IN THIS ISSUE

PREFERENCE OF IPO OVER M&A IN CURRENT INDIAN BUSINESS ENVIRONMENT

Flurry of IPOs in the Equity Markets
Message From The Convenor

Heartiest congratulations to all of you. With the release of the 3rd issue of our magazine we are getting bigger and better. It gives me immense pleasure and satisfaction to be convenor of the forum street. street provides a great platform for the students across all the B schools to share their thoughts and opinions and in the same time be aware in/of the latest events on the financial world. Being an integral part of Team street-NITIE has given me an opportunity to work with students brimming with enthusiasm and striving to advance forth with the common goal of learning and practicing finance to the zenith.

As always we have brought interesting articles to you. The articles in this issue focus on the different aspects of the mutual fund growth in India, insight to the situation of the IPO and Merger & Acquisitions scene in India. Also look out for interesting articles focusing on different financial aspects. Team street has transcended greater heights of achievements since its inception. The previous two editions saw contributions through articles and appreciation from the academia, leading B-Schools and the industry. In-Fin-NITIE is a laudable effort on the part of Team street which has tried in the best possible manner to help students articulate their knowledge through scientific and specialized thinking.

I applaud the efforts of the meticulous students for the unstinted efforts. I hope they strive to take the magazine to greater heights. I hope this issue will entertain you and keep you engrossed in the recent financial happenings around the world.

Congratulations to Team street for their outstanding work. May the efforts grow from strength to strength in the years to come. Looking forward to your comments and wishes to bring out more interesting issues in the future.

Dr. M Venkateswarlu
Professor of Finance
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As you enter the new year, Team Street brings to you the third edition of In-Fin-NITIE; this time addressing an issue that has been the focus of some finance events at NITIE and many financial markets in India: IPO's and Mergers and Acquisitions.

The depressed valuation of companies abroad and cheap access of debt and equity to Indian companies have made cross border M&A very attractive. As the total value deals in India grows from a $69 billion in 2007 to $71 billion in 2010 (according to Bloomberg), it becomes important to understand nitty-gritties of Indian deals.

Having received a humongous response in M&A case study competition at NITIE, we felt that it would be a step in the right direction to bring the intricacies to our esteemed readers and dedicate this issue to this burning topic. We again had an overwhelming response with articles from all over the country. A chosen few from these have made it to the magazine and they promise to be a fulfilling read.

We are extremely grateful to all our alums especially Saurabh Shankar, Tushar K Nayak and Prasann Potdar for their guidance and valuable feedback.

We have added new sections to the magazine. This issue of In-Fin-NITIE brings with it two new intellectually stimulating and fun elements: FinToonz and Crossfire. Turn into page 27. We will say no more.

The team at In-Fin-NITIE, values your comments and suggestions. We would like to hear from you regarding the magazine. Bouquets and brickbats can all be sent to the editor at street.nitie@gmail.com.

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Preference Of IPO Over M&A In Current Indian Business Environment

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With the combined effects of a controlled and cautious fiscal policy and a robust demand-driven domestic market, India has survived the global meltdown and regained its growth trajectory. Companies are back with their plans of diversifying and enhancing capacities and capabilities. The best indicators of economic growth are the buzzing activity in the capital markets in form of IPO's, M&A's, corporate capital restructuring. Owners monetize a portion of their company's value by selling to either a strategic buyer or offering shares to the public markets in an IPO.

IPOs have always been the first choice for the Indian companies for unlocking the company's value (raising funds). The dotcom growth decreased the bar for companies to carry out an IPO. Many startups went public without any income and little more than just a business plan.

When it comes to raising money, strategic acquisitions like M&A have not been enjoying the same level of preference, because of strict regulatory frameworks in the form of sector specific restrictions, which are now easing gradually.

With recent economic downturn and government's regulatory policies like 25 per cent mandatory public float are changing the rules of the capital market.

Indian M&A Market

M&A may be the best option for an unlisted company if it wishes to avoid public scrutiny. This typically involves partnering with companies who have a long term interest in the entity or share the same vision. Such partnering institutions would be expected to infuse more than just cash. Often such institutions have core competencies that complement the core business of the entity they are investing into. Therefore such investors are typically not on the lookout for immediate returns on their investments and stay on with the investee for the long haul. In many instances, strategic buyers are willing to pay more than the public markets for a specific company because they anticipate synergies -- ways in which the acquired company can enhance the value of the overall organization.

Is it Mature or Not?

In Indian context, however, M&A is not very matured activity and companies prefer to go for IPO when they are looking for more funds. This can be attributed to multiple factors that are unique to business environment and mindset of stakeholders. Some of these factors are elaborated below:

1. Business Environment:

The factor which plays an important role in deciding strategy of company is external environment. Rules and regulations of government are significantly important while evaluating cost of going for IPO or M&A for raising funds or as future strategy. Policy of government is more controlled and cautious which has positive impact in terms protecting Indian economy from global recession. But at the same time there is potential for development of framework for mergers and acquisitions.
There are certain factors in government policies which are not encouraging for companies to take route of M&A. These hurdles can be broadly classified in two categories.

a) Complex local regulatory frameworks:

The Income Tax Act, 1961 defines the term 'amalgamation' as the merger of one or more companies. Mergers and acquisitions are regulated under various laws in India. The objective of these laws is to make these deals transparent and protect the interest of all shareholders. The Companies act 1956 and 2002 are two such acts which take care of any irregularities. Some of the legal issues involved in M&A in India are:

1. Mergers are primarily supervised by the court and the Ministry of Company Affairs. The SEBI regulates takeovers of companies that have shares listed on any stock exchange in India.

2. Contractual and legal formalities involved are many. Share sale and purchase/acquisition agreement, asset and business transfer agreements, representations and warranties, indemnity, non-compete and non-solicitation, confidentiality, governing law, post completion matters and indemnities are significant agreements and clauses to effectively execute M&A.

3. Intellectual property assets such as patents, copyrights, trademarks and design transfer are important aspect of execution of M&A. Where the transferor company owns the intellectual property assets, such assets are transferred to the transferee company under the scheme of arrangement.

4. Monopolies and Restrictive Trade Practices Act, 1969 ("MRTP Act") and Competition Act, 2002 define framework and regulation to protect interest of industries. The MRTP Act aims towards controlling monopolistic, restrictive and unfair trade practices, which curtail competition in trade and industry

b) Cross border - Sectors restrictions:

To gain right valuation it is necessary that all parties have equal opportunities including multinational companies. But additional regulations attached with entry of foreign player’s entry into Indian market, realizing true value of company can be difficult many times.

These regulations act as barriers for foreign players, who otherwise may be interested in entering developing market like India. Liberalization saw changes in norms of FDI and realized its importance in economic development of a country.

2) Indians are emotionally attached to their business:

Family Business constitutes most business in India. Economic liberalization and rapid expansion in the industrial base in recent years has not only created growth opportunities for many but also tested their resource capabilities to respond to them. They have a strong emotional bondage and consider their role as a custodian of their business and continue to follow the preservation route. There is growing realization that families have a social role to fulfill and be responsible for specific activity including community development activities so they prefer to go for IPO route instead of M&A route to raise capital. IPO in India is considered to enhance corporate image and seen as a Brand enhancer as compared to M&A which is seen as a Brand dampener.

Indian IPO Market

An IPO is a financing event and not a liquidity event. Since CEOs and other early investors may not be able to sell immediately, much can happen—both good and bad—before one is allowed to sell shares; the underwriters demand a lock-up period on the shares. An IPO can be an attractive option, however, if your management team and you value your independence and wish to continue in your current roles.

Gush of liquidity into the system propels the positive sentiment. When sentiment is positive, corporate promoters sitting on the sidelines look to raise funds for their business expansion plans through the primary markets. The case about tapping the IPO route during bullish conditions is that even smaller companies can get through the process without any hiccups, at much higher valuations, due to following reasons:
1) High valued Indian equity market, high future growth - India a stable market, where stocks are valued fairly (or overvalued), it bodes well for a company to sell equity and raise cash by a primary issue of shares in the open market or a follow-on offer or a rights issue to existing shareholders.

2) Retail investor friendly facilities by SEBI – Several investor friendly initiatives such as ASBA etc. taken by SEBI have contributed hugely to the success of IPO’s. This eliminates problems associated with delay in receipt of refunds in case lesser shares or no shares are allotted. In India the IPO process is very transparent, while it is confidential in other countries.

3) Huge Foreign Fund flow in Indian equity market - India equity market has seen a huge amount of foreign inflows coming to India from last decade, because of its huge growth potential, helped by liberal policies taken up by the government.

4) Its employee considered an integral part of Business - M&A often cut costs by eliminating duplicate departments and functions, compared to an IPO that allows the company to keep their current employees in place.

5) Its employee Incentives – ESOP’s by the company to their employees are major boost for the employee morale. They feel more attached with the company’s growth. IPO unlocks a great value for Employee ESOPs after made public.

6) Marketing hype - IPOs in India invariably tend to attract huge media hype and analyst comment. No doubt this is a result of the substantial marketing spends legally carved out of IPO proceeds.

7) Less retail investor knowledge - It is easier to attract retail investors who are less informed but highly aware because of the media hype. In these kind of environment, sentiments work more than fundamentals. Eg Reliance Power IPO.

8) Surge in financial services companies catering to retailers (Demat Account) – Several Banks have ventured into providing Demat facilities to retail investors offering them lucrative offers for opening the account.

IPO works well for short term and long term investors alike as compared to M&A which needs long term investors.

If the company has a successful track record in a growing market or is perceived to have significant growth potential, going public does offer many advantages. An IPO makes future financing quicker, easier, and less expensive. It enhances the image of the company and provides it with greater visibility among vendors, customers, and the investment community.

IS IPO always better than M&A?

Choice between M&A and IPO depends upon context and reason for which stakeholders are looking out for such options. Reason can be as varied as exiting from company or can be looking for taking company to new heights with more investments.

Though IPO have been enjoying a huge success in Indian capital market compared to M&A, but the situation would not remain same because of several micro and macro economic factors. New regulations where the government has made mandatory for companies to maintain at least 25 per cent of public holding to remain listed and reach this threshold limit by diluting a minimum 5 per cent a year. These moves by the government are in line with practices followed in developed economies globally where M&A enjoys success.

Also, going public, can be a source of considerable trouble and expense. As an exit strategy, selling the company, rather than taking it public, offers many advantages.

1) Prone to market fluctuation – Equity dilution into the open market can often become a one-way ticket and it may become difficult for a company to delist at a later date, if it achieves a certain scale and valuation by then. Indian promoters and companies have this herd mentality of rushing to the market whenever the secondary market turns buoyant.

Selling the company offers a higher degree of certainty: a public company’s valuation is at the whim of the markets.
The valuation could rise, but it could also fall abruptly for any number of reasons, some of which are independent of the performance of the company, such as a change in macroeconomic conditions or degradation of a specific sector.

2) Immediate liquidity—Promoters who face succession planning, may want to sell to a strategic buyer to realize their company's value and exit the business. M&A is faster than exiting through an IPO, since the process of selling the company is generally less time-consuming than the process of going public; in addition, the owner will not be subject to a "lock-up" agreement which will force him to hold on to his stock for months.

3) Complicated - Investors and management teams seeking liquidity or those who are concerned about the costs of being public should consider M&A as a more attractive and less complicated option. IPO process is long and painful. Unlike the disclosure requirements that come along with an IPO, companies involved in most merger or acquisition transactions are not required to file disclosure statements.

4) Less Growth Companies - Selling a business is an option that is available to a wider range of owners than going public. If company has erratic earnings, they may still be able to find a buyer, whereas they will never be able to convince an investment bank to underwrite their IPO.

Conclusion:
While the primary consideration is often price—the greatest amount of money that can be obtained for their company, there are other critical factors to consider as well. The decision also depends on a company's growth prospects, as well as the goals and preferences of the CEO and management team. IPOs are not inherently better than acquisitions, or vice versa. The right choice depends on your personal goals, your company's objectives, your management team, your investors, your employees, and the market environment.

References:

Prerana, the three day management extravaganza at NITIE Started with “The Prerana Business Meet (PBM)” in a simple and elegant style.

It was a forum for the country’s most influential citizens to deliberate on relevant issues. Eminent panelists from Business World graced the occasion which include Mr. Prasada Rao, Chairman, BHEL; Mr. Ravneet Gill, MD, Deutsche Bank; Mr. Lamon Ruten, MD & CEO, MCX India, Mr. Vaidyanathan, Vice Chairman, Future Capital Holdings Ltd. Mr. Adi Godrej, Chairman, Godrej Group and Chairman NITIE Board of Governors.

Underlying theme was -Game Changers: Leadership lessons for turbulent times from India Inc. It brought the pearls of wisdom offered by the veterans to the forefront.
On September 21st, 2010, the 30-share BSE Sensex regained the magical 20000-level for the first time in 32 months. Simultaneously, as if to show that it is not far behind, the primary market recorded its busiest calendar week in 15 years. 11 IPOs were open for subscription. Close to 4000 Crore were raised.

According to PRIME Database, India’s premier database on primary market, corporate India raised around 47,867 crore through the primary market in 2009-10. In the current year so far, Indian companies have raised over 50,000 crore through domestic issues. That is not all. According to an estimate, around 90 companies plan to raise around 77,000 crore in last 3 months of the calendar year 2010 with Coal India, alone, raising around 15000 Crore. Coal India’s IPO is billed as the biggest ever public issue in the country till date. So far, Reliance Power’s 11,500 crore IPO was the biggest one.

The offerings for equity have spanned across sectors. Companies from conventional sectors like energy (Coal India Ltd.), education (Career Point Infosystems Ltd.) and infrastructure (Engineers India Ltd.) etc. to the ones from non-conventional sectors like wellness-services (Talwalkars Better value Fitness Ltd.) and microfinance (SKS Microfinance Ltd.) etc. have all been tapping the primary market with equal élan.

So, what has contributed to a sudden re-buzz in the primary market?

One of the prominent reasons is the robust state of the secondary market itself. The above average valuations, strong performance of benchmark indices, and increased traded volumes illustrate the same.

The Foreign Institutional Investors (FIIs) have pumped in nearly $20 billion into Indian equities so far in 2010. This has also ensured liquidity in the market.

With strong liquidity and the stocks looking up, it presents an ideal opportunity for companies looking to tap the primary market. It is in times like these that investors are more than likely to accept offerings coming their way.

IPO-pricing mechanism is another factor. A bullish-rally such as the one we are currently experiencing provides an opportunity for a company to command a higher price for its shares owing to the relatively higher multiples that its already-listed peers might be trading at. This allows the promoters of the company to raise a higher amount of money from the market for the same percentage of dilution in equity.

A big contributor towards a renewed investor interest in the primary market has been the central government. The government has been faced with a problem of burgeoning fiscal deficit (6.7% of GDP), thanks, largely, to some of its ‘populist’ policies and, to a lesser extent, the fiscal stimulus packages that it initiated to combat the slowdown. It now, expects to reduce the deficit by divesting a part of its stake in some of the state-run entities. During FY10, the government earned 25,000 crore by divesting its stake in Oil India Ltd, NMDC Ltd, REC Ltd and NTPC Ltd. The government expects to earn about 40,000 crore this fiscal by selling its stake in 10 more units this year including Coal India Ltd, Indian Oil Corp (IOC), MMTC Ltd, SAIL, Shipping Corporation of India Ltd. (SCI) and Rashtriya Ispat Nigam Ltd (RINL).
Public Sector Undertakings (PSUs) have, usually, been considered by many an Indian investor to be a safe bet as it is the central government at the helm with a controlling stake. Also, more often than not, PSUs tend to reward their shareholders with relatively higher dividend yields. With the liquidity-brimming secondary market aiding the sentiment, many investors are flocking to the primary market to seize the opportunity.

The reasons mentioned above do not justify the hasty offerings seen in the month of September. However, one of the reasons, explaining the phenomenon could be the September 30th deadline set by SEBI. SEBI had mandated the companies to publish their June quarter results for IPOs that hit the market after September. June quarter results of many of the listed companies were below expectations, and that of yet-to-list companies were likely to be the same. Publishing June quarter results, hence, might not have helped them much in their endeavor to raise funds.

So isn’t everything good about the IPO flurry?

Unfortunately, the answer is ‘No’. With so many companies coming out with IPO/FPO, concerns do arise on the liquidity aspect of the market.

The liquidity that we see in the market today is FII-driven. FII flows are considered to be extremely volatile. Emerging markets like India have been attracting FII inflows not only because of their immense growth potential but also because of the low-interest rate regime prevalent in the developed countries. As of now, FIIs have been able to leverage on the rock-bottom interest rates prevailing in their home countries and invest in emerging economies like India. Thus, an upward revision in interest rates in developed countries, when it happens, may prompt FIIs to pull back their money from India almost instantaneously, thus, drying up the liquidity in the Indian markets.

Overcrowding of IPOs could turn out to be another area for concern. A question mark still arises on the market’s ability to absorb so many issues. The deluge of IPOs will divert a huge amount from the system, that too at a time when the Reserve Bank of India is in the monetary tightening mode, in the wake of high inflation.

This could prove to be disastrous, particularly if the FIIs anticipate any concerns either Indian or global.

When promoters of companies float an IPO, in effect, they are ‘selling’ their stake in the company. With so many promoters wanting to sell their stake at this juncture, do they believe that this is the moment when their assets would fetch them the best prices? If yes, then are we sitting on a bubble waiting to burst?

The Indian primary market has been bustling with levels of activity seen only 15 years back. With India emerging as the destination for ‘hot money’, liquidity in Indian markets has been on an upswing. These factors have combined to help the Indian government reduce its fiscal deficit, corporate India to raise money from the market and provided investors with a plethora of investment opportunities. It would be a challenge for RBI to avert a crisis in case the worst-fears come true.

References
- http://www.businessworld.in/bw/2010_09_20_Busiest_Week_For_IPO_Market_In_15_Years.htm

Fin-Quotes

Put not your trust in money, but put your money in trust. ~ Oliver Wendell Holmes

Inflation hasn’t ruined everything. A dime can still be used as a screwdriver. ~ Quoted in P.S. I Love You

The real measure of your wealth is how much you’d be worth if you lost all your money. ~ Unknown
Is No Brokerage Leading To ‘Broke–Rage’?

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‘No entry load’ rule levied by Securities and Exchange Board of India (SEBI) in August 2009 still continues to be one of the major sources of dissatisfaction among the independent financial advisors selling mutual funds in India. The investors were expecting to reap many benefits from this rule. But as expectations are far away from reality, this rule not only had an adverse impact on the investors and independent financial advisors but also on the asset management companies in the last one year.

The mutual fund industry in India has been undergoing many changes in the last few years. Asset management companies (AMC) sell their mutual funds through AMFI (Association of Mutual Funds in India) certified agents called the independent financial advisors (IFA) apart from banks and national distributors. Selling through IFAs leads to better coverage and wide reach as they are available in plenty and almost in every part of the country. Prior to this ruling of no entry load on mutual fund investments, AMCs charged the client an entry load of 2.25% of the invested amount and passed it on to the IFAs as upfront brokerage. IFAs also earned a respectable annual trail commission on funds they mobilized. They were content with this fee structure and were encouraged to grow their investor’s asset under management. However, most of the IFAs instead of focusing on mobilizing the funds for longer duration and encouraging new investment, started churning the client’s money more often than needed to earn extra commission.

It was unfair for the investors who were uninformed about this practice. As a result, SEBI in August 2009, waived off the entry load empowering the investors to pay at their discretion for the services offered. This was done not only to safeguard the investors but also to improve the quality of financial advising and increase investments through mutual funds. But the impact of this rule on IFAs, investors and AMCs is still questionable.

Independent Financial Advisors –

The removal of entry load caused a lot of havoc among the IFAs in different parts of the country. They claimed that SEBI had taken away the basic source of income and that it would become difficult to run their daily operations. In a few cities, IFAs formed associations and met to discuss the future course of action. IFAs expected AMCs to take necessary steps to revoke the new rule. However, as expectations are usually far away from reality, AMCs didn’t play an active role in helping the IFAs fix the issue. On the contrary, the senior executives of few reputed asset management companies favoured the rule which further aggravated the situation. IFAs in a few cities of Madhya Pradesh took the violent route forcing the AMCs to close their branch offices till the issue was resolved. They started focusing on other investment vehicles that offered an upfront commission. Many IFAs restructured their business models and started selling insurance and other investment products that offered handsome brokerage.
Though this effort was well appreciated by IFAs, it failed to sustain. With an attempt to maintain their business, AMCs started paying brokerage to the IFAs from their pocket and it became a brokerage war among the AMCs. They started offering high brokerages on fixed income closed end funds and the entire focus shifted from equity to debt. Some AMCs paid upfront commission as high as 5% from their revenues on fixed income funds. This resulted in biased selling.

Hence, SEBI’s rule of waiving off the entry load backfired as all the parties were negatively impacted. The motives of SEBI behind waiving off the entry load which included safeguarding investors, preventing frequent portfolio churning, encouraging quality financial advising & increasing investments in mutual funds didn’t look achievable at that point in time.

Adding to the misery of IFAs, SEBI launched the online platform on the National Stock Exchange (NSE) and the Bombay Stock Exchange (BSE) to penetrate mutual fund products through 1,500 towns and cities through over 200,000 stock exchange terminals by enabling online buying and selling of mutual funds just as shares.

The NSE started its online trading platform for mutual funds on 30 November 2009 and the BSE launched its BSE STAR MF platform on 4 December 2009. IFAs believed this move would impact their sales as clients would start investing themselves.
AMCs argued that financial advising was a skill and not everybody had it. The investors didn’t have information about the market and would come to them for advice. “It’s like going to the doctor for consulting” – only a doctor specializing in a particular field can help you with your problem. Similarly, clients would require an IFA’s advise for investing their money.

The limited mutual fund knowledge of stock brokers did not attract investors towards these platforms. Since financial advising is very different from stock broking, a majority of stock brokers were inefficient in helping clients with their investments. For them, the main source of income was the brokerage they earned through high volume of transactions. As a result, the brokers started churning the client’s portfolio to earn brokerage. Since the online trading also required a Demat account, the small investors couldn’t afford it.

Possible Approach

After more than a year of struggle for IFAs and AMCs, sales have come back to normalcy. But this can be a temporary period of equilibrium which may not be sustainable. One of the possible approaches to this problem is that SEBI can follow a global approach. It can mirror the way mutual funds are structured in the U.S. Mutual funds in India can have several share classes as it is mandated by the Securities and Exchange Commission (SEC) in the U.S. Each share class will invest in the same "pool" (or investment portfolio) of securities and will have the same investment objectives and policies. But each class will have different shareholder services and/or distribution arrangements with different entry load structures. A multi-class structure offers investors the ability to select an entry load (up front commission) that is most appropriate for their investment goals (including the time that they expect to remain invested in the fund). Mutual funds in India can have share classes structured in the following way –

1. Class A shares will have a front end commission of 2.25% (Fees to be paid while buying units of a mutual fund). Investors holding class A shares will get premium services from the IFA in terms of portfolio management. The IFA will revisit the client’s portfolio every three months and will make changes as per the objective of the investment.

2. Class B shares will have a front end commission of 1.25%. Investor holding Class B shares will receive limited services from the IFA. The IFA will revisit the client’s portfolio once in a year to make changes if needed.

3. Class C shares will have a front end commission of 0.25%. Investors holding Class C shares will receive very limited or no services from the IFA. The Annual maintenance fees and fees for switching and early redemption can remain the same for all the classes as specified by the Asset management company managing that fund.

This structure will not only empower the IFAs but also provide flexibility to various types of investors. IFAs will strive to provide tailor-made investment solutions to investors. This would provide a fair ground for knowledgeable and less knowledgeable investors in terms of paying the entry load. Knowledgeable investors will invest in Class C funds and pay an entry load relatively lesser when compared to less knowledgeable inventors who would prefer investing in Class A funds. This approach can help SEBI create a win-win situation for all the entities involved.

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Hot Money in Indian stock markets

“Hot money” refers to the flow of speculative capital from one country to another in order to earn a short term profit on interest rate differences and/or anticipated exchange rate shifts. “Hot money” or speculative capital inflow can have great impact in fluctuations of stock market. A significant portion of capital inflows by Foreign Institutional Investors (FIIs) constitute of “hot money”.

Kim and Singal (2000) proposed that the movements of speculative funds, particularly in emerging markets, are allegedly highly sensitive to differences in interest rates, expectations of currency revaluations, and expected returns from holding securities. Chari and Kehoe (2003) argued that financial booms and crises in emerging economies are tightly linked to international capital flows. Domowitz, Jack, Glen, and Madhavan (1997) find that hot money from abroad has significantly affected stock price increases and market capitalization in Mexico, and has contributed to the 1994 Mexican financial market turmoil to a great extent. Hence existing studies corroborate the fact that flow of “hot money” can be detrimental for a country’s economy.

During the recent recession there was flight of foreign capital (especially the Foreign Institutional Investors’ capital) from the emerging market economies like India. This trend has resulted in fall in the liquidity in the short-term money market in India and also led to the free fall in the Bombay Stock Exchange (BSE) Sensex to less than 10,000 points from above 23,000 points. But the reverse trend is being witnessed now as the FIIs are coming back to the Indian capital markets in a big way.

The following table shows some milestone benchmarks set by Indian BSE Sensex in terms of highs and lows during pre and post-recession period

<table>
<thead>
<tr>
<th>Milestone</th>
<th>SENSEX</th>
<th>Date</th>
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<tbody>
<tr>
<td>Peak during pre recession</td>
<td>20873</td>
<td>January 8, 2008</td>
</tr>
<tr>
<td>Nadir during recession</td>
<td>8160</td>
<td>March 9, 2009</td>
</tr>
<tr>
<td>Peak during post recession</td>
<td>20045</td>
<td>September 17, 2010</td>
</tr>
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</table>

Table 1: High and low by Sensex in last three years

The above table shows us that there is a sudden spike in Indian stock markets even as global conditions concerning recession have not subsided fully. One of the reasons can be attributed to the return of FIIs to the Indian market. FIIs made equity sales of $14.84 billion during crisis year 2008, but made positive investments worth $17.23 billion during 2009.
During 2010 that positive figure had touched $13.7 billion even by the middle of September. The total foreign portfolio investments in India for first six months of 2010 including FIIs, ADRs and GDRs are around $22.3 billion. A significant amount of this fund would constitute of hot money highly volatile and speculative in nature. Figure 1 shows a more or less positive correlation between hot money inflows in form of FII capital and senex level.

(FDI) from the change in the nation’s foreign reserves. Total foreign exchange reserve in 31st January 2010 was $280 billion. In 31st July 2010 this increased to $284.2 billion. India’s trade deficit for first six months of 2010 is around $66 billion. FDI inflow for first six months of 2010 is $7.55 billion. Approximating by the above methodology the minimum amount of hot money that might have come into the Indian capital market for first six months of 2010 is at least $62 billion. But the actual figure might be very high compared to this.

Effects of inflow of hot money in the Indian economy

Inflows and Outflows of hot money disrupt macroeconomic policies and make an independent monetary policy virtually impossible. Excessive inflow of hot money has caused a challenge for exchange rate and monetary rate management in India. The huge inflow of foreign capital has led to appreciation of Indian Rupee against the Dollar negatively affecting the competitiveness of Indian exports. The current exchange rate is around 44.5 Rupees for every dollar. This is in sharp contrast to the record low which Rupee reached during March 2009 when at one time it traded for around Rupees 51.8 per dollar. The most visible effect of this is the “perceived” stock market boom in India with the stocks reaching dizzying heights every day. Such a bullish market may not be justified even taking into consideration India’s high GDP growth rate. The nature of this foreign money inflow is such that most of it is into stock markets. Thus in case of any adverse clues such foreign funds can be easily diverted elsewhere out of India. Rather if such funds have been invested in roads, ports or factories in form of direct investments flight of capital would have been much harder as investments of such nature are longer in duration.

Estimating hot money inflow in the Indian capital market

One common way of approximating the flow of “hot money” is to subtract a nation’s trade surplus (or deficit) and its net flow of foreign direct investment

Hot money and absorptive capacity of economy

“Hot money” in form of capital inflows from FII has the potential to cause damage to Indian economy if they are higher than the absorptive power of the economy.
Volatile and speculative funds can be used to pay off the current account deficit in Balance of payments (when imports are greater than exports). But if hot money inflows are greater than current account deficit then it can be said that it is greater than the absorptive capacity of the economy.

**When Outflow of this hot money can happen?**

FILs investment can sometimes be very fickle in nature. They are speculative in nature and respond adversely to unfavourable indicators in real economy or financial variables. If FILs lose confidence in an economy for its weak balance of payment then they retreat. This happened in Mexico in 1994 and in Thailand in 1997. The current account deficit and depreciation of the home currency can lead to withdrawal of FILs and slump in the concerned stock market. Foreign investors in India could suddenly decide to withdraw their money, like in 2008, if the Indian economy slowed or there is an outbreak of another crisis. Such events can decelerate economic growth in India because of flight of capital outside the country.

**Steps to curb flow of hot money**

As the events of 2008 demonstrated, Outflow of hot money can have devastating effects on the capital markets of country and can lead to tremendous loss of investor confidence. Thus steps may be warranted to curb unnecessary flow of such hot and speculative money into Indian markets whose sole purpose is short term profit rather than be a part of India growth story. Government can impose withholding tax on interest and capital gains by foreign investors on Indian bonds. Government can also tax foreigners buying equities and bonds in the secondary capital markets. RBI can also issue longer rated debt to divert funds from short end of the market. The central bank can also impose measures like increasing the minimum holding period for central bank debt to make short term investments less attractive and lengthen the minimum maturity period of its debt. Early withdrawal tax also can be levied. If a foreign investor wants to withdraw funds from Indian capital markets then tax can be levied.

One major reason for inflow of hot money in the Indian market is that Rupee has appreciated significantly against the dollar in the last 18 months. RBI can intervene against any further appreciation of rupee by buying off dollars in the currency markets. To control hot money Indian Government can also impose a ban on certain kinds of financial activity for a temporary period similar to Taiwan banning foreign inflows in time deposits. Investors may also be asked to keep a certain part of the inflow amount with the government/regulator. Chile used this strategy from 1991-98.

**Trade-offs in curbing flow of hot money**

Hot money inflows can help in curbing the current account deficit of a country. The current account deficit in India is expected to reach $57bn by the end of this year. In order to fund this huge amount foreign capital inflows are needed. Excessive intervention by RBI to curb the rising Rupee by buying more dollars would result in more Rupees entering the market and causing inflationary pressures.

**Hot Money and Indian Capital markets in perspective**

Indian policy makers and central bank are of the view that Indian economy has the capacity to absorb $150 billion of capital inflow without resorting to various artificial controls as discussed in the above sections. By absorption we mean using most of this hot money to finance current account deficit. But analysis of Current account deficit to foreign portfolio inflow since 2008 shows that except for the crisis year of 2008 when there was a net outflow of FIL funds for the next 2 years FIL inflows have been almost equal to current account deficit. This leaves a big question mark on the remaining $150 billion dollars that needs to be absorbed. Indeed a majority of these will float around as hot money and on any sign of impending crisis will reverse direction from Indian capital markets causing a lot of damage and heartburn.
<table>
<thead>
<tr>
<th>Year</th>
<th>current a/c deficit ($billion)</th>
<th>Foreign portfolio investment ($ billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008-09</td>
<td>29.8</td>
<td>-13.85</td>
</tr>
<tr>
<td>2009-10</td>
<td>30.3</td>
<td>30.67</td>
</tr>
<tr>
<td>2010 (till July)</td>
<td>25</td>
<td>21.25</td>
</tr>
</tbody>
</table>

Table 2: Current a/c deficit and foreign portfolio investments

It is time Indian policy makers realize the nuisance of hot money inflows and implement more strict measures on the inflow of hot money as many other Asian countries have done.

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© $treet - Finance Club, NITIE Mumbai
A Complete Investment Philosophy
(Fundamentals v/s Technicals)

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Fundamentals v/s Technicals, who is the winner? Efficient Market Hypothesis dismisses both of them, but is the market really efficient? If the markets were that efficient would there ever have been a Dodd or a Buffet? Is there a magic potion to profit from the stock markets?

These things do not have a definitive answer still let us try and gather some insight into this much debated subject.

Fundamental analysis is primarily about identifying fundamentally sound companies sooner than the market based on rigorous data analysis. The most respected and followed approach is the top down analysis which starts with analyzing the broader economic indicators and based on them you zero in on specific industries which have the potential of long term profitability. The next step involves identification of the specific companies in this industry which have a distinct competitive advantage relative to its peers. The competitive advantage might be due to its bargaining power with the suppliers, lesser cost of capital, strong customer loyalty, impeccable management track record, enviable brand name etc. All this boils down to the ability of the company to produce superior growth rates and hence maximization of the shareholders value. A fundamental analyst hence provides a long term story and based on tools like discounted cash flows or relative valuation comes up with a target price.

Technical Analysis on the other hand concerns itself with techniques that are required to successfully trade swings in stock prices and thus to benefit from a position that is held for a period spanning over a relatively short period of time. A technical trader uses host of tools spanning from analyzing chart patterns, candlestick formations, key areas of support and resistance to catch an ongoing trend. He is a stout believer of the tenet that market is always right and there is no point messing with it.

However over the years it has been determined as a matter of fact that no matter how good a technical trader one might be, one would not be able to beat the stock market consistently and everybody is bound to lose at some point or the other. As they rightly say, there are only two kinds of traders in a market, one who have lost something and others who will lose something.

So, why should we use technical analysis at all? Should it be used at all? One great way to use technical analysis is to identify and enter the major trends in the markets and staying with them until there is enough evidence that the trend has reversed.

Observe that we have stressed on two things here, one is the trend itself and second using technical analysis to stay with the trend.
In other words, technical analysis should be merely be used as a tool to gauge the mood of the market, to understand the psychology of the market, to understand the relative strength of buyers and sellers and it should ultimately be used to decipher when to enter or exit the market. Now this is extremely important.

Do we mean to say that trading price swings is bad?, Absolutely not, the important thing to realize is that no system is a bad system, every trader can have his or her own trading system, as long as it suits his investment objective and risk profile.

Having said that, generally it has become a matter of fact that big money is not in the individual fluctuations but in the main movements—that is, not in reading the charts but in sizing up the entire market and its trend.

But, we can stay with the trend only when we can anticipate it, isn’t it? So how can we anticipate a future trend, is there any tool for it? Yes, there is a very potent tool.

The tool is to understand the general conditions; by this we mean the conditions in the general economy. An unbiased view of the general conditions would allow you to anticipate future direction of the economy and hence you would be able to forecast whether the future is for bulls or bears.

Trust me this is all what is important. You can understand this if you visualize what happens in a trending market (bull or bear). In a bull market, the mood is benign; the economic outlook is good; growth rates of companies are expected to improve going forward; domestic consumption, exports and investments look good in the future. In such kind of a scenario markets can be inefficient. They might have paused for some time to gather fuel for further rally or they have corrected and consolidating at lower levels for some time. They may not have yet anticipated the bullish trends or that there may be some risks which are a little exaggerated by the market participants.
At this time, based on your view you need to use technical analysis (chart reading skill) to search for evidence of weakening of the bears and the strengthening of the bulls. In other words you try to find a time that is propitious to enter the market.

Now an obvious question in my reader’s mind would be that after sizing up the general condition of the economy with the help of fundamental tools how do you find out the correct time to enter? This is exactly where chart reading can help you so let us take an example to understand this concept. See prices tend to make lot of formations on charts. If sited early, these formations give us enough clues about the psychology of the market participants.

In the early part of 2010, India was still buoyant about the domestic demand driven growth story. The inflation was not yet looking bad and the government’s fiscal measures had ensured that rural population had deeper pockets. Based on these and many other supporting arguments, we could have formed a view that FMCG sector may do well in the coming quarters. With this background let us look at the Hindustan Unilever Chart and try to find out the correct time to enter. See, as depicted in the chart, the stock from March’10 to June’10 is trading within a very narrow range.

A very interesting thing to note is that the price is making a higher low but facing a stiff horizontal line of resistance (not able to make a higher high). This kind of formation in technical parlance is called Ascending Triangle formation. The psychological aspect of this formation needs to be understood properly. This formation signifies systematic accumulation of the stock at lower levels by big institutions. The big institutions and seasoned traders break their purchase orders in tranches to reduce the impact cost and to get the best available price. It is because of this the price keeps on making a higher low but fails to break the horizontal line as there is not enough demand at that price.

As a long term investor, with this understanding of the mindset of the market participants, you can initiate a long position when the price breakout of this pattern. As pretty much visible the breakout leads to a violent price move in the direction of trade and hence ensuring handsome profits.

An important point to note in this whole analysis is that you used technical analysis only to confirm your understanding of the general conditions. Thus having a view of the market should generally be considered a prerequisite to trade in the stock markets.
Remember, you would make money in the market only when your view matches with what really happens in the market. To take one more example, the monsoon all over India this year has been amazing and we all expect to have a bumper harvest and thus we feel that there is going to be ample supply which would act to depress the prices of certain commodities like wheat. Using this view you use technical analysis to enter the wheat markets on the sell side and if indeed what you had analyzed actually happens only then would you make money.

We would like to reiterate that it is this and only to this extent can technical analysis help you. See technical analysis allows us to fix a very important problem that confronts an average investor which is that it is not humanly feasible to know of everything that can affect the price of an asset. Thus careful observation of the various patterns on the chart hints you towards that missing link which cannot be found on any company’s annual report.

Our ultimate objective should be to find out the “LINE OF LEAST RESISTANCE” which the prices always take. The line of least resistance may be defined as the line in which the prices face the least resistance. This is in nutshell the essence of trading in the stock markets.

To call an end to this fight between the fundamental and technical, we propose a system which uses the best of both the worlds with the ultimate objective profiting from the long term Indian growth story.

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Fin-Quotes

Derivatives are financial weapons of mass destruction. ~ Warren Buffet

Today people who hold cash equivalents feel comfortable. They shouldn't. They have opted for a terrible long-term asset, one that pays virtually nothing and is certain to depreciate in value. ~ Warren Buffet

Wide diversification is only required when investors do not understand what they are doing. ~ Warren Buffet
World economy is in the middle of a major realignment. USA is in middle of Quantitative Easing II (printing money to buy bonds) worth staggering $ 600 Billion. The interest rates in USA are at rock bottom, touching 0.25% for a long time now. As the sovereign yield in USA is very low, all that money is flowing into emerging markets in search for better yields. Major hedge funds have opened their offices in Singapore and other cities in Asia. The fund managers of major fund houses are increasing the exposure to the emerging markets in their portfolio.

Huge amount of foreign money rushing to the emerging markets is causing a lot of problems in some countries. Some point it out as a cause of commodities price rise; others accuse it of importing inflation.

While analyst debate on the exact nature of effects, most of the emerging countries definitely do not like it. To counter the fund flow, Thailand announced 15% withholding tax on its sovereign bonds bought by foreign investors. Brazil doubled transaction tax on foreign purchase of domestic debt to 4% from current 2%.

India is the only country which has not applied any curbs on the foreign funds flow. It received $28 billion of funds in 2010. Capital markets are buoyant. Sensex is trading at 19 times its forward earnings against an historical average of 17 times over the past five years. India needs a lot of overseas funds, especially in the infrastructure sector. The money coming in the country needs to be tracked in terms of creating an asset price bubble.
The markets regulators SEBI and RBI always try to be ahead of the curve. They must be keeping a close tab on whether this hot money inflow is causing any asset price bubble or capital markets instability. The national policy’s balance between fighting inflation or GDP growth targets would be a widely tracked one in the markets.

The buoyant mood of March 2010 took a beating when sovereign crisis in the peripheral European countries started surfacing. The panic which started with Greece spilled over to Ireland. People started questioning the stability of Euro and the Euro Zone in itself. Now the size of the European Financial Stability Facility ($571 Billion) is itself being questioned. European Central bank is said to be buying a lot of toxic assets of these countries. The question remains that would it be sustainable if the situation spills over to other PIGS countries (Portugal, Italy, Greece and Spain).

In the mean time, Chinese policy is also undergoing a gradual change. They have started realizing that it would be difficult to maintain the same GDP growth rate as in the past few years and economy needs to cool down. Steps are being taken to spur domestic demand and increase focus on high technology and high end value chain areas. In the short term, China is mulling over putting lending curbs and raising rates to curb inflation. The forced slowed growth can severely restrain the world’s power to come on track.

Chinese have been making good use of the downturn to push yuan to the centre stage in international arena. China completed a series of currency swap agreements with central banks of Argentina, Indonesia, Belarus, Malaysia, South Korea, India, Pakistan and other countries. It provided yuan in lieu of local currency, thus eliminating the need of hoarding USD as intermediate currency. Beijing also denominated bilateral trade deal with Brazil in the two countries’ currencies, rather than in dollars. As proportion of Chinese trade with other countries increase, it is only pragmatic for them to bypass dollar to gain shorter settlement cycle time and operational cost reduction.

Scheme is being run in Hong Kong to settle trade of certain companies in yuan. Oil is touted to be shifted from trading in dollar to a basket of currencies. China has already bought a large chunk of SDR debt from IMF to gain a prominent role in the world affairs.

Post recession, American growth is likely to slow down and dollar is expected to decline. USA has a low savings rate and huge current account deficit. Fed uses treasury spread – the difference in yields between 90-day Treasury bills and 10-year Treasury bonds to predict recession. As the New York Fed reveals, “Research beginning in the late 1980s documents the empirical regularity that the slope of the yield curve is a reliable predictor of future real economic activity.” Steep Yield Curve points to economic growth, while flat or inverted curve signals an economic slowdown or recession.

Source: US Fed

The world growth post recession would be powered by currently emerging economies. The story in the emerging economies looks buoyant with advanced economies playing catch up.
Notwithstanding the Euro zone panic, the world seems to be rebounding fast. To quote the master Warren Buffet himself, “There's no doubt in my mind, we're coming back.” And he offers irrefutable proof: Most of the 70 companies in which Berkshire Hathaway owns a stake are improving their margins and hiring workers again.

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Beat the $street

Beat the $street was a Merger and Acquisitions case study competition organized by Team $street at NITIE for NITIE's annual B School fest, Prerana. After competitive entries of over 30 teams from top-tier B Schools all over the country, the final race came down to five teams, of which Team Layman from IIFT Delhi emerged victorious. Eminent personalities such as Mr. Amit Shah from YES Bank, and Professor G Srinivasan, Professor of finance at NITIE, were kind enough to judge the event and were all praise for the effort and analysis put in by the teams.

Workshop on Derivatives by Dun and Bradstreet

Students from the First year participated in the finance workshop organized in association with Dun & Bradstreet. The workshop was convened on the topic of derivatives. It was held across a period of 2 days. The workshop consisted of the topics providing insights about the "Derivatives in the form of futures, forwards, swaps and options". The workshop was a great learning experience for the first year students as it gave them an early insight of the derivatives.

NCDEX commodity trading simulation game

Commodities trading today encapsulates a whole gamut of physical and financial products ranging from bullion, crude, cotton, coffee, tea to their derivatives. Students from both the first year and second year participated in the commodity trading game organized in association with NCDEX. The participants took a plunge into the world of commodities and experience the adrenaline, thrill, angst and tension of a commodity trader. The event saw active participation from the B School students honing their hedging, arbitraging and speculating skills to the best.

Session on Bancassurance

'Bancassurance', also sometimes known as Bank Insurance Model, is used to describe the relationship between a bank and an insurance company whereby the insurance company uses the bank sales channel in order to sell insurance products. The speaker for the session was Mr. Vikas Arora, Business Head – Bancassurance, Deutsche Bank AG. He is an IIM Ahmedabad Alumni and has spent years in the area of Sales & Distribution, Business Management & Alternate Channel Development across Financial Services (Insurance and Banking) & Office Automation industry. The session helped students gain valuable first hand insights into the way Bancassurance model works as well as map
1. Identify the logos and connect them with a person

2. Connect the logos with a recent business context

3. Founded in Taiwan, this company was named after the following mythological animal

4. On what basis was the size of the hole in the CD determined?

5. Connect this constellation with a company

6. This book was formally called the Financial Statement in UK. It was informally called X and contained the detailed government spending and revenue forecasts in the UK that accompany the Budget speech. Identify X

7. A stock rallies modestly after a large fall before dropping to new lows. Identify the term used to describe the same. (Clue see the below pic)

Quiz Partner:

Mail in your answers to: street.nitie@gmail.com with the subject ‘Fin-Quizzitive’ before January 20, 2011. Winner to get a cash prize of `1000/-
FIN-TOONZ

Toon # 1: Rocketing India

Toon # 2: The Big-Q

Toon # 3: Done Undone

CROSS-FIRE

ACROSS
2. JP Morgan's creditworthiness
4. Measures average squared deviation between actual returns and average returns (sigma squared)
7. Old german unit of currency
9. Merrill Lynch is refereed as the (2 words)
12. An insurance or other investment paying a fixed amount for a certain time period
13. The strategy of investing in different kinds of assets to reduce risk is called
15. The value of a leased asset at the end of the lease period
16. Trading without using money
19. Exchange rate of one currency for another over a fixed period of time
21. A bond that never matures
22. Name the term used for depreciating a company's intangible assets
23. A company's purchase of its own share

DOWN
1. Jan. 1, 2002 marks changeover to the Euro, Name this day
3. A would-be acquirer's offer to buy stock directly from shareholders (2 words)
5. This country's foreign market is known as 'Rembrandt Market' (2 words)
6. Temporary finance provided until the availability of long term arrangements (2 words)
8. Number of shares available for trading by the public
10. The public sale of stock in a subsidiary in which the parent usually retains majority control
11. English economist who felt government action is necessary for economic stability
14. A type of international finance instrument
17. A type of tax-deferred pension account
18. Where as credits and pixels used as currency
20. 12-month net income divided by common stockholders equity

Rules
1. A team can have maximum two person
2. Write your answers for toon as:
   Toon # 1 - Chat Box 1: __________
   Toon # 2 - Chat Box 2: __________
   Toon # 3 - Chat Box 3: __________
3. You can change the order in which the characters are speaking as:
   Chat Box 1: _______
   Chat Box 2: _______
   Chat Box 3: _______
4. The conversation should follow a theme or depict a story

Mail in your answers for both 'Fin-ToonZ' and 'Cro$$-Fire to' :
street.nitie@gmail.com with the subject 'Fin-WarZ' before January 20, 2011.
Winner to get a cash prize of Rs. 1000/-
About NITIE

The National Institute of Industrial Engineering (NITIE), Mumbai is a centre of excellence recognized by the Government of India. It was setup in 1963, in collaboration with the International Labour Organization (ILO). Since its inception, NITIE has been providing solutions to complex problems of the industry and business. NITIE today, is constantly ranked among the top 10 business schools in the country and its Post-Graduate Programmes are among the best in the country. Throughout the years, NITIE and its alumni have carved a niche for themselves in the industry.

The Team that is - $treet

$treet is a student run Finance Interest Group at NITIE that assists budding managers in assimilating classroom as well as practical learning; thus nurturing them to evolve as better equipped financial managers. Having completed 6 years of existence, $treet has grown from being an informal, in-house discussion forum to a truly national b-school society. In the year 2009-10, $treet organized a wide variety of activities ranging from workshops to lecture series to inter b-school competitions. We also aim to strengthen the Brand ‘$treet’ by fostering partnerships with the alumni, academia and the corporate world.

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