Paper- 11: CAPITAL MARKET ANALYSIS & CORPORATE LAWS

Time Allowed: 3 Hours **Full Marks:** 100

The figures in the margin on the right side indicate full marks.
Please: (1) Answer all bits of a question at one place.
(2) Answers to each question should start from a new page.
Example: Q. No. 2/3/any should start from a new page.

SECTION - I (60 Marks)
(Capital Market Analysis)

Answer Question No. 1 (compulsory) and answer any two from the rest in this Section.

Question 1.

(a) In each of the cases given below one out of four options is correct. Indicate the correct answer and give workings/ reasons briefly in support of your answer. [2×6]

(i) The buy and sell value of two securities in stock exchange are as under:

Security	Buy Value (₹)	Sell Value (₹)
L	5,00,000	2,00,000
M	3,00,000	7,00,000

The Gross Exposure Margin is:
A. ₹ 17,00,000;
B. ₹ 7,00,000;
C. ₹ 12,00,000;
D. Insufficient information.

(ii) The Stock of Ventex Ltd. (FV ₹ 10) quotes ₹ 920 on NSE and the 3 months futures price quotes at ₹ 950 and borrowing rate is given as 8% p.a. If the expected annual dividend yield is 15% p.a. payable before expiry, then the theoretical price of 3 month Ventex Ltd. Futures would be:
A. ₹ 948.80;
B. ₹ 939.90;
C. ₹ 936.90;
D. ₹ 928.40.

(iii) Ms. Vasuda is considering an investment in a Mutual Fund with a 2% load. As another alternative, she can also invest in a Bank deposit paying 10% interest. Her investment planning period is 3 years. What should be the annual rate of return on Mutual fund so that she prefers the investment in the fund to the investment in Bank Deposit?
A. 10.743%;
B. 11.282%;
C. 11.884%;
D. None of the above.

(iv) Consider a bullish spread option strategy using a call option on the stock of Royal Ltd. with ₹ 60 exercise price, priced at ₹ 6 and a call option with ₹ 75 exercise price, priced

at ₹ 3.50. The current market price of stock of Royal Ltd. is ₹ 67. If the price of the stock is ₹ 95 on maturity, the net profit at expiration will be:
A. ₹ 1.50;
B. ₹ 10.50;
C. ₹ 12.50;
D. ₹ 72.50.

(v) Zenion Ltd. has an excess cash of ₹ 9,00,000 which it wants to invest in short-term marketable securities. Expenses relating to investment will be ₹ 21,000. If the securities invested will have an annual yield of 10%, what would be the period of investment so as to earn a pre-tax income of 6%? (Ignore time value of money)
A. 6.50 months;
B. 9.50 months;
C. 10.00 months;
D. Insufficient data.

(vi) Z Ltd. issued right shares that increased the market value of the shares of the company by ₹ 180 crore. The existing base year average is ₹ 750 crore. If the aggregate market value of all the shares included in the index before the right issue made is ₹ 1200 crore, what will be the new base year average?
A. ₹ 782.30 crore;
B. ₹ 862.50 crore;
C. ₹ 978.20 crore;
D. Insufficient information.

Answer:

(i) B.

Security	Buy Value (₹)	Sell Value (₹)	Buy Value-Sell Value (₹)
L	5,00,000	2,00,000	3,00,000
M	3,00,000	7,00,000	- 4,00,000

The Gross Exposure Margin: $(|3,00,000| + |-4,00,000|)$
= ₹ 7,00,000.

(ii) C.
Future Price = Spot Price + Costs of Carrying - Dividend
= 920 + 920 × 0.08 × 3/12 – 10 × 0.15
= 920+18.40-1.50 = ₹ 936.90.

(iii) A.
$(1 - 0.02) \times (1+r)^3 \geq (1.10)^3$
or, $0.98 \times (1+r)^3 \geq 1.331$ or $(1+r)^3 \geq (1.331 \div 0.98)$ or, $(1+r)^3 \geq 1.358163$
or $(1+r) \geq (1.107433)$ or, r = (1.107433 - 1) or r = 0.107433 i.e. r = 10.743%
The annual rate of return on mutual fund = 10.743%.

(iv) C.
Buy a call option with exercise price of ₹ 60 @ ₹ 6.00
Sell a call option with exercise price of ₹ 75 @ ₹ 3.50
Initial outlay ₹ 2.50

If the stock price on expiration increases to ₹ 95 —
Profit from buying call option ₹ (95 - 60) = ₹ 35
Loss on selling call option ₹ (95-75) = ₹ 20

₹ 15

Net Pay -off after considering initial outlay: ₹ (15 - 2.50) = ₹ 12.50.

(v) C.

Pre-tax income required in investment of ₹ 9,00,000.

= ₹ 9,00,000 x 0.06 = ₹ 54,000

Let the period of investment be "P"

$$\therefore \left(9,00,000 \times 0.10 \times \frac{p}{12}\right) - 21000 = 54000$$

Or, 7500 P = 54000 + 21000 = 75000

Or, P = 75000 ÷ 7500 = 10 Months

(vi) B.

$$\text{New Base year Average} = \text{Old Base Year Average} \times \frac{\text{(New Market Value)}}{\text{Aggregate Market Value}}$$

= ₹ [750 x (1200 + 180) ÷ 1200] crores = ₹ 862.50 Crore.

(b) Choose the most appropriate one from the stated options and write it down (only indicate A or B or C or D as you consider correct). [1x5]

(i) Markowitz Mean-Variance Model is used in:
- **A. Modern Portfolio Analysis;**
- **B. Traditional Portfolio Analysis;**
- **C. Modern Capital Market Analysis;**
- **D. None of the above.**

(ii) Following is not a Money Market Instrument:
- **A. Treasury Bill;**
- **B. Certificate of Deposit;**
- **C. Equity Shares;**
- **D. Commercial Paper.**

(iii) The conversion of existing assets into marketable securities is known as:
- **A. Future flows securitisation;**
- **B. Asset-backed securitisation;**
- **C. Venture funds;**
- **D. None of the above.**

(iv) Green shoe option denotes an option:
- **A. of allocating shares in excess of the shares include in the public issue;**
- **B. of allocating of shares lower than the shares included in the public issue;**
- **C. to buy shares at a specified price in the stock exchange;**
- **D. none of the above.**

(v) An investor has received bonus shares from ABC Ltd., a listed company, in the ratio of 1: 2. After the receipt of bonus shares:
- **A. There is no change in stockholding and it remains the same;**
- **B. There is no change in stockholding, but more shares available for trading;**
- **C. Stockholding has gone up with more shares available for trading;**
- **D. Stockholding has gone up.**

Answer:

(i) A
(ii) C
(iii) B
(iv) A
(v) B

(c) Fill in the blanks in the following sentences by using appropriate word(s) / phrase(s) / number(s): **[1x3]**

(i) **"Term money" is a form of _______________ market instrument.**
(ii) **Insurance Regulatory and Development Authority (IRDA) Act was passed in the year _____________.**
(iii) **An option is said to be ______________, when the option's strike price is equal to the underlying asset price.**

Answer:

(i) Money
(ii) 1999.
(iii) at the money

Question 2.

(a) Mr. Vasant Shah an analyst of Revamp Securities Ltd. has made risk and return projections for the securities of Sparx Ltd. and Deprotiv Ltd. which are as follows:

Scenario	Probability (Prob)	Returns % associated with		
		Sparx Ltd.	Deprotiv Ltd.	Market Index
Recession & High Interest Rate	0.20	-13	-4	-9
Recession & Low Interest Rate	0.15	16	-2	8
Boom & High Interest Rate	0.40	32	21	16
Boom & High Interest Rate	0.25	12	20	20

It is felt that the interest rate of 7% on the 91-day T-Bill is a good approximation of the risk free rate. Assume that CAPM holds well in the market. You are required to:

(i) **Calculate the ex-ante Betas for Sparx Ltd. and Deprotiv Ltd.**
(ii) **Comment on the proportions of systematic and unsystematic Risk in the two stocks.**
(iii) **Recommend for fresh investment in any of these two stocks.**
-Show all the necessary calculations. **[8+4+(2+2)]**

Answer:

Revamp Securities Ltd.

(i) Stock-Sparx Ltd.

Prob	R_s	Prob×R_s	$R_s - \overline{R_s}$	$(R_s - \overline{R_s})^2$	$Prob \times (R_s - \overline{R_s})^2$
0.20	-13	-2.6	-28.6	817.96	163.592
0.15	16	2.4	0.4	0.16	0.024
0.40	32	12.8	16.4	268.96	107.584

0.25	12	3.0	-3.6	12.96	3.240
		15.6 = $(\overline{R_s})$			274.440 = (σ_s^2)

Expected Return of Sparx $(\overline{R_s})$ = 15.6%

Variance of Sparx (σ_s^2) = 274.44

σ_s = 16.57%

Stock- Deprotiv Ltd.:

Prob	R_D	Prob× R_D	$R_D - \overline{R_D}$	$(R_D - \overline{R_D})^2$	Prob × $(R_D - \overline{R_D})^2$
0.20	-4	-0.8	-16.3	265.69	53.138
0.15	-2	-0.3	-14.3	204.49	30.674
0.40	21	8.4	8.7	75.69	30.276
0.25	20	5.0	7.7	59.29	14.823
		12.30 = $(\overline{R_D})$			128.911 = (σ_D^2)

Expected Return of Deprotiv $(\overline{R_D})$ = 12.30%

Variance of Deprotiv (σ_D^2) = 128.91

σ_D = 11.35%

Market Return:

Prob	R_M	Prob × R_M	$R_M - \overline{R_M}$	$(R_M - \overline{R_M})^2$	Prob × $(R_M - \overline{R_M})^2$
0.20	-9	-1.8	-19.8	392.04	78.408
0.15	8	1.2	-2.8	7.84	1.176
0.40	16	6.4	5.2	27.04	10.816
0.25	20	5.0	9.2	84.64	21.160
		10.8 = $(\overline{R_M})$			111.56 = (σ_M^2)

Expected Return of Market $(\overline{R_M})$ = 10.80%

Variance of Market (σ_M^2) = 111.56

σ_M = 10.56%

Covariance (Sparx, Market) = $\sum Prob(R_s - \overline{R_s})(R_M - \overline{R_M})$

= 0.20 × (-28.6 × -19.8) + 0.15 × (0.4 × -2.8) + 0.40 × (16.4 × 5.2) + 0.25 × (-3.6 × 9.2)
= 113.256 - 0.168 + 34.112 - 8.28
=138.92%

Covariance (Deprotiv, Market) = $\sum Prob(R_D - \overline{R_D})(R_M - \overline{R_M})$

= 0.20 × (-16.3 × -19.8) + 0.15 × (-14.3 × -2.8) + 0.40 × (8.7 × 5.2) + 0.25 × (7.7 × 9.2)
= 64.548 + 6.006 +18.096 +17.710
=106.360%

$$\text{Beta of Sparx } (\beta_s) = \text{ Cov } \left(\text{Sparx,Market}\right) \div \sigma_M{}^2 = (138.92 \div 111.56) = 1.25$$

$$\text{Beta of Deprotiv } (\beta_D) = \text{ Cov } \left(\text{Deprotiv,Market}\right) \div \sigma_M{}^2 = (106.360 \div 111.56) = 0.95$$

(ii) Systematic Risk of Sparx = $\sigma_M{}^2 \times \beta_S{}^2$ = 111.56 X $(1.25)^2$ = 174.31%
Unsystematic Risk of Sparx = 274.44-174.31=100.13%
Proportion of systematic Risk
= (174.31)÷(274.44)X100 =63.51%
Proportion of unsystematic Risk = (100.13÷274.44)×100 =36.49%

Systematic Risk of Deprotiv = $\sigma_M{}^2 \times \beta_D{}^2$ = 111.56 × $(0.95)^2$ = 100.68%
Unsystematic Risk of Deprotiv = 128.91-100.68=28.23%
Proportion of systematic Risk
= (100.68÷128.91) ×100 =78.10%
Proportion of unsystematic Risk = (28.23÷128.91) ×100 =21.90%

Comment:
Both the securities therefore have little Unsystematic risk as compared to Systematic Risk. But comparatively Sparx has a higher Component of Unsystematic Risk as compared to Deprotiv.

(iii) Normal Retun $= R_f + \beta\,(R_M - R_f)$
Sparx Ltd: 7+1.25(10.8-7) = 11.75%
Alpha / Excess Return = 15.6% -11.75% = 3.85%
Deprotiv Ltd: 7+0.95(10.8-7) = 10.61%
Alpha / Excess Return = 12.30% - 10.61% = 1.69%

The Alpha excess return of both the companies is positive. Hence the stock of Sparx Ltd and Deprotiv Ltd is under priced.

Sparx Ltd: Excess return / Standard deviation: (3.85 ÷ 16.57) = 0.23
Deprotiv Ltd: Excess return / Standard deviation: (1.69 ÷ 11.35) = 0.15

As the excess return / Alpha to Standard deviation is higher for the stock of Sparx Ltd, Investment on the said stock (Sparx Ltd) may be recommended.

(b) Explain the terms, "Call / Notice Money" and "Treasury Bills" in the context of money market instrument. [2+2]

Answer:
Call / Notice Money: Call/Notice money is the money borrowed or lent on demand for a very short period. When money is borrowed or lent for a day, it is known as Call (Overnight) Money. Intervening holidays and/or Sunday are excluded for this purpose. Thus money, borrowed on a day and repaid on the next working day, (irrespective of the number of intervening holidays) is "Call Money". When money is borrowed or lent for more than a day and up to 14 days, it is "Notice Money". No collateral security is required to cover these transactions.

Treasury Bills: Treasury Bills are short term (up to one year) borrowing instruments of the union government. It is a promise by the Government to pay a stated sum after expiry of the stated

period from the date of issue (14/91/182/364 days i.e. less than one year). They are issued at a discount to the face value, and on maturity the face value is paid to the holder. The rate of discount and the corresponding issue price are determined at each auction.

Question 3.

(a) State the differences between futures and options. **[5]**

Answer:

The key difference between futures and options is that the former involve obligations, whereas the latter confer rights. Futures are a Contractual obligation to buy and sell at an agreed price at a future date. The contract terms are standardised by futures exchanges and the obligation from both buyer and seller, is confirmed when the initial margin, or deposit, changes hands. An option does not carry the same obligations.

The fundamental differences between Futures and Option are tabulated below:

Futures	Options
1. Both the parties are obliged to perform the Contract.	1. Only the seller (writer) is obliged to perform the contract.
2. No premium is paid by either party.	2. The buyer pays the seller (writer) a premium.
3. The holder of the contract is exposed to the entire spectrum of downside risk and has potential for all the upside return.	3. The buyer's Loss is restricted to downside risk to the premium paid but retains upward indefinite potential.
4. The parties of the contract must perform at the settlement date. They are not obligated to perform before the date.	4. The buyer can exercise option any time prior to the expiry date.

(b) Bonds of Tuxedo Tech Ltd., an Engineering Company which carries AA rating with 5 years to maturity and 14.50% coupon rate, payable annually, is being traded at ₹ 1015.50. You as a Fund Manager of the Trust Fund, a 80% Debt fund, want to ascertain the intrinsic Value and take a decision accordingly. Face Value of the bond is ₹ 1000. Your Asset Management Company has laid down the guideline that for AA rated Instruments, the discount rate to be applied is 364 day T - Bill rate+4%. (Assume the 364 day T-Bill rate to be 10%).

You are required to:

(i) Calculate the Intrinsic value of the Bond.

(ii) Calculate the current yield (CY) and the yield to Maturity of the bond (YTM).

Note: (I) Ignore Flotation Costs and transaction costs,

(II) Extracted from the table of PV:

Interest rate	10%	11%	12%	13%	14%	15%
PVIFA (5 years)	3.791	3.696	3.605	3.517	3.433	3.352
PVIF (5 years)	0.621	0.593	0.567	0.543	0.519	0.497

[3+2+2]

Answer:

(i) Calculation of Intrinsic Value of the Bond

Appropriate discount rate for valuing the Bond is: R= 10+4 = 14%

Cash Flows:

Years		P.V. Factor @ 14%	Present Value

1-5	Interest ₹ 145 annually for 5 years	3.433	497.78
5	Maturity Value: ₹ 1000	0.519	519.00
	Intrinsic Value per bond (P_0)		1016.78

Since the Current Market Value is less than the intrinsic value of Bond, the Bond is under priced. The Bond should be bought.

(ii) Calculation of current yield (YC):
(145÷1,015.50) x 100 = 14.28%

Calculation of YTM:
Since when discounted at 14%, the value is ₹ 1016.78 (more than ₹ 1015.50)
At the 15% discount rate:
P_0 = 145x PVIFA (15%, 5years) + 1,000 × PVIF (15%, 5years)
=₹ 145 x 3.352 + ₹ 1,000 x 0.497= ₹ 486.04 + ₹ 497= ₹ 983.04
As we found (i) P_0 = ₹ 1,016.79

$$\text{YTM} = 14+(15-14)\text{x}\frac{1016.79-1015.50}{1016.79-983.04}$$

$$\text{BY Interpolation} = 14+1\times\frac{1.29}{33.75} = 14.04\%$$

Yield to Maturity (YTM) = 14.04%.

(c) The market received rumour about Prudential Pharma Ltd's tie up with a multinational company. This has included the market price to move up. If the rumour is false, Prudential Pharma Ltd.'s stock price will probably fall dramatically. To protect from this Ms. Kritika, an investor has bought the call and put options.

She purchased a 3 - month call option for 100 Stocks in Prudential Pharma Ltd. at a premium of ₹ 12 per stock with an exercise price of ₹ 250. She also purchased a 3 - month put option for 100 stocks of the said company at a premium of ₹ 6 per stock with an exercise price of ₹ 240.

Required:

(i) Determine the Investor's (Kritika) position if the tie up offer bids the price of Prudential Pharma Ltd's stock up to ₹ 260 in 3 months.

(ii) Determine the Investor's (Kritika) position if the tie up programme fails and the price of stock falls to ₹ 215 in 3 months. [3+3]

Answer:

Cost of Call and put options:
[(₹ 12 x 100) + (₹ 6 x 100)] = ₹ 1,800

(i) Position if price increases to ₹ 260:

Particulars	₹
Cost of Options	(1,800.00)
Since Market Price is higher than the strike price of put option, Investor may not exercise the put but she will exercise call option.	

Gain on Call : (spot price on expiry date – Exercise price) i.e. (₹ 260 - ₹ 250) × 100 Stocks	1,000.00
Net Profit / (Loss)	(800.00)

(ii) Position if price increases to ₹ 215

Particulars	₹
Cost of Options	(1,800.00)
Since Market Price is lower than the strike price of call option, Investor may not exercise the call but she will exercise put option. Gain on Put : (Exercise price - spot price on expiry date) i.e. (₹ 240 - ₹ 215) × 100 Stocks	2,500.00
Net Profit / (Loss)	700.00

(d) What is Credit Wrapping? [2]

Answer:

Credit wrapping is a technique by which bonds are issued by a company with a poor rating can be shored up with the assistance of an institution with a strong credit rating. It involves the institution agreeing to underwrite a proportion of the amount payable in the event of default at the time of redemption. In many cases it is the only way in which poorly rated companies can issue bonds.

Question 4.

(a) Sun Mutual Fund Ltd. promoted an open-ended equity oriented scheme in 2007 with two plans-Dividend Re-investment Plan (Plan-D) and a Bonus Plan (Plan-B). The face value of the units was ₹ 10 each. Ms. Adita invested ₹ 2,00,000 each on 1.4.2009 in Plan-D and Plan-B respectively, when the NAV was ₹ 38.20 for Plan-D and ₹ 35.60 for Plan-B. Ms. Adita redeemed her units in Plan–D and Plan-B respectively on 31.03.2014. Particulars of dividend and bonus declared over the period were as follows:

			Net Asset Value (₹)	
Date	**Dividend (%)**	**Bonus ratio**	**Plan-D**	**Plan-B**
30.09.2009	10	—	39.10	35.60
30.06.2010	—	1:5	41.15	36.25
31.03.2011	15	—	44.20	33.10
15.09.2012	13	—	45.05	37.25
30.10.2012	—	1:8	42.70	38.30
27.03.2013	16	—	44.80	39.10
11.04.2013	—	1:10	40.25	38.90
31.03.2014	—	—	40.40	39.70

You are required to:
Calculate the Annual rate of return in respect of Plan-D and Plan-B for Ms. Adita.
Note: Ignore: (i) Income Tax of Capital gains
(ii) Security Transaction Tax (STT). [5+5]

Answer:

Sun Mutual Fund Ltd.

1. PLAN-D (Dividend Re-investment Plan)

Date	Particulars	No. Of Units	NAV (₹)

01.04.2009	Purchase for ₹ 2,00,000 (₹ 2,00,000÷38.20)	5,235.602	38.20
30.09.2009	Dividend @10% (5,235.602 ×₹ 1.0) ÷ ₹ 39.10 Balance	133.903 5,369.505	 39.10
31.03.2011	Dividend @15% (5,369.505 × ₹ 1.5) ÷ ₹ 44.20 Balance	182.223 5,551.728	 44.20
15.09.2012	Dividend @13% (5,551.728 × ₹ 1.3) ÷ ₹ 45.05 Balance	160.205 5,711.933	 45.05
27.03.2013	Dividend @16%(5,711.933 ×₹ 1.60) ÷ ₹ 44.80 Balance	203.998 5,915.931	 44.80
31.03.2014	Balance	5,915.931	40.40

Redemption Value (as on 31.03.2014): 5915.931 × ₹ 40.40 = ₹ 2,39,003.61
Investment ₹ 2,00,000.00
Return ₹ 39,003.61

Net Proceeds: ₹ 2,39,003.61

Calculation of Annual Rate of Return:
Net proceeds discounted at annual growth rate of 3% i.e. [PVIF (3%, 5years)]
0.86261× ₹ 2,39,003.61 = ₹ 2,06,166.90
Net proceeds discounted at annual growth rate of 4% [PVIF (4%, 5 years)
0.82193× ₹ 2,39,003.61 = ₹ 1,96,444.24

Therefore, Annual Rate of Return:
3 + [(2,06,166.90 - 2,00,000) ÷ (2,06,166.90 - 1,96,444.24)×1]
= 3 + (6,166.90 ÷ 9,722.66) × 1 = 3.63% (by Interpolation)

2. PLAN-B (Bonus Plan):

Date	Particulars	No. of Units	NAV (₹)
01.04.2009	Purchase for ₹ 2,00,000	5617.978	35.60
30.06.2010	Bonus Units:(5,617.978÷5)×1 Balance	1123.596 6741.574	 36.25
30.10.2012	Bonus Units:(6,741.574÷8)×1 Balance	842.697 7584.271	 38.30
11.04.2013	Bonus Units:(7584.271÷10)×1 Balance	758.427 8342.698	 38.90
31.03.2014	Balance	8342.698	39.70

Redemption Value (as on 31.03.2014): 8342.698 × ₹ 39.70= ₹ 3,31,205.11
Investment ₹ 2,00,000.00
Return ₹ 1,31,205.11

Net Proceeds: ₹ 3,31,205.11

Calculation of Annual Rate of Return:
Net proceeds discounted at annual growth rate of 10% i.e. [PVIF (10%, 5years)]
0.62092 × ₹ 3,31,205.11 = ₹ 2,05,651.88
Net proceeds discounted at annual growth rate of 11% i.e. [PVIF (11%, 5years)]
0.59345× ₹ 3,31,205.11 = ₹ 1,96,553.67

Therefore, Annual Rate of Return:
= 10 + [(2,05,651.88 – 2,00,000)÷(2,05,651.88 – 1,96,553.67)]×1
= 10 + (5,651.88÷9,098.21)×1=10+0.62=10.62% (by Interpolation)

(b) Discuss about the two categories of underwriters in India. [4]

Answer:
Categories of underwriters in India:
The underwriters in India may be classified into two categories:
- Institutional underwriters
- Non-institutional underwriters

The institutional underwriters are:
- Life Insurance
- Corporation of India (LIC)
- Unit Trust of India (UTI)
- Industrial Development Bank of India (IDBI)
- Industrial Credit and Investment Corporation of India (ICICI)
- Commercial Banks and general insurance companies.

The pattern of underwriting of the above institutional underwrites differs vastly in India. LIC and UTI have purchased industrial securities from the new issue market with a view to hold them on their own portfolio. They have a preference for underwriting shares in large and well established firms. The development banks have given special attention to the issues in backward states and industries in the priority list. The thrust of the development banks is also towards small and new issues which do not have adequate support from other institutions. General insurance companies have shown preference in underwriting the securities of fairly new issues.

The non-institutional underwriters are brokers. They guarantee shares only with a view to earn commission from the company floating the issue. They are known to - off load the shares later to make a profit. The brokers work profit motive in underwriting industrial securities.

(c) State the features of Venture Capital. [6]

Answer:

Features of venture capital:
1. Venture capital is usually in the form of an equity participation. It may also take the form of convertible debt or long term loan.
2. Investment is made only in high risk but high growth potential projects.
3. Venture capital is available only for commercialization of new ideas or new technologies and not for enterprises which are engaged in trading, booking, financial services, agency, liaison work or research and development.
4. Venture capitalist joins the entrepreneurs as a co-promoter in project and shares the risks and rewards of the enterprise.
5. There is continuous involvement in business after making an investment by the investor.
6. Once the venture has reached the full potential the venture capitalist disinvests his holdings either to the promoters or in the market. The basic objective of investment is not profit but capital appreciation at the time of disinvestment.

7. Venture capital is not just injection of money but also an input needed to setup the firm, design its marketing strategy and organize and manage it.
8. Investment is usually made in small and medium scale enterprises.

SECTION II (40 Marks)

(Corporate Laws)

Answer Question No.5 (compulsory) and also answer any two from the rest in this Section.

Question 5.

(a) Fill in the Blanks in the following sentences by using appropriate word(s)/ phrase(s)/ number(s): [1x6]

(i) In case of an appointment of directors, normally the names of the first directors are mentioned in the _______________ of a company.

(ii) Proper Authority, Notice, Chairman, Minutes and __________ are the essentials of a valid meeting.

(iii) ___________________ resolution is required in case of alteration of memorandum for changing the place of registered office from one State to other with the permission of the Tribunal.

(iv) The Right to Information Act, 2005 extends to the whole of India except the State of ___________________.

(v) As per the Competition Act, 2002 ________________ includes an association of producers, sellers, distributors, traders or service providers who, by agreement amongst themselves, limit, control or attempt to control the production, distribution, sale or price of, or, trade in goods or provision of services.

(vi) Accounting Standard -14 classifies amalgamation into two types, viz amalgamation in nature of purchase and amalgamation in nature of _______________.

Answer:

(i) Articles of Association

(ii) Quorum

(iii) Special

(iv) Jammu and Kashmir

(v) Cartel

(vi) Merger

(b) Choose the most appropriate one from the stated options and write it down (only indicate A, B, C or D as you consider correct): [1×4]

(i) If in a general meeting of a Company, a matter could not be resolved because of tie, then —

(A) Meeting will be adjourned;
(B) Meeting will be postponed;
(C) Chairman of the meeting can give his second/casting vote;
(D) Managing Director can give his casting/second vote.

(ii) In the context of classification of Risks, Natural risks like fires, floods, earthquakes, etc. fall under:
(A) Liquidity risks;
(B) Disaster Risks;
(C) Systems Risks;
(D) Industry and Services Risks.

(iii) The concept of Corporate Governance was initiated on the recommendation of the report by:
(A) Mr. Narayana Murthy;
(B) Mr. Kumar Mangalam Birla;
(C) Dr. Y.V. Reddy;
(D) None of the above.

(iv) When a person seeks information under the RTI Act with an eligible company, the same shall be dealt with by the following officer of the company:
(A) Public Information Officer;
(B) CEO;
(C) HR Manager;
(D) None of the above.

Answer:

(i)	(C)
(ii)	(B)
(iii)	(B)
(iv)	(A)

Question 6.

(a) "Corporate governance is merely the set of processes, customs, policies, laws and institutions affecting the way a corporation is directed, administered or controlled". Critically examine this statement. [5]

Answer:

To say that Corporate Governance is merely the set of processes, customs, policies, laws and institutions affecting the way a corporation is directed, administered or controlled, depicts a narrow view. It is much more than this. Corporate Governance also includes the relationships among the many stakeholders involved and the goals for which the corporation is governed. The principal stakeholders are the shareholders, management and the board of directors. Other stakeholders include employees, suppliers, customers, banks and other lenders, regulators, the environment and the community at large.

The stakeholders may be internal stakeholders (promoters, members, employees, management and the board of directors) and external stakeholders (suppliers, customers, lenders, banks, the environment and the community at large, government and regulators.)

Corporate governance is a voluntary ethical code of business of companies. According to Cadbury Committee on financial aspects of corporate governance, it is the system by which companies are directed and controlled. The Board of directors are responsible for the governance of their companies. The shareholders role in the governance is to appoint the

directors and the auditors and to satisfy themselves that an appropriate governance structure is in directed and controlled. The Board of directors is responsible for the governance of their companies. The shareholders role in the governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place.

(b) The Competition Commission has served notice on VIPUL PAINTS LTD. to look into alleged contravention of certain provisions. The company wants to object to the same on the ground that the same was consequent to a complaint made by the State Government, which is not in order. Advise the company suitably. [4]

Answer:
Inquiry into certain agreements and dominant position of enterprise:

As per section 19 (1) of the Competition Act, 2002, the Competition Commission may inquire into any alleged contravention of the provisions contained in subsection (1) of section 3 or sub-section (1) of section 4 either on its own motion or on –

(a) receipt of a complaint, accompanied by such fee as may be determined by regulations, from any person, consumer or their association or trade association ; or
(b) a reference made to it by the Central Government or a State Government or a statutory authority.

It can be seen from above that a State Govt. can refer the matter to Competition Commission. Hence the company cannot raise an objection that the Competition Commission cannot enquire into the alleged violations on the strength of reference made by the State Government. Advice should be tendered on the above lines.

(c) In the context of Assessing Control Risk, describe the words, "Control risk at the maximum" and "Control risk at less than the maximum". [3+3]

Answer:

Control risk at the maximum:
- Conclusion based upon the auditor's judgment that the client's internal control policies and procedures do not reduce to a low level the potential that the financial statements are free of material errors and or irregularities.
- After reaching this assessment the auditor would only be required to document in his/her work papers the fact that control risk is at the maximum and not the basis for reaching this conclusion.
- The auditor may decide control risk is at the maximum based upon management accounting technique called cost benefit decisions.

Control risk at less than the maximum:
- Based upon his/her initial understanding of the internal control components, the auditor may conclude that control risk may be less than the maximum.
- The auditor in this situation must evaluate the cost/benefit of extending his/her understanding of internal controls to make a final decision concerning control risk.

- The cost/benefit decision is based upon the audit time involved in extending the auditor's understanding of internal controls, including tests of control, versus the time that may be saved with the possible reduction of substantive audit tests.

Question 7.

(a) Mr. Adam a 15% shareholder of a company and other shareholders have lost confidence in the Managing Director (MD) of the company. He is a director not liable to retire by rotation and was re-appointed as Managing Director for 5 years w.e.f. 01.04.2014 in the last Annual General Meeting of the company.

Mr. Adam seeks your advice to remove the MD after following the procedure laid down under the Companies Act, 1956:

(i) Specify the steps to be taken by Mr. Adam and the company in his behalf;

(ii) Draft a suitable resolution to be passed for removal of MD; [5+2]

Answer:

(i) Under Section 284 of the Companies as Act, 1956, a company may, by ordinary resolution, remove a director before the expiry of his tenure. However this section does not apply to a director appointed by the central Govt. under Sec 408. For the purpose, special notice from a shareholder (Mr. Adam in the present case) shall be required to be given to the company for moving a resolution to remove a director. On receipt of notice, the company shall forthwith send a copy thereof to the director concerned (MD in the present case) and he shall be entitled to be heard on the proposed resolution at the meeting. Copy of the representation, if any, made by the director be also sent to all members of the company to whom notice of the general meeting is normally sent. In case, the representation is received too late, the same shall be read at the meeting. The representation need not be sent if the Company Law Board is satisfied that it will cause needless publicity for defamatory matter. Under Section 190, special notice of the intention to move the resolution shall be given not less than 14 days before the meeting. In the present case, if the AGM is due to be held, Mr. Adam may send the special notice 14 days before the AGM. Otherwise, he may request the company to convent Extra-ordinary General Meeting under section 169 of the Companies as Act, 1956 for consideration of the special notice and resolution for removal of MD. He already holds more than 10% shares in the company. Once the ordinary resolution is passed in the general meeting, MD will cease to be a director of the company and consequently MD of the company.

(ii) Mr. Adam may give special notice of his intention to move the following resolution, as ordinary resolution: "RESOLVED THAT Mr........... Managing Director of the Company be and is hereby removed as a director of the company under Section 284 of the Companies Act, 1956 with immediate effect."

(b) State some of the procedures which an auditor has to follow in order to evaluate going concern uncertainties. [6]

Answer:

Evaluating the going concern uncertainties:

In Order to evaluate various going concern uncertainties an Auditor needs to follow certain procedures which may include:

1) Analyze and discuss cash flow, profit and other relevant forecasts with management.

2) Review events occurring after the balance sheet date for items affecting the entity's ability to continue as a going concern.
3) Analyze and discuss the entity's latest available interim financial statements.
4) Review the terms of debentures and loan agreements and determine whether any have been breached.
5) Read minutes of the meeting of shareholders, the board of directors and important committees for reference to financing difficulties.
6) Review the status of matters under litigation and claims.
7) Confirm the existence legality and enforceability of arrangements to provide or maintain financial support with related and third parties and assess the financial ability of such parties to provide additional funds.
8) Consider the entity's position concerning unfilled orders.

(c) State the meaning of 'Compromises' as per the Companies Act, 1956. [2]

Answer:

Compromises: This term means settlement or adjustments of claims in dispute by mutual concessions. Thus in other words, compromise pre supposes the existence of a dispute and it means settlement of the same by give and take policy. Compromise does not mean one-sided settlement but involves mutual sacrifices and concessions.

Question 8.

(a) List out the general duties of directors. [5]

Answer:

a) Fiduciary Duties: There is a fiduciary relationship between the company and the directors. Hence the directors have to perform duties, which are of fiduciary nature. These duties include —

- Exercising their powers honestly and bona fide for the benefit of the company as a whole and
- Not to place themselves in a position in which, there is a conflict between their duties to the company and their personal interests. They must not make any secret profits out of their position. If they indeed make any secret profits, they will have to account for it to the company.
- These duties are owed to the company and not to the individual shareholders.

b) Duties of care, skill and diligence: Directors should carry out their duties with reasonable care and exercise such degree of skill and diligence as is reasonable expected of persons of their knowledge. The standard of care, skill and diligence depends upon the nature of company's work, business and circumstances of the case.

c) Other duties of directors include attending Board meetings as well as to disclose his interest in a contract and not to delegate his functions except to the extent authorized by the Act or the constitution of the company.

(b) The Memorandum of Association of a company was presented to the Registrar of Companies for registration and the Registrar issued the certificate of incorporation. After complying with all the legal formalities the company started a business according to the object clause,

which was clearly an illegal business. The company contends that the nature of the business cannot be gone into as the certificate of incorporation is conclusive. The company's contention is correct or not? [3]

Answer:

The company's contention is not correct. Since, as per Section 35 of the Companies Act, 1956 the certificates of incorporation is conclusive, but not memorandum, and accordingly any illegal object contained in the object clause of memorandum does not become a legal object because of operation of Section 35. Thus, if the business carried on by the company is an illegal one, the company, its directors, officers shall be liable for penalties as per law, and it shall not be a defence for the company that such business is contained in the memorandum of association.

(c) State some of the situations where the office of the director shall become vacant as per section 283 of the Companies Act, 1956. [7]

Answer:

According to section 283 of the Companies Act, 1956 the office of the director shall become vacant if:

(i) If he fails to hold the qualification shares if any required by the articles of association of the company, within two months of his appointment.

(ii) He is adjudicated to be of unsound mind.

(iii) He has applied to be adjudicated as an insolvent

(iv) He is convicted by a Court of any offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than six months

(v) He fails to pay any call in respect of shares of the company held by him within six months from the last date fixed for the payment of the call.

(vi) He absents himself from 3 consecutive meetings of the Board of directors or from all meetings of the Board for a consecutive period of 3 months, whichever is longer, without obtaining leave of absence from the Board.

(vii) He fails to make disclosures to the Board of directors with regard to any contracts with the company, in which he is directly or indirectly interested.

(viii) He becomes disqualified by an order of the Tribunal from being a director on the ground of having been convicted of an offence in connection with the promotion, formation or management of the company or found guilty of fraud or misfeasance in relation to its winding up proceedings

(ix) He is removed before the expiry of his period of office by an ordinary resolution.

(x) Having been appointed a director by virtue of his holding any office or employment in the company, he ceases to hold such office or other employment in the company.