

3. Discuss the regulatory requirements and compliance considerations associated with the issuance of PCCPS and detachable warrants. Analyse how Network 35 Media and Investments ensured compliance with relevant regulatory guidelines and disclosures in the rights issue. (5 marks)

9) Should Financial Systems be Rule-based? K6 (18)

After evaluating the pitfalls and advantages of both the systems, there is a view emerging that the financial system should be more rules-based. The recent global meltdown has proved one thing: Neither a rules-based regulatory system nor a principles-based regulatory system is a guarantee against bank failure. However, after evaluating the pitfalls and advantages of both the systems, there is a view emerging that the financial system should be more rules-based; this is especially true in the UK.

In contrast, two committees set up in India - the Percy Mistry Committee (2007) and the Raghuram Rajan Committee (2008) - to look into financial sector reforms have recommended that India's regulatory regime should move from rules-based to a principles based one.

Principles-based regulation (PBR) implies moving away, wherever possible, from dictating, through detailed prescriptive rules and supervisory actions, how firms should operate their businesses. Rules-based regulation, it is pointed out, is too rigid and prescriptive, and often the regulator and the regulated adopt adversarial and antagonistic postures. Some of the countries that follow principles-based regulatory systems are the UK, Australia, Canada and Ireland. Some of the leading countries whose regulatory regime is based on rules are the US, Spain and India.

However, as noted in the Turner Review, banks in countries following either of the systems have failed. For example, banks have failed in the US and the UK. So in a way, neither of the regulatory systems has proven to be robust. One way to draw lessons from the crisis would be to examine what countries such as India, Spain and Canada did right to insulate their financial systems from succumbing to the global crisis.

Spanish Method Notes

It would be worthwhile to examine the approaches of the various regulators to housing or mortgage finance. Spain, which follows a rules-based system, has a clearly spelt out mortgage risk policy for its credit institutions. Banco De Espana (BE) lays down that lending policy of credit institutions for mortgage should take into account the repaying capacity of the borrowers and should not just be based on the collateral. BE also emphasises on the importance of the loan to value (LTV) ratio. It cautions its credit institutions against being too permissive about LTV as this typically increases the expected losses in a mortgage loan portfolio.

The conservatism that insulated Spanish banks from crisis also played its role in keeping the banking system healthy in Canada, which follows a principles-based system of regulation. For example, mortgages with less than a 20 per cent down-payment have to be insured, and most of the securitised mortgage market consists of Canada Mortgage Bonds, which carry a government guarantee. The

Canadian central bank also did not allow creation of complex, synthetic securitised instruments involving Canadian mortgage assets. In India, the Reserve Bank of India (RBI) has strict rules regarding housing finance, specifying the risk weights to be attached to loans extended to borrowers. These risk weights vary according to the LTV ratios. The RBI also specifies the maximum sanctioned amount for LTV ratios as less than or equal to 75 per cent.

UK's System

In the UK, the Financial Services Authority (FSA) follows a principles-based regulation. However, in its proposed reforms for mortgage lending, it has categorically banned certain practices such as self-certified mortgages replacing it with those requiring verification of the income of the borrowers. It also now requires mortgage advisers to be personally accountable to the FSA.

Having realised that non-interventionist principles-based system need not always lead to
the desired regulatory outcome, there appears to be a distinct shift in the UK from a noninterventionist stance to a more intrusive one.

The Federal Reserve has also notified a revision in its Regulation Z (which implements the Truth in Lending Act and Home Ownership and Equity Protection Act), prohibiting creditors from making higher-priced mortgage loans based on the "value of the consumer's collateral without regard to the consumer's repayment ability".

Thus, in the case of the US and the UK, at least with respect to mortgage lending, the bias is in favour of a rules-based system. But is this desirable?

One of the biggest criticisms levelled against the rules-based system is that it stifles innovation by being too interfering. In contrast, a principles-based regulation is more accommodative to innovation because it is pliant and flexible. But, as the recent meltdown has shown, while gains from financial innovation benefit a few, the losses affect a greater number through systemic instability. When it comes to a trade-off between profitability and financial stability, the choice is very clear. Financial stability creates conducive atmosphere for profitability and for carrying out banking. Therefore, a rules-based system clearly scores over a principles-based system.

A developing country like India has its own compulsions which make a rules-based system better suited when it comes to meeting our development objectives. For example, with respect to financial inclusion, unless it is specifically laid down that banks must offer no-frills accounts to their customers with zero or minimum balance and also relax criteria for identification and account opening, the goal of financial inclusion may not be achieved. Also, there is nothing in the rules-based system that disallows innovation. If that were the case, Indian banks wouldn't have been allowed to offer several products

that they now offer. The pace of innovation would be slow but if it ensures financial stability for the system, the trade-off would be well worth it.

Question

1. Discuss the importance of rules and regulation in financial system.
2. What are the key regulations governing the operation of financial institutions in India?
3. Can you explain the rules and procedures for filing a complaint with the regulatory authority for financial misconduct?
4. How does the central bank decide on interest rate changes, and what rules govern its monetary policy decisions?
5. Under what circumstances can a financial institution be subjected to regulatory penalties or sanctions?

10) **CASE OF POWER FINANCE CORPORATION FPO** K6 (12)

Power Finance Corporation, a GOI enterprise, made a FPO in 2011 for ₹4,578 crore through the book building route in a price band of 193-203 per share. The ruling market price of the share at that time was higher at around 230 per share. As per the offer document, the offer P/E multiple was 9.85 times at the floor price and 10.36 times the cap and it compared favourably with the ruling P/E multiple of its peer, Rural Electrification Corporation which was at 9.83. The offer price-book value ratio was 1.62 times. The issue was received better by QIB investors but it got subscribed in all categories. Therefore, the cut-off price was fixed at the cap of 203 per share which translated into a discount of around 12% on the average ruling market price. The share quoted below offer price on listing day and closed at 2199 due to profit booking which is understandable. However, it performed well in aftermarket trade thereafter and remained above the offer price until June 2011.

1. Discuss the factors influencing the pricing strategy, including the price band, offer P/E multiple, and offer price-book value ratio. (4 marks)
2. Assess the response of Qualified Institutional Buyers (QIBs) to Power Finance Corporation's FPO and the determination of the cut-off price at the upper end of the price band. (4 marks)
3. Discuss the impact of market dynamics and investor behavior on the share price trajectory following the FPO. (4 marks)