UNIT 2 SHARE CAPITAL AND DEBENTURES

Meaning Of Shares - Kinds Of Shares- Voting Rights- Issue Of Shares At A Premium And Discount- Partly Paid Shares - Bonus Shares - Right Shares- Sweat Equity Shares - Debenture - Meaning, Types.

Meaning of Shares

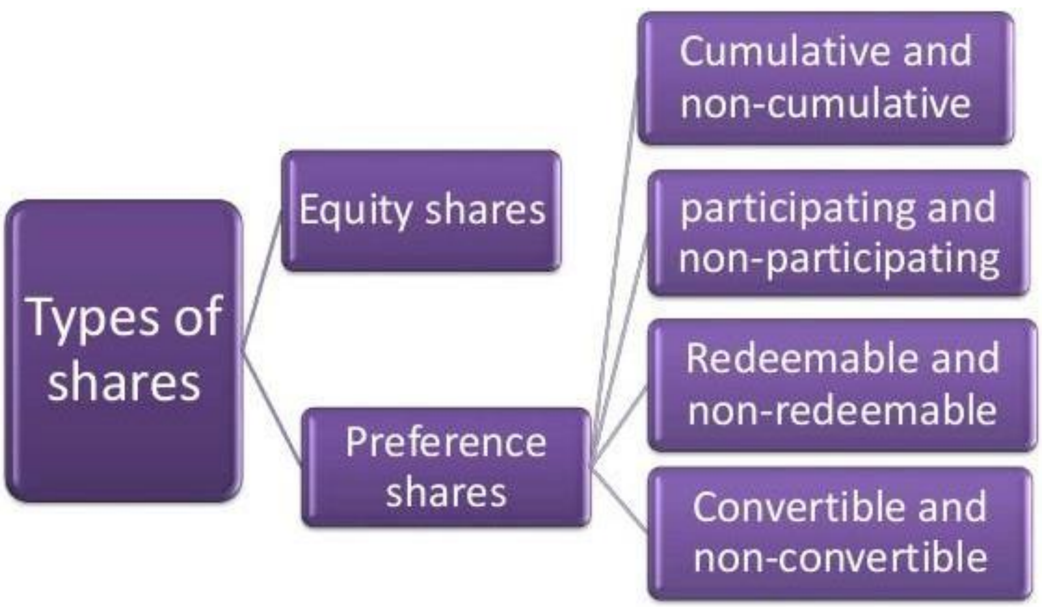
The capital of a company is divided into units of a fixed denomination. Share refers to only such a unit. It is therefore clear that a share is a fractional part of the company's share capital. Otherwise, share capital means the capital raised by a company by the issue of shares.

Definition of Shares

According to section 2 (46) of the companies act, a share means a share in the share capital of the company and includes stock, except where a distinction between stock and shares isexpress or implied. A share indicates certain rights and liabilities.

Kinds of Shares

KINDS OF SHARES



According to the Companies Act, 1956 a company can issue only types of shares viz.,

1. Preference Shares and 2. Equity Shares

I. PREFERENCE SHARES

The term preference shares focus certain preferential rights over other types of shares.

They are,

i) A preferential right to get a fixed rate of dividend during the life of the company. It means that only after payment of dividend to preference shareholders, the surplus, if any, can be used for paying dividend to equity shareholders.

ii) A preferential right to the return of share capital at the time of winding up of the company. This means that when the company goes into liquidation, after discharging debts due to outsiders, the surplus assets must first be used for returning the share capital contributed by the preference shareholders. The remaining surplus alone will be enjoyed by equity shareholders.

Preference shareholders must carry both these preferential rights. However, preference shareholders have certain disabilities. For instance, they do not normally enjoy voting rights. However they get the right to vote.

1. On any resolution affecting their rights
2. On all resolution when dividend has not been paid to them for certain period as prescribed in the Act.

Kinds of Preference Shares

Preference shares are of different types based on differing rights. They are briefly described below;

1. Cumulative Preference Shares

In case dividend is not declared, because of inadequate profit, the right to dividend for that year does not lapse in the case of cumulative preference shares. Dividends not declared and paid get accumulative so that they may be paid out of profits of subsequent years of arrears of dividend before any dividend is paid to equity shareholders.

Preference shares are always cumulative, unless the contrary is expressly stated in the Articles of Association.

2. Non Cumulative Preference Shares

In the case of non cumulative preference shares if dividend is not paid in any particular year, it lapses. Dividend is not allowed to accumulate and such unpaid dividend will not be paid in subsequent years even though sufficient profits are earned.

3. Participating Preference Shares

In addition to the fixed rate of dividend, these shares carry a further right to participate with equity shareholders in the surplus profits which remain after paying a certain rate of dividend to equity shareholders. Thus they get two kinds of dividend, one fixed rate and the other changing every year depending on the level of excess profits.

Similarly such preference shares have a right to participate in the surplus assets of the company on its winding up after paying in full the preference and equity share capital.

The right to participate in the surplus profits or surplus asset at the time of winding up is available to preference shareholders only if it is specially expressed in the articles. In other words preference shares are presumed to be non-participating unless specifically stated otherwise in the articles.

4. Non Participating Preference Shares

These shares are entitled to only a fixed rate of dividend. They do not participate either in the surplus or in the surplus assets. In such a case, the entire surplus goes to equity shareholders.

If the articles are silent with regard to this right to participate in the surplus profit or surplus assets, the preference shares will be considered to be only of non-participating type.

5. Convertible Preference Shares

Where preference shares entitle their shareholders to convert their preference shares into equity shares within a specified period, they are known as convertible preference shares.

6. Non-Convertible Preference Shares

Where preference shares cannot be converted into equity shares, they are called non-convertible preference shares. Once issued as preference shares, they continue to be only preference share throughout the life time of the company without any change in their characteristics.

If the Articles are silent regarding this right to convert, the preference share will be considered to be only non-convertible preference shares.

7. Redeemable Preference Shares

If the Articles of Association authorize, a company can issue redeemable preference shares. It means, that the capital raised by means of these shares can be returned after a specified period or at any time at its options after giving notice as per terms of issue. These shares can be redeemed either out of profits or out of the proceeds of a fresh issue of shares. Redeemable preference shares can be redeemed if they are fully paid-up. A company cannot convert existing preference shares into redeemable preference shares.

8. Irredeemable Preference Shares

Any preference share that cannot be redeemed during the lifetime of the company is known as irredeemable preference shares.

II. EQUITY SHARES

Equity shares are those, which are not preference shares. They were also known as ordinary shares. They are entitled to get dividend only after the fixed rate of dividend is paid to preference shareholders. Similarly at the time of winding up of the company, only after returningpreference shares capital in full, and if there is any surplus, it will be paid to equity shareholders.

The rate of dividend varies from year to year depending on the profits earned by the company. The larger the profits the higher may be the dividend for equity shareholders. In the case of reputed companies, rate of dividend paid to equity shareholders is far higher than the fixed rate paid to preference shareholders. However, when there is no profit in any year, equity shareholders' dividend for that year will not be paid as arrears of dividend in subsequent year even though profits may be very large. Equity shareholders are entitled to vote on all resolutions.

VOTING RIGHTS

Equity shareholders' rights

An equity shareholder of a company limited by shares has a right to vote on every resolution placed before the company. His voting right on a poll is in proportion to his share of the paid-up equity capital of the company. The right of vote is an individual right in respect of which a member has a right to sue. He has a right to say, "whether I vote with the majority or with the minority, you shall record my vote: that is a right belonging to my interest in the company, and if you will not, I shall institute legal proceedings to compel you".

Preference shareholders' rights

A preference shareholder has a right to vote on those resolutions which directly affect his rights. Any resolution for winding up the company or for the repayment or reduction of its share capital is deemed directly to affect the rights of the preference shareholders. But holders of cumulative preference shares have a right to vote on all resolutions of the company at any meeting if their dividends remained unpaid for an aggregate period of at least 2 years preceding the date of commencement of meeting. In the case of non-cumulative preference shares, they have a right to vote on all resolutions of the company at any meeting, if their dividends remain unpaid for 2 financial years immediately preceding the meeting or for any 3 years during a period of 6 years ending with the financial year preceding the meeting.

ISSUE OF SHARES AT PAR, PREMIUM AND DISCOUNT

Issue of Shares

Issue of Shares is the process in which companies allot new shares to shareholders. Shareholders can be either individuals or corporate. The company follows the rules prescribed by Companies Act 2013 while issuing the shares. The process of creating new shares is known as Allocation or allotment. A company may issue shares at their face value or at a price other than the face value.

Issue of Shares at Par

When shares are issued at a price equal to their face value it is termed as shares issued at par. When company issues the shares, it has to fix the price of per share. If the face value and issue price per share will equal, then it is called that shares have been issued at par.

For example, if face value of a share is Rs.10 and company issue a share at Rs. 10, here both value are equal, then it is said that issue of shares at par.

Issue price will not always be equal to the face value per share. If issue price is more than face value, then it is said that issue of shares at premium. If issue price is less than face value, then it is said that issue of shares at discount.

Issue Of Shares At A Premium

If Shares are issued at a price, which is more than the face value of shares, it is said that the shares have been issued at a premium. For example, if face value of a share is Rs.10 and company issue a share at Rs. 12, here issue price (Rs.12) is more than the face value (Rs.10), then Rs.2 (12-10 = 2) is the amount of premium and it is said that issue of shares at premium.

The Company Act 1956 does not place any restriction on issue of shares at a premium but the amount received, as premium has to be placed in a separate account called Securities Premium Account.

Under Section 78 of the Company Act 1956, the amount of security premium may be used only for the following purposes:

i. To write off the preliminary expenses of the company.

ii. To write off the expenses, commission or discount allowed on issued of shares or debentures of the company.

iii. To provide for the premium payable on redemption of redeemable preference shares or debentures of the company.

iv. To issue fully paid bonus shares to the shareholders of the company.

v. In purchasing its own shares (buy back).

Issue of Shares At A Discount

When Shares are issued at a price lower than their face value, they are said to have been issued at a discount. For example, if a share of Rs 100 is issued at Rs 95, then Rs 5 (i.e. Rs 100—95) is the amount of discount. It is a loss to the company.

It should be noted that the issue of share below the market price but above face value is not termed as 'Issue of Share at Discount' Issue of Share at Discount is always below the nominal value of shares.

As a general rule, a company cannot ordinarily issue shares at a discount, except in case of 'reissue of forfeited shares' and in accordance with the provisions of Companies Act.

But according to Section 79 of company act 1956, a company is permitted to issue shares at discount provided the following conditions are satisfied:

i. The issue of shares at a discount is authorised by a resolution passed by the company in its general meeting and sanctioned by the Central Government.

ii. The resolution must specify the maximum rate of discount at which the shares are to be issued but the rate of discount must not exceed 10 per cent of the nominal value of shares. The rate of discount can be more than 10 per cent if the Government is convinced that a higher rate is called for under special circumstances of a case.

iii. At least one year must have elapsed since the company was entitled to commence the business.

iv. The shares are of a class, which has already been issued.

v. The shares are issued within two months from the date of sanction received from the Government.

PARTLY PAID SHARES

Whenever a Company issues shares to investors then those shares can either be fully paid or partly paid. A partly paid share is a share in a company which has only partial been paid compared to the par value. This is with the understanding that as the company requires more funds, calls will be made from time to time until the shares are fully paid. The amounts may be specified in the prospectus or unspecified and the shareholder is liable when a call is made by the company until the shares are fully paid.

In case of partly paid shares, the Company has the right to demand from the shareholder the remaining payment on the partly paid shares as and when required by it.

In the case of partly paid-up shares, the dividend is payable either on the nominal, called-up or the paid-up amount of shares, depending on the provisions in this regard that there may be in the articles of the company.

BONUS SHARES

- Bonus shares are free additional shares allotted and given to the existing shareholders without receiving any additional payment from them, based on the number of shares that a shareholder owns.
- Bonus shares are company's accumulated earnings which are not given out in the form of dividends, but are converted into free shares.
- Bonus shares are issued in certain proportion. Example 1:2
- Bonus shares are allotted by capitalizing the reserves and surplus.
- Issue of bonus shares results in the conversion of the company's profits into share capital. Therefore it is termed as “Capitalization of Company's Profits.”It does not affect the Total Capital Structure of the Company.

Objective of Bonus shares

To distribute accumulated earnings without paying dividends, to improve the creditworthiness of the company.

Advantages of issue of Bonus shares

- It makes available capital to carry a larger business
- Helps the company to get rid of market influences
- Working capital not affected
- Increases creditworthiness of the company
- Abnormally high rate of dividend can be reduced
- Restrict entry to new entrepreneurs
- Balance sheet of the company reveal a realistic picture

Disadvantages of issue of Bonus shares

- Drastic fall in the rate of dividend
- Fall in market price
- Reserves and other funds decline
- Leaves lesser security to investors.

RIGHT SHARES

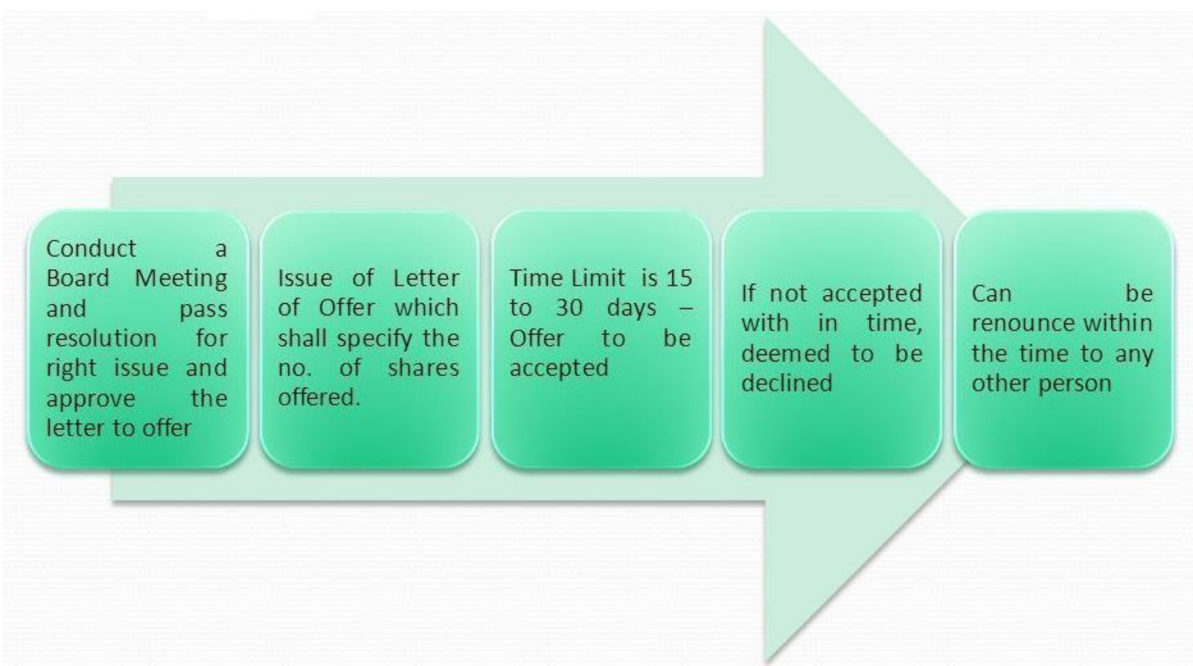
Right shares are the shares that are issued by a company for its existing shareholders. The existing shareholders have their right to subscribe to these shares unless some special rights reserve them for some other persons.

Issue of right shares

A rights issue is a way by which a listed company can raise additional capital. However, instead of going to the public, the company gives its existing shareholders the right to subscribe to newly issued shares in proportion to their existing holdings.

Every right issue share will be issued for 3 existing shares. They can choose to buy the right shares: This is what the company expects from the existing shareholders. If more existing shareholders buy the right shares, they will raise more capital.

Right Issue Procedure



Advantages of Right Shares

- Control is maintained

- Less floatation cost
- Expenses saved
- No misuse by directors

Disadvantages of Right Shares

- Shareholders lose if fail to exercise their right
- If shareholding concentrated in hands of FI.

SWEAT EQUITY SHARES

"Sweat Equity Shares" means such equity shares are issued by a company to its directors or employees at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions.

Sweat equity is the type of investment that measures time and effort put into a project. It is the ownership interest or increased value that results from the owner's hard work. In start-ups, sweat equity may be the biggest contribution of founders who may not have the cash to contribute.

DEBENTURE

Meaning of Debentures:

According to Sec. 2 (12) of the companies Act, 1956, debentures include "debenture stock, bonds and any other securities of a company".

Debentures are debt instruments issued by a joint stock company. Amounts collected by way of debentures form part of the loan capital of a company. They are repayable after a fixed period. Debenture holders get interest on their debentures. They are creditors of the company. They do not get dividend. Only shareholders get dividend.

Characteristics of Debentures

1. Debentures are debt instruments.

2. They generally carry fixed rate of interest.

3. They are normally repayable at the end of a fixed period. Repayment of debenture or cancellation of debenture liability in the books of the company is known as redemption of debentures.

4. They can be issued at par, premium or at discount depending on the reputation of the company.

5. They can either be placed privately or offered for public subscription.

6. They may or may not be listed in the stock exchange.

7. If offered for public subscription, they should be rated by a credit rating agency approved by SEBI, prior to listing.

8. Interest is payable on debentures at a fixed rate irrespective of the profit earned by the business.

9. Debentures may be issued with or without the security of assets of the company.

10. In the event of winding up of the company the debenture holders are treated as creditors and given priority in repayment of their money.

11. Debenture holders normally do not have representation in the Board of the company.

Types of Debentures

Debentures are classified as follows

1. On the Basis of Repayment

a. **Redeemable Debentures:** These debentures are paid off or redeemed after the prescribed period.

b. **Irredeemable or Perpetual Debentures:** These debentures are permanent debentures of a company. They are paid back only in the event of winding up of a company.

2. On the Basis of Transferability

a. **Registered Debentures:** These are debentures for which the company maintains record of debenture holders. Therefore when such debentures are sold or transferred it should be intimated to the company for making change in the register of debenture holders.

b. **Bearer Debentures:** These debentures are transferable by mere delivery. There is no need or registration of transfer with the company.

3. On the Basis of Security

a. **Simple or Naked Debentures:** These are debentures not secured by any asset of the company. If the company goes into liquidation these debentures are treated as unsecured creditors.

b. **Mortgage Debentures:** Mortgage debentures are issued on the security of certain assets of the company. They can be secured by fixed assets or floating assets of the company.

4. On the basis of Conversion

a. **Convertible Debentures:** These debentures are issued with an option to debenture holders to convert them into shares after a fixed period. Convertible debentures are either partially convertible debentures or fully convertible debentures.

b. Non Convertible Debentures: These are debentures issued without conversion option. The total amount of the debenture will be redeemed by the issuing company at the end of the specific period.

5. On the Basis of Pre-Mature Redemption Rights:

a. Debenture with "Call" option: A callable debenture is one in which the issuing company has the option of redeeming the security before the specified redemption date at a pre-determined price.

b. Debenture with "Put" option: This is a debenture in which the holder has the option of getting it redeemed before maturity.

6. On the Basis of Coupon Rate (interest rate)

a. Fixed Rate Debentures: Most of the time debentures are issued with a prefixed rate interest. These debentures are called fixed interest debentures

b. Floating rate Debentures: Floating rate as the names suggests keeps changing.

c. Zero Coupon Bonds: These are debentures issued with no interest specified. They are issued at a substantial discount to compensate the investors. These bonds are known as deep discount bonds.

References

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2. V.Balachandran and S. Thothadri, Legal Aspects of Business, Tata Mc Graw Hill Education Private Limited, (2012).
3. P.Saravanavel S.Sumathi, Legal Systems in Business, Himalaya Publishing House,(2011).

Question Bank

PART – A

1.Define and recall the meaning of Shares.

2.Tell the issue of shares at par with example.

3.Underline the objective of bonus shares.

4.Identify the disadvantages of bonus shares.

5.Recognize the concept issue of shares.

6.State any four purposes for which shares are issued at premium.

7. Report on Right Issue of Shares.

8.List the advantages of Rights Issue Share.

9. Describe Convertible and Non-Convertible Shares.

10. Relate the voting rights for equity shareholders.

PART – B

1. Revise and explain issue of shares at par, premium and discount.
2. Report on different kinds of shares.
3. Classify the kinds of preference shares.
4. Inspect on partly paid-up shares and Sweat equity shares.
5. Categorize the different types of debentures.
6. Discuss about Right Shares along with its procedure.
7. Explain the voting rights of equity and Preference shareholders.
8. Describe about Bonus shares with its objectives, advantages and disadvantages.