

Contents

1	Macro-Economic Scenario in India	..... 1-32
	FOREIGN DIRECT INVESTMENT	..... 2
	Types of FDI	..... 2
	Forbidden Territories:	..... 2
	Benefits of FDI	..... 3
	Foreign Direct Investment and Economic Development	..... 3
	Foreign Direct Investment in 2007	..... 4
	Some investment highlights	..... 4
	FOREIGN DIRECT INVESTMENT IN INDIA	..... 5
	Foreign Investments (in billions)	..... 5
	Countrywise FDI Inflows in India (1991 to 2007)	..... 6
	Shares of Major Sectors in FDI Inflows (1991 to 2007)	..... 6
	Overseas FDI by Indian Corporations	..... 7
	Reasons	..... 8
	FOREIGN INSTITUTIONAL INVESTOR – FII	..... 10
	Economic Figures	..... 10
	Impact of FIIs on Indian Markets	..... 11
	Financial System	..... 12
	STRUCTURE OF FINANCIAL SYSTEM	..... 12
	Monetary Policy	..... 12
	How is the Monetary Policy different from the Fiscal Policy?	..... 13
	Some Monetary Policy terms	..... 13
	Inflation	..... 14

Money Supply (M3)	.....	14
Statutory Liquidity Ratio	.....	14
Repo	.....	14
Open Market Operations	.....	15
Money Market Instruments	.....	15
Repo/ Reverse Repo	.....	15
Inter Corporate Deposits	.....	16
Commercial Paper	.....	16
Bills Rediscounting	.....	16
Govt. Securities	.....	17
Benefits of Investing in Government Securities	.....	17
Treasury Bills	.....	17
Benefits of Investment in Treasury Bills	.....	17
PRIVATE EQUITY: GLOBAL AND INDIAN PERSPECTIVE	.....	18
Global Prospective	.....	18
SECTORAL ANALYSIS OF PRIVATE EQUITY DEALS	.....	20
Top Ten Private Equity Dealmakers In 2006	.....	20
Indian Scenario	.....	21
EMERGENCE OF FINANCIAL INSTRUMENTS	.....	22
Foreign Currency Convertible Bonds (FCCBs)	.....	22
Secured Premium Notes (SPNs)	.....	22
Floating rate Bonds (FRBs)	.....	22
Global /American Depository Receipts (GDR/ADR)	.....	22
CURRENCY CONVERTIBILITY	.....	23
The Gold Standard	.....	23
Participatory Notes??	.....	23
The Gold Exchange Standard	.....	24
External and internal convertibility	.....	24
Convertibility: Why?	.....	24

Current account convertibility	.....	25
Capital account convertibility	.....	25
BENEFITS TO INDIA	.....	26
MUTUAL FUNDS	.....	27
ROLE OF MUTUAL FUNDS IN INDIAN EQUITY MARKETS	.....	27
Benefits	.....	29
Risk vs. Reward	.....	30
Summary	.....	32

2 Accounting Mechanics & Financial Statements 33-54

A. ACCOUNTING MECHANICS	.....	34
DEFINITIONS & MEANING OF ACCOUNTANCY	.....	34
FUNCTIONS OF ACCOUNTING	.....	34
ACCOUNTING CONVENTIONS & CONCEPTS	.....	34
Materiality	.....	35
Consistency	.....	35
Accruals	.....	35
Prudence	.....	35
Realisation	.....	36
Objectivity	.....	36
Duality	.....	36
Entity	.....	36
Cost	.....	37
Monetary Measurement	.....	37
USERS OF ACCOUNTING INFORMATION	.....	37
DOUBLE ENTRY SYSTEM	.....	38
HISTORY OF DOUBLE ENTRY	.....	38
ABBREVIATION USED IN BOOK KEEPING	.....	38

TRADITIONAL CLASSIFICATION OF ACCOUNTS	..... 41
Personal Accounts	..... 41
Nominal accounts	..... 41
Real accounts	..... 41
RULES OF DEBIT & CREDIT	..... 41
B. FINANCIAL STATEMENTS	..... 42
Items on Income Statement	..... 44
EARNINGS PER SHARE	..... 45
Retained Earning	..... 45
Cash Flow	..... 46
PURPOSE	..... 46
Direct Method Cash Flow Statement	..... 47
Indirect method of cash Flow	..... 48
C. EMERGING AREAS IN ACCOUNTING AND FINANCE	..... 49
HUMAN RESOURCE ACCOUNTING	..... 49
Methods based on cost	..... 50
Methods based on value	..... 51
ECONOMIC VALUE ADDED	..... 51
ENVIRONMENT ACCOUNTING	..... 53
Summary	..... 54
3 Financial Statement Analysis	..... 55-84
<hr/>	
FINANCIAL STATEMENT ANALYSIS	..... 56
Financial System of a Company	..... 57
OVERVIEW- FINANCIAL STATEMENT ANALYSIS	..... 58
FINANCIAL STATEMENT ANALYSIS VS. RATIO ANALYSIS	..... 60
STATISTICAL ANALYSIS VS. RATIO ANALYSIS	..... 60
Analysis of Key Factors	..... 61

Ratio Analysis	.....	61
ANALYSIS AND INTERPRETATION OF FINANCIAL STATEMENTS- DIFFERENT TOOLS	.....	62
KEY RATIOS AND THEIR IMPLICATIONS: VALUATION/ INVESTOR RATIOS	.....	65
PROFITABILITY RATIOS	.....	67
MANAGEMENT EFFECTIVENESS	.....	68
FINANCIAL STRENGTH/SOLVENCY RATIOS	.....	69
EFFICIENCY RATIOS	.....	71
CASE ANALYSIS: INDIAN IT SECTOR	.....	74
COMPARISON OF THE INDIAN IT SECTOR	.....	75
Summary	.....	84

4 Sources of Finance **85-114**

FINANCING	.....	86
LONG TERM EQUITY FINANCE	.....	86
Merits	.....	87
Limitations	.....	87
Types	.....	88
Methods of Raising Equity Finance	.....	90
Unquoted Companies	.....	90
They are of two types as follows	.....	91
Quoted Companies	.....	92
Implications of IPO	.....	93
Advantages of Rights Issues	.....	94
LONG TERM DEBT FINANCE	.....	95
Types	.....	96
Benefits	.....	101
Advantages	.....	103

Disadvantages	.....	103
Features	.....	104
Types:	.....	105
HYBRID SECURITIES	.....	106
Features of a Convertible Bond	.....	107
Pricing	.....	109
RETAINED EARNINGS AS A SOURCE OF FINANCE	.....	112
Merits	.....	113
Limitations	.....	113
RECENT CHANGES AND DEVELOPMENTS	.....	113
Summary	.....	114

5 Financing Infrastructure Projects 115-120

INNOVATIVE WAYS OF FINANCING INFRASTRUCTURE PROJECTS	.....	116
Special features of infrastructure projects	.....	116
Innovative ways of project financing	.....	116
Summary	.....	120

6 Cost Accounting System 121-142

Introduction	.....	122
SOME BASIC CONCEPTS OF COSTING	.....	122
Accounting vs. Opportunity costs	.....	124
Utility of cost accounting	.....	124
Cost Accounting Methods	.....	125
Two Major Cost Accounting Systems	.....	126
Contract costing	.....	127
Process costing	.....	127

Service costing	.....	127
Comparing private, external, social, and psychic costs	.....	129
Other Cost Categories	.....	132
Production Costs	.....	132
Total and Average Costs	.....	133
Marginal costs	.....	134
A Manufacturer's Perspective	.....	134
A Retailer's Perspective	.....	135
INVENTORY CONTROL	.....	136
CASE ANALYSIS: Indian Railways (IR)	.....	136
Introduction to Break Even Analysis	.....	138
The Break-Even Chart	.....	139
Fixed Costs	.....	139
Six strategies to control costs	.....	140
Cost Management	.....	141
Summary	.....	142

7 Activity-Based Costing **143-158**

Introduction	.....	144
ABC vs. Traditional Costing	.....	144
What ABC advocates	.....	144
Defining ABC	.....	145
Activity-Based Costing	.....	145
Implementing an ABC system	.....	147
When It Is Beneficial ABC System	.....	148
Identifying cost drivers	.....	149
CASE STUDY: ACTIVITY BASED COSTING SYSTEM	.....	150
Case study one: Mel Co	.....	150
Management expectations of the ABC system	.....	152

Problems during implementation	.....	153
The results of the ABC system	.....	153
Current status of the ABC system	.....	154
Case study two: Ciba Specialty Chemicals	.....	154
Developing the prototype ABC system	.....	155
Problems during implementation	.....	156
Benefits of the ABC system at CAHK	.....	156
Managerial support	.....	157
Limitation of Activity-based costing	.....	158
Summary	.....	158

8 Financial Forecasting 159-188

Introduction	.....	160
USE OF FORECASTS	.....	160
TYPES OF FORECASTS	.....	161
Sales Forecasts	.....	161
Financial Forecasts	.....	161
Economic Forecasts	.....	161
Technological Forecasts	.....	161
FINANCIAL PLANNING, FORECASTING & BUDGETING	.....	161
Financial Forecasting Objectives	.....	162
Fundamentals of Forecasting	.....	162
Time Frame in Forecasting	.....	163
FINANCIAL FORECASTS - FINANCIAL STATEMENTS	.....	164
Income Statement	.....	164
Forecasting Sales	.....	165
Pro Forma Profit & Loss Statement	.....	165
Percentage of Sales Method	.....	166

Budgeted Expenses Method	.....	167
A Combination of Percentage of Sales and Budgeted Expenses Methods	.....	167
PRO FORMA BALANCE SHEET	.....	167
Types of Assets and Liabilities	.....	169
Types of Liabilities	.....	169
External Financing Needed (EFN)	.....	171
Full Capacity	.....	171
Full Capacity Example	.....	173
EXCESS CAPACITY	.....	173
CASH FLOW FORECAST	.....	175
Parts of The Cash Budget	.....	176
Cash Budget: An Example	.....	176
BENEFITS OF CFF	.....	179
COMPUTER BASED FINANCIAL PROJECTIONS - WORKING WITH SPREADSHEETS	.....	179
ASSUMPTIONS BEHIND FORECASTING	.....	181
PRO FORMA STATEMENTS AND FINANCIAL MODELS	.....	182
COMMON SIZE FINANCIAL STATEMENTS	.....	183
Ratio Analysis	.....	183
Trend Analysis	.....	184
OTHERS IMPORTANT FINANCIAL MODELS	.....	184
Scenario Analysis	.....	184
Sensitivity Analysis	.....	185
Simulation	.....	185
MONITORING THE FORECAST	.....	187
CONCLUSION	.....	187
Summary	.....	188

9 Budgeting & Budgetary Control 189-217

WHAT IS BUDGET?	..... 190
THE PRIMARY SOURCES FOR A BUDGET	..... 190
BUDGETING AND BUDGETARY CONTROL	..... 191
FINANCIAL PLANNING	..... 191
The Difference between a budget and a Forecast	..... 191
Budgetary control methods	..... 192
Problems in budgeting	..... 193
Characteristics of a budget	..... 194
Budget Organization and Administration	..... 194
Budget Manual	..... 195
Budget Preparation	..... 195
Steps in preparing a cash budget	..... 197
Budgeting	..... 199
Master budget	..... 201
Reporting	..... 202
Price and quantity variances	..... 203
Labour	..... 204
Materials	..... 204
Overheads	..... 204
Calculation of price and usage variances	..... 205
Management action and cost control	..... 205
Flexible Budget	..... 205
PRIORITY-BASED BUDGETING	..... 206
Introduction	..... 206
PERFORMANCE - BASED BUDGETING (PBB)	..... 207
Achieving PBB	..... 208
The way to CPM and PBB	..... 208
Zero Based Budgeting	..... 209

Advantages of Zero-Based Budgeting	.....	210
Disadvantages of Zero-Based Budgeting	.....	210
Incremental Budgeting	.....	211
Advantages of incremental budgeting	.....	211
Disadvantages of incremental budgeting	.....	211
Activity based costing introduction	.....	212
ACTIVITY BASED COSTING METHODOLOGY	.....	214
Summary	.....	217

10 Strategic Planning and Budgeting 219-233

Strategic Planning	.....	220
Benefits of Strategic Planning	.....	220
When Should Strategic Planning Be Done?	.....	221
Management Planning and Control Systems	.....	222
Planning Process	.....	223
Determine Activities	.....	224
Delegate	.....	224
Schedule Tasks	.....	225
Allocate Resources (and Budgets)	.....	225
Communicate and Coordinate	.....	225
Provide Incentives	.....	225
The control process - consider the effects	.....	226
Behavioral Responses to Control Systems	.....	227
Pitfalls of Strategic Planning	.....	230
Lack of time and resources	.....	230
Buying into the process and the plan	.....	230
Improving analysis in strategic planning	.....	231
Data gathering & analysis	.....	231
Common tools	.....	231

STEP analysis	.....	232
Trend analysis	.....	232
Core competencies	.....	232
SWOT analysis	.....	232
Key or critical success factors (KSFS)	.....	232
Scenario planning	.....	233
Final thoughts	.....	233
Summary	.....	233

11 Time Value of Money 235-259

Introduction	.....	236
Interest	.....	237
Simple Interest	.....	237
Compound Interest	.....	238
The Power of Compounding: A Case Study	.....	238
Rate of Return	.....	240
Effective Rate (Effective Yield)	.....	240
Number of Periods	.....	241
Annuity Payments	.....	241
Calculate Payments When Present Value Is Known	.....	242
Calculate Payments When Future Value Is Known	.....	242
Present Value	.....	243
Present Value of Annuities	.....	244
Present Value of an Ordinary Annuity	.....	244
Present Value of an Annuity Due (PVad)	.....	246
Combined Formula	.....	247
Future Value	.....	247
Future Value of Annuities	.....	248
Future Value of an Ordinary Annuity	.....	248

Future Value of an Annuity Due (FVad)	.....	250
Combined Formula	.....	251
Amortization	.....	251
Amortization Schedule	.....	251
Negative Amortization	.....	252
Constructing a Cash Flow Diagram	.....	252
PRACTICAL IMPLICATION	.....	254
One Proposal, Four Perspectives	.....	254
Future Value	.....	255
Bottom Line	.....	259
Summary	.....	259

12 Bond Valuation **261-280**

Bonds	.....	263
COUPON BONDS	.....	264
ZERO COUPON BONDS	.....	264
CLASSES OF LONG-TERM DEBT	.....	264
Unsecured Debt	.....	265
Secured Debt	.....	265
Income Bonds	.....	266
Tax-Exempt Corporate Debt	.....	266
Deep Discount Bonds	.....	266
Principal Features of Long-Term Debt	.....	266
VALUATION OF BONDS	.....	267
Valuation: The Basic Process	.....	268
Bond Valuation	.....	268
Computing Yield-to-Maturity on a Bond (YTM)	.....	269
COMPOUNDING	.....	269
THE RATE OF INFLATION	.....	269

BOND PRICING AND YIELD: THE TRADITIONAL APPROACH TO BOND PRICING	.....	270
BOND YIELD	.....	271
BOND PRICING AND YIELD: THE CURRENT APPROACH	.....	272
Zero-coupon Bonds	.....	272
Coupon Bonds	.....	272
CORPORATE BONDS	.....	273
Tax Treatment	.....	273
Bond Value: Three Important Relationships	.....	273
Bond value behavior	.....	274
Fisher's Effect	.....	274
Fundamental Determinants of Interest Rates	.....	274
Spot Rates	.....	276
Forward Rates	.....	276
Term Structure Theories	.....	276
Expectation theories	.....	277
The Preferred Habitat Hypothesis	.....	277
The Market Segmentation Theory	.....	277
Buy-and-hold Strategy	.....	277
DURATION	.....	278
Convexity and Duration	.....	278
Properties of Convexity	.....	279
Summary	.....	280

13 Dividend Policy 281-290

LINTNER'S MODEL	.....	282
THREE OPPOSING VIEWS ABOUT DIVIDENDS AFFECT ON FIRMS VALUE	.....	283
SOME OF THE LEADING DETERMINANTS OF DIVIDEND POLICY ARE	.....	286

Empirical Testing of Dividend Policy	.....	287
Dividend Discount Models	.....	287
Ex-Dividend Date And Market Price	.....	289
Summary	.....	290

14 Working Capital Management **291-322**

Working Capital Management: Liquidity	.....	292
Working Capital is	.....	292
Significance of Working Capital Management	.....	292
Working Capital Cycle	.....	292
Committees	.....	293
Chore Committee Report	.....	294
Tandon Committee Report	.....	294

IMPLEMENTATION OF CHORE COMMITTEE'S RECOMMENDATIONS **295**

Second Method of Lending	.....	296
Temporary Limits	.....	296
Export Transactions	.....	296
Quarterly Information Statements	.....	297
Applicability of Lending Discipline	.....	297
Construction Companies/Turnkey Projects	.....	297
Advance Payment of Income-tax	.....	298
Advances against Gold Ornaments	.....	298
Loans for Purchase of Consumer Durables	.....	299
Co-operative Bank Deposits	.....	300

CREDIT SNIPPETS **300**

Credit to Sugar Mills	.....	300
New Scheme of IDBI	.....	300
Banks and IRD Programme	.....	301

Repayment of Agricultural Term Loans	.....	301
DICGC Guarantee Cover	.....	301
Bills Discounting Limits	.....	302
Advances to Jute Industry	.....	302
PRODUCTIVITY IN COMMERCIAL BANKS	.....	302
Estimation of Working Capital Requirement	.....	303
Standard Formulae for determination of Working Capital	.....	304
Illustrative Example	.....	305
VODAFONE CASE	.....	310
The Acid Test Ratio	.....	312
Asset Usage	.....	314
Vodafone total asset turnover ratio	.....	316
Working Capital Turnover	.....	317
Working Capital Management	.....	317
Stock Turnover: stock control	.....	318
Creditors' Turnover Ratio	.....	321
Summary	.....	322

15 Financial Strategy (Capital Structure Planning) 323-348

Introduction	.....	324
Why Financial Strategy Matters	.....	324
CAPITAL STRUCTURE	.....	325
Benefits and Costs of Debt	.....	325
Considerations in Designing Financial Policy	.....	327
Theorems in Capital Structure	.....	328
Capital structure in a perfect market	.....	328
Capital structure in the real world	.....	329

Trade-off theory	.....	329
Arbitrage	.....	330
Right-financing	.....	331
Market timing hypothesis	.....	332
Cost of capital	.....	332
Cost of Debt	.....	333
Cost of Equity	.....	333
Weighted average cost of capital	.....	334
Formula	.....	334
Financial risk management	.....	335
FINANCIAL STRATEGY FOR MERGERS & ACQUISITIONS	.....	335
MANAGEMENT BUYOUTS (MBO)	.....	336
The team	.....	337
The business plan	.....	337
Continual growth	.....	337
Timing	.....	338
Financial backing	.....	338
Structuring the deal	.....	338
The approach	.....	339
Due diligence	.....	339
Post completion	.....	339
INTERNAL FINANCING	.....	339
EXTERNAL FINANCING	.....	340
External finance sources finance type	.....	340
Debt	.....	340
Equity	.....	341
Initial Public Offering	.....	341
Friends and family	.....	342
Venture capital	.....	342
Gifts	.....	343

Grants	.....	343
Leasing	.....	343
COMMON SHARES, PREFERRED SHARES AND WARRANTS		..... 343
SECURED LOAN	.....	345
What the rate depends on.	.....	345
Credit rating agency (CRA)	.....	346
MORTGAGE	.....	346
HYPOTHECATION	.....	346
PLEDGE	.....	347
Summary	.....	348

16 World Economy and International Monetary System **..... 349-377**

INTERNATIONAL MONETARY SYSTEM	.....	350
Bretton Woods System	.....	350
International Monetary Fund	.....	350
The SDRs	.....	351
IMF's track record	.....	352
World Bank	.....	352
Activities	.....	353
World Bank Assistance to India	.....	354
An Evaluation of IMF – World Bank	.....	355
Gold Standard [1792-1973]	.....	357
Exchange Rate Regime	.....	358
World Trade Organization (WTO)	.....	358
Evaluation of WTO	.....	359
Benefits of WTO	.....	359
Drawbacks/Criticisms	.....	359
WTO and India	.....	361

Should India Quit WTO?	.....	361
India's Possible Trade Gain	.....	362
EUROPEAN MONETARY SYSTEM AND EURO		..... 363
The Euro	.....	364
Benefits of Euro	.....	365
The Impact	.....	365
EURO vs. DOLLAR		..... 366
FORIEGN EXCHANGE MARKET		..... 367
Market Size and Liquidity	.....	367
Factors Affecting Currency Trading	.....	368
Political conditions	.....	369
Market Psychology	.....	369
INTERNATIONAL MARKETS		..... 370
Business	.....	370
Market Share	.....	371
Quote Availability	.....	371
Selection	.....	373
Weighting	.....	373
Holdings	.....	375
Weighting and modifications	.....	376
INTERNATIONAL CURRENCIES		..... 376
Summary		..... 377

17 International Finance 379-430

INTERNATIONAL MONETARY SYSTEM	.....	380
EXCHANGE RATE MECHANISMS	.....	380
FIXED EXCHANGE RATE SYSTEM	.....	381
CURRENCY BOARD SYSTEM	.....	381

TARGET ZONE ARRANGEMENT	.....	383
MONETARY UNION	.....	383
FLOATING EXCHANGE RATE SYSTEM	.....	384
FREE FLOAT	.....	384
MANAGED FLOAT	.....	384
Crawling Peg	.....	385
PURCHASING-POWER PARITY PRINCIPLE	.....	386
INTEREST RATE PARITY	.....	386
Investors' Decision		386
RELATIONSHIP BETWEEN PPP AND INTEREST RATE PARITY	.....	387
The Fisher Effect	.....	387
Reasons for Departure from Interest Rate Parity (IRP)	.....	387
Transaction Costs	.....	388
Political Risks	.....	389
MANAGEMENT OF TRANSACTION AND TRANSLATION EXPOSURE	.....	389
Exposure Netting	.....	390
Leading and Lagging	.....	391
Hedging by Choosing the Currency of Invoicing	.....	391
Hedging through Sourcing	.....	391
Hedging through the Forward Market	.....	392
Hedging through Futures	.....	393
Hedging through Option	.....	393
Hedging through the Money Market	.....	394
Illustration	.....	395
Management of Economic Exposure	.....	397
MARKETING STRATEGIES	.....	398
Market selection	.....	398
Price Strategy	.....	399

Promotional Strategy	.....	400
Product Strategy	.....	400
PRODUCTION STRATEGIES	.....	401
Input Mix	.....	401
Product Sourcing	.....	402
Plant Location	.....	403
Raising Productivity	.....	403
Financial Management Strategies	.....	404
The Final Word	.....	404
INTERNATIONAL FINANCIAL MARKETS AND INSTRUMENTS	.....	405
Saving, Investment and Balance of Payments (BOP)	.....	405
ORIGIN	.....	407
India's presence in international Markets	.....	407
THE INSTRUMENTS	.....	408
Debt Instruments	.....	408
Equity Instruments	.....	410
Quasi-instruments	.....	411
THE PLAYER	.....	412
Borrowers/ Issuers	.....	412
Lenders/ Investors	.....	412
Intermediaries	.....	413
RESOURCE MOBILIZATION – THE DECISION CRITERIA	.....	415
EQUITY	.....	416
The Instrument	.....	417
The Procedure	.....	417
Issuance of GDR	.....	417
The Documentation	.....	419
The Launch	.....	421
Marketing	.....	422

Pricing and Closing	.....	422
Costs	.....	423
American Depository Receipts (ADR)	.....	423
ADR	.....	424
Regulatory Framework	.....	424
Potential	.....	425
DEBT INSTRUMENTS	.....	425
Eurobonds	.....	425
The Instruments	.....	426
Procedure	.....	428
Summary	.....	430

18 Investment in Options 431-449

OPTIONS	.....	432
Option relative to price	.....	432
Option – Its constituents	.....	432
ATM: At the Money	.....	433
ITM: In the money	.....	433
OTN: In the money	.....	433
Derivatives market in India	.....	434
Structure of Derivatives Market in India	.....	434
How are Options Different from Futures	.....	436
Contracts Specifications	.....	437
Underlying Instrument	.....	437
Trading cycle	.....	437
Expiry day	.....	437
Strike Price Intervals	.....	437
TRADING PARAMETERS	.....	438
Contracts size	.....	438

Price bands	.....	439
Quantity Freeze	.....	440
Market Statistics	.....	440
Options Trading	.....	441
INFOSYS CALL Option INFOSYS CA-Dec-1950	.....	442
SOME DERIVATIVE TRADING STRATEGIES	.....	443
Long Straddle	.....	447
Long Butterfly	.....	447
DEFINITION OF OPTIONS TERMS	.....	448
Summary	.....	449

19 Mergers and Acquisitions 451-487

DEFINING M&A	.....	452
DISTINCTION BETWEEN MERGERS AND ACQUISITIONS	.....	452
MOTIVES BEHIND MERGERS AND ACQUISITIONS	.....	453
M&A MARKETPLACE DIFFICULTIES	.....	455
VARIETIES OF MERGERS	.....	456
VALUATION MATTERS	.....	457
Valuation Procedures	.....	459
SYNERGY: THE PREMIUM FOR POTENTIAL SUCCESS	.....	460
TAXABLE VERSUS TAX-FREE TRANSACTIONS	.....	460
FINANCIAL ACCOUNTING FOR MERGERS AND ACQUISITIONS	.....	461
FINANCING M&A	.....	462
A SIMPLE EXAMPLE TO EXPLAIN MERGER AND ACQUISITION	.....	463
Example of Cost & Gains	.....	464
Additional Condition	.....	464

WHAT TO LOOK FOR	.....	465
Doing the Deal	.....	466
MAJOR M&A IN THE 1990S	.....	468
Cross-Border Mergers and Acquisitions	.....	469
Indian Mergers and Acquisitions	.....	470
DUE DILIGENCE	.....	471
LOOK TOWARD THE FUTURE	.....	474
Apply outside-in benchmarks to cost synergies	.....	476
Forming effective deal teams	.....	476
ARCELOR MITTAL	.....	477
The Controversy	.....	480
Moves by Arcelor to counter the bid by Mittal	.....	480
End Result	.....	481
The Future	.....	482
CASH FLOW STATEMENT	.....	484
CONCLUSION	.....	486
Summary	.....	487

20 Human Resource Accounting 489-511

WHY HUMAN RESOURCE ACCOUNTING	.....	490
Our main asset is our people	.....	490
Why is Human Resource Key?	.....	491
Why value human resource?	.....	492
Changing Scenario	.....	492
BASICS OF HUMAN RESOURCE ACCOUNTING (HRA)	.....	493
Need for HRA in "Third Wave Societies"	.....	493
Defining HRA	.....	494
The rationale for the emergence of HRA	.....	494

VALUATION METHODOLOGIES	..... 497
Cost based approaches	..... 497
Behavioral model	..... 498
Economic model	..... 498
MANAGEMENT AND VALUATION OF HUMAN ASSETS AT INFOSYS	..... 501
History	..... 501
Leadership and Culture	..... 502
Management of the Human Resource Assets	..... 503
Valuation of Human assets	..... 505
HRA - KEY ISSUES	..... 507
Is HRA just an old wine in a new bottle?	..... 507
Is HRA improving or supplementing balance sheet?	..... 507
Conclusion	..... 510
Summary	..... 511

21 Economic Value Added (EVA) 513-525

Introduction	..... 514
How Companies Have Used EVA	..... 515
EVA – Another barometer for corporate performance	..... 515
So how do you define EVA?	..... 516
Where do I use the concept?	..... 517
EVA & P/E	..... 517
4 Ms of EVA	..... 517
Measurement	..... 517
Management System	..... 518
Motivation	..... 518
Mindset	..... 518
The EVA Concept of Profitability	..... 519

Measurement of EVA	.....	519
EVA Calculation and Adjustments	.....	520
The Importance of EVA and its Indian Implications	.....	521
THE INDIAN ENVIRONMENT	.....	522
Calculation of EVA	.....	522
INFOSYS Technologies Ltd	.....	522
Economic value addition (EVA)	.....	523
Strategies for increasing EVA	.....	524
WHY EVA IS IMPORTANT	.....	524
Advantages of EVA	.....	524
Limitations of EVA	.....	525
Summary	.....	525
Index	.....	527-534
