COMPANY LAW

UNIT 3 : Share Capital

TOPIC-SHARES (ISSUE, BUYBACK ETC.)

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SHARES (ISSUE, BUYBACK etc.)

SHARE- As per Sec.2(84),Share means 'share in the share capital of a company and includes a stock'. A share in a company is one of the units into which the total capital of the company is divided. A share secures to its owner certain rights and liabilities e.g. right to dividend, right to vote etc., liability to pay call etc. A share is regarded as' goods' in India i.e. moveable and marketable but these are transferable in a manner provided in the Companies Act.

STOCK- A stock is different from share in the sense that a company cannot originally issue stock. Only fully paid up shares, if authorized by AOA, can be converted into stock. The benefit of this conversion is that stock can be transferred in fractional value whereas fractional transfer is not possible in case of shares. Eg. 10 shares of face value of Rs. 100 each if converted into stock of Rs.1000 can now be transferred in any amount say as stock of Rs.625 or stock of 450 or 760 etc.

There may be different kinds of shares in any company - Equity Shares and Preference Shares.

Equity Shares are the shares which have **residual right in the matter of dividend and repayment** of capital at the time of winding up. They get dividend only after the preference shareholders have been paid their fixed dividend and similarly at the time of the winding of the company, they are entitled to return of capital only after preference holders have been paid. A company may issue the following types of equity shares-

- ✓ Equity Shares with voting rights (Ordinary Equity)- These shares carry normal voting rights on them .
- ✓ Equity Shares with differential rights (Special Equity)-These carry differential rights as to dividend, voting or otherwise.

Preference shares are those which enjoy preferential rights (a) as to payment of dividend at a fixed rate during the life of a company and (b) as to return of capital on the winding up of the company. The preferential shareholders do not enjoy normal voting rights like the equity shareholders with voting rights. They are entitled to vote only in the following cases-

(a) When any resolution directly affecting their rights is to be passed. e.g. *resolution for winding up of the company*

(b) When the dividend due on their preference shares has remained unpaid for 2 years or more ,then they become entitled to vote on ALL the resolutions placed before general meeting.

Equity Shares with differential rights

Conditions that must be satisfied-

- **The AOA of the company must authorize the issue of shares with differential rights**
- **An Ordinary Resolution authorizing issue of such shares must be passed by shareholders in the general meeting.**
- **Resolution passed by shareholders must specify a) the rate of voting right and b) rate of additional dividend on them**
- **Holders of equity shares with differential voting rights shall be entitled to bonus/rights shares of the same class only.**
- **The company should not have defaulted in filing financial statements and annual returns in the last 3 FYs**
- **The company should not have defaulted in the payment of declared dividends to shareholders \ interest obligation on debentures\ interest on deposits\payment of interest on term loans borrowed from banks or financial institutions\ redemption of preference shares or debentures\ repayment of matured deposits\ repayment of term loans etc.**
- **The company should not have defaulted in payment of statutory dues relating to its employees to any authority etc.**

Example- Tata Motors in 2008 introduced equity shares with differential voting rights .In this issue every 10 of such shares carried only one voting right but would get 5 percentage points more dividend than declared on each of the ordinary shares.

Advantages of equity shares with differential voting rights

- Small shareholders, who hardly exercise voting rights, find such shares attractive as these offer more rate of dividends.
- Management of the co. also finds it attractive as it can raise capital without diluting/reducing its control in the company .

Issue of Shares at Premium(Sec.52), at Discount (Sec.53)

When a company issues shares at a price higher than their face value, it is called **issue of shares at premium**. The company is free to make such an issue but there are certain *restrictions on use of the premium amount* so collected. The Securities Premium Account may be used for-

- ✓ Issue of fully paid **B**onus shares
- ✓ Writing off the **p**reliminary expenses of the company
- ✓ Writing of **c**ommission/**d**iscount/**e**xpenses on any issue of shares or debentures of the company
- ✓ **B**uyback of shares
- ✓ Providing **P**remium payable on redemption of preference shares or debentures of the company.

Similarly, when a company issues shares for consideration less than their par value, it is called **issue of shares at a discount**. **Sec.53 prohibits issue of shares(except sweat equity shares) at a discount.** Thus , except sweat equity shares, no shares can be issued at a discount.

Sweat equity shares (Sec.54) are such equity shares which are issued by the company to its **employees\ directors** at a **discount\for consideration other than cash** for providing their **knowhow \ IPRs \ value additions.** The company may issue sweat equity if the following conditions are satisfied -

- The shares must be of a class already issued.
- Passing of SR authorising such issue in the general meeting .
- The resolution must specify the number of shares, their current market price, consideration, discount offered, names of directors\ employees who would be issued such shares.
- The issue of sweat equity must also conform to SEBI guidelines(in case of listed shares) or prescribed CG Rules (in case of unlisted shares)

ESOPs(Employee Stock Option Plans)Sec.62(1)(b)

A company can make further issue of shares to its employees under the scheme of ESOPs. It is an instrument used by companies to attract, retain and motivate its employees. Here option is given to the directors, officers and employees of a company which gives them a right to purchase or subscribe for, the shares of a company at a future date at a predetermined price which is usually lower than the market price .

- **The scheme of ESOPs must conform to SEBI Guidelines(in case of listed companies) or prescribed CG Rules (in case of unlisted companies)**
- **ESOPs are given to permanent employees(whether working in India or abroad) and to directors(whether whole- time or part- time) of the company**
- **Independent Directors or employees who are promoters or belong to promoters group are not eligible for ESOPs**
- **The company should get Special Resolution passed by shareholders for approval of ESOP Scheme.**
- **The explanatory statement annexed to the notice for general meeting shall contain particulars like total no. of stock options granted, exercise price, lock in period etc.**
- **The option granted shall not be transferable to any other person**
- **The employees will not have right to dividend or right to vote etc .until option is exercised by them and shares are issued.**
- **The company shall maintain an ESOP Register to enter the particulars of options granted in it.**
- **The details of ESOPs must also be disclosed in Directors Report**

Sweat Equity vs Employees Stock Option Plans

SWEAT EQUITY SHARES	EMPLOYEE STOCK OPTION PLANS
Covered u/s 54 of Companies Act,2013	Covered u/s 62(1)(b) of Companies Act, 2013
Here shares are allotted to the directors/ employees of the co.	Here options are granted to the employees/ directors. If option is exercised by them, then only shares are allotted to them
These shares can be issued at a discount (i.e. price lower than face value) .	Shares under an ESOP scheme can be purchased at a predetermined price which is generally lower than the market price.
Sweat equity may be issued for consideration other than cash eg. making available value addition, IPRs, knowhow	Consideration for purchase of shares under ESOP scheme is only cash/ money
Sweat equity can be issued to promoters	ESOPs cannot be issued to promoters or promoters group

Rights Issue and Bonus Issue

RIGHTS ISSUE\SHARES(Sec.62)	BONUS ISSUE\SHARES(Sec.63)
Whenever a company, proposes to increase its subscribed capital by allotment of further shares, the offer must first be made to the present equity shareholders. Such shares are called Rights Shares	Whenever a company having large undistributed profits issue fully paid up shares to their existing shareholders ,free of charge, they are known as Bonus Shares.
Rights Shares are to be paid for by existing shareholders .	Shareholders don't have to pay anything on bonus shares .
Rights shares are offered at a price decided by the directors of the company.	Bonus shares are totally free of charge. No price is charged on them.
Rights shares bring cash into the company.	Bonus shares don't bring any cash into co.
Rights shares may be partly paid.	Bonus Shares are always fully paid up.
The shareholder has right of renunciation of the rights offer in favour of his nominee.	There is no right of renunciation in case of bonus shares.
Rights Issue must comply with minimum subscription requirements.	Bonus Issue need not comply with minimum subscription requirements.
Rights issue is made when a company needs funds to meet the growth and diversification requirements of the company.	Bonus issue is made when a company doesn't want to distribute its profits and reserves by way of dividends but retains them and converts them into shares.
It is also known as RIGHT OF PRE-EMPTION.	It is known as CAPITALISATION OF UNDISTRIBUTED PROFITS

Rights Issue and Bonus Issue

RIGHTS ISSUE (Sec.62)	BONUS ISSUE(Sec.63)
CONDITIONS TO BE SATISFIED	**CONDITIONS TO BE SATISFIED**
• *Approval by shareholders not required for rights issue.Offer must be made to present equity shareholders on a pro rata basis.* • *Notice must be issued to shareholders specifying the number of shares offered and the period of offer (time limit for exercising this right must be not less than 7 days and not more than 30 days from date of offer)* • *If offer is not accepted during this period ,it will be deemed to be declined. In case the members declines or is deemed to have declined the offer, the board of directors can dispose them off as they think most beneficial to the company.* • *The member shall be given the **right of renunciation of offer** in favour of his nominee* • *Listed companies must also comply SEBI(Issue of Capital and Disclosure Requirements) Regulations, 2009 for rights*	• *Bonus issue must be authorised by AOA, resolution of BOD and ordinary resolution of shareholders in a general meeting* • *Fully paid bonus shares can be issued by company out of its free reserves or securities premium account or the capital redemption reserve account* • *The company issuing bonus shares must not have defaulted in payment of debts (eg. interest ,principal) or statutory dues of employees (eg. gratuity, bonus, contribution to PF)* • *If on the date of allotment of bonus shares, company has partly paid up shares, they must be first of all made fully paid.* • *Listed companies must also comply SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 for bonus issue.*

Buyback of shares (Sec.68,69, 70)

It means repurchasing of shares by the company that issued them. The Companies Act through Sec.68 to 70 permits companies to buyback its shares subject to certain restrictions.

Rationale for Buyback

- Enhancement of shareholders wealth- When shares are bought back and cancelled, it reduces the outstanding number of shares thus improving earning per share, EPS
- Better investment alternative- A cash rich company looking for investment alternatives may prefer to buyback its own shares at the market rate rather than investing in shares of some unknown company.
- Ownership consolidation- Through buyback, the existing management can increase its percentage stake and thereby avert any hostile takeover bid.

Provisions relating to Buyback

Funds out of which buy back can be financed [Sec.68(1)] - A company may buyback its shares\ securities out of

- **a) its free reserves or**
- **b) securities premium account or**
- **c) proceeds of issue of any shares or specified securities** *(but not of same kind of shares/securities)- This implies that equity shares can be redeemed out of an earlier preference shares or debentures issue but not out of earlier equity shares issue.)*

Conditions to be fulfilled before resorting to buyback [Sec. 68(2), 68(3),68(4)]

- **The AOA must authorise buyback of securities**
- **Passing of SR by shareholders in general meeting- (** ***However no SR is required where buyback is up to 10% of (total paid up capital + free reserves of co.) and is authorised by Boards' Resolution)***
- **The notice convening general meeting to contain** ***explanatory statement*** **containing details of buyback including justification for buyback, securities to be purchased, amount involved and time limit for completion of buyback**
- **The shares or securities to be bought back should be fully paid up.**
- **The amount involved in buyback must not exceed 25% of (total paid up capital + free reserves of co.)**
- **After the buy back, the ratio of(debt) to (capital + free reserves) should not exceed 2:1.**
- **The buyback operations must be completed within 12 months of passing of SR.**
- **The time gap between two buybacks must be minimum 1 year.**
- **Buyback must be in accordance with SEBI regulations(in case shares are listed) or with CG rules (in case shares are unlisted).**

Methods of buyback [68(5)]

1. **From existing shareholders or securities holders** on a proportionate basis- **Tender Method -** Here the company fixes and announces the price and quantity of shares which it wishes to buyback. If number of shares offered by shareholders at that stated price exceeds the required quantity, shares will be bought on pro rata basis.
2. **From open market** under

✓**Stock Exchange Purchase Method -**Here, the company buys shares through stock exchange till it reaches maximum number of shares it had originally decided to buyback and the market price does not exceed the predetermined maximum price for buyback.

✓**Dutch Auction Method-** Here, the company announces the **quantity of shares** to be purchased and **offer price range** ,say ₹80 to ₹100 . The company then invites bids from shareholders within that price range and analyses those bids. The company selects the offered price from lowest price onwards at which the cumulative number of shares offered equals or exceeds the required quantity of shares it announced to buyback. This is the final buyback price and is paid to all shareholders whose shares have been accepted for buyback.

3. **From employees of the company** whom it had issued securities under the' scheme of stock option' or 'sweat equity '

OTHER PROVISIONS RELATING TO BUYBACK

- **Declaration of Solvency** [Sec.68(6)] - Before buyback, the company is required to file with ROC and SEBI a declaration of solvency duly signed and verified by an affidavit from the board of directors that the company is capable of meeting its liabilities and will not be rendered insolvent within a period of one year.
- **Physical destruction of securities**[68(7)]- After completion of buyback operations, the securities must be extinguished and physically destroyed within 7 days of completion of buyback.
- **Restriction on further issue after buyback** [68(8)]- Where a company has bought back its securities it cannot make a further issue of same kind of securities within a period of six months from date of completion of buyback.
- **Register of bought back securities** [Sec.68(9)]- The company has to maintain a register containing the following particulars relating to buyback such as consideration paid, date of cancellation or physical destruction of shares etc.
- **Return of Buyback**[68(10)]- Within 30 days of completion of buyback, the company has to file a return in prescribed form with ROC and SEBI containing all relevant information regarding buyback .
- **Transfer of certain sum to Capital Redemption Reserve** [Sec.69] - In case a company purchases its own shares out of its free reserves or securities premium account, an amount equal to nominal value of shares purchased must be transferred to CRR .The CRR is a special type of reserve which is treated as share capital for reduction of capital purposes and can be utilised only for issue of bonus shares.
- **Prohibition for buyback in certain circumstances**[Sec.70] - A company is prohibited from buying back in cases below

✓ through any subsidiary company \ or its own subsidiary company \or any investment company

✓ if it has defaulted in repayment of its deposits\term loan\ redemption of preference shares or any interest\ dividend thereon.

✓ it has not complied with provisions relating to filing of annual return (Sec.92) or declaration of dividend (Sec.123), timely payment of dividend(Sec.127) or preparation of Financial Statements in prescribed form (Sec.129)

- **Penalty-** In case of non compliance of the above provisions, the company shall be punishable with fine ranging from ₹ 1 lakh to 3 lakh and officers in default shall be punishable with imprisonment up to 3 years and\or fine ranging from 1 lakh to 3 lakh .