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Subject: LAW

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e- Content for Post Graduate Courses

Paper : CORPORATE LAW

Module : Share capital, its nature, kinds, rights and liabilities of shareholders

ज्ञान-विज्ञान विमुक्तये

Q1: E-TEXT

Module ID 5:Share capital, its nature, kinds and rights and liabilities of shareholders

Module Overview:

The Module on 'share capital, its nature, kindsand rights and liabilities of shareholders' is the first topic in the Corporate Law that introduces students to the needs of companies to raise finance for meeting their business requirements of funds for different business activities and expansions. In this module, the concepts relating to share capital, how to become a shareholder of any company and what are the rights and liabilities of the shareholders of any company are discussed. The module will cover the need of the companies to raise share capital, decision making by the companies to raise share capital instead of borrowing money, the nature of share capital and different types of shares and alteration of the share capital. It will also cover rights and liabilities of share holders.

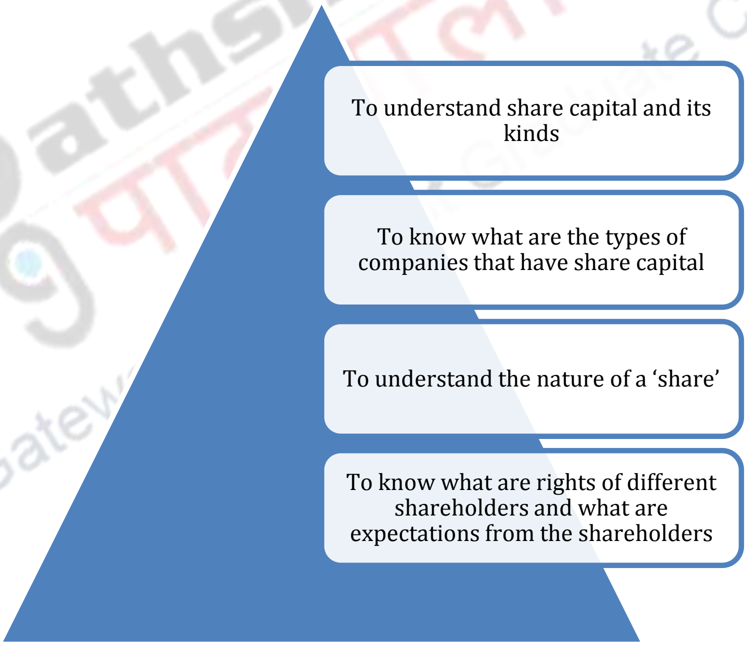
Subject Name: Law

Paper Name: Corporate Law

Module ID: 5

Pre-requisites: Knowledge of different types of companies and their need to raise finance for funding business activities

Objectives:



Keywords: share capital, equity share capital, preference share capital, paid-up capital, shareholders, members, equity shareholders, preference shareholders, bonus shares, sweat equity shares, dividend, transfer of shares, transmission of shares, voting rights, variation of shareholders' rights

Learning outcomes:

- Student will understand share capital and its kinds
- Student will be able to distinguish between equity shareholders and preference shareholders and their rights
- Understanding the nature of a 'share'

- Knowledge of shares other than equity and preference that can be issued by companies
- Distinction between the terms 'shareholder' and 'member'
- Knowledge of rights and duties of shareholders of companies

Introduction: The words 'capital' and 'share capital' are synonymous [1]. Although requirement of share capital is not compulsory for the purposes of incorporation but companies prefer to get incorporated with share capital because of their objectives of running business requiring capital. S. 13(4)(a) of the Companies Act, 1956 (CA, 1956) provided that the last clause i.e the capital clause of the memorandum of association must state the amount of nominal capital of the company and the number and value of shares into which it is divided. S. 4 (e) of the Companies Act, 2013 (CA, 2013) provides that in case of a company having a share capital, the amount of share capital with which the company is being registered should be stated. Division of the share capital into shares of a fixed amount and the number of shares which each subscriber to memorandum has agreed to subscribe should also be stated. In no case a subscriber should agree to have less than one share.

It is also necessary to know here that the company law also prescribes the minimum capital requirement for incorporating a company as a public or a private company. A public company must have a minimum paid-up share capital of a five lakh rupees or such higher paid-up share capital as may be prescribed [s. 2(71), CA, 2013). Similarly, a private company is a company having a minimum paid-up share capital of one lakh rupees or such higher paid-up share capital as may be prescribed [s. 2(68), CA, 2013)]. Only a public company can raise funds from the public through public offerings and increase its share capital. Private companies can raise finance through private placement of securities. Even a public company can raise capital through private placement of securities. A company may meet its fund requirements either through raising share capital or through borrowings. Such a decision depends upon the business of the company and its requirement of capital, existing interest rates, and availability of assets with the company to give as security for borrowing, profitability of the company and the number of shareholders etc. A proper financial analysis is done by the companybefore taking such a decision. Similarly, the company also has to make a choice between issue of equity shares and preference shares in case it decides to raise capital through share capital.

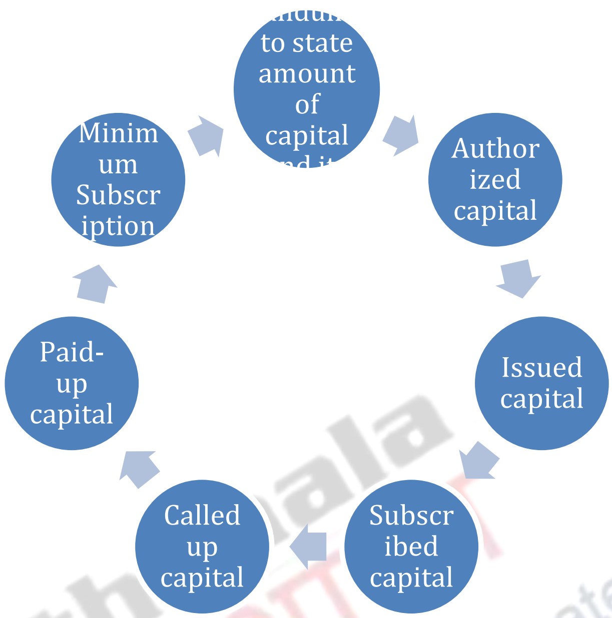
Share Capital:

As we discussed earlier, for a company to have share capital, it is necessary that its memorandum should state the amount and its division. The amount that is stated in the memorandum is known as the 'authorized capital' of the company. 'Authorised capital' or 'nominal capital' means such capital as is authorized by the memorandum of a company to be the maximum amount of share capital of the company [s. 2(8), CA, 2013]. Whole of the authorized share capital or any part of it can be issued by the company depending upon fund requirement of the company. Part of the share capital which is issued to the public is called 'issued capital' of the company. 'Issued capital' means such capital as the company issues from time to time for subscription [s. 2(50), CA, 2013]. Whole of the issued capital may be subscribed by the public. That part of the issued capital which is subscribed by the public or allotted to the publicis known as 'subscribed capital' of the company. As per s. 2(86), CA, 2013, 'subscribed capital' means such part of the capital which is for the time being subscribed by the members of a company. Minimum subscription requirement presently is ninety percent of the issued capital. The company has the flexibility of calling the subscribed

[1] SNDP Yogam, Quilon , Re, (1970) 40 Comp Cas 60

capital wholly or partially. The actual amount received by the company from the subscribed capital is called the 'paid-up capital' of the company. The un-called capital of the company can be converted into reserve capital by passing a special resolution.

SHARE CAPITAL



Kinds of share capital:
Share capital must be divided into shares of a fixed amount. The CA, 1956 permitted only two kinds of share to be issued, namely, 'equity share capital' (ordinary shares) and "preference share capital" (preference shares). S. 86 of the CA, 1956 provided that equity sharecapital shall be with voting rights or with differential rights as to dividend, voting or otherwise. Two other categories of shares namely, 'derivative'and 'hybrid' were also introduced by the Companies (Amendment) Act, 2000. 'Derivative' wasgiven the same meaning as in s. 2 of the Securities Contracts (Regulation) Act, 1956. 'Hybrid' meant any security whichhas the characteristics of more than one type of security, including their derivatives.
Chapter IV of the CA, 2013 deals with share capital. S. 43 deals with kinds of share capital and it provides that the share capital of a company limited by shares can be of two types, namely, equity share capital and preference share capital.

Equity share capital:
Equity share capital means all share capital which is not preference share capital for any company limited by shares. This is the ordinary share capital of the company and can be of two types:

i. equity share capital with voting rights, or

ii. equity share capital with differential rights as to dividend, voting or otherwise in accordance with prescribed rules.

Preference share capital:

It means that part of the issued share capital of the company which either carries or would carry a preferential right with respect to payment of dividend and a preferential right of repayment in case of winding up or repayment of capital. Dividend may be paid as a fixed amount or amount calculated at a fixed rate. Right of repayment would be irrespective of preferential right to the payment of any fixed premium or premium on a fixed scale specified in memorandum or articles of the company. Apart from these two preferential rights, preference shares can be of participating or non-participating type depending upon their right to participate in dividend payment with capital not entitled to the preferential right. That means that if shareholders are participating type they will have the right to extra dividend apart from their preferential dividend in case the company decides to distribute more profits as dividend. Similarly, preferences shareholders may have also the right to participate in any surplus capital which may remain after the entire capital has been repaid.

S. 55 of the CA, 2013 provides for issue and redemption of preference shares. It prohibits issue of irredeemable preference shares by any company limited by shares. A company may, if it is authorised by its articles, issue preference shares liable to be redeemed within a period not exceeding twenty years. Only for infrastructure projects, a company may issue such shares for a period of more than twenty years but not exceeding thirty years. This is subject to redemption of minimum of 10% of such shares per year from twenty first year onwards or earlier at the option of preference shareholders. This redemption will be on proportionate basis. Redemption will be subject to the conditions that only fully paid shares can be redeemed, redemption can be made only from company's profits available for dividend or out of the proceeds of a fresh issue made for this purpose and a sum equal to nominal value of shares to be redeemed should be transferred to a reserve known as Capital Redemption Reserve Account from the profits out of which redemption will take place. Capital Redemption Reserve is to be preserved with same sanctity as share capital. Redemption of preference shares is not treated as reduction of share capital. Premium on redemption can be paid from profits of the company or securities premium account. If a company is not in a position to redeem preference shares or to pay dividend, it may with the consent of holders of three-fourths in value of such preference shares and with the approval of the Tribunal further issue redeemable preference shares of the same value including dividend. This will be deemed redemption of unredeemed preference shares. A company has to notify the Registrar about the redemption of preference shares within a period of thirty days of redemption.

Bonus shares:
A bonus share is an accretion. A bonus share is issued when a company capitalizes its profits by transferring an amount equal to the face value of the share from its reserves to the nominal capital[2]. If the articles of accompany authorize, it may convert its accumulated undivided profits into bonus shares[3]. This is a mechanism to provide capital to the company by utilizing its own accumulated profits instead of public offering or borrowing by the company. S. 63, CA, 2013 provides that a company may issue bonus shares to its members in any manner whatsoever, out of its free reserves or amount lying in the securities premium account or capital redemption reserve. Reserves created from revaluation of assets cannot be utilized or capitalized for the purpose of issuing bonus shares. Bonus shares cannot be issued in lieu of dividend.

Sweat Equity Shares:
Sweat equity shares are equity shares issued by the company at a discount or for consideration other than cash. They are issued only to directors or employees of the company for providing technical know-how to the company or making available intellectual property rights to the company or for any value addition to company.

Share:
A share in a company is chose-in-action and a share certificate is the evidence of it. According to s. 2 (46) of the CA, 1956 and s. 2 (84) of the CA, 2013 a 'share' means a share in the share capital of the company. It includes 'stock' also where the distinction between shares and stocks is made. S. 44 of CA, 2013 provides for nature of shares and it says that shares, debentures or other interest of a member in a company is a movable property transferable in the manner provided by the articles of the company. Shares are a peculiar kind of movable property which cannot pass from hand to hand like bales of cotton. The property in these shares belonged to the registered shareholders and could not be transferred to another except according to the articles of the company. Shareholders are owners of certain rights and interests and subject to certain liabilities[4].

Shareholders and Members:
In relation to a company,a 'member' under s. 2(55), CA, 2013 means:
i. the subscribers to the memorandum of the company. They are deemed to have agreed to become members of the company and after registration of the company; their name is entered in register of members.
ii. every other person who agrees to become a member of a company in writing and whose name is entered on the register of members.
iii. every person holding shares of the company and whose name is entered as beneficial owner in the records of a depository.

Therefore, a shareholder is also a member of the company. Although the terms 'shareholder' and 'member' are used interchangeably, member is a broader term. Companies limited by guarantee and unlimited companies may not have shareholders as such companies may not have share capital. However, they have members.
A person may become member of a company by subscribing to memorandum, by allotment of shares or by agreeing in writing to become a member and whose name is entered on

[2] Standard Chartered Bank v Custodian, (2000) 6 SCC 427
[3]ShriGopal Paper Mills Ltd v CIT, (1970) 2SCC 80
[4]Vadilal Sarabhai v ManeckjeePestonjeeBharucha, AIR 1923 Bom 1923

register of members, beneficial owners in depository records, by transfer or transmission of shares.

Rights of shareholders: Important rights of shareholders or members of a company are as under:

1. Voting Rights: Section 47, CA, 2013 provides that every equity shareholder of a company has the right to vote on every resolution placed before the company. Equity shareholder's voting right on a poll will be in proportion to his share in the paid-up equity share capital of a company.

Every preference shareholder of a company will have a right to vote only on resolutions placed before the company directly affecting his rights attached to the preference shares and any resolution for winding up of the company or for repayment or reduction of its equity or preference share capital. Voting rights of every preference shareholder on a poll shall be in proportion to his share in the paid-up preference share capital of the company. Proportion of the voting rights of the equity shareholders to preference shareholders will be in the proportion of the paid-up equity share capital and paid-up preference share capital held by them. If dividend in respect of a class of preference shares is not paid for a period of two years or more, such class of preference shareholders will have the right to vote on all the resolutions placed before the company.

Where the company accepts unpaid share capital which is not yet called up by the company, such shareholders will not be entitled to any voting rights in respect of such share capital paid by them.

2. Dividend: Every equity shareholder has the right to receive dividend declared by directors of the company yearly as well as interim dividend if declared by the directors in accordance with s. 143 of the CA, 2013. Every preference shareholder has the right to receive preferred dividend as per the terms of issue of preference shares. Participating preference shareholders have also the right to receive extra dividend from surplus profits. A company may pay dividends in proportion to the amount paid-up on each share if its articles authorize it to do so.

3. Right to uniform calls on shares: Where any calls are made by the company for a class of shares from uncalled capital of the company, such calls should be made uniformly for all shares of that class.

4. Right to be paid at winding up of the company: Every preference shareholder has the preferred right of payment at the winding up of the company or repayment of capital. They may also have the right to participate in surplus capital if they are participating type. Equity shareholders also have the right of payment from the capital of the company left after repaying creditors and preference shareholders of the company at the winding up of the company.

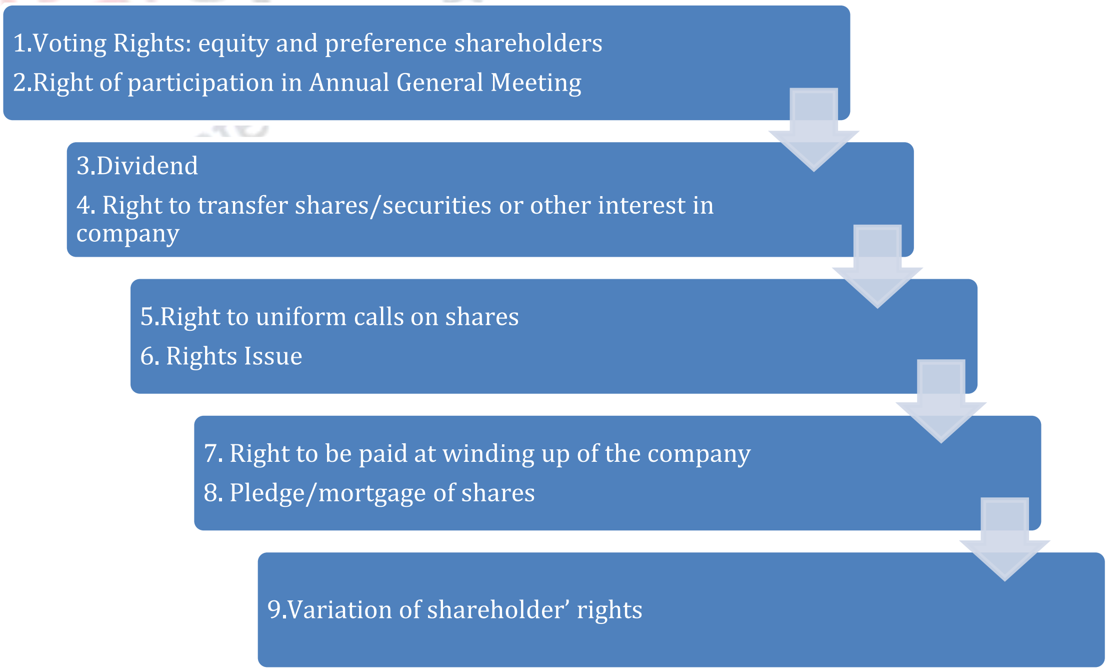
5. Variation of shareholder' rights: S. 48, CA, 2013 restricts the variation of shareholders' rights except with the consent in writing of the holders of not less than three-fourths of the issued shares of the class of shares whose rights are being modified. Such a variation may also be made by means of a special resolution passed at a separate meeting of shareholders of that class if provision in respect of such variation is contained in memorandum or articles of the company or in its absence such variation is not prohibited by terms of issue of shares of that class.

If variation by one class of shareholders affects the rights of any other class of shareholders, consent of three-fourths of such other class of shareholders shall also be obtained.
Dissenting shareholders by not less than ten percent of the issued shares of that class whose shares are under variation may apply to Tribunal for cancellation of variation.

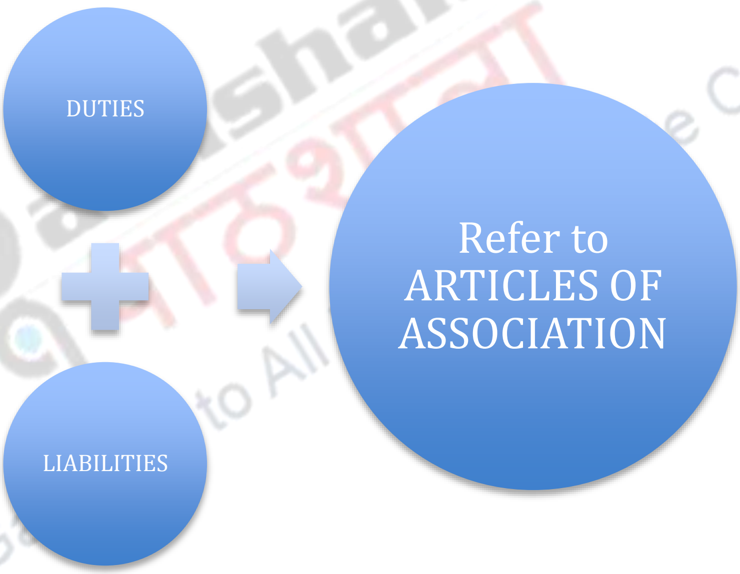
6. Right of participation in Annual General Meeting: Shareholders have the right to receive notice for attending the AGM of the company. Each shareholder has the right to receive financial statements, including auditors' report and other documents annexed to financial statements, along with directors' report presented by Board of directors at AGM.

7.Right to transfer shares/securities or other interest in company: Securities or other interest of any member in a public company are freely transferable under s. 44, CA, 2013. Shareholders of a public company have freely transferable shares/ securities without any restriction on transferability of shares. In case of private companies, approval of the Board of directors may be necessary before any transfer of shares. Members also have the right of transmission of shares/securities or other interest in the company. The company has the power to register on receipt of intimation of transmission of any right to securities by operation of law from any person to whom such right has been transmitted under s. 56, CA, 2013. Every holder of securities has also been given the power to nominate any person to whom his securities will vest in the event of his death. In case the nominee is a minor, holder has to appoint a person who will be entitled to securities of the company in the event of death of nominee during his minority [s. 72, CA, 2013].

8. Rights Issue: Every equity shareholder of a company has a right to be offered shares when the company goes for further issue of capital. Such right falls under pre-emptive rights of existing shareholders of any company having a share capital and is protected by s. 62 of the Companies Act, 2013.



Duties and Liabilities of shareholders/ members: All rights and liabilities of shareholders are subject to terms and conditions contained in the articles of the company. The provisions of the CA. 2013 are also applicable. The members are under a duty to participate in the meetings of the companies and vote on resolutions of the companies. They should not merely be 'functionless rentiers' of capital[5]. They should not only be bothered about their dividend but also take active interest in the decision making. Appointment of directors, auditors, alteration of memorandum and articles of company are few of the important resolutions where their participation is a must. Minority shareholders should also be vigilant for their rights in the company. Shareholders of companies are under a liability to pay the full amount of their shareholding.
Shareholders, if required, may also pledge or mortgage their shares since shares are a movable property. Where share certificate is in physical form, it can be pledged for raising a loan. Where it is given as security, pledge retains possession of it till the loan amount is repaid. In case some right or interest in shares is transferred to the creditor, then it amounts to mortgage of shares. Where shares are in dematerialized form and with the depositories, pledge or mortgage of shares has to be registered with the depository.



Summary:
The module has discussed what a share and share capital is, what are the kinds of share capital, what are the different types of share holders in a company. The module has also highlighted different types of shares which a company can issue like bonus shares and sweat equity shares. Rights, duties and liabilities of shareholders and members of companies have also been discussed. The provisions of the Companies Act, 2013 have been referred in the module.

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[5] As quoted by Dr. Avtar Singh in Company Law, fifteenth edition, Eastern Book Company, reprint 2009, p. 197