Dr. MPS MEMORIAL COLLEGE OF BUSINESS STUDIES, AGRA

BBA 3rd SEMESTER

COMPANY LAW (BBA 301)

UNIT – II

SYLLABUS: - Share Capital – Types of Shares, Types of Share Capital, Alteration and Reduction of Capital, Allotment of Shares, Debenture and Its Types.

What Are Shares?

Shares are units of equity ownership in a corporation. For some companies, shares exist as a financial asset providing for an equal distribution of any residual profits, if any are declared, in the form of dividends. Shareholders of a stock that pays no dividends do not participate in a distribution of profits. Instead, they anticipate participating in the growth of the stock price as company profits increase.

Shares represent equity stock in a firm, with the two main types of shares being common shares and preferred shares. As a result, "shares" and "stock" are commonly used interchangeably.

Understanding Shares

When establishing a corporation, owners may choose to issue common stock or preferred shares to investors. Companies issue equity shares to investors in return for capital, which is used to grow and operate the firm.

Unlike debt capital, obtained through a loan or bond issue, equity has no legal mandate to be repaid to investors, and shares, while they may pay dividends as a distribution of profits, do not pay interest. Nearly all companies, from small partnerships or LLCs to multinational corporations, issue shares of some kind.

Shares of privately held companies or partnerships are owned by the founders or partners. As small companies grow, shares are sold to outside investors in the primary market. These may include friends or family, and then angel or venture capital (VC) investors. If the company continues to grow, it may seek to raise additional equity capital by selling shares to the public via an initial public offering (IPO). After an IPO, a company's shares are said to be publicly traded and become listed on a stock exchange.

Most companies issue common shares. These provide shareholders with a residual claim on the company and its profits, providing potential investment growth through both capital gains and dividends. Common shares also come with voting rights, giving shareholders more control over the business. These rights allow shareholders of record in a company to vote on certain corporate actions, elect members to the board of directors, and approve issuing new securities or payment of dividends. In addition, certain common stock comes with preemptive rights, ensuring that shareholders may buy new shares and retain their percentage of ownership when the corporation issues new stock.

In comparison, preferred shares typically do not offer much market appreciation in value or voting rights in the corporation. However, this type of stock typically has set payment criteria, a dividend that is paid out regularly, making the stock less risky than common stock. Because preferred stock takes priority over common stock if the business files for bankruptcy and is forced to repay its lenders, preferred shareholders receive payment before common shareholders but after bondholders. Because preferred shareholders have priority in repayment upon bankruptcy, they are less risky than common shares.

Types of share

As per Section 43 of the Companies Act 2013, shares can be broadly classified into two types

- Ordinary equity shares
- Preference shares

Both these types of shares vary in regards to share in profitability, voting rights, as well as a settlement of capital when a company is winding up or is being liquidated.

Ordinary Shares: Meaning and Types of Shares

Ordinary or equity share is the commonest variant of stock that a public company issues to raise capital. Typically, holders of ordinary shares enjoy voting rights, can attend general and annual meetings of a company, and are also entitled to a company's surplus profits.

In regards to voting rights, typically a single share denotes one vote, which might be concerning company policies or election of directors. However, companies can tweak the relation between the number of shares and vote count.

For instance, Tata Motors issued a special category named 'A' equity shares in 2008. By policy, 10 'A' shares were equivalent to 1 vote; but, they received 5% more dividends than regular shares.

Feature-based types of shares are –

- **Voting shares and non-voting shares**

As the name suggests, entities holding these voting shares are entitled to cast their vote in matters concerning a company's policies or election of directors. Typically most ordinary shares are voting shares.

In the case of non-voting shares, it might entail differential voting rights or none at all. An example of differential voting rights is mentioned above, where Tata Motors issued 'A' shares in 2008.

- **Sweat equity shares**

Companies can issue shares to its employees and directors as a means of compensation, usually when they perform excellently. By means of sweat equity shares, companies retain efficient employees by giving them a stake in the ownership.

- **Right shares**

Among the many types of stocks, a company issues this variant to its existing shareholders. In a stricter sense, companies proffer existing stakeholders the right to purchase such shares before it is open for trade to external investors.

- **Bonus shares**

Companies issue bonus shares in lieu of monetary compensation for dividends. Therefore, existing shareholders are only entitled to bonus shares. Organizations can also issue bonus shares for converting a portion of retained earnings into equity shares.

Preference Shares: Meaning and Types of shares

Preference shares carry special rights or preferential treatments, especially in regards to dividend receipt and capital reimbursement when an organization is winding up. In other words, preference shareholders receive dividends on the highest priority, and also companies return their capital before ordinary shareholders when undergoing liquidation.

Moreover, preference shareholders enjoy the guarantee of a fixed dividend, which ordinary shareholders do not. Thence, investors looking for low-risk investment options can choose to purchase preference shares of a company.

However, typically, preference shareholders cannot partake in an organization's profits beyond their fixed entitlement. Therefore, if a company raises its dividend rate in correspondence with its net income, preference shareholders cannot enjoy that raise, but only ordinary shareholders can.

Plus, preference shares usually do not carry voting rights. For these reasons, preference shares are usually not a popular choice among investors.

Nevertheless, types of stocks under preference shares are –

- **Redeemable and irredeemable preference shares**

In the case of redeemable types of shares, the issuing company and such shareholders agree that the company can redeem or buy-back those shares at a later period, either after the lapse of a certain time or on a future date. Redeemable shares vary based on who can exercise the buy-back provision – the shareholder or the organization. An irredeemable share is, therefore, the exact opposite of a redeemable stock.

- **Convertible and non-convertible preference shares**

Another way types of shares can be categorized based on whether they carry the provision of conversion or not. To that effect, holders of convertible preference stocks can convert their holdings to equity shares upon meeting specific conditions. Conversely, holders of non-convertible preference shares are not entitled to that provision.

- **Participating and non-participating preference shares**

Holders of participating preference shares have the right to partake in a company's profits once a company allots dividends to ordinary shareholders. Therefore, when a company's net income is substantially high, such shareholders stand to receive a part of such profits. On the other hand, holders of non-participating shares are only entitled to a fixed dividend payment. The latter is a commoner variant.

- **Cumulative and non-cumulative preference shares**

If a company does not provide dividends for preference shares in a particular year, such dividend entitlement is carried forward to the following year if it is a cumulative stock. Conversely, in the case of non-cumulative preference shares, the dividend amount is not carried forward if an organization does not pay dividends in a specific year.

What Is Share Capital?

Share capital is the money a company raises by issuing common or preferred stock. The amount of share capital or equity financing a company has can change over time with additional public offerings.

The term share capital can mean slightly different things depending on the context. Accountants have a much narrower definition and their definition rules on the balance sheets of public companies. It means the total amount raised by the company in sales of shares.

Understanding Share Capital

Share capital is reported by a company on its balance sheet in the shareholder's equity section. The information may be listed in separate line items depending on the source of the funds. These usually include a line for common stock, another for preferred stock, and a third for additional paid-in capital.

Common stock and preferred stock shares are reported at their par value at the time of sale. In modern business, the "par" or face value is a nominal figure. The actual amount received by a company in excess of par value is reported as "additional paid-in capital."

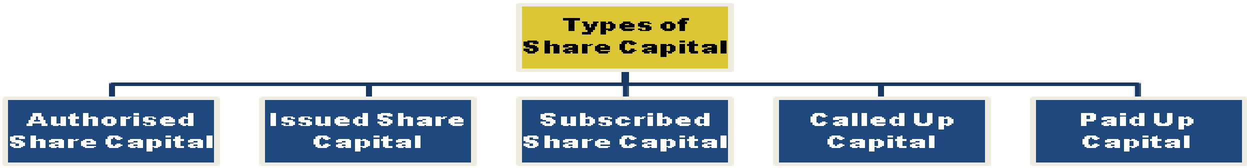
On a balance sheet, the proceeds of stock sales are listed at their nominal par value while the "additional paid-in capital" line reflects the real price paid over par for the shares.

The amount of share capital reported by a company includes only payments for purchases made directly from the company. The later sales and purchases of those shares and the rise or fall of their prices on the open market have no effect on the company's share capital.

A company may opt to have more than one public offering after its initial public offering (IPO). The proceeds of those later sales would increase the share capital on its balance sheet.

What are the Different Types of Share Capital?

Following are the different types of Share Capital –



1. Authorized Share Capital

Authorized Share Capital is the total Capital that a company accepts from its investors by issuing shares which are mentioned in the official document of the company. It is also called as Registered Capital or Nominal Capital because with this Capital a company is registered.

According to Section 2(8) of the Companies Act, 2013, the limit of Authorized Capital is given under the Capital Clause in the Memorandum of Association. The company has the discretion to take the required steps necessary to increase the limit of authorized capital with the purpose of issuing more shares, but the company is not allowed to issue shares that are exceeding the limit of authorized capital in any case.

2. Issued Share Capital

Issued Share Capital is the part of Authorized Share Capital issued to the public for subscription. And this Act of issuing Share is called Issuance, allocation or allotment. In a simple way, you can say that Issued Share Capital is the subset of the Authorized Share Capital. After the allotment of shares, a subscriber becomes the shareholder.

3. Subscribed Capital

Subscribed Capital is the part of issued Capital which has been taken off by the public. It is not mandatory that the issued Capital is fully subscribed to by the public. It is that part of the issued Capital for which the application has been received by the company. Let's understand this with an example – If a company offers 16000 shares of Rs. One hundred each and the public applies only for 12000 shares, then the issued Capital would be Rs 16 lakh, and Subscribed Capital would be Rs 12 lakh. Issued Share is equal to the sum total of share outstanding and treasury shares.

4. Called-Up Capital

Called up Capital is the part of the Subscribed Capital, which includes the amount paid by the shareholder. The company does not receive the entire amount of Capital at once. It calls upon the part of subscribed Capital when needed in installments. The remaining part of the Subscribed Capital is called Uncalled Capital.

5. Paid-Up Capital

The part of Called-up Capital which is paid by the shareholder is called Paid-up Capital. It is not mandatory that the amount called by the company is paid by the shareholder. The shareholder may pay half the amount of the called up Capital, which is called as Reserved Capital. As the name reserve means to keep some amount in the treasury of the company. This is quite useful in case of winding- up of the company.

The Companies Amendment Act 2015, has amended that minimum requirement of the paid up capital is not required in the Company. That signifies that at present the formation of the Company can be done with even Rs.1000 as the company's paid up capital. The paid up capital shall always be less than or it can be equal to the authorized share capital at any point of time and the Company is not allowed to issue shares beyond the company's authorized share capital.

ALTERATION OF SHARE CAPITAL

Alteration of Share Capital refers to the changes in the existing capital structure of the firm. A company can alter its share capital only if it is authorized by its Articles of Association. An article of association is the document framed at the time of incorporation of the company to govern its internal affairs.

In case of public company, the shares are being subscribed from the public. So the limited company has to make alteration of the memorandum of association clause also. There is a capital clause in the memorandum of association that contains the details regarding the amount of share capital that can be raised by the company during its lifetime. The capital clause has to be get altered by the registrar appointed under Companies Act 2013.

PROVISIONS REGARDING ALTERATION OF SHARE CAPITAL

The following are the provisions regarding the alteration of share capital of the company:

SECTION: 61- WAY TO ALTER SHARE CAPITAL

Section 61 of the Companies Act, 2013 states the five different ways to alter the share capital which are as follows:

Increase in Authorized Capital: Authorized Capital is also known as Registered or Nominal Capital. This is the capital with which company gets incorporated. The company can increase its share capital by altering its capital clause mentioned in the Memorandum of Association.

Consolidation of Shares: The Company can also alter its share capital by consolidating the smaller denominations shares into larger denominations. In case there is any change regarding voting rights of shareholders results out of the consolidation, the permission of the tribunal or court is compulsory. In case of consolidation of shares, the following journal entry is passed:

Share Capital (Old) A/c Dr.

To Share Capital (New) A/c

EXAMPLE: A company has 50,000 equity shares of Rs. 10 each fully paid up. A resolution was passed to consolidate the shares into shares of Rs. 100 each. The journal entry to be passed is as follows:

Equity share capital A/c (Rs. 10) Dr. 5,00,000

To Equity Share Capital A/c (Rs. 100) 5,00,000

(Being the consolidation of 50,000 equity shares of Rs. 100 each into 5,000 shares of Rs. 100 each fully paid up.)

Sub-Division of Shares: A company can also alter its share capital by sub dividing the value of the shares held by the shareholders. Section 61 allows the company to sub-divide its shares of higher denominations into smaller denominations. The company can do so only if it is authorized by the memorandum of association. In case there is sub-division of partly paid up shares, the condition to be fulfilled is that the difference between the paid up amount and unpaid amount continues to be the same. This way of alteration of share capital results in the holding of more number of shares in the hands of the shareholders with low denomination. The journal entry to be passed in this method is as follows:

Share Capital (Old) A/c Dr.

To Share Capital (New) A/c

EXAMPLE: A company has passed the resolution for conversion of 4,000 equity shares of Rs. 10 each and Rs. 80 paid up into 10,000 equity shares of Rs. 40 each and Rs. 32 paid up. The journal entry will be:

Equity share capital A/c (Rs. 100) Dr. 3,20,000

To Equity Share Capital A/c (Rs. 40) 3,20,000

(Being the sub-division of 4,000 equity shares of Rs. 100 each Rs. 80 paid up into 10,000 equity shares of Rs. 40 each Rs. 32 paid up)

Cancel the unissued shares: the company can also cancel its unissued capital. But this does not leads to alteration of share capital. In this method, no journal entry is passed and no treatment is done in the books of the accounts.

Conversion of shares into stock: The Company can also alter its shares capital by converting the fully paid up shares into the stock. Stock is the aggregate of fully paid up shares. The company can do so only if it is authorized by its articles of association. Also the company can re convert its stock into shares.

The journal entries to be passed are as follows:

A) Conversion of shares into stock

Equity share capital A/c Dr.

To Equity Capital Stock A/c

B) Conversion of stock into shares

Equity Capital Stock A/c Dr.

To Equity Share Capital A/c

EXAMPLE: A company passed the resolution for conversion of 8,000 shares of Rs. 50 each fully paid into the stock. The journal entry to be passed is as follows:

Equity share capital A/c	**Dr.**	**4,00,000**	
To equity stock A/c			**4,00,00**

SECTION 64- PASSING OF SPECIAL RESOLUTION

The company must pass a special resolution in the general meeting to take the consent of the shareholders in the presence of board of directors regarding the alteration of share capital. The special resolution must contain the details regarding the method to be followed for the alteration of share capital along with the value of shares to be altered.

SECTION 64- NOTICE TO REGISTRAR

The company can never alter its capital without providing the details of alteration to the Registrar appointed under the Companies Act, 2013. The company must furnish all the details by filing the e-Form SH-7. The notice must be given to the registrar within 30 days of passing of the resolution.

SECTION 99- RESERVE CAPITAL

The uncalled capital of the company is known as the reserve capital or reserve liability. This capital can be called upon only in the case of company being wound up. So while making alteration of share capital, this capital should remain untouched.

Reduction of Capital

A reduction of capital occurs where a company reduces the amount of its share capital. A company may reduce its share capital in a variety of ways, for example, it can extinguish or reduce the liability on any of its shares in respect of share capital not paid up, cancel any paid-up share capital that is lost or not represented by available assets (known as a loss reduction) or repay any paid-up share capital in excess of the company's wants.

A company can reduce its share capital by reducing the number of shares in issue, the nominal value of shares in issue or the amount paid up on the shares in issue.

A company may want to reduce its share capital for various reasons, including to create distributable reserves to pay a dividend or to buy back or redeem its own shares; to reduce or eliminate accumulated realised losses in order to be able to make distributions in the future; to return surplus capital to shareholders; or to distribute non-cash assets to shareholders (usually in the context of a demerger).

A private company can reduce its share capital by a special resolution of its shareholders supported by court approval or a solvency statement signed by all of the directors.

Allotment of Shares

Allotment of shares is an appropriation of a certain number of shares to an applicant and distribution of shares among those who have submitted written application. It is governed by companies act, 2013

Allotment of shares is an appropriation of a certain number of shares to an applicant and distribution of shares among those who have submitted written application. It is governed by companies act, 2013 and rules & regulations incorporated therein and for Listed Companies) whose shares are listed on the NSE and BSE or any other applicable Stock exchanges in India and whose shares are freely tradable without any restrictions) and Subsidiary of Listed Companies the provisions of SEBI act, 1992 and the securities contracts (regulation) act, 1956, are also applicable

Mode of Allotment of Shares

- A public company may allot shares in the following ways:
    a. to public through prospectus (public offer)
    b. through private placement
    c. through a rights issue or a bonus issue

- A private company may allot shares in the following ways:

a. through a rights issue or a bonus issue
b. through private placement/ preferential Allotment

Public Offer

An application is made to stock exchange(s) for the shares to be dealt through it/ them, before any offer of allotment to public. Allotment of shares is always in e-materialized form and the offer for the allotment of shares is made through red herring/ shelf prospectus, as the case may be. In public offer, no allotment is made unless minimum amount stated in the prospectus has been subscribed and consequently return of allotment is to be filed with the registrar.

Private Placement/ Prefertial Allotment

A private placement offer letter is issued to such number of persons not exceeding 50 but limited to 200 in a financial year and the allotment of shares through private placement is to be approved by the shareholders through a special resolution only. A complete record of private placement offers is to be kept by the company and is to be filed with the registrar and to SEBI (for listed company).

Rights Issue

A letter of offer in the form of notice is issued to the existing equity shareholders for the purpose of rights issue which provides with the right of renunciation to the existing equity shareholders w.r.t. the offer for the allotment of shares.
Accordingly, subscribed capital of the company is increased in rights issue.

Bonus Issue

Only fully paid-up bonus shares are issued to the members, out of:

a. free reserves
b. securities premium account; or
c. capital redemption reserve account, maintained by the company in this regard

Bonus issue is to be authorized by the AOA of the company making the allotment of bonus shares and it is recommended by the board and then approved by the shareholders in the general meeting of the company.

Debentures and Its Types

A debenture is a bond or promissory note that is issued by a business to a creditor in exchange for capital. The repayment and terms of the loan are completed based on the general creditworthiness of the business and not by a lien, mortgage, or any specific property. An indenture is a legal document that sets the terms for the transaction. Therefore, a debenture is commonly found within an indenture.

A debenture is usually a type of bearer instrument, a type of fixed-income security in which no ownership data is recorded, and the security is issued in physical form to the purchaser. The person holding the debenture at the time of payment will receive the funds even if they're not the original creditor. Coupons representing semi-annual or annual payments of interest are attached. They are to be redeemed for payment on the due date.

The creation of a debenture acknowledges the fact that a debt is owed by the issuing company. The term "debenture" includes:

- Stocks
- Bonds
- All other debt securities that were issued by the business

Ordinarily, a debenture is issued with secured borrowings and has either a floating or fixed interest payment attached to it. In less common scenarios, a debenture is issued with unsecured borrowings. In a commercial setting, the term "debenture" will typically refer to the legal document that describes the secured debt.

A debenture is considered a more secure way to invest in a business than purchasing shares because the company must pay the interest on the debenture before any dividend payments can be made to the shareholders. For example, if a company declares bankruptcy, the debenture holders will receive payment before the shareholders. The main disadvantage to being a debenture holder is that they have no control over the decision-making process of the company because they control no shares in the business.

The business has to pay interest to the debenture holder during the period of the loan. A debenture holder may take hold of some or all of the assets of the business as collateral. This would be done to improve the odds of recovering the entire debt from the organization. When a creditor takes control of the assets of a business, it carries a legal interest that the business will not be allowed to sell the assets without receiving permission from the debenture holder or paying off the debt.

Characteristics of Debentures

- The repayment of funds is secured by:
  - The rights of the trustee over the business
  - The tangible assets of the business
  - The guarantor or co-signer
- The tangible property or assets that make up the security are sufficient to meet the entire liability for the repayment.

Types of Debentures

- **Secured debentures**: The assets of the issuing company are essentially held as collateral to encourage payment to its creditors.
  - The charge may be floating or fixed.
  - A floating charge is applied to the general assets, while a fixed charge is applied to a specific asset.
- **Unsecured debentures**: There are no assets held as additional security.
- **Redeemable debentures**: Payable at the end of a specific period or through instalments
- **Irredeemable debentures**: The business pays a specific interest rate regularly but provides no data on when principal will be returned.
- **Convertible debentures:** Debentures that are convertible into shares or any other form of security that are exercised by option of the company or the holder
- **Subordinate debentures:** Will be repaid after some other privileged debt has been satisfied
- **Convertible subordinate debentures**: Is subordinate or subject to the prior repayment of other outstanding debts but which can convert into another type of security
- **Specific interest rate debentures**: Issued with a specific interest rate
- **Zero-interest rate debentures**: Do not carry a specific interest rate

- **Registered debentures**: All details of the debenture holder are entered in a register that's kept by the company.
- **Bearer debentures:** The Company doesn't keep a record of the debenture holder. Therefore, the debenture can be transferred by way of delivery.
- **Sinking debentures**: The repayment is secured because the company is making systematic payments into a sinking fund.