

Corporate Finance

This book introduces corporate finance to first-year students in business schools. Basic subjects such as marketing, human resources and finance are fundamental to the learning of a business manager. A book on these subjects must emphasize learning that is conceptual in nature and, at the same time, application oriented. This book attempts to achieve this in a manner that is comprehensive and shorn of complexity. It examines the practice of finance without diluting theory and conceptual knowledge. Corporate finance is necessarily quantitative in nature, and the book duly places emphasis on that aspect. It ensures the primacy of ideas and concepts, utilizing numbers as supportive elements. Grounded in fundamental concepts, it is application oriented with global, real-world examples and contains corporate snippets and insights aiding the understanding of theoretical frameworks.

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Corporate Finance

Theory and Practice in Emerging Economies

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Corporate Snippets

I have made extensive use of what can be termed *corporate snippets* in each chapter.

These have been positioned close to the concept they refer to and are used for the following purposes:

1. Practical illustration of the concept being discussed: For instance, the concept of corporate governance is illustrated with an example of how the Securities and Exchange Board of India's (SEBI's) efforts helped to protect minority interest at Raymonds Ltd. Similarly, the concept of intermediation is illustrated with details of HDFC Bank intermediation.
2. Complexity of a concept: While the basic concept is explained in the main chapter, corporate snippets will expose the students to a little more intricacy. For instance, while discussing intra-year compounding in the main body of the chapter, continuous compounding has been explained as a snippet.
3. To explain a little extra, relating to a topic, without disturbing the flow of the chapter.

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Abbreviations

ADR	American depository receipts
AGM	annual general meeting
APV	adjusted present value
ARR	accounting rate of return
BG	bank guarantee
BOP	balance of payments
BSE	Bombay Stock Exchange
CA	current assets
CAGR	compounded annual growth rate
CAP	competitive advantage period
CAPM	capital asset pricing model
CDMA	code division multiple access
CKD	completely knocked down
CL	current liability
COC	cost of capital
CP	commercial paper
CSR	corporate social responsibility
DCF	discounted cash flow
DDM	dividend discount model
DDT	dividend distribution tax
DF	discount factor
DRIP	Dividend Reinvestment Plan
DTH	direct-to-home
EBIT	earnings before interest and taxes
EBITDA	earnings before interest, tax, depreciation and amortization
ECB	external commercial borrowing
ECGC	Export Credit Guarantee Corporation
EMH	efficient markets hypothesis
EPC	engineering, procurement and construction
EPS	earnings per share
ERP	enterprise resource planning

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ESOP	employee stock option plan
EVA	economic value added
FC	fixed costs
FCF	free cash flows
FDA	Food and Drug Administration
FDI	foreign direct investment
FEMA	Foreign Exchange Management Act
FII	foreign institutional investment
Fintech	financial technology
FMCG	fast-moving consumer goods
forex	foreign exchange
FPI	foreign portfolio investment
FVIF	future value interest factor
GAAP	generally accepted accounting principles
GDR	global depository receipts
GMAC	General Motors Acceptance Corporation
GSM	global system for mobile communications
HUL	Hindustan Unilever Ltd
IIAS	Institutional Investor Advisory Services India Limited
IMF	International Monetary Fund
IPO	initial public offering
IRR	internal rate of return
ITM	in the money
JV	joint venture
KFA	Kingfisher Airlines
LC	letter of credit
LEAPS	long-term equity anticipation securities
LRS	Liberalized Remittance Scheme
MIBOR	Mumbai inter-bank offered rate
MIRR	modified internal rate of return
MM Model	Modigliani–Miller Model
MNC	multinational company
NABARD	National Bank for Agriculture and Rural Development
NDTL	net demand and term liabilities
NOPAT	net operating profits after tax
NPA	non-performing asset
NPV	net present value
NSE	National Stock Exchange
OTC	over the counter
OTM	out of the money
PAT	profit after tax
PBT	profit before tax
P&L	profit and loss
P/E ratio	price earnings ratio

PE	private equity
PI	profitability index
PIGS	Portugal, Ireland, Greece and Spain
PIK	payment-in-kind
PVIF	present value interest factor
R&D	research and development
ROE	return on equity
SEBI	Securities and Exchange Board of India
SLR	Statutory Liquidity Ratio
SME	small and medium enterprises
SWIFT	Society for Worldwide Interbank Financial Telecommunication
TIPS	treasury inflation protected securities
TSI	total societal impact
UK	United Kingdom
USA	United States of America
VIX	volatility index
WACC	weighted average cost of capital
WDV	written down value
YTM	yield to maturity

Preface

I have been teaching for over two decades. During this period, I have witnessed a quantum jump in the number of students pursuing business management in India and a significant decline in standards. Maybe, there is a correlation between the two. Business management as a course and the corporate sector as a career choice are demanding. Not everyone has the competence, or the inclination, to pursue it successfully. In our desire to be inclusive and to pass on the benefit of business management as a career to everyone, we may have diluted the standards significantly.

Management education in India presents a contrast. The top few business schools are demanding in terms of who they accept and the inputs they provide during the two years of the course. Only the best and the toughest emerge unscathed, ready to take on the challenges the corporate sector throws at them. They compete with the best global business schools on equal terms and the students have, over time, proven their competence in the corporate world throughout the world.

At the bottom are a large number of schools lacking in funding, competent faculty, infrastructure and, of course, students who can stand up to the rigour demanded by the study and practice of management. Of course, the desire to establish standards may also be lacking. The consequent dilution in quality has created a wide chasm, which has destroyed the credibility of management education in the country. MBA is not an inclusive course; by trying to make it inclusive, we have diluted its core and it no longer commands the respect it earlier did.

At the same time, management education in the country cannot be restricted to the top few. Not only would that be an elitist approach, it would ensure that the country is unable to provide for and meet the rising demand for professionals for a fast-expanding corporate sector.

This demand is currently fulfilled by business schools in the mid-range that may not match the best in the country but are able to provide inputs to students that enable them to pursue a lucrative career. My book is designed for students from these institutes, who are desirous of learning, imbibing and applying management theories and concepts but may not have the inclination or the capability to master the esoteric books and cases that are the bread and butter of the Indian Institute of Management (IIM) students.

The attempt has been to write a book that is simple and easy to read, without in any manner compromising on the conceptual knowledge required by a management student. Some of the books on the subject, written by well-known authors, are the finest one can come across. Books by Brealey and Myers; Ross, Westerfield and Jaffe; Damodaran; Vanhorne and others open up a new world that leads to lifelong fascination with the subject. But these books are also daunting, and quite frankly

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many would-be corporate sector managers are likely to be put off, as they usually are, by the size and complexity of these books.

What we need is a book that is relatively short and easy to read, current in terms of its coverage, elaborating on the latest developments in the subject, extensively incorporating quantitative aspects and throwing sufficient light on the practice of finance, without in any way diluting theory and conceptual knowledge. That has, in a nutshell, been the objective with which I have ventured into writing a textbook on a subject that otherwise presents a wide choice.

The book is primarily based on my teaching of the subject over the years. My first interaction with management students of a new batch is always in the second trimester/semester when they study corporate finance. The discussed objectives have been firmed up over many years of experience in teaching the subject. Students who intend to specialize in finance will find that the book provides sufficient expertise for them to pursue specialization subjects in the latter part of the course, while others will gain the requisite fundamental knowledge they may need on the subject.

The idea for the book germinated many years back when one of my students ‘advised’ me to write a book encapsulating what I usually teach in my classes. I had resisted the urge but now feel the need for such a book is imminent. I leave it to the students to judge whether it serves the purpose it is intended for.

Acknowledgements

Writing a book can be an exhausting and, at times, a lonely and tortuous experience. Often, it seems to be an endless task; there is always scope for improvement. One never realizes how onerous it can be until one starts. I would not advise it for the faint-hearted.

I am happy I was unaware it would take so much out of me; probably that is why the eventual satisfaction is much greater. Hopefully, the final output will justify the efforts that have gone into writing it. And, hopefully, it will encourage some students to take up finance as a career path, while others will be able to appreciate the role and influence of finance in their own streams of choice and in their work.

I have been fortunate to have received help from many people, directly and indirectly. The late Prof. P. L. Arya, my senior from IIM Ahmedabad, was instrumental in my shift from the corporate sector to academics and gave me the initial breathing space to make the changeover. Prof. Aruna Katara, president, the International Institute of Information Technology, Pune, gave the faculty the academic freedom that is so critical to the teaching–learning process. In her own way, she prodded me to write even when I showed reluctance. Prof. Swaminathan Sankaran was quite liberal in helping me, going through some of the chapters and providing advice. He was the first person whose views I sought before embarking on the journey.

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My students have, over the years, been responsible for keeping alive my interest in teaching, and challenging me with their inquisitiveness and incisive questioning. To them I owe a big gratitude.

My profuse and heartfelt thanks to Cambridge University Press, Anwesha Rana and Tapajyoti Chaudhuri. This is my first attempt at writing a book, and I was unaware of the many aspects of publishing. It is only with the constant help and assurances provided by Anwesha and Tapajyoti that the book has seen the light of day.

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My wife has probably suffered the most in the process of writing. As I have mentioned, writing a book can be a tortuous process and she was more tortured than I was during this time. While I cannot say she bore the torture without complaint, she did keep egging me on even while complaining. Hers has been a tremendous help in the whole process, helping me with concepts, structuring, editing, playing the devil's advocate and ensuring that the output is a quality one.

I thank them all. As I thank many others, friends and colleagues, whom I have had the fortune of knowing and who have enriched me in many ways.

Sunil Mahajan