

Margin Call

- In the illustration, what is the price at which margin call will be triggered?
 - Price should drop enough to make equity = $0.25 * \text{Market Value (MV)}$
 - For a price of \$ P, $MV = 1000 * P$; $\text{Equity} = (1000 * P) - 10000$

$$\text{Margin} = \frac{1000P - 10000}{1000P} = 0.25$$

- $P = \$ 13.333$
- Suppose price drops to \$12 per share. Then, $MV = \$ 12,000$; $\text{Equity} = \$ 2000$; $\text{Margin} = 2/12 = 16.6\%$. Investors gets margin call.
- To prevent winding up of position, margin has to brought upto maintenance margin of 25%.
 - Bring equity upto \$3000.
 - Pay \$1000 of debt out of pocket.
 - Sell some shares to pay down the debt.

Margin Call – How many shares to sell?

Introduction to Investments
Prof S G Badrinath
Advanced Margin Considerations

Premise: Both Market Value and Debt decrease by the amount of Stock sold.

Margin Call – How many shares to sell?

Introduction to Investments
Prof S G Badrinath
Advanced Margin Considerations

Here, equity stays the same at \$2000
\$8000 of MV to bring up margin to 25%
Sell \$ 4000 of shares and pay down debt
Sell $4000/12 = 333.333$ shares

Or formally, Say sell N shares @ \$12
 $MV = 12000 - 12N$; $Debt = 10000 - 12N$
Equity = 2000 (as before)
 $Margin = 2000/(12000-12N) = 0.25$
 $N = 333.333$ shares

© All Rights Reserved.

This document has been authored by Prof S G Badrinath and is permitted for use only within the course “Introduction to Investments” delivered in the online course format by IIM Bangalore. No part of this document, including any logo, data, illustrations, pictures, scripts, may be reproduced, or stored in a retrieval system or transmitted in any form or by any means – electronic, mechanical, photocopying, recording or otherwise – without the prior permission of the author.