FUNDAMENTAL ANALYSIS

Fundamental analysis is a Three level systematic process that analyse the overall external and internal environment of the company before placing a value on its shares.
The three levels at which the analysis is carried out are the following: (a) Analysis of the economy (b) Industry Level Analysis (c) Company Analysis We shall describe the analytical process at all these levels in greater details hereunder:

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Performance of a company is intimately related to the overall economic environment of the country because demand for products and services of the company would under normal circumstances be directly related to growth of the country's economy. If the country has an improving GDP growth rate, controlled inflation and increasing investment activity then chances are that the valuation of securities shall be rise. The capital market is said to be in a bullish phase when share values shooting up across the board. As the economy is growing, the analyst expects almost every industry to do well. On the other hand, if the GDP growth rate falls , inflation is out of control and investment activity is stagnant or declining, the analyst will expect the performance of industries to slow down. Under such circumstances, valuation of securities tends to be conservative. The capital market enters a bearish phase and share values decline across to board.

INDUSTRY LEVEL ANALYSIS

Industry level analysis focuses on a particular industry rather than on the broader economy. In this analysis, the analyst has to look for the composition of the industry, its position along the industrial life cycle, entry and exit barriers .All these factors have a bearing upon the performance of the company. Having a common market, the participants in the industry group face similar problems and opportunities. To the extent that an industry loses or gains from certain happenings, the performance of the participants is sure to be similarly impacted. These happenings may be technological changes, shifts in consumer preferences, availability of substitutes etc. These changes also drive the life cycle of the industry. The industry life cycle or the industry growth cycle can be divided into three major stages-pioneering stage, expansion stage and stagnation stage. The pioneering stage is related to sunrise status of the industry. It is the stage when technological development takes places. The products have been newly introduced in the market and they gain ready acceptance. The pioneering units in the industry make extraordinary profits and thus attract competition. As competition increases profitability in the industry comes under strain and less efficient firms are forced out of the market. At the end of the pioneering stage, selected leading companies remain in the industry. In the expansion stage of the growth cycle the demand for the products increases but at a lower rate. There is less volatility in prices and production. Capital is easily available in plenty for these units. Due to retention of profits, internal accruals increase. At the stagnation stage, the growth rate initially slows down, then stagnates and ultimately turns negative. There is no product innovation. External capital is hard to come by. Even the internal capital takes flight. This stage of the industry is most valuable during times of slow down in national economy.