



**STOCK EXCHANGE AND INVESTMENTS :
STRAIGHT ANSWERS TO 100 NAGGING
QUESTIONS** By V. Raghunathan, Tata
McGraw-Hill Publishing Company Ltd., New
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Ancient form of Indian teaching, dating back to 'Nāchinetopākhyana' of *Kathopanishat*, consisted of the 'Guru' answering questions raised by the 'Sishyas'. Professor. Raghunathan has modernised the ancient art by providing answers in anticipation of questions, to be raised by many all over the country, in his book under review.

The book is divided into two parts. Part one provides answers to 66 questions pertaining to the Stock Exchanges. The questions range from Capitalisation to Capital Asset Pricing Model, Money and Capital Markets to Markowitz's Portfolio theory, call money to credit rating etc. The second part is devoted to answering 34 questions on Investments, ranging from time value of money to finetuned Present Value Tables, Capital Gains to Convertible Debentures, Present Value to Publicity Brochures etc. While both the parts are lucidly written in a conversational style Part one excels the other. This may have been due to the author's 'insider information' gathered as a member of the Board of Directors of Ahmedabad Stock Exchange and/or the self-imposed restriction to minimize mathematical models. Professor. Raghunathan is at his best while making short-work of the tall claims made by investment and other companies in the publicity brochures. though the subject matter is technical the author made it extremely readable by his

sense of humour as revealed by the adaptations from Lewis Carroll's Book as also in the text of the answers.

With a view to improving some aspects of the book (more in the nature of painting a lily !) the following comments have been made :

In the Boxed illustration of Financial Risk, (P.58) the Return on Equity (R.O.E) is calculated as profit after Interest divided by Equity. As the book is primarily meant for the layman he may get the impression that corporate Income Tax does not figure in the calculation of R.O.E. The author could have made an assumption that there are no Taxes to dispel misapprehension. Similarly, an assumption that there is no Preference Share Capital in the capital structure will make things easy as the formula for Financial Leverage will change in the presence of Preference Shares.

For question 49 on CAPM, (P.65) the illustration of Ice cream Firm and Hot Coffee Firm is really ingenious. Perhaps due to a typographical error the quantity of risk premium is shown as $(R_m - r)$ instead of $(R_m - r)$.

In the last paragraph (P. 83) for question 61, the difference between Fundamentalists and Chartists is explained by an analogy of coin-tossing. It is stated that a Chartist "will rate the chance of occurrence of a "head" higher and higher, as the number of "heads" obtained in the previous consequent throws increases". Elementary Probability theory suggests that simultaneous occurrence of "heads" in five consequent throws is $(0.5)^5$ which is about 0.03. To expect one more "head" in the sixth consequent throw, given the past information, will have a probability of 0.015. The analogy is not very clear unless, of course, it is intended to denigrate the Chartists.

For question 68 (P. 96) there is a typographical error. Towards the end of the page it is stated that Rs 100 to be received two years hence (at 10% rate of interest p.a) should be Rs. 82.64 today, instead of Rs. 90.91.

There is scope for ambiguity in the answer given for question 70 (p. 98). The terms NPV and IRR are introduced. Three investment opportunities, a, b and c, each with an initial outlay of Rs 1 lakh but varying in cash inflows and time horizons are taken for illustration. The IRRs for a and b turned out to be 15% each while it is 16% for C. A conclusion, not without reason, is immediately drawn that Project c is more attractive. From the point of view of decision-making c may not be attractive. From the point of view of decision making c may not be attractive enough if the cut-off rate happens to be higher than 16%. Let us assume, for a while that there are only two projects a and b. Are we justified in saying, on the strength of IRRs, that both a and b are equally attractive? The answer is No. Annualized NPV at a given cut-off rate will be different for both the Projects and we can take a decision based on them. the ambiguity arises as NPV is considered in a passive manner, as one which gives IRR, when it is zero at a given rate of

discount. The full potential of NPV should have been considered to obviate the ambiguity.

The twelfth root sign should be for 1.18 but not for 1.18-1 as appeared in the book (P.120)..

For question 78 and 80 very lucid explanations are given for the adjustments for Bonus issues and Rights Issues along with a numerical illustration. The question (a nagging one) may arise as to the adjustments needed for Bonus and Rights issues made prior to the chosen time span. Similar question may arise while considering the share price and D.P.S of two companies one of which had Bonus/Rights issues prior to the common time span. This aspect may be considered in the second edition which may not be far off thanks to Harshad Mehta !

Despite the minor aberrations, Prof. Raghunathan's contribution to the literature on Stock Exchanges and Investments in India is unique and praiseworthy. Though primarily meant for laymen even professionals will do well to go through the book , at least for the sheer pleasure of it.

- N. Krishna Rao