Paper-11 Capital Market Analysis & Corporate Laws

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

Working notes should form part of the answers.

Section I

(Capital Market Analysis)

Answer **Question No.1** (carrying 20 marks) which is compulsory and answer **any two** (carrying 20 marks each) from the rest in this section

Question 1.

(a) In each of the cases given below, one out of four is correct. Indicate the correct answer (= 1 mark) and give workings/ reasons briefly in support of your answer (=1 mark) [7 × 2]

(i) Consider two stocks P and Q:

Particulars	Expected Return(%)	Standard Deviation(%)
Stock P	16%	25%
Stock Q	18%	30%

The returns on the two stocks are perfectly negatively correlated.

What is the expected return of a portfolio constructed to drive the standard deviation of portfolio return to zero?

A. 16.48%;
B. 16.91%;
C. 8.72%;
D. 8.19%.

(ii) If the sale price of an open ended fund is ₹ 12.30 per unit and the fund is sold with a front end load of 5%, what is the NAV?

A. ₹ 10.00;
B. ₹ 9.75;
C. ₹ 11.71;
D. ₹ 11.07.

(iii) A company issue commercial paper for ₹ 3 crore with a maturity period of 90 days. The interest rate is 11% p.a. The net amount received by the company will be (approx.):

A. ₹ 2.94 crore;
B. ₹ 2.85 crore;
C. ₹ 2.87 crore;
D. ₹ 2.92 crore.

(iv) The Beta co-efficient of equity stock of Reeva Ltd. is 1.6. The risk free rate of return is 12% and the required rate of return is 18% on the market portfolio. What is the expected rate of return (based on CAPM)?

A. 21.6%;
B. 23.8%;
C. 2.4%;
D. 60%.

(v) Nifty Index is currently quoting at 1329.78. Each lot is 250. Mr. Bose purchases an April contract at 1364. He has been asked to pay 10% initial margin. What is the amount of initial margin?

A. ₹ 33,244.00;
B. ₹ 136.40;
C. ₹ 132.97;
D. ₹ 34,100.00.

(vi) Consider the following information related to a bond :

Par value	₹ 1,000
Time to maturity	20 years
Coupon rate (interest payable annually)	10%
Current market price	₹ 851
Yield to maturity (YTM)	12%

Other things remaining the same, if the bond starts paying interest semi-annually, then the change in the market price of the bond will be approximately:

A. -0.2%;
B. -0.1%;
C. +0.1%;
D. +0.2%.

(vii) Determine the beta for the following portfolio :

Stock	% of portfolio	Beta
1	45	1.20
2	20	0.75
3	35	1.00

A. 1.05;
B. 1.04;
C. 1.40;
D. 1.50.

(b) Choose the most appropriate alternative from the stated options and write it down: [6 × 1]

(i) A special contract under which the owner of the contract enjoys the right to buy or sell without the obligation to do so is called —

A. Forward;
B. Option;
C. Spot;
D. Future.

(ii) An issue where an allotment is made to less than 50 persons, is called —

A. Rights Issue;
B. Bonus Issue;

C. Bought out deal;
D. Private Placement.

(iii) As the business cycle enters the initial phase of economic recovery the stock prices generally:
A. Decline;
B. Maintain the same trend as before;
C. Rise;
D. Rise to an extent and then take a downturn.

(iv) Fair value of an option represents:
A. Intrinsic value of the option;
B. Time value of the option;
C. Both;
D. None of the above.

(v) A shareholder has received bonus shares in the proportion of 1:1. What is her stockholding in the company (indicate the most appropriate alternative)?
A. Stakeholding remains the same;
B. Stakeholding has gone up with more shares available for trading;
C. Stakeholding has gone up;
D. Stakeholding remains the same with more shares available for trading.

(vi) The contract of insurance is required to fulfill certain principles of insurance. From below mentioned alternative find which of them is not the principle of insurance:
A. Insurable Interest;
B. Proximate Cause;
C. Market Risk;
D. Subrogation.

Answer to Question 1(a):

(i) B. 16.91%

The weights that drive the standard deviation of portfolio to zero, when the returns are perfectly negatively correlated, are:

$W_p = \sigma_Q / \sigma_P + \sigma_Q$
= 30 / 25 + 30
= 0.545
The expected return of the portfolio is:

0.545 x 16% + 0.455 x 18%
= 16.91%.

(ii) C. ₹11.71

Sale Price = NAV (1 + Load%)
Therefore NAV = Sale Price / (1 + Load%) = ₹ 12.30/1.05 = ₹ 11.71 Approx.

(iii) D. ₹ 2.92 crore

11% p.a. interest for 90 days on ₹ 1.

= 0.11 x 90/365 = 0.027123

Amount after 90 days : 1.027123

Net amount received $= \dfrac{₹\,3{,}00{,}00{,}000}{1.027123}$

= 2,92,07,797 i.e. ₹ 2.92 crore (approx.)

(iv) A. 21.6%

Expected rate of return: (By applying CAPM)

$R_e = R_f + \beta_i\,(R_m - R_f)$

= 12% + 1.6 (18% –12%)

= 12% + 9.6%

= 21.6%

(v) D. ₹ 34,100.00

The closing price for the spot index was 1329.78. The rupee value of stocks is thus 250 x 1329.78 = ₹ 3,32,445.00

The closing futures price for the April contract was 1364.00, which has a rupee value of 1364 x 250 = ₹ 3,41,000.00 and therefore requires a margin of ₹ 34,100.

(vi) A. -0.2%

The equation expressing the relationship between market price of the bond and YTM is as follows:

$P_0 = C_0 \times PVIFA_{(k,n)} + F \times PVIF_{(k,n)}$

Substituting the given value in the equation, we get

$P_0 = 50 \times PVIFA_{(6\%,40)} + 1{,}000 \times PVIF_{(6\%,40)}$

$= 50 \times 15.046 + 1{,}000 \times 0.097 = ₹\ 849.30$

Therefore, the change in market price = ₹ (849.30 – 851.00)/₹ 851 = -0.199% = -0.2%

(vii)B. 1.04

Portfolio beta:

(0.45 x 1.20) + (0.20 x 0.75) + (0.35 x 1.00) = 1.04

Answer to Question 1(b):

(i) B. Option
(ii) D. Private Placement
(iii) A. Decline
(iv) C. Both
(v) D. Stakeholding remains the same with more shares available for trading.
(vi) C. Market Risk

Question 2.

(a) "There are differences in approach, attitude and areas of operations between commercial banks and merchant banks." — State those differences between commercial banks and merchant banks.

(b) There are certain assumptions of Capital Asset Pricing Model. Write any six of them.

(c) Six Mutual Funds experienced the following results during a 7 year period:

Mutual Funds	Average Annual Return	Standard Deviation	Correlation with Market
A	18.4%	27.0%	0.81
B	14.8%	18.0%	0.65
C	15.1%	8.0%	0.98
D	22.0%	21.2%	0.75
E	-9.0%	4.0%	0.45
F	26.5%	19.3%	0.63
Market	13.0%	12.0%	
Risk Free Rate	9.0%		

(i) Rank these portfolios using Sharpe's method, and Treynor's method.

(ii) Compare the ranking in part (i) and explain the reasons behind the differences.

[3+6+(9+2)]

Answer:

(a) The differences between merchant banks and commercial banks are summarized below:

1. Commercial banks basically deal and debt related finance and their activities are appropriately arrayed around credit proposal, credit appraisal and loan sanctions. On the other hand, the area of activities of merchant bankers is "equity and equity related". They deal with mainly funds raised through money market and capital market.

2. Commercial banks are asset oriented and their lending decisions are based on detailed credit analysis of loan proposals and the value of security offered against loans. They generally avoid risks. The merchant bankers are management oriented. They are willing to accept risk of business.

3. Commercial bankers are merely financiers. The activities of merchant bankers include project counselling, corporate counselling in areas of capital restructuring, amalgamations, mergers, takeover etc, discounting and rediscounting of short term paper in money markets, managing, underwriting and supporting public issues in new issue market and acting as brokers and advisers on portfolio management in stocks exchange. Merchant banking activities have impact on growth, stability and liquidity of money markets.

(b) Because the CAPM is a theory, we must assume for argument that —

1. All assets are infinitely divisible
2. All investors in the world collectively hold all assets
3. All assets in the world are traded
4. For every borrower, there is a lender
5. There is a riskless security in the world
6. All investors borrow and lend at the riskless rate

(c) Sharpe Index = $\frac{\text{Rp - Rf}}{\sigma}$

$A = \frac{18.4\% - 9\%}{27\%} = 0.3481$	IV
$B = \frac{14.8\% - 9\%}{18\%} = 0.3222$	V
$C = \frac{15.1\% - 9\%}{8\%} = 0.7625$	II
$D = \frac{22\% - 9\%}{21.2\%} = 0.6132$	III
$E = \frac{-9\% - 9\%}{4\%} = (-)4.5$	---
$F = \frac{26.5\% - 9\%}{19.3\%} = 0.9067$	I

Treynor's method = $\frac{\text{Rp - Rf}}{\beta}$

Calculation of β

$$\beta = \frac{\sigma_{sec} \times r_{sec\&mkt}}{\sigma_{mkt}}$$

$$\beta_A = \frac{27 \text{ x } 0.81}{12} = 1.8225$$

$$\beta_B = \frac{18 \text{ x } 0.65}{12} = 0.975$$

$$\beta_C = \frac{8 \text{ x } 0.98}{12} = 0.6533$$

$$\beta_D = \frac{21.2 \text{ x } 0.75}{12} = 1.325$$

$$\beta_E = \frac{4 \text{ x } 0.45}{12} = 0.15$$

$$\beta_F = \frac{19.3 \text{ x } 0.63}{12} = 1.0132$$

	Rank
$A = \frac{18.4\% - 9\%}{1.8225} = 5.158$	V

$$B = \frac{14.8\% - 9\%}{0.975} = 5.949 \qquad \text{IV}$$

$$C = \frac{15.1\% - 9\%}{0.6533} = 9.337 \qquad \text{III}$$

$$D = \frac{22\% - 9\%}{1.325} = 9.811 \qquad \text{II}$$

$$E = \frac{-9\% - 9\%}{0.15} = (-)120 \qquad \text{---}$$

$$F = \frac{26.5\% - 9\%}{1.0132} = 17.272 \qquad \text{I}$$

Reason for Difference in Ranking

Sharpe Index considered standard deviation or total risk as its measure of risk whereas Treynor index considered only the systematic risk as its measure of Risk.

Treynor Index gives Importance to correlation of security & market and establishes a link through correlation between market risk and security risk where as Sharpe index considered only the security S.D.

Portfolio 'C' is ranked II in Sharpe Index but pushed back to IIIrd position as per Treynor Index owing to the reason of correlation effect. The same is also evident in Portfolio A & B.

Question 3.

(a) What are the various risks associated with derivatives? State those in few sentences.

(b) What is Bought Out Deal (BOD)? Write down its advantages from different perspectives.

(c) Mr. Zed established the following spread on the Puri Corporation's stock: (i) Purchased one 2-month call option with a premium of ₹ 30 and an exercise price of ₹ 550. (ii) Purchased one 2-month put option with a premium of ₹ 5 and an exercise price of ₹ 450.

Puri Corporation's stock is currently selling at ₹ 500. Determine profit or loss, if the price of Puri Corporation's:

(i) remains at ₹ 500 after 2 months.

(ii) falls at ₹ 350 after 2 months.

(iii) rises to ₹ 600.

Assume the option size is 100 shares of Puri Corporation.

(d) What is Financial Futures?

[5+8+6+1]

Answer:

(a) Various risks associated with derivatives are as follows:

(i) Market Risk – Price sensitivity to fluctuations in interest rates and foreign exchange rates.

(ii) Liquidity Risk – Most derivatives are customized instruments, hence may exhibit substantial liquidity risk.

(iii) Credit Risk – Derivatives trades not traded on exchange are traded in the Over the Counter (OTC) markets. OTC contracts are subject to counter party defaults.

(iv) Hedging Risk – Derivatives are used as hedges to reduce specific risks. If the anticipated risks do not develop, the hedge may limit the funds total return.

(v) Regulatory Risk – Owing to the high risk characteristics inherent in the derivatives market, the regulatory controls is sometimes too oppressive for market participants.

(b) Bought Out Deal (BOD) is a process of investment by a sponsor or a syndicate of investors/sponsors directly in a company. Such direct investment is being made with an understanding between the company and the sponsor to go for public offering in a mutually agreed time. Bought out deal, as the very name suggests is a type of wholesale offer of equities by a company. A company allots shares in full or in lots to a sponsors at a price negotiated between the company and the sponsor(s). After a particular period of agreed upon between the sponsorer and the company the shares are issued to the public by the sponsorer with a premium. The holding cost of such shares by the sponsor may either be reimbursed by the company or the sponsor may absorb the profit in part or full as per the agreement, arising out of the public offering at a premium. After the public offering the shares are listed in one or more stock exchanges.

Bought out deal is not only advantageous to the company going for it but also to the sponsors and common investors, such as —

1. The company has the advantage of using the fund immediately without waiting as in the case of direct public issue. In case of BOD the company instantly gets funds and is able to focus its attention on project implementation without worrying for source of investment. Bought out deals are ideally suited in circumstances when money needs to be arranged fast without which the project may suffer. Lowering or eliminating issue cost from the preliminary expenses is another advantage to the company.
2. The time taken to raise money in the capital market by a company takes as much as six months and this time is very high for a company in an infancy stage. The waste of time in the initial stage can be avoided by going for BOD.
3. In case of a new and untried product it is easier to convince an investment banker for an investment in the company rather than the general public. Hence BOD is an innovative method of financing for such companies.
4. When the market sentiment is low and the secondary market is undergoing a bear phase, a company may not like to come to the market with a public issue. In such case BOD is a superior process to get fund for the company.
5. The merchant bankers also gain handsomely from a BOD. The merchant banks expect a return of around 30% from a BOD whereas private financing institutions expect a return of 40% to 60% from a BOD. The gains can be tremendous provided the sponsors select proper issues and price it attractively to the investors.

6. The investors also gain from the BOD in a way that they get good issues where some merchant banker has already invested in it. The common investors do not have enough scope and information for proper evaluation of a company. The merchant bankers are professionals and can make proper appraisal of a company.

(c) (i) Total premium paid on purchasing a Call and Put Option
= (₹ 30 per share x 100) + (₹ 5 per share x 100)
= ₹ 3,000 + ₹ 500 = ₹ 3,500

In this case, Zed exercises neither the call option nor the put option as both will result in a loss for him.

Ending Value = - ₹ 3,500 + zero gain

= - ₹ 3,500

i.e., Net Loss = ₹ 3,500

(ii) Since the price of the stock is below the exercise price of the call, the call will not be exercised. Only put is valuable and is exercised.

Total Premium paid = ₹ 3,500

Ending Value = - ₹ 3,500 + ₹ [(450 - 350) x 100] = - ₹ 3,500 + ₹ 10,000

= ₹ 6,500

∴ Net Gain = ₹ 6,500

(iii) In this situation, the put is worthless, since the price of the stock exceeds the put's exercise price. Only call option is valuable and is exercised.

Total Premium paid = ₹ 3,500

Ending Value = - ₹ 3,500 + [(₹ 600 - ₹ 550) x 100]

Net Gain = - ₹ 3,500 + ₹ 5,000 = ₹ 1,500

(d) Financial Futures are those where the underlying is a financial asset such as foreign exchange, interest rates, shares, treasury bill or stock index.

Question 4.

(a) What are the sources from where a company can purchase its own shares?

(b) Why junk bonds are often called as speculative-grade bond? Also state the usefulness of this bond.

(c) What are the factors that affect the value of a call option?

(d) Mr. Mukherjee is considering investment in the shares of PB Ltd. He has the following expectations of return on the stock and the market:

Probability	Return (%)	
	PB	Market
0.35	30	25
0.30	25	20
0.15	40	30
0.20	20	10

The yield on 182 days T-bills is 8% p.a. You are required to:

(i) Calculate the Expected Return and Risk for PB.
(ii) Calculate the Expected Return and Risk for the Market.
(iii) Find out the Beta Coefficient of the PB shares.

(e) Who is the settlement agent of BSE?

[3+5+5+6+1]

Answer:

(a) A Company can purchase its own shares from —

(i) Free reserves; Where a company purchases its own shares out of free reserves, then a sum equal to the nominal value of the share so purchased shall be transferred to the capital redemption reserve and details of such transfer shall be disclosed in the balance sheet or
(ii) Securities premium account; or
(iii) Proceeds of any shares or other specified securities. A Company cannot buy back its shares or other specified securities out of the proceeds of an earlier issue of the same kind of shares or specified securities.

(b) Junk bonds are corporate bonds with low ratings from major credit rating agencies. High rated bonds are called investment grade bonds; low rated bonds are called speculative-grade bonds or less formally called as 'Junk bonds'. A bond may receive a low rating for a number of reasons. If the financial condition or business outlook of the company is poor, bonds are rated speculative-grade. Bonds are also rated speculative-grade if the issuing company' already has large amounts of debt outstanding. Some bonds are rated speculative-grade; because they are subordinated to other debt i.e. their legal claim on the firm's assets in the event of default stands behind the other claim, so called senior debt.

Junk bonds are traded in a dealer market rather than being traded in stock exchanges. Institutional investors hold the largest share of junk bonds. Firms with low credit ratings are willing to pay 3 to 5 percent more than the investment grade corporate debt to compensate for greater risk. Junk bonds are a high yield security, because of this reason junk bonds are widely used as a source of finance in takeovers and leveraged buy-outs. Junk bonds lie between conventional investment as equities and investment- grade bonds. Junk bonds are riskier than investment-grade bonds but less risky than equity. Junk bonds may have cost or tax advantage that allow for some marginal increase in debt. But these advantages are not likely to induce bondholders to invest in junk bonds more recklessly than other safer debt instruments.

(c) The factors that affect the value of a Call option are:

(i) An increase in stock price causes an increase in the value of a call option.
(ii) An increase in exercise price causes a decrease in the value of a call option.
(iii) An increase in the time to expiration causes an increase in the value of a call option.
(iv) An increase in the risk-free rate causes an increase in the value of a call option.

(v) An increase in variance of stock return causes an increase in the value of a call option.

(d) (i) Expected Return for PB = 30% (0.35) + 25% (0.30) + 40% (0.15) + 20% (0.20) = 28%
Risk for PB shares:

Variance of Returns (σ^2) = $(30 - 28)^2$ (0.35) + $(25 - 28)^2$ (0.30) + $(40 - 28)^2$ (0.15) + $(20 - 28)^2$ (0.20) = 38.50%

Standard Deviation of Returns (σ_i) = $\sqrt{38.50}$ = 6.20%

(ii) Expected return for the market = 25(0.35) + 20(0.30) + 30(0.15) + 10 (0.20) = 21.25%
Risk for Market:

Variance of Returns

(σ^2 m) = $(25 - 21.25)^2$ (0.35) + $(20 - 21.25)^2$ (0.30) + $(30 - 21.25)^2$ (0.15) + $(10 - 21.25)^2$ (0.20)

= 42.2(%) approx.

Standard deviation of Returns (σ m) = $\sqrt{42.2}$ = 6.5% (approx)

(iii)

$$\beta = \frac{Cov(i,m)}{\sigma^2 m}$$

Cov(i,m) = (30 – 28) (25 – 21.25) (0.35) + (25 – 28) (20 – 21.25) (0.30) + (40 – 28) (30 – 21.25) (0.15) + (20 – 28) (10 – 21.25) (0.20) = 37.5%

σ^2 m = 42.2%

$$\therefore \ \beta = \frac{37.5\%}{42.2\%} = 0.89$$

(e) The clearing and settlement operations of the BSE are managed by a company called BOI Share Holding, this is a subsidiary of Bank of India and BSE and is known as Clearing House. All settlements for securities are through the Clearing House on a delivery versus payment (DVP) basis.

Section II

(Corporate Laws)

Answer **Question 5** (carrying 10 marks) which is compulsory and answer **any two** (carrying 15 marks each) from the rest in this section.

Question 5.

(a) Choose the most appropriate alternative from the stated options and write it down: [6 × 1]

(i) In case of an extraordinary general meeting which is called by the Board of Directors, the notice for the meeting should be given for at least:
- A. 17 days;
- B. 19 days;
- C. 21 days;
- D. 14 days.

(ii) As per Section 123(4) of the Companies Act, 2013 the amount of interim dividend shall have to be deposited from the date of declaration of such dividend in a separate bank account within:
- A. Three Days;
- B. Five Days;
- C. Seven Days;
- D. Ten days.

(iii) Which of the following is not a type of debenture:
- A. Secured debenture;
- B. Redeemable debenture;
- C. Sweat debenture;
- D. Bearer debenture.

(iv) Government company means a company in which not less than 51% of the paid-up share capital is held by:
- A. the Central Government;
- B. Any State Government or Governments;
- C. Partly by Central Government and partly by one or more State Governments;
- D. Any of the above.

(v) In the context of Corporate Governance, Narayana Murthy Committee was formed in the year:
- A. 2002;
- B. 2003;
- C. 2004;
- D. 1999.

(vi) Under Competition Act, 2002, penalty for offences in relation to furnishing of information may extend to:
- A. ₹ 5 lakh;
- B. ₹ 25 lakh;
- C. ₹ 10 lakh;
- D. ₹ 1 crore.

(b) Fill in the blanks in the following sentences by using appropriate word(s)/phrase(s)/ number(s): [4 × 1]

(i) Every ______________ Officer shall deal with requests for information and shall render reasonable assistance to any person seeking such information.

(ii) **__________________ is the set of processes, customs, policies, laws and institutions affecting the way a corporation is directed, administered or controlled.**
(iii) **The _____________ has the power to fill up the casual vacancy caused in the Board.**
(iv) **According to section 31 of Companies Act, 2013 ____________ means a prospectus in respect of which the securities or class of securities included therein are issued for subscription in one or more issues over a certain period without the issue of a further prospectus.**

Answer to Question 5(a):

(i) C. 21 days
(ii) B. Five Days
(iii) C. Sweat debenture
(iv) D. Any of the above
(v) B. 2003
(vi) D. ₹ 1 crore

Answer to Question 5(b):

(i) Central or State Public Information
(ii) Corporate governance
(iii) Board of Directors
(iv) Shelf Prospectus

Question 6.

(a) State any five differences between a public company and a private company.

(b) Pigmo Ltd. sent notices to its members on 22nd July, 2013 for its AGM to be held on 19th August, 2013. Subsequent to the said notice, Mr. Paul acquired 100 shares of the company on 31st July, 2013 through the depositories. Whether Mr. Paul is entitled to attend the AGM of the company to be held on 19th August, 2013 even though no notice of the meeting has been sent to him? Give reason.

(c) State Sweat Equity Shares. List the applications of Securities Premium in the context of Shares Issued at Premium.

(d) State the duties to be performed by the auditors in the course of audit?

[5+2+(2+2)+4]

Answer:

(a) The difference between a public company and a private company:

1. For public companies, the minimum number of members is 7 while there is no restriction on maximum number of members. In case of private companies, minimum number of members is two and maximum number is 200 excluding present and past employees.

2. Shares in a public company are freely transferable. In case of private company, Articles restrict the right to transfer the shares.

3. The minimum number of directors required in case of public company is three while it is two in case of private company.

4. It is required to appoint independent director for public company but there is no requirement to appoint independent director in case of private company.

5. The minimum paid-up capital in case of public company is ₹ 5 lakhs while it is ₹ 1 lakh in case of private company.

(b) Mr. Paul was entitled to attend the AGM of the Company to be held on 19th of August, 2013 even though no Notice of the meeting has been sent to him.

(c) Sweat Equity Shares: It means equity shares issued by a company to its employee or directors, at a discount or for consideration other than cash, for providing technical know-how or making available rights in the nature of Intellectual Property Rights or value addition.

The applications of Securities Premium in the context of Shares Issued at Premium:
(i) for issuing fully paid bonus shares to members;
(ii) for writing off the preliminary expenses of the company;
(iii) for buy-back of own shares or other securities;
(iv) providing premium payable on redemption of any redeemable preference shares or debentures of the company.

(d) The following are the duties of auditors:
1) The auditor of a company should acquaint himself with the articles of association and memorandum of association of the company as well as with the Companies Act.
2) The auditor has to perform his work in a professional manner and he should exercise reasonable care and skill in the performance of his duties. He need not be suspicious all the time but whenever he feels that a particular matter is suspicious, he should probe the same thoroughly. It is said that, 'an auditor should be watch dog and not a blood hound'.
3) An important duty of an auditor is to make a report on the accounts of the company and submit the same to the members in an annual general meeting. It should be noted that the auditor is appointed by the members in the annual general meeting and he is accountable to them. He has to state in his report, whether the accounts of the company show a true and fair view of the affairs of the company.
4) In addition to the above mentioned duties, the auditor has the other duties like preparation of statutory report, certifying specified things in the prospectus and providing assistance in investigation.

Question 7.

(a) Ghosh & Roy Associates, are appointed as a statutory auditor of Sun Ltd. Ghosh, a partner of the firm holds 300 equity shares of Moon Ltd., a subsidiary of Sun Ltd. Discuss whether the appointment of the auditor is valid.

(b) The board meeting of Rishi Ltd. was held on 12th December, 2014 at Kolkata at 11 a.m. At the time of starting the board meeting the numbers of directors present were 7. The total numbers of directors were 10. The board transacted ten items in the board meeting. At 12 noon after the completion of four items in the agenda, 4 directors left the meeting. Write about the validity of these transactions explaining the relevant provisions of the Companies Act, 2013.

(c) State the legal provisions by which a person can become a member of a company.

[4+6+5]

Answer:

(a) As per section 141(3) of the Companies Act, 2013, Ghosh cannot be appointed as auditor of Moon Ltd. on account of holding security in a company. Again, Ghosh cannot be appointed as the statutory auditor of Sun Ltd., since sec 141(3) states that a person is not eligible for appointment as auditor, if he is holding security a company or its subsidiary company.

Where a firm is appointed, every partner of the firm is deemed to be appointed. Hence the disqualification applies to the Firm. So, in this case, the appointment of Ghosh & Roy Associates is not valid.

(b) As per section 174(1) of the Companies Act, 2013, the quorum for a Board meeting shall be higher of —

(i) 1/3rd of total strength (any fraction contained in that one-third shall be rounded off as one); or

(ii) 2 directors.

Total strength means the total strength of the Board of directors of a company, as reduced by the number of directors whose places are vacant at that time.

Quorum has to be present at the time of transacting each and every business. It is not enough that a quorum was present at the commencement of the meeting. Therefore, where quorum is present at the beginning of the meeting, but some of the directors leave the meeting, so that remaining directors do not constitute quorum, any subsequent resolutions will be invalid.

In the given case, total strength is 10. Quorum for the Board meeting held on 12th December, 2014 shall be l/3rd of 10 directors, *i.e.* 3.33, taken as 4 directors. Since 7 directors were present at the time of commencement of the Board meeting, the Board meeting has been validly held.

However, after transacting 4 items on agenda, 4 directors left, because of which the number of directors present has fallen below the quorum required. Since, quorum is required at the time of transacting each and every business, the remaining 6 agenda items cannot be validly discussed and voted upon. Therefore, resolutions passed in respect of these 6 agenda items are void, and have no legal effect.

(c) A person can become a member of a company in any of the following ways:

i. A person can become a member in regular course by making application for getting shares and getting the allotment of shares. An application for shares is an offer made by the person to the company and when the allotment is made, the acceptance is given and the contract is complete. Thus membership can be obtained by application and allotment.

ii. A person may not apply for getting shares from the company, but he can acquire membership by getting shares transferred in his favor by another person. A person may purchase shares in the open market and thus become member by registering transfer of shares in his name.

iii. Subscribers to the memorandum of association of a company become members of a company.

iv. Membership can also be acquired by transmission of shares. If a person holding shares of a company dies, the shares standing in his name are transmitted in favor of these legal heirs. Thus the legal heirs become the members of the company.

v. Every person, holding equity share capital of a company and whose name is entered as beneficial owner in the records of a depository shall be deemed to be a member of the concerned company.

Question 8.

(a) The object clause of the Memorandum of Q Ltd. authorises it to publish and sell text books for students. The company however, entered into an agreement with P to supply 50 computers worth ₹ 8 lakhs for resale purposes. Subsequently, the company refused to make payment on the ground that the transaction was ultra vires the company. Discuss the validity of the company's refusal for payment to P under the provisions of the Companies Act.

(b) "Synergy is the magic force that allows for enhanced cost efficiencies of the new business. Synergy takes the form of revenue enhancement and cost savings." — What are the benefits can a company get from synergy in the field of merger?

(c) There are some restrictions on political contributions made by the companies to the political parties or for political purpose to any person directly or indirectly out of their profits. Mention those restrictions.

(d) What do you understand by the term, 'Promoter'?

(e) State the contents of advertisement of Prospectus.

[3+4+4+2+2]

Answer:

(a) The contract to purchase computers is an ultra vires contract and is therefore, void ab initio. P cannot enforce the contract against Q Ltd. because the contract is ultra vires and no party to an ultra vires contract has the right to use. Therefore, the Court may order Q Ltd. to deliver back the computers to P:

— if the laptops are still in the possession of the company;

— if the Court, applying the principle of equity, deems it fit considering the circumstances of the case.

(b) By merging, synergy helps the companies hope to benefit from the following:

1) Staff reductions - As every employee knows, mergers tend to mean job losses. Consider all the money saved from reducing the number of staff members from accounting, marketing and other departments. Job cuts will also include the former CEO, who typically leaves with a compensation package.
2) Economies of scale - Size matters. Whether it's purchasing stationery or a new corporate IT system, a bigger company placing the orders can save more on costs. Mergers also translate into improved purchasing power to buy equipment or office supplies— when placing larger orders, companies have a greater ability to negotiate price with their suppliers.

3) Acquiring new technology - To stay competitive, companies need to stay on top of technological developments and their business applications. By buying a smaller company with unique technologies, a large company can keep or develop a competitive edge.
4) Improved market reach and industry visibility - Companies buy companies to reach new markets and grow revenues and earnings. A merger may expand two companies' marketing and distribution, giving them new sales opportunities. A merger can also improve a company's standing in the investment community: bigger firms often have an easier time raising capital than smaller ones.

(c) As per section 182 of the Companies Act, 2013, a company can give political contributions to the political parties or for political purpose to any person directly or indirectly out of their profits. However there are some restrictions on these contributions, which are as follows:

i) Political contributions to any political parties or to persons for political purposes are prohibited for Government companies and other companies which are in existence for less than 3 years.
ii) Any amount or aggregate of the amounts so contributed by a company in any financial year shall not exceed 7.5% of its average net profits during the three immediately preceding financial years.
iii) Before any such contribution is made by the company, a resolution authorizing the making of the contribution shall be passed at a meeting of the Board of directors. Such resolution shall be deemed to be justification in law for the making of the contributions authorized by it.
iv) The company shall disclose in its profit and loss account the amount or amounts of such contributions during the financial year to which that account relates giving the particulars of the total amount contributed and the name of the party or persons to which or to whom such amount has been contributed.

(d) A promoter is a person who does the groundwork or the preliminary work to bring a company into existence. It is a term used to describe a person, who undertakes, does and goes through all the necessary and other preliminary activities with an objective of bringing the company into existence. A promoter is expected to do the work of selecting the name of a company, preparing the memorandum of association as well as articles of association, nominating directors, auditors, secretaries etc. of the company, arranging the payment of prescribed fees for obtaining registration and doing any other work for bringing the company into existence.

(e) As per sec 30 of the Companies Act, 2013, where an advertisement of any prospectus of a company is published in any manner, the following particulars should be specified there:

(i) the contents of its memorandum as regards:
    — the objects of the company;
    — the liability of members; and
    — the amount of share capital of the company
(ii) names of the signatories to the memorandum and the number of shares subscribed for by them; and
(iii) the capital structure of the company.