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Mestrado em Gestão

How and why modern corporate finance is important internationally?

Realizado por:
Dev Prasad Pun

Orientado por:
Prof. Doutor António Jorge Duarte Rebelo de Sousa

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PRESENTATION

How and why Modern Corporate Finance is important Internationally?

Dev Prasad Pun

The destination topics have the main two roles that I had mentioned that's how and why corporate finance is important internationally. There are two things, science and opinion, the former begets knowledge, the latter ignorance. We should be concern about the future because we will have to spend the rest of our life there.

The earth is just too small and fragile easily broken or damage a basket for the human race to keep all its eggs in. If Chance will have me king, why chance may crown me. These are the text that I have mentioned and some more, so that how each topic is used.

Keywords: Valuation Concepts, Capital Budgeting.

INDEX OF FIGURES

INDEX OF TABLES

INDEX OF EQUATION

SUMMARY

1. PRESENTATION

As we know Money has a universal powerful attraction, charm but few people seem to understand it very well. One of the few organization attempts to study the relationship between money- past, present, and future- and financial markets. Financial decision making is provided by the discipline of financial economics. And to those who wants to continue career in finance.

And for that we should study the given points that I have mentioned in the below like Why finance matters, Institutional Feasibility and Pricing of Stocks and Bonds, Risk and Return, Options of Corporate Finance, Corporate Strategy and Capital-Budgeting Decision, Creating Value of Share Holders. Which are very useful points in international corporate finance, so these are an important topic for changing the world economy.

How companies create value? and how corporate finance can facilitate the process of value creation? how the financial manager can add value to the firm? Corporate advantages of corporate manager lies in understanding the details of modern corporate financial market place and using then full advantage to manage the organization´s financial activities.

The guiding principal is that financial management has to do with the “real” business of the firm, which is to produce and sell goods and services. However, the financial manager gets this kind of job in company but he has to do looking at customer as well as owner. In one word make company profitable.

This is also trying to take basic driving principal to the maximization of shareholder’s wealth. Also recognize the ownership use to analyzed manager, owner and stockholder-bondholder conflicts in professionally managed firms. Focus your effort on your most profitable customers who place large or frequent orders, pay the full price on time. Sometimes the more people you talk to or communicate with, the greater the chance they will become a customer.

It is also to understand the wave of corporate finance of making more profit or better organization looking at present situations. Some times for the short term firm have to reduce cost or increase sales, reduce cost by controlling insurance, utility, telephone and internet. Give small works to junior staffs and on free time senior staffs give time to focus on directing business.

The manager must look the business form a global perspective, internationally is not just another section of domestic economy, like office machines or auto, that can be ignore with no cost. Manager must look from the business prospective which is necessary for the firm not for the luxury.

Because of these above reasons which is clear, strong and easy to find importance of corporate finance internationally that is why I choose this topic.

2. METHODOLOGY OF THEORETICAL PART

2.1. WHY FINANCE MATTERS?

“There are two things, science and opinion; the former begets knowledge, the latter ignorance” (Shapiro, Modern Corporate Finance, 1991, p. 1)

To Carry on business modern finance plays a great role in modern world economy. Needs an almost endless variety of real assets. Many of them are tangible assets such as machinery, factories, and offices that we found all over the world.

Here in the given figure we can see the tangible and intangible assets that we need to be sure about it. If we cannot separate and be there might be a problem in your daily life transaction. Like shopping where to spend your money and where not.

Table 1: Tangible and Intangible assets

Tangible assets	Intangible assets
Machinery	Technical experience
Factories	Trademarks
Offices	patents

Source: (A.Brealey & Stewart C.Myers, 1988, p. 6)

All of them unfortunately need to be paid for. To obtain the necessary money the company sells pieces of paper called **financial assets**, or securities. These pieces of paper have value because they are claims on the firm’s real assets. Financial assets include not only shares of stock but also bonds, bank loans, lease legally bond to do something, and so on.

Which can be helpful for changing the lifestyle and the way how to sell and buy the financial assets.

The financial manager’s face two basic problems. First, how much should the firm invest, and what specific assets should the firm invest in? Second, how should the cash required for investment be raised?

The answer to the first question is the firm’s **investment** and there is no limitation like, how much money we need. For short term we can borrow the money or sell assets and can provide the money. But you have to be sure that if output is fixed then we need to reduce the input cost**.**

The stock holders who own the company wants its manager to maximize its overall value and the current price of its shares. Shareholders are always in hunger of maximizing the share value to do that everybody do agree. Looking at the financial market i.e., financial securities stock bonds, raw materials, and other good contract items of value low transaction cost show them to manage their investment plan.

Shareholders do not want the maximum possible stock price. They want the maximum honest share price. Similarly, **capital budgeting decision** they must make a budget like the objects of the form could be maximize profit or minimize costs when outputs are fixed or maximize revenue when inputs are fixed. In the long run all things can change are very. In the short run something is fixed.

The answer to the first question can be the firm's **investment,** or **capital budgeting decision** they must make a budget like the objects of the form could be maximize profit or minimize costs when outputs are fixed or maximize revenue when inputs are fixed.

Example,

Two firms producing t-shirt using labor a capital (machine). The partial productivity ratios conflict.

Table 2: Total factor productivity

Firm	Labor(*1)	Capital(*2)	Output(*q)	q/*1	q/*2
A	2	2	200	100	100
B	4	1	200	50	200

Source: (Oliveira, 2017)

Total factor productivity (TFP)

Use an aggregate measure of input: TFP = Y/ (a1*x1+a2x2)

What we use as the weights? – Price.

Data: labor wage = $80 per day and rental price of the machines = $ 100 per day.

Calculation:

TFP_A = output/(labor*machine) = $\frac{\text{output}}{labour*machine} = \frac{200}{(80*2+100*2)} = \frac{200}{360} = 0.56$

$$TFP_B = \frac{200}{(80*4+100*1)} = \frac{200}{420} = 0.48$$

= ≥ A is more productive using this measure. By this calculation manager can decide which product must give more priory. (Oliveira, 2017, p. 44)

The answer to the second is its **financing decision**. Money can be raised by selling the share. Money spend on fixed assets (items of value that have a long-term function –i.e., land, machinery). Loan capital like loan obtained from a commercial lender bank which must be paid back with interest.

Buy now, pay later (usually have 30 – 60 days to pay). The more credit given to clients, the higher the chance of facing bad debt where debtors don't pay back what is owned. So if company A does not pay back to Company B, then company B won't be able to pay back Company C and so forth, resulting in a ripple effect.

So, this kind of conflict must be review carefully by the financial manager so that company would not face any problem in upcoming days. Financial decision is a comprehensive financial planning and wealth management firm that helps high-net-worth individuals and businesses achieve their financial decision.

Success is usually judged by value: Shareholders are made better off by any decision which increases the value of their stock gamble in the firm. Thus, you might say that a good investment decision is one that results in purchase of a real asset that is worth more than it costs which makes company net cash.

The secret of success in financial management is to increase value, quality or number. That is a simple statement, but not a very helpful one. It is like advising an investor in the stock market to "buy low, sell high" The problem is how to do it. Even many years experienced people get angry with the result of share price.

2.2. THE ONE WE SHOULD KNOW FIRST: THE GOALS OF FINANCIAL MANAGEMENT.

All businesses objectives, goals, aim is to maximize their profits, minimize their expenses and maximize their market share. To maximize the profit a company must important goals is to make money. Profit margin ratios are one way to measure how much money a company must press from all angle to give a good fine shape from its total revenue or total sales.

There are three key profit-margin ratios: gross profit margin, operating profit margin and net profit margin.

Gross Profit Margin

The gross profit margin tells us the profit a company makes on its cost of sales or cost of goods sold.

Gross Profit Margin = (Sales - Cost of Goods Sold) ÷ Sales

Equation 1: Gross profit margin

Gross Profit Margin = $(\frac{sales - cost\ of\ goods\ sold}{Sales} * 100) = (\frac{1000{,}000-600{,}000}{1000{,}000}) = 0.4 * 100 =$ 40%

Suppose that a company has $1 million in sales and the cost of its labor and materials amounts to $600,000. Its gross margin rate would be 40% ($1 million - $600,000)/$1 million).

The gross profit margin is used to analyses how efficiently a company is using its raw materials, labor and manufacturing related fixed assets to generate profits. A higher margin percentage is a favorable profit indicator. The airline industry has a gross margin of about 5%, while the software industry has a gross margin of about 90%. (Investopedia, Goals of Financial Management, 2017a)

Operating Profit Margin

By comparing earnings before interest and taxes depreciation and taxes (EBITDA) to sales, operating profit margins show how successful a company's management has been at generating income from the operation of the business:

Operating Profit Margin = EBIT/Sales

Equation 2: Operating Profit Margin

Operating profit margin = $(\frac{EBITDA}{Sales}) = (\frac{\$200{,}000}{1000000} * 100) = 20\%$

Where,

EBITDA = Earnings Before Interest Taxes Depreciation and accusation taxes.

If EBITDA amounted to $200,000 and sales equaled $1,000,000 the operating profit margin would be 20%.

Net Profit Margin

The measurement makes secrete information know to others the amount of profit that has a business can be remove or taken out from its total sales. Net profit margin is the percentage of revenue left after all expenses have been deducted form sales. The net sales part of the equation is gross sales minus all sales deductions, such as sales allowances. The formula is:

Net Profit Margin = $\frac{Net\ Profit\ \ (before\ tax)}{Sales} * 100)$

Equation 3: Net profit margin

Example of Net Profit Margin

ABC International has a net profit of $ 20,000 in its most recent month of operations. During that time, it has sales of $160.000 Thus, its net profit margin is:

Net Profit Margin = $\frac{Net\ Profit\ \ (before\ tax)}{Sales} * 100)$ = $(\frac{\$20{,}000}{160{,}000} * 100)$ = 12.5% net profit margin.

Similarly, net profit margin is also known as net margin. (Investopedia, 2017a)

How can we Minimize costs?

Bank balance must be checked daily like a newspaper so that they can know their income, expenses and minimize where necessary. The firms use cost control to manage and or to reduce their business expenses. And by that analyzing the expenses firm can make decision whether the cost are acceptable or not too expenses or affordable.

And then if necessary, they can look into a way to reduce cost through various methods such as cutting back, moving to a less expensive plan or changing service providers. Further can reduce by cutting telephone, internet and utility bills to employee payroll and outside professional services.

Likewise, to be profitable, companies must not only earn revenue an income that government or company received regularly but also cost control. If the costs are too high, profit margins will be too low, which result difficult to the company to success against its competitors.

In the case of public company, if costs are too high, then firm must understand is depressed and that it is difficult to attract investors. Looking at the company standard we can examine whether the cost of the company is reasonable or unreasonable. A firm examine their costs during the drafting or a written order for money to be paid by bank of their annual budgets.

2.2.1. HOW CAN WE MAXIMIZE MARKET SHARE?

Companies are always looking to expand their share of the market, in addition to trying to grow the size of the total market by lowering prices or through advertising. Market share increases can allow to achieve greater scales in its condition of functioning and improve profitability.

The size of the market is always in continues change but the rate of change depends on whether the market is growing or mature. As the total market for a product or service grows, a company that is maintaining its market share is growing revenues at the same rate as the total market. A company that is growing its market share will be growing its revenues faster than its competitors.

Once a company achieves a large market share, however, it will have a more difficult time growing its sales because there are not as more ability to achieve or success or develop customer available.

2.3. WHO IS FINANCIAL MANAGER?

Sometimes we do not know who is Financial manager and what his role in corporate finance. In big company's we have CEO too. If we don't have any idea of them then we are investing good money to bad thing.

Many people have their own definition but here we will use the term financial manager to refer to anyone responsible for an important to be worthy of attention to corporate investment or financing decision. But except in the smallest firms, no single person is responsible for all the decisions discussed in here. (A.Brealey & Stewart C.Myers, 1988)

Responsibility is break up throughout firm. Top management is of course continuously involved in financial decisions. But the engineer who designs a new production facility is also involved. The advertising manager may also make important investment decisions in the course of his or her work.

Table 3: some typical responsibilities of the treasurer and control.

Treasurer	Controller
- Banking relationship	- Accounting
- Cash management	- Preparation of financial statements
- Obtaining financing	- Internal auditing, conduct an official financial examination of individual or organizations accounts
- Credit management	- Payroll, a list of a company's employees and amount of money they are to be paid.
- Dividend disbursement	- Custody of records
- Insurance	- Preparing budgets
- Pensions management	- Taxes

Source: (Myers, 1988)

Nevertheless, there are managers who specialize in finance. The **treasurer** is usually the person directly responsible for obtaining financing, managing the firm's cash account and its relationships with banks and other financial institutions, and making sure the firm meets its works to be done to the investors holding its securities.

Typical responsibilities of the treasurer are listed in the left –hand column of table above. For small firm's treasury, treasurer is likely to be the only financial executive. However, large corporations usually also have a controller. The controller managers the manager's responsibility are budgeting, accounting and auditing**.**

The largest firms usually appoint a financial vice –president, who acts as the chief financial officer, overviewing both the treasurer and controller's work. In addition, the financial vice president is deeply involved in financial policymaking and corporate planning. Often he or she will have general managerial responsibilities beyond strictly financial issues.

Major capital investment projects are so closely tied to plans for product development, production, and marketing that managers from these areas are inevitably drawn into planning and analyzing the projects. If the firms have staff members specializing in corporate planning. They are naturally involved in capital budgeting too.

Usually the treasurer, controller, or financial vice –president is responsible for organizing and supervising the capital budgeting process. Because of the importance of many issues, ultimate decisions often rest by law or by custom with the board of directors.

For example, only the board has the legal power to declare a dividend or to make a string action in order to make people obey a law or rule, or a punishment given when they do not obey a public issue of securities. Boards usually delegate decision making authority for small – or medium – size investment outlays, but the authority to approve large investments is almost never delegated.

We should ask first to yourself who is financial manager so that we do not have to face any problems later and we will enjoy our work which means a positive result this is one of the important reason why corporate finance is important internationally.

Financial manager needs to do a lot of work on the subject matter is lots of research, he must arrange an emergency meeting if it is needed while making a serious decision of the company. If anything needed or some changes have to be made, which is beyond his limit, then shareholders of a company might help them or the board of directors.

2.4. WHY FINANCE IS INTERESTING AND CHALLENGING?

There may be a few activities in which one can read a textbook and then “do it” but financial management is not one of them. That is why finance is worth or important studying. Who wants to work in a field where there is no room for experience, creativity, judgment, and a pinch of luck?

There are many reasons to explain why a manager must act as an intermediary, standing between the firm’s operations and capital markets, where the firm’s securities are traded or action of buying and selling the goods. The financial manager’s roles.

Where to invest? - Capital budgeting decision. How to raise money to fund the investment? - capital structure decision. How to manage cash flows form daily operations? - working capital decision. Financial manager should know about the

importance of capital markets. He must understand the time and uncertainty, must understand the people.

Time and uncertainty - the financial manager cannot avoid coping with time and uncertainty. Firms often have the opportunity to invest in assets which cannot pay their way in the short run and which expose the firm and its stockholders to considerable risk.

The investment if it promises to do the particulate thing, may have to be financed by debt which cannot be fully repaid for many years. As a result, a firm cannot walk away from such choices; someone has to decide whether the opportunity is worth more than it costs and whether the additional debt of heavy load of money can be safely carried.

Understanding people, the financial manager needs the right to buy and act or work together with many people. Likewise, by the plan manger many investment ideas come. The financial manger wants these ideas to be prepared fairly, therefore, there should not have any personal encourages a person to do something to be either overconfident or over risk avoided.

For example: In some firms the plant manager needs permission from the head office to buy a company car but no to lease it, and the line of least against or refusing to accept may be lease the car.

In other firm the plant manager needs permission form head office to buy or lease, and the line of least action to stop may be to travel everywhere by cab. This kind of conflict must be solved by financial manager. So, it's challenging too. (A.Brealey & Stewart C.Myers, 1988, p. 6)

Most of the developing countries financial market work well must of the time. "when they are good, they are very good indeed, but when they are bad they are horrid." In 2008 financial markets were horrid. Financial market bounced like a trigger like nightmare. Some business disappears forever.

Out of thousands of reasons this is also one of the example how finance manager is important and challenging on the other way he has a key role in the Modern corporate finance. Looking at the above reasons finance manager is also one of the key persons that helps in the finance internationally.

3. INSTITUTIONAL FEATURES AND PRICING OF STOCKS AND BONDS

"We should be concerned about the future

Because we will have to spend the rest of our live there." (Shapiro, 1991, p. 58)

As we know firms finance for the latest projects, assets or object budgets further by working capital by issuing against income that own or get by the firms. If we talk about the claims then that includes like bonds, preferred stocks and common stocks, and other long term securities.

Whereas the claim that made by the firms are in the dividends and principal repayment. The common characterizes of these securities is that they promise to pay more or less certain amounts of cash in the future.

Here we have to be very careful about how the values of corporate securities are determined is important to a firm's manager and owner, as well as to investor to interiors. As everybody aspect something more after investing their money. Here in the field for the financier or the investors need to compare their valuation of a firm security with an actual market price. In order to decide where now is time to buy low or sell high.

Example

If a retail clothing business wants to purchase an existing store, it would first estimate the future cash flows that store would generate, and then discount those cash flows (r) into one lump-sum present value amount of, say $500,000. If the owner of the store were willing to sell his or her business for less than $500,000, the purchasing company would likely accept the offer as it presents a positive NPV investment.

If the owner agreed to sell the store for $300,000, then the investment represents a $200,000 net gain ($500,000 - $300,000) during the calculated investment period. This $200,000, or the net gain of an investment.

Conversely, if the owner would not sell for less than $500,000, the purchaser would not buy the store, if no one buys the store then as the clothing store would present a negative NPV at that time and could, reduce the overall value of the larger clothing company.

Subtract the C_0 (total initial investment cost) from 500,000 if Net Present Value is positive it is profitable and if the Net Present Value is negative then it is not profitable.

If we look at the disadvantage of Net present value amount if it is negative which is bad for the company plus he must take risk like by selling less than expected amount the estimated future cash flow may be far from actual result.

Advantage of NPV (Positive net present value) on the other side Net Present Value accounts for time value of money, so it is reliable than other investment which do not discount the future cash flows such as payback period and accounting rate of return. It´s about taking risk. (Investopedia, Net Present Value, 2017c)

If we look at Pay Back Period example, then we can see the given below **example.**

Assume company A invests $1 million in a project that will save the company $250,000 every year. The payback period is calculated by dividing $1 million by $250,000, which is four. In other words, it will take four years to pay back the investment. Another project that costs $200,000 won't save the company money, but it will make the company an incremental (addition) $100,000 every year for the next 20 years, which is $2 million.

Clearly, the second project can make the company twice as much money, but how long will it take to pay the investment back? The answer is $200,000 divided by $100,000, or 2 years. Not only does the second project take less time to pay back, but it makes the company more money. Based solely on the payback method, the second project is better. (Investopedia, Pay Back Period, 2017b)

When is it Right time and how is the payback period time further how much profit you are expecting form that particular project you need to visualize carefully to change your financial status of you own. That’s how you make a profit in your organization and some time because of the wrong decision you might get trouble to sell your goods.

3.1. CHARACTERISTICS OF CORPORATE DEBT

As we know if we borrow some amounts of money weather from person or by bank, firm we had a promise to repay not only the principal amount that we take but also the interest according to the schedule of debt control. On the other hand, the debt holders who gave the money wants on time.

If the payments are not made on time as mentioned on the contract, the debt holders can take a variety of actions to collect their due. Some debt can be converted to equity. As a result, if any organization, company or a firm do have a lot of debts sometimes may close the organization.

Weather the company is big or small with huge profit but if it does not have the net cash then that may create a great problem. And need to take variety of action but on the other hand there is not limit too, forcing the firm into bankruptcy if the company cannot pay its debts then there are some insurance contracts and so on which might not be enough.

Borrowers may find default costly as well. A borrower´s reputation can suffer not reparable damage upon default, and managers also must worry about default, as it could harm their future career prospects.

Neither a borrower, nor the lender be, for loan they often lose both itself and friends. It does not say close relation or friends. Further if we look at lease financing it is a cash and creativity but we need to know how to use it.

In the case of lease, the owner of the asset is specialized called lessor, grant or accept the argument to the other party called lessee, the right to use the asset or property, for the certain period of time as concern by the agreement. But however it depends upon the lease agreement.

The term of the lease must be less than 30 years. If the term is greater than 30 years, the transaction will be regarded as a conditional sale which means until the last installment payment according to purchase price that had done the agreement in contract while selling the goods.

In the absence of any market imperfect or tax is asymmetries or not equally balanced between lessor and lessee, leasing is a zero sum game. If the leasing become positive both the party become will gain. As there is a government support as well as they are receiving the revenue from them.

3.1.1. MATURITY

Debt that must be paid back in less than one year is considered to be short-term debt and is carried on the books as a current liability. By convention, debt having a maturity greater than one year is consider mid-term loan and more than 3 years is considering as long-term debt and is carried as a noncurrent liability.

Maturity is the date on which the life of a transaction or financial instrument ends, after which it must either be renewed or it will cease to exist. The term is commonly used for deposit, foreign exchange spot and forward transactions, interest rate and commodity

take part in an exchange of options, loans, and fixed income instruments such as bonds. (Investopedia, 2017b)

The maturity of a deposit is the date on which the principal is returned to the investor. Interest is sometimes paid periodically during the lifetime of the deposit, or at maturity. Many interbank deposits are overnight, including most euro deposits, and a maturity of more than 12 months is rare.

The maturity date represents the date on which the bond matures i.e. the date on which face value is repaid. Most bonds have original maturities ranging from 10 to 40 years, but any maturity is legally permissible. The effective maturity of a bond declines each year after it has been issued.

Firms borrow money for periods ranging from overnight to a hundred years and more. Thus, Nepalese bank called Himalayan Bank's bonds have a 7- years original maturity year 2002, a 4-year later, they will have a 3 years' maturity, and so on. (Manandhar, et al., 2012)

3.1.2. SECURITY

Bonds very (tie together) in the degree of security they afford investors. A Mortgage bond is secured by specific corporate assets, where as a debenture is unsecured. Holders of debentures must look to the firms claim to the mortgaged assets. Debenture holders share equally with other creditors in the cash generated by mortgage assets but have only a residual right to mortgaged assets.

Here in Europe according to the professor António Rebelo de Sousa said I had mentioned before that bankers pay up to 100,000 (one hundred thousand euros) Euro for cash deposited. (Sousa, 2017)

3.1.3. SUBORDINATED DEBENTURES

Rank behind senior debt with respect to their claim on assets. In the event of default, subordinated claims are paid off only after all other creditor claims are fully satisfied. Leaders are considered to be senior unless their loans are specifically subordinated (lower in rank).

3.1.4. FLOATING-RATE VERSUS FIXED-RATE DEBT

Most long- term debt is issued with a fixed coupon or interest payment. Because the coupon amount is fixed in nominal terms, the present value of these future cash flow fluctuates in line with interest rate fluctuations.

In recent years, the greater volatility in interest rates- due primarily to inflation uncertainty – has led investors to demand floating– or variable-rate debt. Usually the rates on floating-rate debt are adjusted every three to six months Currency and Jurisdiction (the official power to make a legal decisions and judgment).

Debt can have denominated in either the domestic currency or a foreign currency. The foreign currency borrowing option is frequently used by multinational firms. A Eurocurrency being any currency to be borrowed can be separated from the choice of the country in the burrow take place. For example, nestle can borrow Swiss francs in Zurich or in Frankfurt.

3.2. ASSET VALUATION

Valuation can be done in the assets e.g., (investment on marketable securities such as stocks, options, business enterprises, or intangible assets such as patents and trademarks) or liabilities e.g., (bond issued by a company) In the finance asset valuation it is necessary to decide the present value of an asset.

If we look at asset valuation where price or value of a financial asset like a stock or a bond is determined by the future cash flow that the owner expects to obtain from that asset. These cash flows take the form of future interest or dividend payment's plus the amount the owner receives on sales of the assets.

An investor opportunity cost of money depends on the next best investment opportunity available. Investors who want to maximize their wealth should never accept a lower return on an asset than could be obtained elsewhere. If each investor faces almost equal investment opportunities in the market, they all will have the same minimum required return. (Shapiro, 1991)

This is why the existence of easily able to reach, organized markets for the purchase and sales of assets is so important. This is also one of the reasons why modern finance is important always looking to increase their wealth by taking risk or by investing in assets.

3.2.1. CAPITAL MARKETS AND ASSET VALUATION.

Markets in which people trade current dollar (pounds, Euro and the like) for claims to future dollars (pounds, euros,). Opportunities to invest exist for a wild range of financial assets with varying amount of risk. Especially in the rich and developed countries.

The return on these traded the action of buying and selling goods and services of assets establish, for each degree of risk, the minimum return that an investor should accept on a particular investment. (Shapiro, 1991)

Because people are generally risk averse which means having strong dislike that is, all else being equal they prefer less risk to more. The higher the risk is the higher the required return will be. Each investor gets the same faces essentially the same set of investment opportunity has a very important implication or action being involved for a corporate finance.

Two individual, no matter how different their consumption performance or wealth, will always use the same discount rate to value the future cash flows associated with a particular asset.

Therefore, the manager does not have to worry about different shareholders assigning different present values to the same investment project; The market establishes a single discount rate-which equals the required risk adjusted return- to be used in all investment having the same risk.

Consider an investor who demands an 18% return on an asset, which is completely different with the market required return of 13%. If the asset product of expected return of 15%, the investor will still buy it. This means that an investor who demands a higher return can buy the asset of low price and then sell it to another investor at a gain.

Alternatively, someone who uses a lower personal discount rate to value assets should not accept any investment demanding, yielding less than the markets required return on assets of similar risk.

For an example, an investor who demands a 10% return should not purchase an asset providing 12% if the market discount rate is 13%. The reason is that the investor can always put another asset having the same risk but a 13% return.

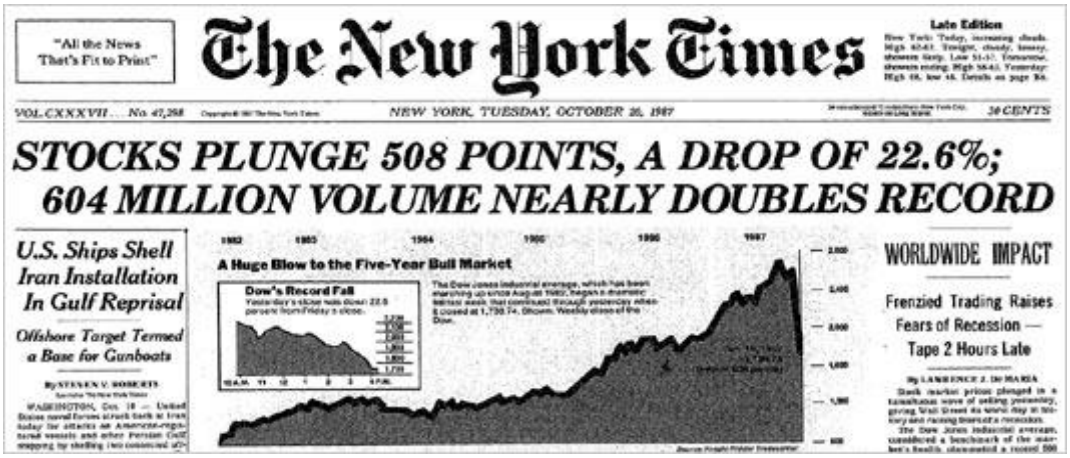
What matters is not what an asset is worth to the investor but what the asset is worth in the market place. If you think an asset is over prices you can always sell it, whereas if you think an asset is underpriced you can always buy it.

3.2.2. MARKET ABILITY TO AVOID WASTING MATERIAL AND ASSET VALUATION.

Recent evidence has suggested some superior investors systematically beat market. Although this could be due to luck, it seems unlikely to be the case. Indeed, it would be surprising if among as many people beating the market, none would succeed. Some investors must be able to understand design where others see only chaos or must be able to forecast trends where others see nothing.

Nobody really knows how to beat the stock market, or any other financial market for that matter. According to the efficiency market hypothesis about financial market – that thousands of highly professional, hardworking, and clearly intelligent stock pickers are continually get anger by the market.

3.2.3. BLACK MONDAY AND MARKET EFFICIENCY (OCTOBER 19,1987)



"All the News That's Fit to Print"

The New York Times

Late Edition

VOL. CXXXVII ... No. 47,288 NEW YORK, TUESDAY, OCTOBER 20, 1987 50 CENTS

STOCKS PLUNGE 508 POINTS, A DROP OF 22.6%; 604 MILLION VOLUME NEARLY DOUBLES RECORD

U.S. Ships Shell Iran Installation In Gulf Reprisal

Offshore Target Termed a Base for Gunboats

A Huge Blow to the Five-Year Bull Market

Dow's Record Fall

WORLDWIDE IMPACT

Frenzied Trading Raises Fears of Recession — Tape 2 Hours Late

Figure 1: Black Monday – the Stock Market Crash of 1987. (Colombo, 2012).

The stock market crash of 1987 or "Black Monday" was the largest one-day market crash in history. The Dow lost 22.6% of its value or $ 500 billion dollars in October 19th 1987.

"Microcomputers" now known as personal computers were becoming a fast growing industry. People started to view the personal computer as a revolutionary tool that would change our way of life, while creating wonderful business opportunities. The investing public eventually became caught up in a contagious euphoria that was similar to that of

any other historic bubble and market crash. This euphoria made investors, as usual, believe that the stock market would “always go up.” (Colombo, 2012)

As in the finance black Monday refers to Monday, October 19,1987, when stock markets around the world crashed by huge price down a huge value in a very short time. In Australia and New Zealand, in 1987crash is also referred to as “Black Tuesday” because of the time zone difference. Targeted situation that change the world finance that time.

More recently, the volatility or change of stock prices since Black Monday (October 19,1987) has caused many people to question the efficiency and rationality of the stock pricing process. How can a market in which a share price can drop 23% in one day, clear out over a trillion dollars in market value, be considered efficient?

Is it possible, if prices are set by rational people on the basis of all economically relevant information, that IBM stock could be worth $135 on Friday and only $102 on the following Monday? It still has the same plant and equipment, the same work force and customers, and the same patents and products.

Black Monday that investors learned during the previous week that the market was more changeable then they had beloved. The market had a highly unusual 9.6 % the previous week and investor may have concluded over the weekend that market volatility had reached unprecedented levels. As we can see a large rise in perceived market volatility or worse leads to an increase in the required return on stocks and hence to a drop in stock prices.

3.2.4. MARKET EFFICIENCY AND “TRUE VALUE”

Market efficiency and ‘’True Value’’

Market efficiency hypothesis is popularly known as the Random Walk Theory, it deals with one of the most fundamental and exciting issues in finance - why prices change in security markets and how these changes take place. It also has very important suggestion for investors as well as the financial managers.

The first time the tern “efficient market” was in a 1965 paper by E.F. Fama who said that in an efficient market, on the average, competition will cause the full effects of new information on being naturally values to be reflected “instantaneously” in actual prices. Market efficiency also suggests that as price changes randomly it’s very difficult to get the profit.

The key reason from leaving of an “efficient market” is the naturally competition among investors to profit from any new information. The ability to prove that is value which it would allow investors to buy some stocks for less than their “true value” and sell at high. If there is more computation among same product price become small that may exit the weaker.

Market efficiency can be put in the form of a slogan Trust market price! At any point in time, price of securities in efficient markets reflects all known information available to investors. There is no room for fooling investors, and as a result investment in efficient market are fairly prices. i.e. in average investors get exactly what they pay for. Raising and falling is similar to all security.

Market price could be change sometimes dramatically every day, hour, and minute so Market efficiency hypothesis could be incorrect sometime. But in favor of market efficient Suppose you have a Research department of CJM, an agriculture corporation, develop a new revelation of corn that can be grow in desert. Which is showing durable and develop in the future with having a very profitable activity.

Assume that on Monday CJM’s stock price is $100, and estimated present value of corn development project is $50 per share. What could happen on Tuesday morning when CJM announced the discovery of new corn type? If the market is efficient will adjust the new information. And the price would jump to $150 with fully new project announced the company.(Clarke, Jandik, & Mandelker, 2001)

3.3. PRICING BOND

We can define a bond as a specific type of long-term loan debt security. Like any other corporate creditor, bondholders lend money to a company. In return for this loan, the company promises to pay to the bonds owner a series of fixed interest or coupon payment until the bond is matured.

The price of bond is just a present value of the future cash flows associated with it - the coupon payment plus the face value. As we shall see, if the required return of the bond is unequal to the bonds coupon rate, the market prices of the bond will differ from its face value (the value printed or depicted in a coin, banknote, postage stamp and ticket, especially when less than the actual or intrinsic value).

The price of a bond issued by a party is directly linked to the credit rating of that party, since there is always default risk associated with a bond, which means that the borrower might not be able to pay the full or partial amount to loan taken.

So, bonds with low ratings, called junk bonds which are sold in low price where as those with higher ratings, called investment grade bonds are sold at higher ratings.

When interest rates rise, bond prices fall, which results in a rise in yields of the older bonds and brings them into the same category as newer bonds being issued with higher coupons and vice-versa. (Bennett, Coleman & Co, 2017)

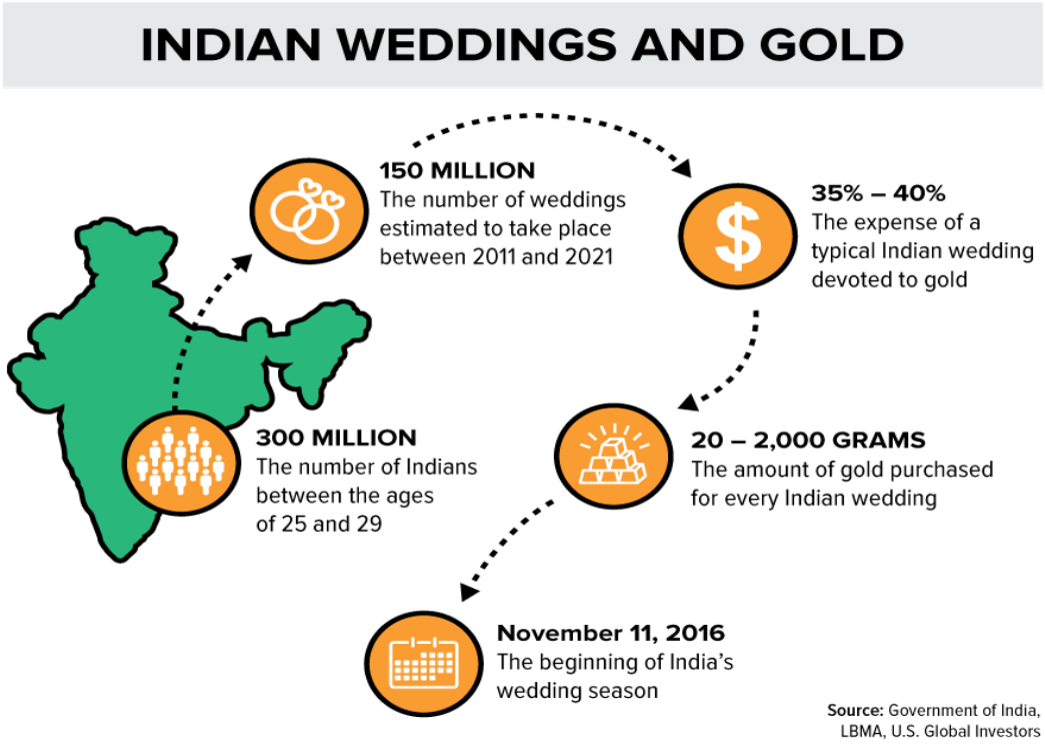


Figure 2: The price under gold in India. (U.S. Global Investors, 2016).

In the above figure its shown how much gold do they use in their culture and that's what plays a great role in world financial economy changer as the tones of gold also plays a very important role in the exchange rate of dollar.

This tradition carries on today, with India's demand for gold jewelry in 2015 reaching more than 668 tones, nearly a third of total global demand and second in size only to China which is also a king of cash by which money can be taken out like a treasury bill from banks. (U.S. Global Investors, 2016)

3.4. PREFERRED STOCKS VALUATION

Preferred stock is the long-term sources of financing under which the stocks are entitled to get fixed amount of dividend out of the earning of the company after payment of debenture interest and tax. Preferred stock payments are treated as dividends rather than interest, they are not tax-deductible expenses for the firm.

Preferred stocks is a hybrid securities having some characteristics of debt and some of equity. Preferred dividends are similar to interest payments on bonds in that they are fixed in amount and generally must be paid before common stock dividends can be paid. Preferred stock may be issued with or without maturity period. (Lane, 2017)

3.4.1. VALUATION OF FIX MATURITY PERIOD PREFERRED STOCK

Fixed maturity period stock has infinite period. It is also called the impossible to cure preferred stock. The value of a stock of fix maturity stock is found as divided by the required rate of return. (Lane, 2017)

$$\mathrm{Po} = \frac{\mathrm{Dp}}{\mathrm{Kp}}$$

where,

D_p = Preferred stock dividend.

P_o = Value of preferred stock.

K_p = Required rate of return on preferred stock.

For example, Necon Air sold 12%, preferred stock with a par value of Rs.50. If the cost of preferred stock is 11%, then the value of preferred stock is Rs.54,55.

$$P_o = \frac{(0.12 * Rs.50)}{(0.11)} = 54.545$$

Therefore, the value of this preferred stock is Rs.54,55 and one can pay Rs.54,55 for this stock.

Valuation of repayable at the maturity date stock.

Repayable of maturity preferred stock has finite maturity period. The valuation of a stock of repayable at the maturity date preferred stock is the present value of its dividend payment plus the present value of its par, or face value.

$$\text{Po} = \sum_{t=1}^{n} \left(\frac{\text{Dp}}{(1 + \text{Kp})\text{t}} + \frac{M}{(1 + \text{Kp})\text{n}} \right)$$

$= D_p^* PVIFA_{kp,\,n} + M*PVIF_{,\,kp,\,n}$

For example, Tara Gaun Regency issues Rs.100 face value preferred stock, which carries 12% dividend and is repaid after 12 years at par. If the cost of preference stock capital 13% the value of preferred stock is Rs. 94.116.

$Po = Rs.12*PVIFA_{13\%,12}+Rs.100*PVIF_{13\%,12}$

Po = Rs.12*5.9176+100*0.2307

Po =71.0112+23.07

Po =94.018

working note:

Dividend per share (D.p) = Rs.100*0.12 = Rs.12

Therefore, the value of given preferred stock is Rs.94.018. One can pay maximum of Rs.94.018 for this preferred stock. (Manandhar, et al., 2012, p. 256)

3.5 CHARACTERISTICS OF PREFERRED STOCK

Claim on income and assets

When company income is clamed bye the preferred stock in between common stock and debt. Preferred stock has priority over common stock with respect to the firm's income, because preferred dividends must be paid before common stock dividends. But creditor

claims against the firm's income must be settled completely before any preferred dividends are paid.

If we look at when their Bankruptcy, preferred stock is senior to common stock but subordinate to all debts. Creditors must be paid fully before preferred or common stockholders receive anything. Any money left over from the sale of the firm's assets is then used to settle preferred stock claims.

The value of their claims in liquidation is usually stated on the firm's balance sheets. Considering the rights to Preferred stocks.

3.4.2. VOTING RIGHTS

The main purpose of Preferred stock is to preserve the priority of its company income and assets. For example, the New York Stock Exchange lists only preferred stocks that provide contingent voting rights after the firm has skipped the equivalent of six quarterly preferred dividends. In such an event, the preferred stockholders may have the right to elect one third of the members of the board of directors.

3.4.3. RETIREMENT OF PREFERRED STOCK

Although preferred stock has no mature date, firms generally make provisions for its retirement. As with most bond issues, almost all preferred issues contain a **call** provision that gives the firms the right to buy back the preferred stock at a price specified when it is first issued.

Speaking to the tax status Unlike interest payments, preferred and common dividends are not tax deductible. However, dividends received from domestic corporations are 70 % tax free to corporate investors, whereas interest income if fully taxed. Thus, an insurance company that receives a dividend of $100 would have to pay corporate tax on only $30 of that income.

If it is in the 34 % bracket, its tax on the $100 dividend will be just $ 10.20 ($30*.34). because of this tax advantage, most preferred stock is held by corporation in instead of holding debt securities, whose interest receipts are fully taxed. (Shapiro, 1991, p. 73)

4. RISK AND RETURN

> "Do not put all eggs in one basket."
>
> "The earth is just too small and fragile a basket for the human race to keep all its eggs in" (Heinlein *apud* Shapiro, 1991, p. 101)

The function of financial manager is to maximize the wealth of shareholders. The wealth is maximized when return is maximized and risk is minimized. Returns are the gains or losses from a security in a particular period and are usually quoted as a percentage. What kind of returns can investors expect from the capital markets? A number of factors influence returns.

Risk:

In the investing world, the dictionary definition of risk is the chance that an investment's actual return will be different than expected. Risk means you have the possibility of losing some, or even all, of your original investment. Low levels of low risk are associated with low potential returns.

High levels of uncertainty (high risk) are associated with high potential returns. The risk/return trade-off is the balance between the desire for the lowest possible risk and the highest possible return. If you take a high risk, there might be chances of high profit as well as high risk of losing it too. Risk can be defined as the chance that some unfavorable event will occur. (Investopedia, 2017e)

Returns

The returns are the difference between the terminal wealth what an investor received and initial wealth what an investor invested. The investor wealth can be increased or decreased or remains the same in the future.

If the terminal wealth is less then the initial wealth there is negative return from the investment. If the terminal wealth is equal with the initial wealth there is zero return. Investor always wants to higher return other things being the same.

4.1. RISK AND SENSIBLE INVESTOR:

A well-diversified portfolio less risk less return, how do we know that investors even want such portfolio? Suppose they like risk and do not want it to disappear? Having gone to all this trouble to show that unsystematic risk disappears.

We must admit that, theoretical at least, this is possible, but we will argue that it doesn't describe what we think as the typical investor. Our typical investor is risk averse. Risk-averse behaviour can be defined in many ways, but we prefer the following example: a fair gamble is one with zero executive return. A risk- averter investor avoids fair gamble.

Why investors choose well-diversified portfolio? Answer to this is that they are risk averse, and risk-averse people avoid unnecessary risk, such as the unsystematic risk on stock. If you do not think this is much of an answer, consider whether you would take on such a risk.

For example, suppose you had worked all summer and had saved $5.000, which you intended to use for your college expenses. Now, suppose someone come up to you and intended or plan to use for your college expenses. Now, suppose someone come up to you and offered to flip a coin for the money. Head, you double your money, and tails, you would lose it all.

Would you take such a bet? Perhaps you would, but most people would not. Leaving aside any moral question that might surround gambling that some people would take such a bet, it's ours view that the average investor would not.

To induce the typical risk- adverse investor to take a fair gamble, you must sweeten the pot. For example, you might need to raise the odds of winning from 50-50 to 70-30 or higher. The risk-averse investor can be induced to take fair gable only if they are sweet-ended so that they become unfair to the investors advantage. (Ross, Westerfield, & Jaffe, Corporate Finance, 1999, p. 263)

4.2. CREDIT OR DEFAULT RISK

Credit risk is the risk that a company or individual will be unable to pay the contractual interest or principal on its debt obligations. This type of risk is of particular concern to investors who hold bonds in their portfolios. Government bonds, especially those issued by the federal government, have the least amount of default risk and the lowest returns.

If we look at corporate bonds tend to have the highest amount of default risk but also higher interest rates. Bonds with a lower chance of default are considered to be investment grade. While bonds with higher chances of default are considered to be junk bonds. Bond rating services, such as Moody's, allows investors to determine which bonds are investment grade and which bonds are not suitable to the company or investors.

4.2.1. COUNTRY RISK

Country risk refers to the risk that a country won't be able to high respect its financial commitments. When a country defaults on its obligations it can harm the performance of all other financial instruments in that country as well as other countries. Country risk applies to stocks, bonds, mutual funds, options and futures that are issued within a particular country.

Sometimes a country takes a high amount of credit from the world bank or from a country and has a huge amount that he is not able to pay back on a given period some time even cannot pay and by that all people face problems.

4.2.2. FOREIGN-EXCHANGE RISK

When we talk about investing in foreign countries you must consider the fact that currency exchange rates can change the price of the asset as well. Foreign-exchange risk applies to all financial instruments that are in a currency other than your domestic currency.

As an example, if we are a resident of China and invest in some Qatar stock in Qatar Rial, even if the share value appreciates, we may lose money if the Qatari rial depreciates in relation to the Chinese Yen; here we need to see the right time when is it right time to exchange as time is different according to different country, must be done on time.

4.2.3. INTEREST RATE RISK

Interest rate risk is the risk that an investment's value will change as a result of a change in interest rates. This risk affects the value of bonds more directly than stocks. If the interest rate is increase its benefited to the owner who provide credit and if its interest rate decreases, it´s a benefit able for the debtors.

4.2.4. POLITICAL RISK

Political risk represents the financial risk that a country's government will suddenly change its policies. This is a major reason why developing countries lack foreign investment. This kind of risk can make great ups and downs to the investors who had already invested and they make encourage to the new investor if it´s suitable to them.

If politician is corrupted then the police is also corrupted; if police are corrupted then the people are put into jail, so there might be difficult to get the paper certified by the government for the company. (Investopedia, 2017e)

4.2.5. SYSTEMATIC VERSUS UNSYSTEMATIC RISK

Stocks can be categorized as occurring in cycles countercyclical. A cyclical stock is one whose returns move in line with the state of the economy. It does well when the economy does well and poorly when the economy does poorly. Depends upon the economic condition of the country.

4.2.6. IS THERE A POSITIVE CORRELATION BETWEEN RISK AND RETURN?

There is a positive correlation between risk and return with one important caveat step by step. There is no guarantee that taking greater risk results in a greater return. Rather, taking greater risk may result in the loss of a larger amount of capital.

A more correct statement may be that there is a positive correlation between the amount of risk and the possibility of something might happen or return from given condition. Generally, a lower risk investment has lower potential for profit. A higher risk investment has a higher potential for profit but also a potential for a greater loss.

On the low-risk end, there are short-term government bonds with low productions. The middle of the spectrum, colorful may contain investments such as rental property or high-yield debt. On the high-risk end of the spectrum are equity investments, futures and commodity contracts, including options in different level of risk there is also maximize the return , while mining the risk also have the results in the lowest risk for a given return.

An investor must need to understand individual risk and must understand the risk tolerance. We must understand of your ability and willingness to stomach large wings in the value of his investment, if we take on too much risk, we might panic and sell at the wrong time.

4.3. THE RELATIONSHIP BETWEEN RISK AND RETURN.

Suppose we decide to go for big time. We borrow at the treasury bill rate an amount equal to our initial, beginning wealth, and we spend everything in ability of investment. We make a twice of your money in investment, but we have to pay interest on load.

Investing with beta you would aspect return more than that, by investing half of money in treasury bill. Wise investor does not take risk just for fun. They are playing with real money. Therefore, they require a higher return from the market portfolio than from treasury bills.

Suppose that 60% of your portfolio is invested in Wal-Mart and the remaining invested in IBM (International Business Machine Corporation). We aspect that over the coming year Wal-Mart will give you a return of 10% and IBM 15%. The expected return on our portfolio is simply a weighted average of the expected returns on the individual stocks.

Expected portfolio return = (.60*10) + (.40*15) = 12%, which is the calculation of portfolio risk. The portfolio return is 12.00/100= 0.12, or 12%.

4.4. PORTFOLIO RISK AND RETURN

Portfolio is the combination of two investments in two or more than two assets. Portfolio return is the weighted average return of the expected return of the individual assets included in the portfolio. This risk is also the function of the weight, covariance or correlation and standard deviations. (Manandhar, et al., 2012, p. 133)

For example, we can see in London application Lloyd's of London how the financial manager takes a decision to change the economy of the Lloyds bank of London and we can see how they get unsuccessful by their program it well be clear if you see below and you will know how they face the problem I mean how their project was fail.

The biggest loss in 290-year history of Lloyd's of London claim of up to $300million resulted from the insurance markets failure to distinguish adequately between diversification or the action making or not making the action risk. The trouble began when Lloyds devised or plan an insurance contract protecting leasing companies against losing money on cancelled computer leases.

Such losses could arise from having to release the computers at a lower rental. Lease terminations resulting form factors affecting specific businesses are clearly diversifiable.

But Lloyd's fail to anticipate or guess the risk of technological outdate and no longer use that would systematically affect the value of all computers out on lease.

This risk materialized happen in 1977 when IBM (International Business Machine Corporation) introduced a new, less expensive line of computers that outmoded the older 379s, for which most of the insurance was written. As customers cancelled leases, the 370s had to be remarketed at distress which mean they published in sale by its mortgage prices and the leasing companies filed claims against Lloyd's. (Shapiro, Modern Corporate Finance, 1991)

4.5. REQUIRED RATE OF RETURN

Every investor made an investment expecting something positive return form the investment. It is the minimum rate of return an investor will accept. The required rate of return for an asset can be estimated using the equation for the security market line suggested by the capital assets pricing model.

After calculating the require rate of return, the investment decision should be made. The investment is made if the expected return is greater or at least equal to the required rate of return. If the expected rate of return is less than the required rate of return, the investment should not be made.

For example: if the expected return is 10% and required return is 8%, the investor will make investment decision in this investment. (Manandhar, et al., 2012, p. 106)

4.6. FAILURE OF RISK

In finance, a price (premium) is paid or received for purchasing or selling options. As we know there was a financial crisis on 2007- 2008 it was the global recession that took place in year 2008. That made many economics the worst financial crises since the great depreciation of 1930s.

The reason of crises is like Ireland become too trusty to the U.S. government and lend the money. Because of new technology that also one of the reasons. Banks become too careless about lending the money to the public. Likewise, the house prices go down inexpertly in U.S housing pricing goes 20% down from their mid-2006 peak.

4.7. CAPITAL ASSET AND PRICING MODEL.

Capital asset price can be defined as the pricing model that describes the relationship between systematic risk and expected return for assets, particularly assets. It can be compare in two ways: time value of money and risk. (Investopedia, 2017f)

When looking at the investments in an international C.A.P.M (Capital Asset Pricing Model) model is used to incorporate foreign exchange risks (typically with the additional of a foreign currency risk premium) when dealing with several currencies.

According to the Nobel prize winner William Sharpe, the return on an investment should equal its cost of capital and that the only way to earn a high return is by taking on more risk. There are several international CAPM is one of them. (Investopedia, 2017h)

The more risk averse investors are, the higher will be the required return for bearing risk. less risk aversion leads to a smaller risk premium and a lower required return.

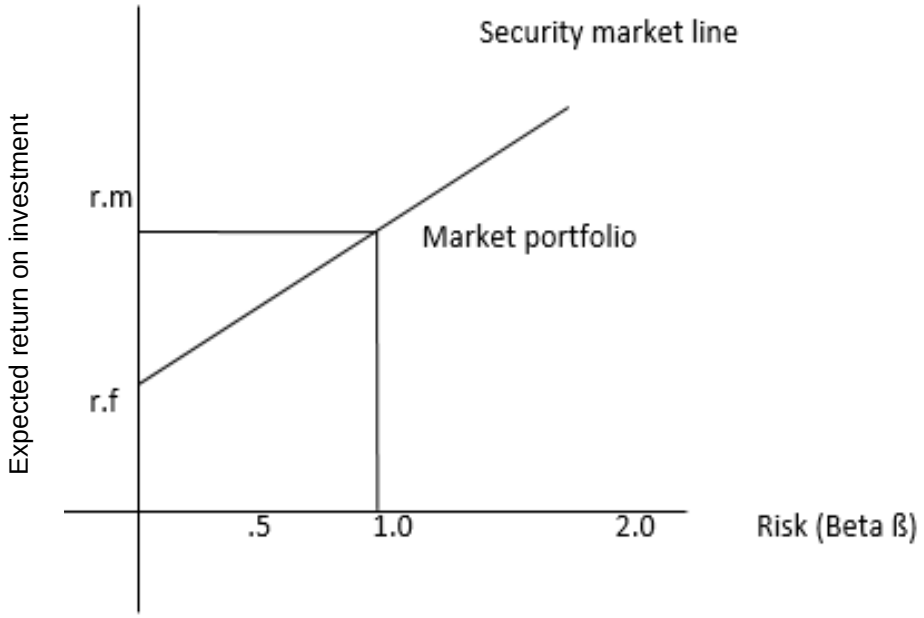


Figure 3: Market relationship Between Risk and Return. (Shapiro, 1991, p. 123)

The capital asset pricing model states that the expected risk premium in each investment is proportional to its beta. This means that each investment should lie on the sloping security market line connecting Treasury bills and the market portfolio.

Application Using the CAPM

The market has an expected rate of return of 15 percent, the riskless rate of interest is 5 percent, and the common stock has a beta of 2. Using the CAPM, what is the expected rate of return of the stock?

Solution apply the CAPM as followings:

Expected return on the stock =risk less rate of interest + Beta (expected rate of return-riskless rate of return)

Expected return on the stock = $r_f + ß (r_m - r_f)$

$= 5\% + 2(15\% - 5\%)$

$=25$ percent

Table 4: Stock Market Capitalizations as Percent of World Total (20 main markets)

	March 1966	December 1970	December 1980	Sepetember 1988
Japan	3%	5%	15%	42%
United State	71	66	53	31
Europe	19	20	20	21
Rest of World	7	9	12	6

SOURCES: morgan Stanley Capital International.

Source: (*apud* Shapiro, 1991, p. 125)

In the above table is shown the destruction connected with using an index of stocks listed on the New York Stock Exchange as a proxy for the true market portfolio has gotten more severe over time. As we can see in the above figure that about two-thirds of the world´s stock market capitalization is in non- U.S. companies and this fraction has been increasing over time.

Table 5: Global Top 100 companies by market capitalization 31sr March 2017

	2009	2016	2017
China	11%	11%	11%
United states	42%	54%	55%
Japan	4%	4%	6%
European countries	19 16	17	
United kingdom	(9%)	(7%)	(5%)
Germany	5%	5%	4%
France	7%	4%	4%
Switzerland	3%	3%	3%
Australia	1%	2%	3%
Spain	2%	1%	2%
Netherlands	1%	1%	1%

Sources: (PricewaterhouseCoopers, 2017)

If we look at the table above in 51 years' European countries are still at almost same percentage by subtracting England. United States are covering half of the market but in as year 1966 almost 71% of world market. China is covering only 11% as we see rest of the world percentage in year 1966 china covers more than that its GDP growth by 6.8%.

Scientist believe that one-day world will be destroyed (movie- End of the world 2012) may be in upcoming years we can see something totally different then the above figure after half century. We can see some percentage of different countries as China is appearing above some African countries is missing. Everything written is not true.

Some people think they are going to flood their markets with cheap stuff will broke down their companies will be bankruptcy and whole country will be a crap. That's something, a really extreme vision of what can happen that I don't think will happen. People who leave in U.S they don't like the product made in China they want U.S.

So, Chines' new generation People says China is growing so fast but it's not it`s a little plant and you put a heavy brick one a beans plant and somehow they are growing up but think how it could grow if the brick was taken out from that plant. Different people have different thought but this is also reason why China is not growing as it has to. (Miranda González, 2017)

In 2015 EU27 becomes the world no 1 export which is more then 2/3 of China and 3 times more than U.S which is 5.8 trillion dollars. (European Union, 2017, p. 23)

4.8. THE KEY CONCEPT OR MAIN IDEAS OF RISK AND RETURN.

The nature of risk and return is linear or positive. The rate of return consists of capital gains yield and dividend yield. The expected return for any asset is the weighted average of the expected return. Risk can be defined as the change that some unfavourable event will occur.

Covariance and correlation measures the relation of the two assets. Minimum risk portfolio represents all portfolios that can be constructed from a given set of assets. An efficient portfolio is one that offers the most return for a given amount of risk, or the least risk for a given amount of return.

The optimal portfolio for an investor is defined by the investor's highest possible indifference curve that is tangent to the efficient set of portfolios. The capital asset pricing model describes the risk return relationship for efficient portfolios.

The capital market line describes the risk return relationship for efficient portfolio, that is, for portfolios that consists of a mix of the market portfolio and a riskless asset. The security market line equation shows the relationship between a security's market risk and its required rate of return.

The beta of a portfolio is a weighted average of the betas of the individual securities in the portfolio. (Manandhar, et al., 2012, p. 133)

4.9. FOREIGN EXCHANGE RISK AND ECONOMIC EXPOSURE.

The most important aspect of foreign exchange risk management is to incorporate currency change expectations into all basic corporate decisions in performing this task the firm must know what is at risk. However, there is a major lack of confidence between accounting practice and economic reality in terms of measuring exposure, which is the degree to which a company is affected by exchange rate change.

Example for the proofed let's see American Film Makers Suffer When the Euro Slumps fall in price.

According to the recent story in the Wall Street Journal (May 19, 2000, P. B1)," The euros plunge against the dollar is casting a pall over this year's Cannes Film Festival, forcing European distributors to curtail their purchases of American films and triggering concessions by U.S. producers of a short once unheard of in this glitzy resort."

The Euro's decline by 24% against the dollar is a problem for European distributors because the international movie business is priced almost exclusively in dollars. It is a problem for the U.S. producers because Europe is such a big market for American films. Before a film goes into production, a studio will "presell" the foreign rights to distributors and use this presale revenue to finance the films production.

The presale of rights to continental European distribution often accounts for about a third

of a films budget. The rise in the value of the dollar has hurt the prices that U.S. producers can get for these rights. At the same time, the higher euro prices for these rights this caused Euro distributor to seek better financing terms, such as stretching out payment for their acquired rights.

Although some U.S. producers have talk about switching to pricing their rights in euros, the problem of a fallen euro will still remain: if the euro price is set at a level that yields the same dollar price, European distributors would face the same higher cost, if it is set at the same euro price as in the past the U.S. producer would receive fewer dollars. (Shapiro, 2002)

5. OPTIONS OF CORPORATE FINANCE

“If Chance will have me king, why chance may crown me” (Shapiro, 1991, p. 147)

Option features are especially unwelcome influence spread widely through the group of people in corporate financial decision. They are involved in decisions of whether to build, expand, or close a factory, to buy a productive asset like trucks or machines, to drill for oil or mine for gold, or to build building.

Sometimes they are involved in decision about how to pay managers and other employees. (Ross, Westerfield, & Jaffe, 2005, p. 620)

The option to wait and learn before investing. When we have to invest, if they get chance to invest then they will love it. For that you need to get organized, keep detail records, analyze your competition, understand the risk and return, be creative, stay focused, prepaid to make sacrifices, provide great service or better offer.

Options in corporate finance are the contracts that gives buy or sell a fixed number. If goods are at an advance dedication price, but they do not give because of the government rules and regulation that the buyers to do so. They do have certain rules and regulations to buy and sell the stocks.

In April 1973, trade in stock options began on the floor of the Chicago Board Option Exchange (C.B.O.E.). The succeeding years have witnessed enormous very large in size, quantity growth in the variety of options available in investors. Options on the stock, stock indexes, commodities, foreign currency, and government securities are listed on over a dozen exchange worldwide.

We can see some example like an investment in new technology or a new distribution network may allow a company to expand into new products or markets at a later date.

In every steps, the company is investing money today for the option of making future. If the future projects appear to be profitable, the company will invest in them. Otherwise it will let its option expire. It´s about making profits and making the owner financially strong.

An option is a security giving the right to buy or sell an asset, subject to certain conditions, within a specified period of time. An “American option” is one that can be exercised at

any time up to the date of option expires. A “European option” is one that can be exercised only on a specified future date.

The price that is paid for the asset when the option is exercised is called the “exercised price” or “striking price.” The last day on which the option may be exercised “expiration date” or “maturity date.” The simplest kind of option is one that gives the right to buy a single share of common stock. In detail I have mentioned below too((Black & Scholes, 2008))

5.1. THE BASIC OF STOCK OPINION

In financial Options comes in many forms, but all share has the following characteristics: The holder has the right but not the obligation or legally bond to buy or sell, buy an asset at a set price and date. The seller of the put or call option must fulfill the contract if the buyers so derives it.

The option not to buy or sell has value, and so the buyers must pay the seller of the option a premium for this privilege that would be profitable to exercise at the assets. Current price is said to be the money. Conversely, an out of money option in one that would not be profitable to exercise at the current asset price.

The price at which the option is exercised is the exercise or stock price. If the option can be exercised only at the expiration date, it is called a European option. The options that can be exercised at any date or existing, or coming before time to expiration in any American Option.

5.2. UNDERSTANDING OPTION

Related to the option why the managers are interested we can see some examples first company use regularly commodity, currency and interest rate risk. For example, a meatpacking company that wishes to put ceiling on the cost of beef might take out an option to but like cattle at a fixed price. Looking at their limitation of future cost.

Second, for instance, the company may invest in a patent that allows to exploit a new technology to make a full use of a new technology or it may purchase adjoining land that gives it the option in the future to increase capacity. In each case company is investing its money today for the opportunity to make a future investment and growth opportunity.

If we look at the another example which is something different option of investing: suppose you are making a decision to buy a track of desert land which is known as containing gold deposit on it. But the cost of taking out the gold from the mine is higher than the current price of gold.

Does that mean the land is almost worthless? Not at all. Obviously not, you are not forced to understand legally and survey the mine of the gold, but ownership of that land is giving you an option to you. If you think the price of mining gold is expensive then the todays gold price the option is worthless.

But what if there is riskless about future gold prices, if the price increase you could be lucky and make a killing. But for that you will get the result only when you make take out the gold from mine and subtract the cost price of mining gold only after that you could know the result. If project is unprofitable cut the loss and let the option be expiring. (Brealey, Myers, & Allen, 2008, p. 564)

5.3. CALL OPTION (BUY)

A call option gives the owner the right to buy an asset at a fixed price during a particular time period. The most common type of option is a call option. There is no restriction on the kind of asset, but most common ones traded on exchanges are options on stocks and bonds.

For example, call options on IBM stock can be purchased on the Chicago Board Options Exchange. IBM does not issue (that is, sell) call options on its common stock. Instead, individual investors are the original buyers and sellers of call options on IBM common stock.

A representative call option on IBM stock enables an investor to buy 100 shares of IBM on or before July 15, at an exercise price of $100.This is a valuable option if there is some probability that the price of IBM common stock will exceed $100 on or before july15. (Ross, Westerfield, & Jaffe, 2005, p. 620)

The relation among the expiration price, and the profitability of a European option contract is shown in figure below. Figure illustrate profit available on a call option with an exercise price of $25 and a call premium of $3 Euro. At a price of $25 or lower, the option will not be exercised, resulting in the loss of $3 option premium.

At a price above $28, the option is sufficiently deep in the money to cover the option premium and yield a net profit. For example, if the expiration price is $32, the option will be worth $ 7 ($32-$25), and the profit net of the $7 premium.

Between $25 and $ 28, the option will be exercised, but the gain in insufficient to cover the cost of the premium. For example, if the expiration price is $27, the option will yield $2 ($27-$25), but the overall impact is a $1 loss net of the $3 premium.

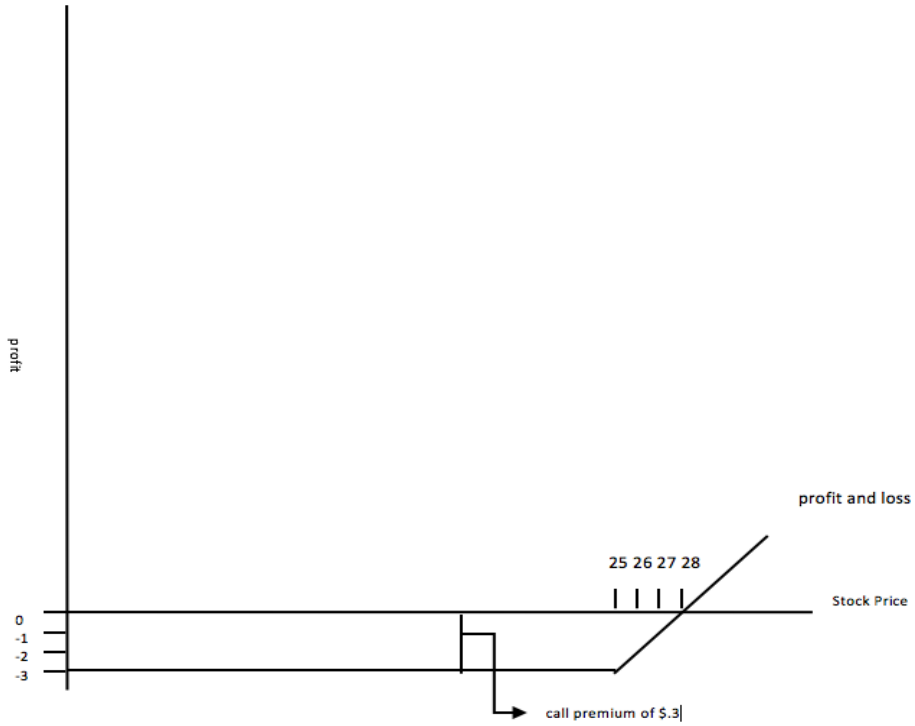


Figure 4: Call option. (Shapiro, 1991, p. 148)

C= max (0, S-X) or

Call option = (0, stock price - exercise price)

In other word, the call option is worth the different between the current stock price and the exercise price of Zero, whichever is greater. If the stock price happens to equal the exercise price, the option is said to be at the money, and the investor will be indifferent between excising it for a Zero gain or allowing it to expire.

5.4. PUT OPTION (SELL)

A put option can be viewed as the opposite of a call option. Just as a call gives the holder the right to buy the stock at a fixed price, a put gives the holder the right to sell the stock for a fixed exercise price. (Ross, Westerfield, & Jaffe, 2005, p. 620)

Figure below illustrate the profit from buying a put option with an exercise price of $25 and a premium of $2. As the assets price rises towards $23. The profit falls.

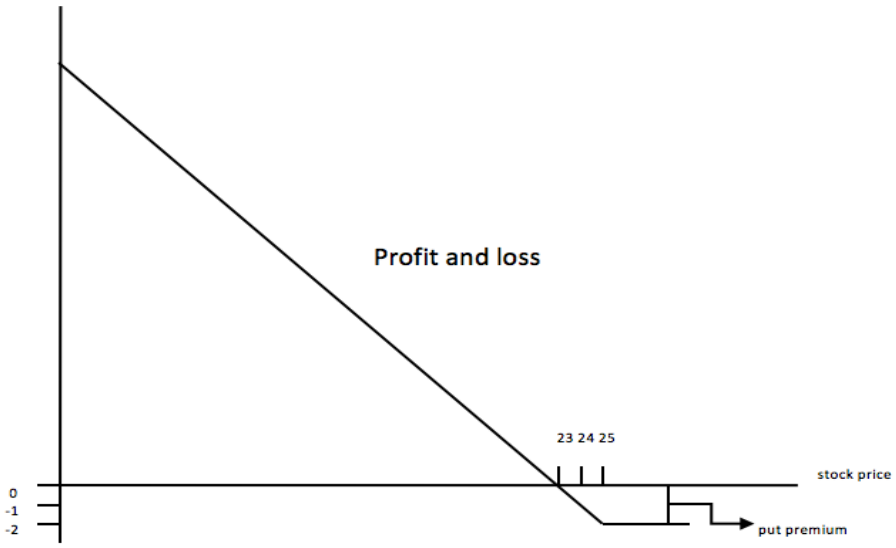


Figure 5: Put Option. (Shapiro, 1991, p. 148)

In particular, each $1 rise in price of the asset causes the profit on the put option to drop by $1. For example, if the price of the asset goes from $15 to $16, the value of the option will drop from $10 to $9, and the profit on the option net of the $2 premium will fall from $8 to $7.

At $23, the net profit on the put option is Zero and because loss of the "$2 put premium at $25 and up. In general, the value of a put option, P, at expiration with exercise price X and stock price S on that date is

P= max (O, X - S) or,

value of put option = max (0, exercise price – stock price)

If the put premium is b, then the buyers profit on the put option will equal P-b (value of put option – put premium). The seller of the put option will realize profits that are the negative of the buyer's profits.

5.5. OPTION PRICING

Option pricing refers to amount per share that an option is traded. It is important to understand how priced, options are derivative contracts that give the holders (the buyers)

the right, but not the legally bound to do something, to buy or sell the underlying instrument at an agreed-upon price on or before specified future.

The option written the (The seller) has an obligation to buy or sell the underlying instrument if the option is exercised. (Folger, 2017)

Using Arbitrage to Value an Option.

To see how the Black and Scholes (1973, p. 640) arbitrage technique for valuing options works, consider the following sample example: suppose that the currency price of meridian Inc., is $100 per share, which is also the exercise price of a one year call option.

To make keep matters simple, we will assume that at the end of one year half of price will either rise to $100 or fall to $90. Given a one-year interest rate of 5 % we can show that the option must be worth $7.143. If the stock price at the expectation of the call turns out to be $110, the call options will be in the money, and its value will be (110-100) =10.

On the other hand, if the stock price is one year is $90, the call will expire worthless. The option that are possible payoff are

Table 6: Option payoff

Stock price = 90	$110
Value of call option =0	$10

Source: (Shapiro, 1991, p. 150)

The pay offs form this options can be exactly duplicated by buying one share of Meridians stock, financed in part with $85.714 of borrowed money.

Financed part Borrowed amount =

$$\frac{lower\ value\ or\ end\ of\ period\ stock\ price - end\ of\ period\ option\ contrct\ value\ per\ share}{(1 + \mathrm{r}\ (Borrowed\ rate))}$$

Borrowed amount = $\frac{(90-0)}{(1+0.05)}$ which is 85.714

Borrowed amount=85.714

Half of borrowed amount which is 7.143 option must worth.

This portfolio has the current net present value of $14.286, equal to the $100 price of the stock less the $85.5 of borrowed money.

Table 7: The Payoffs on the year one from this portfolio

Stock price	**$90**	**$ 100**
Value of the share	$90	$110
Repayment of loan plus interest@ 5%	$90	$90
Total pay off	**0**	**20**

Source: (Shapiro, 1991, p. 150)

Because the payoffs from the profit exactly duplicate the payoffs from owning two call options, their value must be identical. Therefore, given a current value of the portfolio equal to $14.285, the call option must be worth half that amount or $ 7.1425.

If the call option of the market price should differ from above number, riskless arbitrage profits could be earned. But such a situation could not last for long. In the process of capitalization on this profitable opportunity, buying and selling judgment would drive back the price of call option to its equilibrium value of $ 7.1425.

5.6. OPTION VALUATION AND INVESTMENT DECISION

Consider a firm that must decide whether to make a $5,000 down payment on an undeveloped piece of land. The down payment will permit the firm to purchase the property outright by paying additional $ 50,000 at any time during the next six months.

The corporation must value the set of available investment project in order to decide which are worth undertaking. How, many investments have very uncertain payoffs that are best valued with an option approach.

The down payment agreement is a call option, with the $5,000 will be forfeited the down payment agreement is a call option, with the $5,000 down payment equivalent to the option price. The extra money needed to complete the deal ($50,000) is the striking price, and the uncertain value of the land after it is developed is the ``stock`` price.

The decision to ``exercise the option`` that is to pay the additional $50,000 to own the land depends on wheatear the value of the land exceeds $50,000 at the time the agreement is about to expire. Before entering into this agreement and spending the $ 5,000 option price. Clearly, the Black-Stock formula could be used for this purpose. The figure shown how?

Fig. shows how the value of this option varies with the price of the land in six months. Other explicit which means without leaving no doubt and easily connected with very close contracts, or connection to which a firm is a party can be though value as option. A lease with an option to cancel can be viewed as a put (sell) option.

If the value of leasing the property drops below the value of the lease payments, the lease will be canceled and the property will be ``returned`` to its owner. Just as a stock will be sold to a (sell) put writer if its value drops sufficiently low. For example, a federal crop price support program is equivalent to issuing put options to farmers.

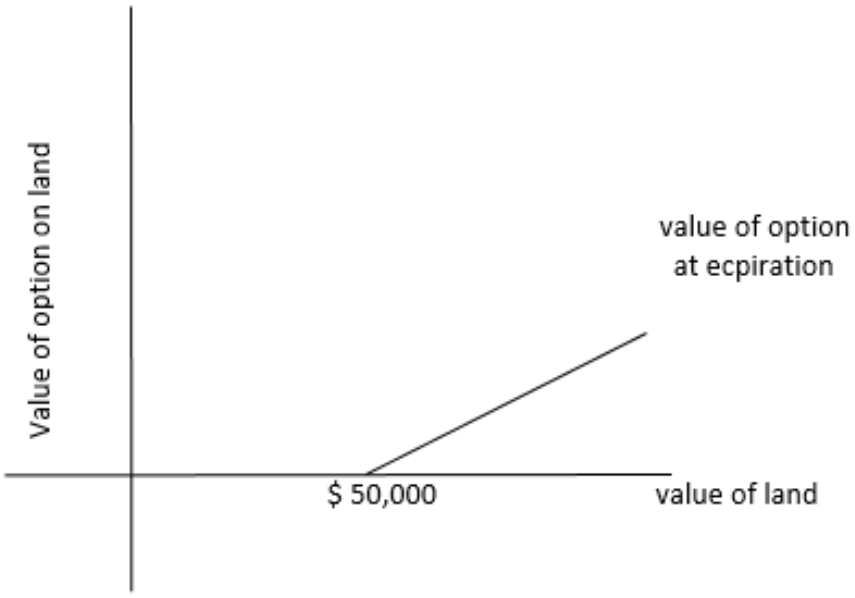


Figure 6: Value of a Call Option on Land at expiration. (Shapiro, 1991, p. 155)

A farmer would prefer to sell his crop at a higher price in the market but can always sell to the government at the guaranteed price if the market price plummets. The purchase in the insurance policy on property can also be through of as a put (sell) of the property is not damaged and remained valuable.

The insurance contract will not be used. If the firm or earthquake damage the property, it will be loosed in return for the real made insurance payoff. It is similar to other us to exercising a put option when the price of the stock drops below the exercise price.

Any investment that requires an additional infusion of funds for its competition or the action of process of finishing and offers an uncertain payoff can be viewed as an option. Consider the value of a patent on an untested cure for cancer, the price of obtaining the patent is the option price.

The cost of developing, producing, and marketing the equivalent to the stock price. The extra funds require to start production will be only invested if their costs are less than the payoff in the form of subsequent profits from the sale of the drug.

The opportunity that a farm may have to increase the profitability of its existing product lines and benefit from expanding into new products or markets may be through as growth option. Similarly, a firm ability to capitalize on its managerial talent, its experience in a particular product line, its brand name or its other resources, may provide valuable but uncertain future prospects.

Consider a gold mine, its owners may increase or decrease the mines gold output depending on the current price of gold and expectations of future gold price. The mine can be shut down and then reopened when production and market conditions are more favorable, or it can be having being empty people permanently.

Each decision is an option from the viewpoint of the mines owners. They have an option like if the market price is high they can open the mine of the market price of gold is down and if they think there is no profit then they can close.

5.7. OPTION OF RISK MANAGEMENT

Put options might say, for example that you buy 10 tons of candy corn to sell at the stock price of $10,000. Here if the price goes down the purchase of selling price put (sale) option and the expiration date, then definitely you will make an exercise to make your product to sell at higher price.

For the purpose of managing risk company can use both the options tools put and call. Like if you buy a put option then you're always hunting and opportunity to sell your goods at the best price possible then the price that the market is offering.

Call option the company always allows to purchase the goods at strike price which means typically for a sale of gilt-edge or gold paint securities or a new stock market issue. Or the price where the put and call options are expiring. Now here above candy corn 10,000 for 10 tons' means is bought at strike price.

If the price goes down before the expiration date, the buyer will simply let the contract expire and buy the candy corn on the market for the lower price. If the price goes up, however, then the buyer will exercise the call option in order to buy the candy corn more cheaply than the market is currently offering.

5.8. OPTION STYLES

Options are classified into a number of styles, the most common of which are:

American option – an option that may be exercised on any trading day on or before expiration. American option can be exercised anytime during its life. It allows option holders to exercise the option at any time important to and including its maturity date, thus increasing the value if the option to the holder relative to European options, which can only exercise at maturity.

American options allow the holder to buy or sell a specified underlying asset, on or before a predetermined expiration date. Since investors have the freedom to exercise their American options at any point during the life of the contract, they are more valuable than European options, which can only be exercised at maturity.

The last day to exercise a weekly American option is normally on the Friday of the week in which the option contract expires. Conversely, the last day to exercise a monthly American option is normally the third Friday of the month. (Investopedia, 2017g)

European option – European option can only have expired at the end of its life, at its maturity. An option that may only be exercised on expiry. These are often described as **vanilla** options. European options are contracts that give the owner the right, but not the duty or command, to buy or sell the underlying security at a specific price, known as the strike price, on the option expiration date. (Investopedia, 2017g)

A European call option gives the owner the right to purchase the underlying security, while a European option gives the owners the right to sell the underlying security, a buyers of European option who does not want to wait for maturity to exercise it can sell the option to close the position. (Investopedia, 2017b)

Other styles include:

Bermudan option – An option that may be exercised only on specified dates on or before expiration. Bermuda option can expire on in advance dates, typically every month. Berman options are combination of American and European option. They are combine at the date of expiration, and certain specified dates that occur between the purchase date and the date of expiration.

American option is exercisable any time between the purchase date and the date of expiration. European options, are exercised only at the date of expiration. Bermudan options are a hybrid security because they fall somewhere in the middle of European and American options.

Asian option – An Asian option can protect an investor for the liability change especially for the worse time risk that comes with the market. An option whose payoff is determined by the average underlying price over some preset time period. This type of option contract is attractive because it tends to cost less than regular American options. (Investopedia, 2017i)

Barrier option – This option is more complex then European and American option. Any option with the general characteristic that the underlying security's price must pass a certain level or "barrier" before it can be exercised. A Barrier option can be a knock-in or knock-out.

A knock-In option is a type of barrier option that only comes into existence when the price of the underlying security reaches a specified barrier at any point in time during the option's life. Once a barrier is knocked in, or comes into existence, the option will not cease to exist until the option expires.

An example of knock-in, assume an investor purchases an up-and-in call option with a strike price of $60 and a barrier of $65, when the underlying stock was buying and selling at $55. Therefore, the option would not come into existence until the underlying stock price moved above $65.

An example of knock-out, assume a trader purchases an up-and-out put option with a barrier of $25 and a strike price of $20, when the underlying security was trading at $18. The underlying security rises above $25 during the life of the option, and therefore, the option-eases-to-exist (Investopedia, 2017j)

Binary option – An binary option are tradable options that simply require you to predict which direction the price of an asset will move. With the binary option you are not required to predict or estimate for future size of the movement. All that are So important is the direction of price movement.

The success of a binary option automatically exercised, meaning the option holders does not have the choice to buy or sell the underlying assets (such as stock, futures, a commodity, a currency or an index which is based on another sources). (Investopedia, 2017k)

The Options Valuation Formula

The value of the option will depend only on the price of the stock and time and on variables that are taken to the known constants. The value of an option in terms of price and the stock assuming “ideal conditions” in the market for the stock and for the option. The value will not depend on the price of the stock, but will depend only on time and the value of known constant.

a) There are no transaction costs in buying or selling the stock or the option.

b) The short-term interest rate is known and is constant through time.

c) The stock pays no dividends or other distributions.

d) The option in “European,” that is, it can only be exercised at maturity.

e) It is possible to borrow any fraction of the price of a security to buy it or to hold it, at the short-term interest rate.

f) There are no penalties to short selling. A seller who does not own a security will simply accept the price of the security form a buyer, and will agree to settle with the buyer on some future date by paying him an amount equal to the price of the security on that date.

Warrant Valuation.

It is an option which is a liability of a corporation. The owners of a warranty have the right to buy the corporation’s stock (or other assets) on specified terms. There are few reasons that the analysis of warrants is often much more complicated than the analysis of simple option is as below:

a) The life of a warrant is typically measured in years, rather than months. Over a period of years, the variance rate of the return on the stock may be expected to change substantially.

b) The exercise price of the warrant is usually not adjusted at all for dividends. The possibility that dividends will be paid requires a modification of the valuation formula.

c) The exercise price of a warrant sometimes changes on specified dates. It may pay to exercise a warrant just before its exercise price changes. This too requires a modification of the valuation formula.

d) If the company is involved in a merger, the adjustment that is made in the terms of the warrant may change its value. (Black & Scholes, 2008)

6. CORPORATE STRATEGY AND THE CAPITAL-BUDGETING DECISION

“Man is not the creature of circumstances.

Circumstances are the creatures of men.” (Shapiro, 1991, P. 305)

As we know strategy is the stringiest point of a business. If the company have a good strategy, then there is a chances of getting profitable to the company. But it´s not easy to maintain the good strategy. There is not any particular strategy that can fit for the business.

In Nepal in 1996 to 2006 as there was civil war running inside country (mouste against government in those year) and in 5 star hotels there was a gossip all the Nepalese business were gone down, it’s impossible of growing the business but on the other hand these Chaudhary group was starting with success in 80 bigha Audigi gram.

Wai-Wai is one of the famous Nepalese noodles which covers 2% of world noodles. Noodles take just around 4 minutes to get ready. They opened the 17th manufacture of Wai-Wai noodels in Serbia from august 2017. Forged announced his name dollar bilinear Mr. Binod Chaudari chairman of Chaudhary group. (Chaudhary, 2015)

According to its latest calculation, the brand claims an all India share of 27%, which makes it the second largest selling noodle brand after Maggi. Wai-Wai noodles `Munch It! Soup It! Lunch It!´ it’s very easy to eat especially for the youth (Bapna & Balakrishnan, 2016, p. 4).

6.1. DIFFERENT TYPES OF STRATEGY

Classical Strategy. The classical strategy is a strategy that many companies adopt the default. This kind of strategy is suitable for business that operate in industries that are expected. In IT sector how can we survive/win/in the future the answer for that is – technology Entrepreneurship and innovation in IT. (Tsolova, 2013)

The strategies are analyzing the factors that affect the business formulate the strategy for the company, starting with the goal setting. Classical strategy works well especially for the long term.

Adaptive strategy this is where classical strategy may be insufficient. The adaptive strategy may be more suitable that industry which industries that are not expected. This

strategy plan is for adopt the quick to new environment. This strategy is suitable for short term changes in industry. The company that fail to follow the right approach may experience big troubles and even go out of business. (Mirzayev, 2017)

Example 1:

In 2007, Nokia Corporation was earning more than half of all the profits in the mobile phone industry. Six years later, in 2013, however, it had 3% of the global smartphone market before it sold its mobile phone business to Microsoft Corporation.

How could a mobile phone giant go out of business over such a short period of time? Nokia was the most dominant market player until it failed to adapt to the new era of smartphones ushers in by Apple Inc. and Samsung. One of the reasons why Nokia reacted to the new market segment so late was that from 2006 to 2007, smartphone sales composed a small portion of Nokia's revenue.

Consequently, Nokia's managers failed to predict the fast growth of the smartphone market. As James Surowiecki states in *The New Yorker*: *"*Diverting a lot of resources into a high-end, low-volume business (which is what the touch-screen smartphone business was in 2007) would have looked risky.

In that sense, Nokia's failure resulted at least in part from an institutional refuse to transition into a new era." Nokia's management believed that thanks to its solid old reputation and brand it could still catch-up to its main rivals, even if their transition was late.

However, the harm caused by this poor strategy was so huge that even Nokia's popular brand did not rescue the company. Ultimately the company sold its devices business to Microsoft for $7.2 billion. (Mirzayev, 2017)

Shaping strategy

By changing the company industry, they can grow strength and their market position. Especially technology industry uses this kind of strategy. Microsoft is the good example that change the shaping strategy.

Visionary-Strategy

Electric cars and solar cars are one of the visionary strategies that can bring a great change in the transportation industry. If we look for further more that scientist is planning

to make a gravity train from one hole to next. Like Nepal to Portugal, U.S to China, but they have a problem with the high temperature $10{,}000^0$ F in inner core. (Kaku, 2009)

6.2. COMPETITIVE MARKET AND EXCESS RETURNS

A purely competitive (price taker) market exists when the following conditions occur:

- Low entry and exit barriers - there are no restraints on firms entering or exiting the market.
- Homogeneity of products - buyers can purchase the good from any seller and receive the same good.
- Perfect knowledge about product quality, price, and cost.
- No single buyer or seller is large enough to influence the market price.

The success full competitive industry is one characterized by costless entry and exit, undifferentiated products, and increasingly marginal costs of production. These undifferentiated products, also known as **commodities,** are sold exclusively on the basis of price.

If we look at those competitive industry, as every student of microeconomics knows, each firms produces at the point at which price equals marginal cost. Long-run state of physical balance exists when price also equals average cost. At this point, total revenue equals total cost for each firm taken individually and for the industry as a whole.

In each firm cost is require on the capital. Therefore, in long run, the actual return on capital in a competitive industry must equal the required return. Any excess return quickly attracts new entrants to the market. Their additional capacity and attempts to gain market state lead to a reduction in the industry price and lowering of returns for all market participants.

As we look at the 80s in the year 1980s, we can find many examples, as we can look the high returns available in the video-game market, combined with the ease of entry into the business, attracted a host of competitors. This leads to red ink bath for the industry in 1983, followed by the exit of a number of firms from the industry.

Alternatively, should the actual returns for the industry be below the required return, the opposite happens. The weakest competitors exit the industry, resulting in an increasing in the industry price and a boost in the overall return in capital for its remaining members.

This process, which is now taking place in the oil-refining business, continues until the actual return once again equals the required return. Only a firm that can bring to earn on new projects competitive advantages that are difficult to reproduce having any promise of earning excess returns in the long run.

These advantages take the form if either being the low-cost producer in the industry or being able to add value to the product-value for which customers are willing to pay high (relative to cost) price.

The latter type of advantage requires the ability to convert a commodity business into one characterized by products that are differentiated on the basis of service and/or quality. By creating such advantages, a firm can impose barriers to entry by potential competitors, resulting in a less than perfectly competitive market and the possibility of positive NPV projects.

6.3. BARRIERS OF ENTRY AND POSITIVE NET PRESENT VALUE PROJECTS

In any company they do have challenger and barriers but how to handle financial manager has to face a great challenge with his team. If the barriers or a company does not exit, new competitors would enter the market and as a result your rate of return and required return will go drive down which company does not want be to.

If we have High barriers to entry and the threats of a strong reaction from ignored competitors will reduce the risk of entry and extend the duration of the opportunity to earn excess returns.

A clear understanding of the possible barriers to competitive entry can help identify possible value-creating investment opportunities. The five major source are – economic of scale and scope, cost disadvantages, access to distribution channels, product differentiation, and government policy and suggests some lessons for successful investing.

6.3.1. ECONOMICS OF SCALE AND SCOPE

A. ECONOMICS OF SCALE

As we know that company need production, advertising and publicity in media street distribution and many more and for that we need to separate the extra budget which definitely increase the cost but if we look at other side that makes multiple profit for long term profit too.

High capital requirement go hand to hand with economics of scale. In order to take advantage of scale economics in production, marketing, or new product development, research and development, and advertising. These capital requirement themselves serve as a barrier to entry.

We can find in every industry the facts such as petroleum refining, mineral extraction, and mainframe computers. That is also the expenses of the company. If we do misuse, then that makes the company extra expenses, so if we have a fixed output then we need to reduce the cost of the company.

For example, the economics of the cement industry. The low value-to-weight ratio of cement makes the cement business a very regional one, beyond a radius of about 150 to 200 miles from the cement plant, transportation costs become for sure unless cheap water or rail transportation available.

For instance, suppose that demand in a landlocked region is sufficient to support only one or two modern cement plans. By expanding production and adding substantial new capacity to that already available, firm can significantly raise the price market entry by new firms and make plant expansion or replacement by existing competitors look much less attractive.

And this type of industry we may have to face losses or have to take high risk sometimes we need to run our company without profit until we do not get big market. This is also one of the barriers that every industry faces and if they get the big market it does not take long time to drive up.

Scale economies, on both the individual store level and the citywide market level, are both important to the grocery-retailing business as well. Weather a store has $100,000 or $10,000,000 in annual sales, it still needs a manager. In addition, the cost of constructing and outfitting a supermarket doesn’t increase in production to the number of square feet of selling space.

Likewise, the expenses of sales like transportation and taxes to different country surely raise the cost amount but this also increase the sales volume too. Here the market is of 10% or 25% one super market or store must advertise and supply its stores from its wire house.

The greater the share of market is, the lower the advertising cost per customer will be, the faster the warehouse will turn over its inventory, and the more likely its delivery trucks will be used to capacity. This cost planning's translate directly into a higher return on capital.

Computer store chains, to take another example, also enjoy significant economies of scale. These show up on the form of lower average costs for advertising, distribution, and training. Even more important, they receive larger discounts on their products form manufacturers.

B. ECONOMIES OF SCOPE

We know economic of cope means rewriting like making a shape by hammering again we can see. For example, 3M has taken its basic fixing technology and applied it across a broad range of products and Markets-Bandages and dental restoratives in health care. Do have many products like for instance cars wash and shampoo.

Reflective highway sight, floppy disks and optical disks for personal computers; and video cassettes and audio cassettes in the consumer electronics market. Similarly, Honda has leveraged its investment in small engine technology on the automobile, motorcycle, generator and so forth.

Matsushita has leveraged its investment in advertising and distribution of Panasonic-brand products in a number of consumer and industrial markets, ranging from personal computers to Video Cassette (VCRs). Each dollar invested in the Panasonic brand name or distribution system aids sales of dozens of different products.

Production economics of scope are becoming more prevalent as flexible manufacturing system allows the same equipment to produce a variety of products more cheaply in combination then separately. The ability to manufacturing a wide variety of products with little cost penalty relative to the large-scale manufacture of a single product opens up new market, section and channel of new distribution, and, along with them, new routes to competitive advantage.

For example, a plastic company, which manufacture heavy manufacturing pails (a bucket) directly to boutiques when it acquires a new machine that greatly expanded the range of products it could make economically. As we know we can reproduce the plastics material though it has some disadvantages too.

6.3.2. COST DISADVANTAGES.

As we know nobody can have fixed the price of competitive market. As we know if there is ups and downs of price in competitive market then a company has to face a loss or even sometimes shot down their company. So cost prices are sometime very dangerous.

Cost decline creates a barrier to entry because new competitors, lacking experience, face higher unit costs than do established companies.

Monopoly control of low-cost raw materials is another cost advantage open to established very firmly that change is very difficult firms. This was the advantage held for so many years by Aramco (Arabian-American oil company), the association, typically of several business companies of oil companies that until the early 1980s Hs Exclusive access to low-cost Saudi Arab oil.

Next example we can see like McDonald's has developed yet another cost advantages vis-à-vis potential competitors – it has already acquired, at a relatively low cost, many of the best fast food restaurant locations. Favorable locations are also important to super-markets and department stores.

The major cost advantage enjoyed by IBM's personal computers is the fact that software programs are produced first for it because it has a commanding share of the market. Only later if at all are those programs, which now number in the thousands, rewritten for other brands.

A company that do not develop IBM (International Business Models corporation) look-alike has to write its own software, pay to have existing software modified for its machines, or wait until the software housed get around to rewriting its programs.

Now if we look at new entrance new entry enjoy a cost advantages by the existing competitors. Particularly if we look at the airlines industry and trucking which is removed by driving down and closed. Where there is a fare wars in transportation in trucks and airlines. Where time and cost play vital role for any industry.

If we look for airlines industry. For example, new low-cost competitors in the airlines industry, such as Texas Air and southwest Airlines, have much lower wages (about half of what big airlines pay) and more flexible work rules (which permit pilots to load baggage and flight attendants to serve at reservations phones.)

Every company shareholders or the investor wants the low cost of delivery and those industries who give priority to reduce their cost expenses on delivery product they are more likely to success. This is also one of the strong tips for the financial changes of company and somehow connected to changes of world economy.

6.3.3. PRODUCT DIFFERENTIATION

We can find many example related to the product difference. Some companies, like Coca-Cola and Procter & Gamble (P&G), take advantage of enormous advertising and highly developed marketing skills to differentiate their products and keep out potential competitors wary of the high marketing costs and risks of new product introduction.

The above both product have very strong position in the market nobody cannot enter to their positon as they are well known in the world. They do have their uniqueness formula to their product and do provide in market.

For example, Nalco Chemical, a specialty chemical firm, is a counsellor to its customers and problem solver, whereas Worthington Industries, which turns semi-finished steel into finished steel, has a reputation for quality workmanship what allows it to charge premium prices. They have handsome reward for their effort, with average equity returns exceeding 20% annually from year 1974 to 1983.

Similarly, Caterpillar Tractor has combined dedication to quality with outstanding distribution and after-market support to differentiate its line of construction equipment and gain a commanding 35% share of how world market for earth-moving machinery.

6.3.4. ACCESS TO DISTRIBUTION CHANNELS

Shareholders and investors very loving or loyal to gaining better product distribution often lead to higher profitability. So they are always willing to get more and more profit from the company and they do make lots of distribution channels and invest a huge amount so to get net present value.

Currently, over 200 manufacturers are competing for this very limited amount of self-space. Moreover, the concentration of retailors outlets among chains means that new computer makers have even fewer avenues to the consumers.

6.3.5. GOVERN POLICY

As we can see many example like in airlines, trucking and paramedical industries they do have their own limitation and rules. Different countries have their own rules and regulations and that makes this industry difficult to entry. As they do have like import barriers, import restrictions, environmental control some licensing requirement and so on.

For example, American quotes for Japanese cars have limited the ability of companies such as Mitsubishi and Mazda to expend their sales in the United States, leading to a higher return on investment for American car companies.

The effect of licensing restrictions on the taxi business in New York City are reflected in the high price of a medallion or giving one he right to operate a cab there, which in turn reflects the higher fares to which the absence of competition has led.

Investments in projects protected from competition by government regulation can lead to extraordinary profitability. However, what the government gives, the government can take away.

6.3.6. BUILDING COMPETITIVE ADVANTAGE

The investment should focus on in a clear detailed manner on building competitive advantages. This could be strategic geared building volume, when economies of scale are all an important, or broadcasting the product scope, when economies of scope are critically success.

To evaluate a sequence of tactical projects designed to achieve competitive advantage, the project must be analyzed jointly, rather than relating to fixed scale.

For example, if the key to competitive advantage is high volume, the initial entry into market should be to evaluate or estimate the nature on the basis of its ability to create future opportunities to build market share and to connect with something else benefits of the things just mentioned.

Alternatively, market entry overseas may be judged according to its ability to deter a foreign competitor from launching a market share battle by posing a creditable characterized by a desire for revenge threats to the competitor base. By reducing the likelihood of a competitive intrusion, foreign market entry may lead to higher future profits in the home market.

6.4. INVESTMENT STRATEGIES AND FINANCIAL RETURNS: EMPIRICAL EVIDENCE

If we are investing in any field, we do respect the financial return if we have a good strategy. In finance at the bottom point, at the end, the viability of a value-creating strategy can only be gauged by examining the based on evidence.

Theory and intuition tell us that companies that follow strategies geared toward creating and preserving competitive advantages should earn higher returns on their investment than those that do not.

Foreign competitors achieved high market shares in three of the industries.

- Steels, tire and rubber and automotive;

Moderate share in two others

- heavy duty trucks and construction and materials handling equipment;

Entry position in the other three

- major home appliances, beer, and cigarettes.

Caterpillar combined the lowest-cost manufacturing with outstanding distribution and after sale service to move well ahead of its domestic and foreign competitors in profitability.

6.5. DESIGNING AN INVESTMENT STRATEGY

> "You cannot imitate our global operation. It is just incapable of being reproduced. Domestically, we have some [copies styles] for pieces of our business, but not the entire business. And in any event, we can only imitate what we have done.
>
> You can't imitate what we are thinking. You cannot copy what we are going to do tomorrow." (Shapiro, 1991, p. 322)

These days there is a strong competition area like in technology or marketing skills and that may enable a firm to earn excess returns, these barriers to entry eventually naturally destroyed, leaving the firm likely to increased competition.

Existing firms are entering new industries, and there growing number of firms from a greater variety of countries, leading to new, well-financed competitors that are able to meet the high marketing costs and enormous capital outlays necessary for entry.

Caterpillar Tractors, for example, faces continuing threats from low-cost foreign competitors, especially Japan's Komatsu, number 2 in worldwide sales. To say on top, therefore, a firm's strategy must constantly have an evaluation, seeking out new opportunity feeding off new competitors.

Caterpillar has reached to Komatsu challenge by attempting to slash its costs, closing plants, shifting production overseas, forcing union and nonunion workers alike to take pay cuts, completely remove or get rid of many positions and pressuring its suppliers to cut prices and speed deliveries.

To get lower prices, the company is shopping around for hungrier suppliers, including foreign companies. McDonalds' has an observe concern for quality control, IBM for customer service, 3M for innovation.

6.6. CORPORATE STRATEGY AND FOREIGN INVESTMENT

Out of many one of the Famous product that found in US called Himalayan Dog Chew Natural Dog Treats by Himalayan Dog Chew which is made with natural yak milk in Himalayan part of Nepal. Which is natural, no preservatives, the original. That we can order here even in Portugal. It's a good example of corporate strategy. (Chewy, Inc., 2017)

We can find most of the company have examined are MNCs (multinational corporation) with worldwide operations. For many of this farms, becoming multinational was the end result of an obvious principle of organization process.

But as international operations become a more important source of profit and as domestic and foreign competitors become more aggressive, it is apparent that domestic survival for many firms is increasingly dependent on their success overseas.

To insure this success, multinationals must develop global strategies that will enable them to maintain their competitive edge both at home and abroad.

Example, Bringing foreign investment to Canada

Foreign direct investment is a critical driver of economic growth for both developing and advanced economies. In any economy it can help raise productivity, competitiveness, and living standards over the long term. In modern Foreign direct investment has important role raising firm 0.6 percentage global Gross GDP (Domestic Product) during the 1980s to 2.7 percentage over the past 15 years

In 2013, foreign-controlled multinational enterprises in Canada responsible for 50% of all merchandise exports and 37% of business expenditures in research and development. (Advisory Council on Economic Growth, 2016)

Figure 7: Percent of GDP. (World Bank, McKinsey analysis *apud* Advisory Council on Economic Growth, 2016, p. 3)

Canada ranks 33rd out of 40 countries on the OECDs (Organisation for Economip Co-operation and Development) Foreign Direct Investment restrictiveness index.To attract the foreign investment Canada should (1) develop a national policy Foreign Direct Investment strategy and (2) create a world-class agency to attract new investment aligned with that strategy.

FDI (Foreign Direct Investment) would stimulate more intense competition among domestic firms, leading to lower price for goods and services. Exporting firms tend to pay higher wages than companies serving only domestic customers and Canadian incomes would be likely to increase. (Advisory Council on Economic Growth, 2016)

Nest example: Poland had been open to foreign investment since 1976, when the council of Ministers passed the regulation permitting the establishment of small enterprises. Under these law, however, the investors were significantly constrained both in the scale of their operations and in their potential profitability.

They were not eligible, for instance for credit at any polish banks. They had to make an advance deposit of 30% of their project of their projects costs of a Polish Bank, and they were allowing to transfer only 50% of their export profits out of the country in the mid-1991. According to the Polish Government law for foreign investment. (Keohane, Nye, & Hoffmann, 1993, p. 290)

Poland's EU action in 2004 was a game changer for the country. By arranging the things in straight line our lows with the acquis communautaire, we manage to reap enormous economic and socio- political benefits: our cumulative GDP growth in 2004- 2012 amounted to 46.3%. By Radostaw Sikorski, former Minister of Foreign affairs of Poland. (European Union, 2017, p. 10)

7. CREATING VALUE FOR SHAREHOLDERS

> Stockholders aren't dumb. Many companies…Have a good stock price, sometimes without having any profit. Their stockholders believe in Its future.
>
> Management doesn't get paid to make the Shareholders comfortable. We get paid to make the shareholders rich. (Shapiro, 1991, p. 333)

How management increase the value if the firms share and as a result creates value for shares?

According to the author Alan C. Shapiro is that a firm's economy value depends on its future long-run profitability from existing the fact or condition of function, its future long-run investment opportunities and their likely returns. The riskiness of the firm's current and future investment, and the markets required return on these investments.

Future profitability, in turn, depends on the quality of the firm's management, the competitive positions of its products, and its ability to adapt quickly to changing product market circumstances.

Book value of equity assets minus liabilities represent the cost of the company's investments less the debt used to finance these investments. That is, it equals the amount of stock sold and the earnings continue to have to finance the company's investments.

A look at their past earning histories gives us a clue to the great difference in market book values for IBM (International Business Machines Corporation) and Boston Electronic. Between 1975 to 1980, IBM earned approximately 22% annually on its book value equity compared with estimated required return of 16 %. Corresponding figures for Boston Electric during this same period where 9% to 15%.

Thus IBM with its high return on equity and numerous future profitability investment opportunities, sold at a 125% premium over book. Boston Electronic, on the other hand, sold at a 35% discount to book value because of its poor earnings record and unfavorable prospects for the future.

The main focus is on the growth in future dividends because dividends are the ultimate source of cash flow to shareholders.

7.1. INVESTMENT PROSPECTS AND VALUE CREATION

Shareholders value is destroyed when firms invest in projects, including the developing of the skill of other firms, which provide a return less than that required by their shareholders. The loss in the value of the firm stock will be directly proportional to the gap between the required and actual returns and the volume if investment undertaken at the below-market return.

For example, a firm with shareholder value of the share issued by the company if $10 million and a 15% cost if equity capital must earn at least $1.5 million annually to leave shareholders as well off at the end of a year as they were at the start of the year. If the earns only $1 million in profit during the year an ROE (Return on Equity) of 10 %, the firm will have cost its shareholders $500,000.

Companies that ignore this fact are vulnerable to hostile takeover: Such companies are more likely to treat retained earnings as if they were essentially free capital, giving them an added incentive to grow- even if investments in new projects and corporate an act of purchase of one company by another are earning below-market returns and there by destroying shareholders' wealth.

By reversing these ''growth at any price'' policies, raiders can afford to pay a premium price for such companies and still earn a profit for themselves.

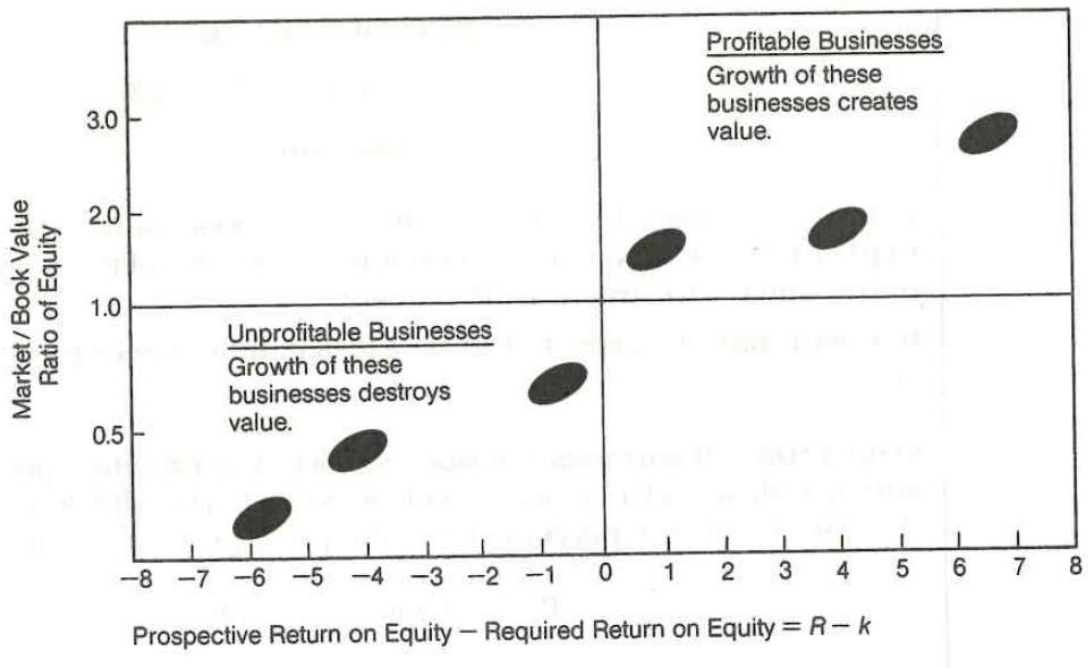


Figure 8: The market book value. (Shapiro, 1991, p. 338)

The market-to-book value ratio is biased upwards by inflation. During times of inflation, the nominal market value of assets raises to reflect their higher replacement cost. Thus, the book value of assets, which reflects their historical cost, will understate their current replacement cost. As a result, the market to book value ratio will exceed on even if the firm creates no value for its shareholders.

Formula to the market -to -book value ratio $=\frac{\text{market value}}{\text{book value}}$ / = $\frac{\text{expected return on equity}-\text{dividend growth rate}}{required\ return\ on\ equity-dividend\ growth\ rate}=$

Table 8: How growth and profitability affect the market / book value ratio

	scenario	Expected return on equity (R%)	Requited return on equity(K%)	Dividend growth rate (g%)	Market –to-book ration of equity=$\frac{(R-g)}{(k-g)}$
1.	Medium growth –no value creation	12	12	4	$\frac{(12-4)}{(12-4)}$=1.0
2.	Slow growth – profitable	14	12	2	$\frac{(14-2)}{(12-2)}$=1.2
3.	Slow growth Unprofitable	10	12	2	$\frac{(10-2)}{(12-2)}$=0.8
4.	High growth Profitable	14	12	8	$\frac{(14-8)}{(12-8)}$=1.5
5.	High growth unprofitable	10	12	8	$\frac{(10-8)}{(12-8)}$=.5

In the above figure and table shows that weather dividend growth rate is low growth or medium even high growth if there is a constant required return on equity.

Expected return on equity is might be higher or constant or even lower than required return on equity if the Market value is below one there is no profitable and if the market to book ration of equity is more then on then the company will be profitable.

Is Your Stock Worth Its Market Price?

It is assumed that the ROE (Return on Equity) is either given or computed from other sources. Furthermore, it is assumed there is no debt financing. Thus, the ROE (Return on Equity) is identical to the ROI (Return On Investment), and the required returns on equity and investment are the same.

With inflection, the replacement cost of assets, and hence their market value, would tend to exceed their historical cost. Because the net worth equals assets minus liabilities, an increase in the inflation-adjusted value of assets would increase the value of net worth.

7.2. VALUE BASED ANALYSIS AND CORPORATE RESTRUCTURING

If we look in year 1980 it's been decade. Global completion, deregulation, accelerating technology change, and thread of takeover. In response company after company, including over half of the Fortune 500, restructuring, cutting costs, putting employee. The work of restructuring is not over.

But it has become the part of the corporate routing this restructuring is called Value Based Analysis. V.B.A stems from the recognition that you can calculate the value of each business in a company portfolio using the valuation techniques developed earlier. Add these up and down and you should arrive at the market value of company as a whole.

Application trans world corporation spins off TWA (Trans World Airline)

TWC (The World Corporation), consisting of TWA (Trans World Airline), Hilton International, Century 21, Canteen, and Spartan Food Systems, was consistently profitable. But TWA had lost substantial amounts of money each year since airlines remove regulations or restrictions form in 1978, largely because of uneconomic wage and benefit levels for employees.

With a New York investment group odyssey partners, The World Corporation made partners. Although odyssey Partners loss the battle, it won the war. On September 23,1983, TWC sold a 19% stake in TWA to its shareholders, creating a separate, publicity traded corporation TWA's (Trade World Airline) price falls nearly 4% where as TWC's (The World Corporation) stock price raise more than 11%.

These stock price reactions reflected the economy effects of ending TWC's subsidy to TWA employees. Overall, value was created because as an independent company, TWA could no longer have a negative value. (Shapiro, 1991, p. 343)

In case of restructuring, purchase, sales distribution, R&D figure out how much it cost and how much value can each adds, which means V.B.A products lines, customers, organization structure, identifying those who create value and those who destroy it. Response to profitable product and do it in something new way.

7.2.1. FIT

In a firm deciding which business and assets to keep and which to get ride or free looking at relative value: Is the business or asset worth more in someone else's hands? A key issue is the process of selling off subsidiary business interests or investment, therefore, is whether another company or management team possesses a distinct competitive advantage that enables it to further increase value.

If so, the business or asset will be worth more to the buyers, and it can be sold for a price that exceeds its value to the seller. This is a tangible touchable reward for ending a better "fit".

7.2.2. APPLICATION UNION CARBIDE SELLS EVEREADY

In 1986, Union Carbide fended off GAF'S Hostile takeover bid by going deeply into debt to repurchase 55% of its shares at a premium price. Union Carbide paid down part of this debt by selling its everyday battery business, widely regarded as the company's most attractive unit. According to Robert D. Kennedy, Chairman and Chief Executive Officer of Union Carbide, considerations of relative worth made this move economically sensible.

Did you like panting with a billion-dollar battery protects business that was a leader in its field? I'd be lying if I said it was something we would have done without a gun to our heads. But if your mission is getting value to your shareholders, a good case can be made that it was the right thing to do even before the gun was drawn.

In fact, I'm inclined to think that all strategic planning should be done as if somebody had a gun to your head. It forces you to make the tough choices. Now, after the fact, I can tell you that it might have been time to sell battery products precisely because it was good business, and there wasn't much we could do to make it better…

As for the purchaser, Ralston Purina with dog food, cat food, animal health products, breakfast cereals, crisp bread establish 123 year ago a total consumer products company with broad consumer distribution, wholesaler leverage, marketing smarts, having large amount of advertising budget. Battery business is much more suitable environment than it ever was, that's a fact. And a lesson learned.

7.2.3. FOCUS

By unrelated business activities, a management team can than focus on solving problems and finding attractive investment opportunity in the core business. A related benefit is that by simplifying the company, unnecessary management layers can often be pull away, reducing expenses, speeding decision making, and promoting initiative.

7.3. THE LONG-TERM VALUE INDEX

A good indication of the market's longer-term showing right or wrong relationship between two visible objectives is to estimate and then subtract from the current market price the present value of dividends over the next five years.

The difference is the proportion of the stock price assignable to dividends beyond five years. Called the LVI (Long Term Value Index) by its developer, Alfred Rappaport, this proportion gives us an idea of investors' confidence in management's ability to create a sustainable competitive advantage in its business.

Table 9: Corporate capital budgeting from 1975 through 1981

Company	Recent stock price	Present value of next 5 years' Dividends	Long term Value Index*
General motors	$77.0	$19.41	74.8
Exxon	46.00	9.20	**80.0**
Ford Motors	53.50	15.58	70.9
IBM	124.25	20.94	83.1
Mobil	46.25	9.78	78.9
General electronic	44.75	6.67	85.1
Texaco	45.25	13.93	69.2
AT&T	27.25	4.89	82.2
Du pont	84.75	15.77	81.4
Chrysler	27.00	4.84	82.1
Chevron	47.00	10.25	78.2
Philip Morris	97.25	19.95	79.5
Amoco	75.75	13.55	82.1
United technologies	42.00	6.52	84.5
Occidental petroleum	26.00	8.93	65.6
Procter & Gamble	84.50	11.44	86.5
Atlantic Richfield	82.75	16.14	80.5
RJR Nabisco	76.75	10.87	85.8
Boeing	67.00	7.23	89.2
Tenneco	49.75	11.09	77.7

(Adapted from: Fortune *apud* Shapiro, 1991, p. 347)

*Percentage of stock price assignable to dividends beyond five years.)

John McConnell and Chris Muscarella studied the stock market's responses to public announcements of changes in corporate capital budgets from 1975 through 1981.They found that stock prices rose when companies increase their capital budgets and dropped when companies cut their capital budgets.

Similarly, Gregg jarrell, Kenneth Lehn, and Wayne Marr studied the stock market reaction to public announcements between in 1973 to 1983 that stock price increased by an average of 1 or 2 % when companies increased their R&D expenditures.

In oil companies, their stock drops and they announced they increased in the amount of money they have invested for exploration and development raise when they cut back investment. Most major oil companies have been wasting money on too much exploration and too many refineries.

Clearly, the market cares most about firms' long term prospects. Why then do stock prices sometimes react so strongly to short-term financial results? The answer more or less seems to be that investors often see longer-term the action in new information, like the latest quarterly earnings report and receive their expectation of future prospects accordingly.

Likewise, if we look at the companies like Coca-Cola, McDonald's, and IBM depend heavily on market share, profit margins, and growth. If bad news suggests a basic weakness in market share or margins or a slowdown in growth analysists revise their profit forecasts not only for the next quarter, but perhaps for years. The results can be damaging, sending a stock own as much as 50% in a day.

7.4. EVALUATING AND MOTIVATING MANAGEMENT PERFORMANCE.

Very close connection in our discussion up to this point is the motion that the separation of ownership and control in the modern corporation often leads managers to follow someone or something in order to catch or attack their goals other than shareholder wealth maximization.

Ideally, there, companies should have an evolution and reward system that motivates executives to achieve business goals designed to create shareholder value. For the system to work as expected, management must be clear about what sort of performance it wants to reward, and it must be able to measure that performance.

An important, though often neglected point, is that a manager's performance should be judged on the basis of results in those areas over which he or she controls. It is unreasonable, as well as dysfunctional, to reward or Punish a manager for the impact of economic events beyond his or her control.

Corporation headquarter must distinguish between the manager's performance and the business performance: A business can be doing quite well without being affected by the poor performance of its management, and vice versa.

7.4.1. CONCERNING THE EVALUATING AND MOTIVATING MANAGEMENT PERFORMANCE

During the dramatic run-up in oil prices during the 1970's most oil companies were making enormous profits; and managements are rewarding themselves with high salaries and big bonuses. Yet, in an environment in which oil prices went from under $5 a barrel in 1970's to over $ 40 a barrel in 1980, it took no management skill at all to show profits.

Similarly, the rising or falling sharply drop in oil price during the 1980s, down to under $10 a barrel in 1987, led to a sharp decline in oil industry profits, independently of any management actions. In either case, management was not responsible for, and should not have been rewarded or penalized for, price-related profit fluctuations.

7.4.2. THE TRADE –OFF BETWEEN SHORT-TERM PROFITS AND LONG-TERM PROFITS

Maximizing shareholder's wealth often requires resource commitments that may adversely affect short-run profits, even though these investments have highly positive net present values.

Creating and maintaining an organizational environment in which the firm can earn excess returns may require attachment or commitment to a person to a specific strategy- such as a product, market, or labor relations strategy- that in the short run leads to higher expenses.

As short-term profit commitments become more difficult to achieve-because of a change in external environment or overly optimistic forecasts - management may be doing something that is risky or dangerous to cut these expenses the immediate effects of such reductions is to boost current profits - but at the risk of sacrificing competitive position and longer-term profitability.

7.4.3. THE FOLLOWING ARE SOME SHORT-RUN TRADE-OFFS THAT MANAGERS CAN MAKE.

a) Postponing Capital Outlays

This is also one of the short run trade off that manager can make. As we can find the return on most capital projects are more than a year off; yet the costs of into effecting

the program and depreciation of project assets can easily reduce near-term profits. Therefore, projects are highly vulnerable to delay.

By postponing projects, managers can reduce current expenses and report higher operating profits, even though postponement could significantly increase the long-run costs to the firm.

b) Deferring Operating Expenses

The manager makes some short trade off like Many operating expenses for the current period can be postponed, but a significant cost. This includes items such as advertising, research and development, maintenance of plant and equipment, marketing research, and personnel development.

c) Reducing Operating Expenses.

As there is also a Managers under pressure to make their current profit target may choose to eliminate some operating expenses, rather than merely only defer them, by cutting corners of products quality and customer service, laying off workers, and dropping some new product development work.

These cuts can destroy some of the forms organization capital by adversely affecting its reputation for quality and fairness among customers and employees.

d) Making Other Operating Chances.

If look at making other operation chances, then the companies can boost or help current profits at the expense of future profits in other ways as well. A common technique among consumer goods companies is to lunch various price promotions before the end of the current operating period. This action transfers sales from the coming period to the present period, and at a lower profit margin.

Moreover, customers being waiting for the sales rather than buying at the higher regular price. Alternatively, raising prices can raise short-run profits if demands is price inelastic, but at the expense of longer-run profitability if the tactic draws additional competitors into the market or causes customers to search for substitutes.

7.5. CONTROLLING TRADE-OFFS.

One way to control such trade-offs is to include in the budget allowances that encourage long-term profit-maximization behavior, or at least that discourage short-run oriented

policies that may provide immediate benefits for the managers (such as higher profits) but hurt the company's long-run interests.

Such allowances include those for training programs, R&D, advertising, maintenance, and other vital functions that may be neglected in the event there are problems in meeting the budgeted profit figures.

A firms can raise its reported profits today by depleting its stock of intangible assets, but that will lower the firm's future income and, thus, its current market value.

8. CONCLUSION

It is time to sign off. Let's us finish by thinking about some of the things that we do find how and why each topics is important internationally. That I have mention in, detail in the above pages.

In short below reason tell us how and why corporate finance is important internationally. Though there are a lot of important points but I have made collection of some important topics from few books and through internet.

The financial manager is breaking down into 1. The investment, or capital budgeting, decision and 2. The financial decision. In other words, how much to invest and what assets to invest likewise how to raise the necessary cash. The objectives are to increase the value of the shareholders stake in the firm. This is also one of the reason why and how corporate finance is important.

The financial manager job is a challenging and interesting one. He or she acts as an intermediary between the firm and capital markets. Good financial understands how capital markets work and how long-live, risky assets are valued. They also encourage and give motivation to the firms when financial problems arise. A good financial manager understands TEAM T-ogether, E-everyone, A-chieves M-ore.

In small companies there is often only one financial executive. However, the large corporation usually has both a treasurer and a controller. The treasure job is to obtain and manage the company's financing. By contrast, the controllers job is one of inspecting to see that the money is used correctly. In the large financial offices there may also be a financial vice-president who acts as the firm's CEO chief Executive officer.

Financial management is concern such as at the heart of the decision making process, weather in a private or public sector organization. In introduction part trying to give an idea like how to change the financial positon of the world economy like by giving idea of basic concept and principal applicable to the participate of corporate finance. Its only by maximizing shareholder's wealth, which translate into maximizing price per share.

We never achieve a goal by only making a good plan to achieve we need to come into action. So behind achieving goal, include the time value of money, the trade-off between risk and return, the distinction between nominal or money values and real, the value of delaying decisions until more information becomes available.

In the **institutional features and pricing of stocks and bonds**, Investors must see how is your NPV and IRR because if you are running the business without profit its ok if the business is with small amount of capital. But What if it is in case of huge amount like you are investing in airplane then. You are taking a big risk sometimes you have to penalty of a huge amount of money.

Here current and expected future investors need to compare their valuation of firm's securities with actual markets prices in order to decide whether now is the time to buy low or sell high.

Equally important, managers responsible for maximizing the wealth of their stockholders must understand how their investment and financing decision are likely to affect the price of the firm's common stocks.

They also must try to explain how Indian people use the gold as regarding to their culture as well as to look good. Which is an example of pricing bond. As we know pricing bond is a kind of loan which is taken but have to pay the interest. Gold is also a cash in hand every time you need cash you can get the money be selling it.

Saudi Arab, England, Hong Kong they do have a high demand of gold. Whereas Indian people have high demand as well as cultural use.

The risk and returns is trying to explain what is risk and gives us ideas how the financing is changing the world economy obviously the ordinary people. It also explains how it affects expected asset returns.

Beta which is use as CAPM (capital assets pricing model) which measures the tendency of a stock to move up or down with the market. There is always high return if you risk high likewise less profit if you risk less. How you need to understand how? How can we do that is difficult.

Sometimes you need to say no the reason behind this is like you work hole summer for your university fee and someone comes to you offer you head for double and tail for zero. Many investors would not choose this kind of risk. Now if we look at the top 100 companies around the world which of course change the world economy.

If we look at the top 100 companies by market capitalization 31st March 2017 and in year 1966 European companies stock market capitalization is same. Where U.S.A was covering 71% of world market capitalization now almost half where as some new country

like Chinese stock market capitalization is covering around 11% of world market capitalization. Which GDP is increasing by 6.7 percentage.

Which is at the second position of the world economy. Which is just a beginning may be after complete of china one belt road they may increase share market capitalization. As we can see recent economy growth of China is 6.7% which is a positive symbol they are making huge growth in upcoming years.

Again if we talk about American film industry they do have almost one third of their market in the Europe. If there are any ups and down in euro price, then suppose euro decline by 24% against the dollar European distributer face the problem.

The presale money goes to the revenue to the finance the films production. If the U.S dollars raise, then U.S produces can get rights on the other hand If the euro price higher the Euro distributors get better financing. Well some U.S producers talks about switching to pricing to euros the problem of fallen euro still remain.

If euro is set as same dollar price European distributor face the problem if the dollar is set as euro dollar then as on the Past the U.S producer receive the fewer dollar. This is also one of the important points how the currency price plays important role in the revenue of film industry which also has a very important role in the change of country finance.

In **option of corporate finance,** option valuation can help managers both understand and solve fundamental problems in corporate finance. The problems could be like with valuation of investment whose returns are subject to change on how investor response to know the future state of nature, the effect of debt financing on both risk and return if equity capital further the conflict between the shareholders and bondholders and between stakeholders and the manager.

Options features are involved in decisions of whether to build, expand, or close a factory, to buy a productive asset like trucks or machines, to drill for oil or mine for gold or to build building. Sometimes they are involved in decision about how to pay managers and other employee.

American options are one that can be exercised at any time up to the date of option expires. A European option is one that can be exercised only on a specified future date. The price that is paid for the asset when the option is exercised is called the exercised

price or striking price. The last day on which the option may expires expiration date or maturity date.

The simplest kind of options is one that give the right to buy a single share of common stock. There are call option that gives the owner the right to buy an asset at a fixed price during a particular time period. The most common ones are stocks and bonds.

Whereas the put option can be viewed as the opposite of a call option. Just as a call gives the holders the right to buy the stocks at a fixed price, a put gives the holders the right to sell the stock for a fixed exercised price.

If we look at **Corporate Strategy and the Capital –Budgeting Decision,** we can take an example of CG company in Nepal even though there was a civil war and market was totally down even though in that difficult period they were able to make success in their business with their strategy able to make “wai-wai” which covers 2% of world noodles.

The greater the share market lower the advertising cost per costumer. In production, marketing or new product development, research and development and advertising increase in cost but on the other hand that may have large market and high rate of return too.

As we can see the rate of return in competitive industries are driven very determine to success to their required returns. One must be creative and quick to recognize the new opportunities.

However, without dictating what should be done in every specific circumstance, the topic points out some basic lessons we have learned from economic theory and the experiences of successful firms.

The basic lessons include the following: invest in projects that take advantage of your competitive edge. The things that are naturally following is to stick to doing one or two things and doing them well; do not get involved in businesses with which you are unfamiliar.

Invest in developing, maintaining, and increasing your competitive advantages. The naturally following is threat investments that are easily replicated, such as those in pure research and new plant and equipment, are unlikely by themselves to provide sustainable competitive advantage.

Develop a global scanning capability. Don't be blindsided by new competitors or lower-cost production techniques or locations.

Pick market for a specific customer group for marketing and area of segment which is very small where there is a very little competition. Be prepared to look after markets where competitors are catching up and to apply your competitive advantage to new products or markets.

Where in **Creating Value for Shareholders** as we can see corporate management creates value for shareholders to the extent that it can find investment opportunities that produce more than the required return on equity. We also find that one of the principal techniques used to manage an organization performance is the evaluation and reward system.

Likewise, some managers are underpaid and others overpaid, most are miss-paid- with pay and bonus attached to accounting profits instead of the value they create for shareholders.

We find here like sources of funds is convertible securities, either convertible debt or convertible preferred. Common equity –in the form of retained earnings or newly issued share is the most important source of corporate funds. Preferred stock is another sources of financing, combining some of attributes of both common equity and debt. Next comes debt in all its many varieties.

Most of the external financing comes in the form of debt, new equity issues account for a very small fraction of external finance. New equity issues have been negative in recent years.

The need for external finance is most pronounced during periods of economic growth. During recession or times of slow growth the demand for external funds falls. Depending upon whether one measuring the debt ratio using replacement cost data or market value, the debt ratio is either stable or rising.

The raising debt ratio does not necessarily indicate a higher risk of default because corporate profits have become more stable as well. Where debt ratio is not high by historical standards. Nevertheless, an increasing fraction of corporate cash flow is going to service interest payments.

According to the methods and sources of finance, corporate practice appears to be meet at the point were as importantly differences among different countries. Mainly

commercial banks, are going directly to the financial markets for funds very seriously. The process of corporate financing practice reflects the globalization of financial market worldwide.

Eurocurrency and Eurobond markets, is largely response to the various restrictions and regulation that governments impose on domestic financial transaction if we look at growth in international capital market.

At the same time, capital flows between the international capital markets and domestic markets have linked domestic markets in a manner that increasingly makes such government explaining lack of respect.

Firm can raise short term cash by selling the asset or by borrowing the cash but there is not exact figure that how much cash the company needed. That the difficult question. So if we want to know the value of future cash flow then, we have to look at the price quoted in the capital market. As if we buy at low price and increase the value of investor.

We also should understand the question that why some assets are too risky and some are not. Rules and regulation of particular area must understand to have a new business because government rules may be different in different country.

Like two different people have a different choice in investment like one person is interested in wine business where as another may be interested in ice cream business that's shorts of interest must be understand. So, that it will be easy to deal while making the company decision.

Some people are interested to make a merger business where as some do not and after making mergers. There is a big bubble about that and for that many economics are finding new theories. Because of these kinds of reason modern corporate finance is important internationally.

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GLOSSARY

Auditing - organizations accounts (Page no. 28.)

Giant - A very big company or organization (Page no.70.)

Horried - Causing horror, a horrid night mare.(Page no 30.)

Hybrid - A hybrid of donkey and horse, cross (Page no. 41,66.)

Jurisdiction - The official power to make a legal decisions and judgement (Page no. 35.)

Medallion - Giving one he right to operate a cab there (Page no. 77.)

Obligations - Legally bond to do something (Page no 47,58,61.)

Outlays - An amount of money spend on something.(Page no. 29,79,88.)

Payroll - A list of company's employees and amount of Money theory are to be paid. (Page no. 26, 28.)

Unprecedence - Condition of being considered more important than someone or something else. (Page no 38.)

APPENDICES

APPENDICES LIST

Appendice A - Some important formula.

APPENDICE A

Some important Formula

Estimate cost of Equity = Dividend Yield + Expected dividend growth rate

Gross Profit Margin = $\frac{Sales - Cost\ of\ Good\ Sold}{Sales}$

Operating Profit Margin =

$$\frac{Earning\ Before\ Interest\ Tax\ Depreciatioes\ and\ Acquationa\ Taxes}{Sales}$$

Net Profit Margins = $\frac{Net\ Profit\ after\ Taxes}{Sales}$

Present Value (PV)

PV= PV(C1) + PV(C2) +……+PV(Ct)

PV = $\frac{C1}{1+r} + \frac{C2}{(1+r)^2} + \frac{C3}{(1+r)^3} + \cdots \frac{Ct}{(1+r)t}, + \cdots$

C = Cash Flow

r = Discount Rate

T = time

Net Present Value

$$NPV = PVo = -\mathrm{I} + CF0 + \frac{CF1}{(1+i)} + \frac{CF2}{(1+i)2} + \cdots \ldots \frac{CFn}{(1+i)n}$$

Formula to the market -to -book value ratio

$$=\frac{\text{market value}}{\text{book value}} = \frac{\text{expected return on equity} - \text{dividend growth rate}}{required\ return\ on\ equity - dividend\ growth\ rate}$$