2. CAPITAL OF A COMPANY

Introduction

Company form of business organization is best suited to raise the funds compared to sole proprietorship and partnership. There are several reasons for this. Firstly, the capital of a company is raised through public issue of shares. A company can appeal to a large number of people to contribute to the share capital. Different types of shares be issued to suit the requirement of different types of investors. Since, there is no limit to the number of owners, unlike in case of sole proprietorship and partnership, a public company can issue shares to a large number of shareholders.

Share capital

A company raises its capital through issue of shares. Share capital of a company consists of individual shares of fixed denomination. The shares of public company are transferable. Share capital is the money a company raises by issuing common and preferred stock. It refers to a fund that company raises from selling the shares to the investors.

For example: The sale of 1,000 shares at Rs. 15 per share raises Rs.15,000 of share capital.

The share capital of a company may be in following forms

- **Nominal / Authorized / Registered Capital:** This refers to the amount of the share capital which a company is incorporated with. It is the share capital as mentioned in the Memorandum of Association of a company. The capital clause of the MOA of a company contains the total capital which a company is proposed to be registered with it also contains the share capital which a company is authorized to issue.
- **Issued Capital:** This refers to that portion of the authorized capital which a company decides to issue for public subscription. The issued capital can be less than or equal to the nominal capital. Normally, a company may not issue the complete authorized capital for public subscription at once.
- **Subscribed Capital:** The entire number of shares which a company issues to the public may or may not be subscribed by the investing public. Subscribed capital refers to that portion of the issued capital which investing public subscribed to.
- **Called-up Capital:** It refers to that portion of the issued capital which the company call on shares.
- **Paid-up Capital:** This refers to that portion of the called-up capital which is paid by the shareholders.

- **Uncalled Capital:** The balance remained of the issued capital which is not called-up is called uncalled share capital. The company may call the uncalled shares any time subject to the stipulated terms of the issue and provisions of its Articles of Association.
- **Reserve capital:** This refers that portion of uncalled capital of a company which is called only in the event of winding up.

Kinds of Share Capital

As per section 86 of companies Act, 2013 share capital can be of two types namely,

1. **Preference Share capital:** Preference Share capital is that part of share capital that carries two preferential rights –

   a) Preferential right as to the payment of dividend.
   b) Preferential right as to the payment of capital at the time of winding up.

2. **Equity Share Capital:** Equity share capital is that part of the capital which consists of ordinary shares. In other words, equity shares do not carry any preferential rights.

   Equity share capital, with reference to a company limited by shares, means all share capital which is not preference share capital.

Shares

Meaning of shares: The share capital of a company is divided into certain indivisible units of fixed amount. Each such indivisible unit is called share.

Definition of shares: As per section 2(84) of the companies Act, 2013 "A share means a share in the share capital of the company and includes stock, except where a distinction between stock and share is expressed or implied".

Merits of Shares or Share Capital

1. **Raising Capital:** Companies have many sources of raising capital including selling of shares. Except the share capital source, other sources are painful. Interest need not be paid on the capital raised through this source. Equity shares do not create any obligation to pay fixed rate of dividend as in case of preference shares. Even after earning profits, the board may skip dividend to

shareholders due to want of liquidity or for utilisation of profit for working capital or for any other immediate expenditure.

2. **Source of Long-term Finance:** Issue of shares, as a source of capital need not be paid back, except on liquidation of the company. Share capital serves as a long-term and permanent source of finance. The funding is committed to the concerned business or project. But shareholders can realize their share money at any time by selling the shares. The sale or resale will not affect the capital of the company.
3. **Credit worthiness:** The capital raised through shares does not affect any asset position of company. On the other hand, it enhances the credit worthiness of the company. This means that company can raise further capital on the security of these assets. It eases the further flow of capital to the company.
4. **Trading on equity:** Share capital is considered as risk capital. In the bad period of the company, it can trade on equity. This means it can vary its debt-equity ratios find money for its working capital. The company can take risk of raising more capital through debentures and other borrowings in its good time. But in the riskier situation it can always lean only on equity shares.
5. **Cost of capital:** Equity share capital is less expensive when compared to preference capital and borrowed capital. It is considered as ownership and shareholders are considered as residual claimants of earnings or of their own funds. As shareholders are the owners of the company, they cannot claim any interest or dividend on their investments, except receiving dividend or their portion of profit in company's best position.
6. **Growth advantage:** The burden of cost of capital is almost zero. Shareholders will be benefited only by the growth of the organisation through good governance. Shareholders always expects growth of business through exploring and executing growth ideas.
7. **Ownership:** Share capital creates ownership to shareholders. Shareholders acquire voting rights and will have voice in the management of the company. Active shareholders do control the operations of the company through their voting rights. Even small shareholders can join together and raise against the misdeed or malpractice of the company. Companies Act, 2013 also empowers the rights of shareholders.
8. **Profit and Wealth maximisation:** Raising capital through shares, reduces certain costs and all the company to grow in terms of increased value of assets. Not all the profits or assets of the company will be distributed to the shareholders. By retaining major portion of earnings, the company the company adds value to the asset and creates good image to the company.
9. **Voting rights:** Share capital, as a major source of finance, creates innumerable small holders of share and legally all these small and big holders are the owners of the company. Every shareholder has the decision-making power, as every issue of the company will be discussed with the

shareholders in annual general meeting. Every shareholder, irrespective of the size of the holdings, will have voting right every matter or issue discussed in annual general meeting.

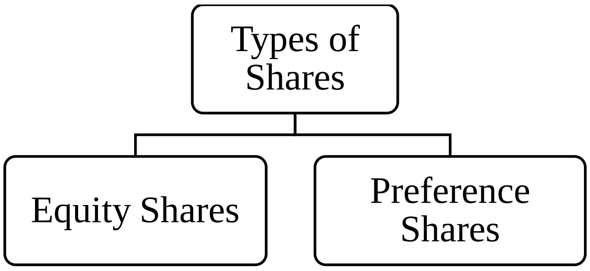
Demerits of Shares / Share Capital

1. **Demanding and time consuming:** Issue of shares in the capital market whether it is Initial Public Offerings (IPO) and Follow on Public Offer (FPO), is a time-consuming process and it is demanding too. This will take away the management focus on core busines of the company. Company will be worried till such time the required finance is subscribed by investors towards share capital. The cost of issue will also be expensive.
2. **Trading on Equity not possible:** If the company relies only on equity capital, “Trading on Equity” cannot take place and the shareholders will be put to loss during the growth and successful period of the company. If they cannot balance the capital position with borrowed finance, major portion of earnings in boom period will be distributed to shareholders and less or no portion profit can be retained for the future wealth creation.
3. **Over-capitalisation:** Issue of more shares to raise the capital results in over-capitalisation. This situation puts down the morale of investors as the company will pay less dividend to them. It is difficult situation to overcome.
4. **Inflexibility of capital structure:** As the shares once issued cannot be paid back till liquidation or winding up of the company with this, capital structure of the company will not be flexible. Proper balancing between equity and debt will not be possible to take advantage of boom period of business. Inflexibility in capital structure with more issue of equity, will hamper the interest of investors.
5. **Investors Anxiety:** When more funds are raised through share capital, investors look the background of promoter in case of IPO. The shareholders will study financial statements of 3years in case of FPO. In both the cases, investors think too much to invest and it may cause delay in raising funds of the company. The problem in this situation is to satisfy and clarify the doubts of investors, which is difficult for companies.
6. **Legal Hurdles:** The companies will have to pass through various legal barriers to raise the capital through shares. Companies cannot raise equity capital till such time they are incorporated as per the provisions of companies Act. Even issue procedure is more legal-oriented and it will difficult job for inexperienced promoters.

7. **Speculation:** Equity shares are well recognised organisation are always subjected to hectic speculation in the stock market. Their prices fluctuate frequently, which are not in the interest of the company.
8. **Recession period management:** During recession period, earnings will be less and rate of dividend comes down. This results in fall in market price of such shares and finally investors may lose their capital. Managing recession time and keeping investors in restful mood is tough task for the company.
9. **Loss on liquidation:** At the time of liquidation, shareholders will be the last recipients of proceeds of realisation of assets. The shareholders may or may not get the money of share value hold. On many liquidations, shareholder lose their money.

<u>Types of Shares</u>

Shares of a company can be of two types, they are-



1**. Equity Shares**

Section 43 of the companies Act, 2013 states that "equity share capital" with reference to any company limited by shares, means all share capital which is not preference share capital.

Though the definition is vague, it can be said that equity shares do not carry preferential rights enjoyed by the preference shareholders.

In other words, equity shareholders do not enjoy the two important preferential rights:

- Preferential rights as to payment of dividend
- Preferential rights as to repayment of capital at the time of liquidation of the company

2. **Preference Shares**

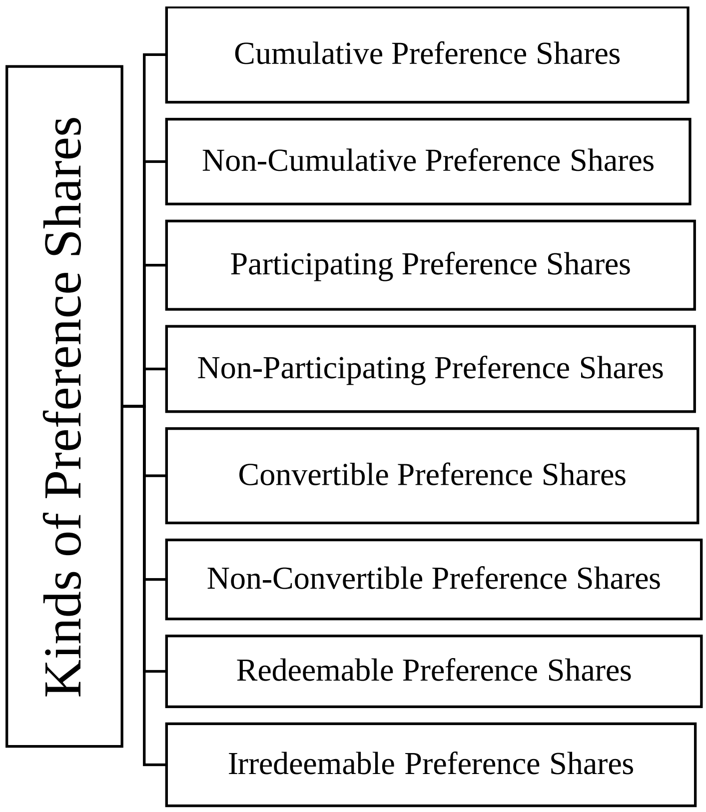
According to section 43 of companies Act, 2013, preference shares are those which have,

- Preferential rights as to payment of dividend
- Preferential rights as to repayment of capital at the time of liquidation of the company

<u>Rights enjoyed by Preference Shareholders</u>

1) The preference shareholders enjoy preferential right as to the payment of dividends. They are paid dividend in preference over equity shareholders.
2) The preference shareholders may enter into agreement with the issuing company to participate in surplus profit after paying dividend to equity shareholders.
3) Further, the cumulative clause will provide for accumulation of dividend in a year when dividend is not given because of non-availability of profits.
4) Though the preference shareholders do not enjoy normal voting rights, they can vote on all matters affecting their interest. The preference shareholders will not be having a right to vote on matters like – when dividends are in arrears, creation of prior charge, heavy accumulation of debts, reorganization and consolidation schemes.
5) Right on redemption is an important right, wherein the preference shareholders will get the repayment of their capital after the stipulated period of time as per the terms of issue of shares.

<u>Types / kinds of Preference Shares</u>



- **Cumulative Preference Shares:** Cumulative Preference Shares are those shares in which the holders have right of dividend even if the company has missed to give them the dividends in the past. in particular year when the dividend is not paid to preference shareholders, it will not lapse. It will get accumulated and paid out of subsequent year's profits. However, the company need not pay dividend in case of insufficient profits.
- **Non-Cumulative Preference Shares:** Under this category, the dividend of preference shareholders in case of inadequate profits in a year. These preference shareholders cannot claim arrears of dividend in the subsequent period. In the absence of specific provision to the contrary in the Articles of Association of the company, preference shares are presumed to be Cumulative preference shares.
- **Participating Preference Shares:** In addition to enjoying a fixed rate of dividend, these shareholders enjoy a share in the surplus profits of the company remaining after paying dividend to equity shareholders at the stipulated rate. The surplus will be shared between the participating preference shareholders and equity shareholders in the agreed ratio.

  In the absence of specific provision to the contrary in the Articles of Association of the company, preference shares are presumed to be Non-participating preference shares.
- **Non-Participating Preference shares:** The holders are entitled only for stipulated rate of dividend. Surplus profits, if any, will be enjoyed only by the equity shares.
- **Convertible Preference Shares:** This kind of shares carry the conversion clause (Converting Preference shares into equity shares). The holders of these shares enjoy the right to convert their shares into equity shares within stipulated period.
- **Non-Convertible Preference Shares:** As the name suggests, the holders of these shares do not enjoy the right to convert their shares into equity shares.
- **Redeemable Preference Shares:** Redeemable preference shares are those shares which carry the provision of redemption of capital to the shareholders during the lifetime of the company. The issue of preference shares is subject to following conditions.
  - The Article of Association of the company must specifically provide for issue of redeemable shares.
  - Redemption is possible only when the shares are fully paid.
  - Redemption is possible only out of profits of the company or out of proceeds of the fresh issue of shares made for the purpose of redemption.
  - In case when the redemption is made out of profits, a sum equivalent to the nominal value of shares redeemed must be transferred to the 'Capital redemption reserve account'

- Any premium payable on redemption is possible only out of the profits of the company or out of the share premium account maintained by the company.

➢ **Irredeemable Preference Shares:** As per section 55 of the companies Act, 2013 all the existing preference shares which are redeemable or irredeemable not earlier than 10 years are compulsorily redeemed. Further, companies can issue only such preference shares articles authorises in future as are redeemable for not more than 20 years. In case of infrastructural projects, preference shares can be issued for more than 20 years. The issue of Irredeemable preference shares is prohibited.

Difference between Equity shares and Preference Shares

Basis	Equity Shares	Preference Shares
Meaning	Equity shares are called ordinary shares because the equity shareholders do not enjoy the preferential rights which preference shareholders enjoy	The preference shares are those shares which enjoy the following preferential rights. a) Preferential rights as to payment of dividend b) Preferential rights as to repayment of capital at the time of liquidation of the company
Rate of Dividend	The rate of dividend on equity shares is not certain. The shareholders may or may not get dividend during a particular year. The payment of dividend to equity shareholders is subject to discretion of the Board of directors of the company.	The rate of dividend will be fixed in case of preference shareholders. The preference shareholders will receive dividend as per stipulated rate fixed at the time of issue of shares.
Voting rights	Equity shareholders enjoy normal voting rights, which the preference shareholders do not enjoy. Equity shareholders can vote on all matters which come before the meeting	Preference shareholders can vote only on those matters which affect their interest directly.
Arrears of Dividends	Equity shareholders will not be having a right to claim the arrears of dividend. They have to forego dividend when it is not declared during the year.	Cumulative preference shareholders will enjoy the right to claim the arrears.
Redemption	Equity shareholders will not get back their capital from the company in its life time. In other words, there is no redemption of	Preference shares especially redeemable preference shareholders the capital will be repayable to the shareholders on the

	capital for the equity shareholders during the lifetime of the company.	expiry of the stipulated period for which such shares are issued.
Liquidity	Though equity shareholders do not enjoy the preferential rights, they are most preferred by the investing public. The listed equity shares enjoy more liquidity in the stock market.	Preference shares are not liquid.
Role in Management	Equity share comes with the power to participate in the company's Management.	Preference shares does not have any rights to participate in company's management
Convertibility	Equity shares cannot be converted.	Preference shares can be converted into equity shares.
Capital Repayment	The capital for equity shareholders will be repaid at the end	The capital for preference shareholders will be paid before equity shares holders.
Capitalisation	There is a high chance of over capitalisation	There is relatively less chance of over capitalisation.
Financing Term	Equity shares serves as a means of long-term finance	Preference shares serves as a means of mid-term or long-term finance.
Types of investors	Equity shares are suitable for risk-taking investors.	Preference shares are suitable for risk-averse investors.

Debentures

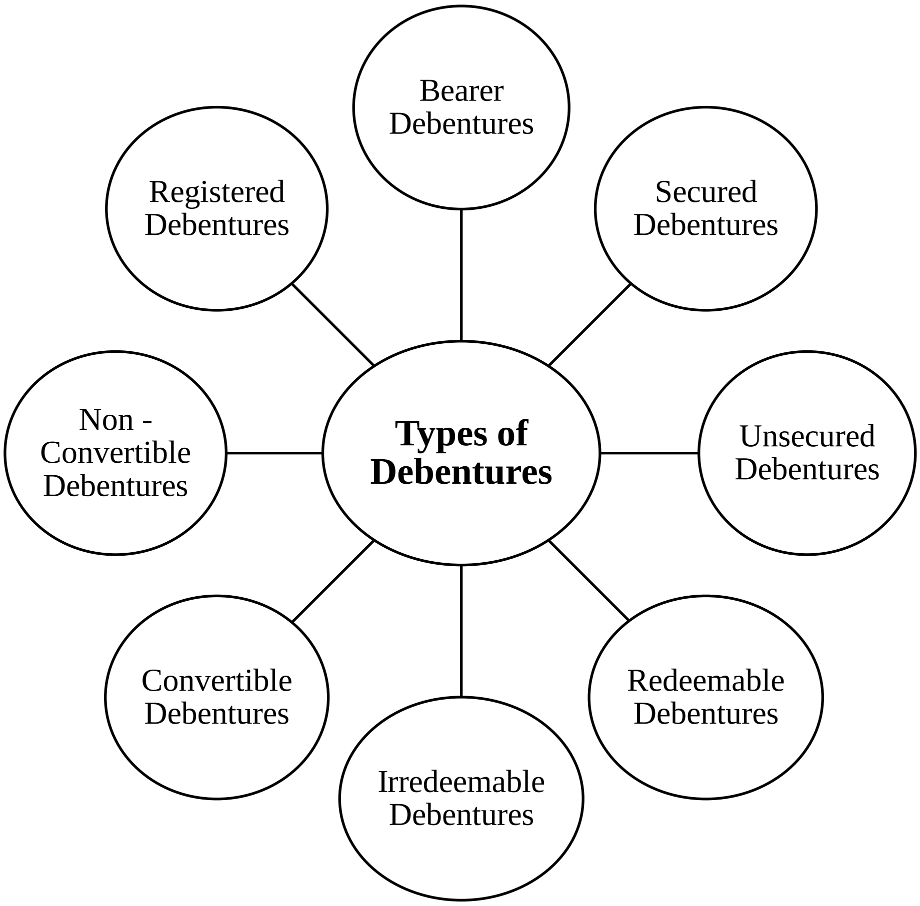
According to Section 2(30) of the companies Act 2013, "Debentures includes debenture stock, bond and any other securities of company whether constituting a charge on asset of the company or not". The term debenture refers to an instrument under the common seal of the company to the holders of the debenture. It is an instrument also contains an undertaking to repay debt at a specified date or at the option of the company.

Features of Debentures

- Debenture is an instrument issued by the company acknowledging the debt.
- Debentures is issued under the common seal by the company, though it is not compulsory.
- Though debenture is one of series, it is not uncommon to issue a single debenture.

- Normally debenture is issued involving a stipulated period of time after which the repayment is made. Irredeemable debentures also can be issued by a company.
- Normally, debenture creates a charge on the assets of the company.
- The debenture holder is treated as a creditor and thus does not enjoy normal voting right.

Kinds of Debentures



1) Registered Debentures: These debentures are registered in nature; in the sense the name of the holder is mentioned both in debenture certificate as well as in the register of debenture holders. The rights attached to registered debentures are enjoyed only by registered debenture holder. The repayment of the debenture amount, interest on debenture will be paid to the person whose name is registered.

Conditions to issue registered debentures, normally following are the important points included in debenture bond;

- Stipulation regarding the payment of principal amount
- Stipulation regarding payment of interest

- Stipulation regarding charge on undertakings and property of the company
- A statement that these debentures are issued subject to the stipulated conditions

2) Bearer debentures: Bearer debentures are those where there is no registration of the holder is done. The name of the holder is not mentioned either on debenture bond or in the register of debenture holders. It is a bearer instrument where the bearer (holder) will get repayment. Like negotiable instruments, bearer debentures are transferable by delivery.

3) Secured debentures: Secured debentures are those, where the charge is created on the undertaking or property of the issuing company. The interest of the debenture holder will be secured through creating a charge on the assets of the company. The charge may either be fixed or floating in nature.

- Fixed charge: Debenture is said to enjoy fixed charge when the charge is created on specific or definite property of the company. For example, the fixed charge can be created on land and building of the company.
- Floating Charge: In case of floating charge the charge is not created on any specific property of the company. Floating charge is created on property which is constantly floating. For example, in case of stock-in trade on which floating charge is created, the charge on this property ceases to exist as soon as the asset is sold. Under this case, the charge is not attached to any specific property until it crystallizes.

4) Unsecured debentures: These debentures are also called as a naked debenture. Unsecured debentures are those which do not create any charge on the assets of the company. The unsecured debentures will be treated as ordinary unsecured creditors who can sue the company for recovery of their money due.

5) Redeemable Debentures: Normally, debentures are issued with a stipulation regarding repayment of the amount due on expiry of the stipulated period of issue. The amount due on the debentures will be redeemed to the debenture holders. The debentures which are redeemed can be reissued by the company.

6) Irredeemable debentures: This means that redemption of debenture amount will not be done. In case of irredeemable debenture either there is no fixed period for repayment of the principal amount or repayment of the debenture amount is subject to an event which may or may not happen.

7) Convertible Debentures: In case of this debentures, the holders are given an option to convert their debentures into equity or preference shares at a stated rate of exchange on the expiry of stipulated period. On exercising the option to convert, the holders will become members of the company.

8) Non-convertible Debentures: The holders of this category of debentures do not enjoy the option to convert the debentures into shares.

Advantages of Debentures

1) The company can raise funds through debentures without diluting the control
2) There is certainty of finance for a specified period of time and the company can adjust its financial plan accordingly.
3) The company will have distinct advantage of trading on equity.
4) Debentures appeal to cautious investors
5) The cost of issue of debenture for the company is comparatively low
6) Debentures may be issued out of necessity as a situation may be reached in a company where it may be compelled to mortgage its assets for raising the funds.
7) A company might have already incurred number of small debts of short duration which may be costlier and burdensome. These innumerable debts can be converted into debentures which will prove less costly.

Disadvantages of Debentures

1) Slackness in earnings may affect the capacity of the company.
2) Assets of the company are charged in case of debenture issue.
3) A company may be debt ridden and may find it difficult to face emergency situation.
4) Care must be taken while trading on equity. Trading on equity often magnifies losses.

Difference between Shares and Debentures

Shares	Debentures
1.Shares constitute ownership securities.	1.Debenture represents the creditorship securities.
2.Shareholders are the owners of the company.	2.Debenture holders are the creditors of the company.
3.The return on shares is called dividend	3.The return on debentures is called interest.

4.The dividend paid to the shareholders are not pre-fixed.	4.The interest on debentures is pre-fixed as per the terms of the issue of debentures.
5.Shareholders (Especially equity shareholders) may or may not get the dividend. Dividend payment depends on the profitability position of the company. Further, dividend is at the discretion of the board of the directors of the company.	5.Payment of interest on debentures is mandatory. It is not dependent on profitability position of the company.
6.Shareholders (some of the equity shareholders) do not receive the share amount back from the company during the life time of the company.	6.Debenture amount will be returned to the debenture holders on the expiry of the stipulated period for which the debentures are issued.

SEBI Guidelines

I Issue of Equity shares

The important aspects of SEBI Guidelines, with reference to issue of equity shares are as under:

1) As per the guidelines, an unlisted company can make an initial public offering of equity shares or any security convertible at a later date into equity only if it has net tangible assets of at least Rs. 3 crores in each of the preceding 3 full years if which not more than 50% is held monetary assets. If more than 50% is held in monetary assets, the company should have made firm commitments to use excess in its business or projects.

2) An unlisted company which do not satisfy the requirements specified above can make only offer to the public of equity or any security convertible at a later date into equity only through book building process.

3) The minimum post-issue face value capital of the company should be Rs.10 crore or there should be a compulsory market-making for at least 2 years from the date of listing of shares subject to following,

    - Market makers undertake to offer buy and sell quotes for a minimum depth of 300 shares.
    - Market makers undertake to ensure that the bid-ask spread for their quotes shall not at any time exceed 10%.

- The inventory of the market makers on each of such stock exchanges, as on the date of allotment of securities, shall be at least 5% of the proposed issue of the company.

4) It is stipulated that an unlisted public company shall not make an allotment pursuant to a public issue or offer for sale of equity shares or any security convertible into equity shares unless in addition to satisfy the aforesaid conditions, the prospective allottees are not less than 1000 in number.

5) The guidelines require that a public issue of equity shares or any other security which may be converted into equity shares at a later date, in case of a listed company, may be made provided that the aggregate of the proposed issues and all previous issues made in the same financial year, in terms of issue size, does not exceed five times its pre-issue net worth as per the audited balance sheet of the financial year.

6) If there is a change in the name of the issuer company within the last one year, the revenue accounted for by the activity suggested by the new name should not be less than 50% of its total revenue in the preceding one full year period. The last one year should be reckoned from the date of filing of the offer document.

7) If the net worth after the proposed issue of equity shares or any security convertible at a later date into equity becomes more than five times the net worth prior to the issue, it is also required to satisfy the criteria book building process and allot 50% of the issue size to QIB's (Qualified Institutional Buyers) failing which subscription money is required to be refunded.

8) Eligibility norms require credit rating from credit rating agency registered with board and its disclosure in the offer document. Where credit ratings are obtained from more than one credit rating agencies, all the credit ratings, including the unaccepted credit ratings, should be disclosed. It also requires disclosure regarding all the credit ratings obtained during 3 years preceding the public or right issue or issue of debt instrument in the offer document.

9) An issuer company cannot make an allotment of non-convertible debt instrument pursuant to a public issue if the proposed allottees are less than 50 in number.

10) Eligibility criteria also requires the company to file a draft of prospectus through eligible merchant banker with SEBI at least 30 days prior to the filing of prospectus with registrar of companies as prescribed in the guidelines.

11) If the board specifies changes or issues observed on the draft prospectus, the issuer company or the lead manager to the issue is required to carry out changes in the draft prospectus or comply with the

observations issued by the board before filing the draft prospectus with the registrar of company. Further the period within which the board may specify changes or observe issue is 30 days from the date of receipt of draft prospectus by the board.

12) If the issue is found in the draft prospectus, the board has to search for any clarification or additional information by the lead manager/s to the issue, the period within which the board may specify changes or observed issues, if any, on the draft prospectus is 15 days from the date of receipt of satisfactory reply from the lead managers.

13) If the board has made any reference to or sought any clarification or additional information from the regulators or such other agencies, the board may specify changes or issue observations, if any, on the draft prospectus only after receipt of such comments.

14) The board may specify change or issue observations, if any on the draft prospectus only after receipt of copy of principal approval from all stock exchange on which the issuer company intends to list the securities proposed to be offered through the prospectus.

15) The company has to make statement to the effect that the company has made an application for listing of those securities in the stock exchanges and should not have been prohibited from accessing the capital market under any order or directions passed by SEBI.

16) The company is also required to entered into an agreement with a depository for dematerialization of securities already issued or proposed to be issued to the public or existing shareholders and give an option to shareholders to receive the security certificates or hold shares in the dematerialized form with the depository.

17) There should not be outstanding warrants or financial instruments or any other right which would entitle the existing promoters or shareholders any option to receive equity share capital after the initial public offering in case of unlisted company making a public issue of equity shares.

18) The existing partly paid-up shares must be fully paid or the subscription money be forfeited if the investors fails to pay call money within 12 months.

<u>II Issue of Preferential shares</u>

SEBI Guidelines to issue preferential shares are as follows:

Sl. No	Clause	Description
1.	**13.0**	The preferential issue of equity shares/ Fully Convertible Debentures (FCDs) / Partly Convertible Debentures (PCDs) or any other financial instruments which would be

		converted into or exchanged with equity shares at a later date, by listed companies whose equity share capital is listed on any stock exchange, to any select group of persons under section 81(1A) of the Companies Act 1956 on private placement basis shall be governed by these guidelines.
2.	**13.1**	Such preferential issues by listed companies by way of equity shares/ Fully Convertible Debentures (FCDs) / Partly Convertible Debentures (PCDs) or any other financial instruments which would be converted into / exchanged with equity shares at a later date, shall be made in accordance with the pricing provisions mentioned below:
	13.1.1	**(a) Pricing of the issue:** The issue of shares on a preferential basis can be made at a price not less than the higher of the following:
	13.1.1.1	➢ The average of the weekly high and low of the closing prices of the related shares quoted on the stock exchange during the six months *(as per amendment passed on 22nd January 2021, the period is extended to 12 months)* preceding the relevant date; Or ➢ The average of the weekly high and low of the closing prices of the related shares quoted on a stock exchange during the two weeks preceding the relevant date. **<u>Explanation:</u>** (i) "relevant date" for the purpose of this clause means the date thirty days prior to the date on which the meeting of general body of shareholders is held, in terms of Section 81(1A) of the Companies Act, 1956 to consider the proposed issue. (ii) "stock exchange" for the purpose of this clause means any of the recognised stock exchanges in which the shares are listed and in which the highest trading volume in respect of the shares of the company has been recorded during the preceding six months prior to the relevant date.
	13.1.2	**(b) Pricing of shares arising out of warrants, etc.**
	13.1.2.1	➢ Where warrants are issued on a preferential basis with an option to apply for and be allotted shares, the issuer company shall determine the price of the resultant shares in accordance with Clause 13.1.1.1 above. ➢ The relevant date for the above purpose may, at the option of the issuer be either the one referred in explanation (a) to Clause 13.1.1.1 above or a date 30 days prior to the date on which the holder of the warrants becomes entitled to apply for the said shares.
	13.1.2.2	The resolution has to be passed in terms of section 81(A) shall be clearly specify the relevant date on the basis of which price of resultant shares shall be calculated
	13.1.3	**(c) Pricing of shares on conversion** :Where PCDs/FCDs/other convertible instruments, are issued on a preferential basis, providing for the issuer to allot shares at a future date, the issuer shall determine the price at which the shares could be allotted in the same

		manner as specified for pricing of shares allotted in lieu of warrants as indicated in Para (b) above.
3.	**13.2**	**Currency of financial instruments**: In case of Warrants/PCDs/FCDs/or any other financial instruments with a provision for the allotment of equity shares at a future date, either through conversion or otherwise, the currency of the instruments shall not exceed beyond 18 months from the date of issue of the relevant instrument.
4.	**13.3** **13.3.1** **13.3.2**	**Non-transferability of financial instruments**: (a) The instruments allotted on a preferential basis to the promoter / promoter group as defined in Chapter VI in Clause [6.4.2 (m)] of these guidelines, shall be subject to lock-in of 3 years from the date of their allotment. (b) In any case, not more than 20% of the total capital of the company, including capital brought in by way of preferential issue, shall be subject to lock-in of three years from the date of allotment. (c) The lock-in on shares acquired by conversion of the convertible instrument/exercise of warrants, shall be reduced to the extent the convertible instrument warrants have already been locked-in. These locked in shares or instruments may be transferred amongst promoters / promoters' group or to new promoter in control of company, subject to continuation of lock-in in the hands of transferee for the remaining period.
5.	**13.4** **13.4.1** **13.4.2** **13.4.3**	**Currency of shareholders resolutions** ➢ Allotment pursuant to any resolution passed at a meeting of shareholders of a Company granting consent for preferential issues of any financial instrument, shall be completed within a period of three months from the date of passing of the resolution. ➢ The equity shares and securities convertible into equity shares at a later date allotted in terms of the above said resolution shall be made fully paid up at the time of their allotment. ➢ If allotment of instruments and dispatch of certificates is not completed within three months from the date of such resolution, a fresh consent of the shareholders shall be obtained and the relevant date referred to in explanation above.
6.	**13.5**	**Certificate from Auditors**

		(a) In case of every issue of shares/warrants/FCDs/PCDs/ or other financial instruments having conversion option, the statutory auditors of the issuer Company shall certify that the issue of said instruments is being made in accordance with the requirements contained in these guidelines. (b) Copies of the auditor's certificate shall also be laid before the meeting of the shareholders convened to consider the proposed issue.
7.	**13.6**	**Preferential allotments to FII's**: Preferential allotments, if any to be made in case of Foreign Institutional Investors, shall also be governed by the guidelines issued by the Government of India/Board/Reserve Bank of India on the subject.
8.	**13.7**	**Non-Applicability of the guidelines** Clauses 13.1 to 13.5 shall not be applicable in the following cases: (i) where the further shares are allotted in pursuance to the merger and amalgamation scheme approved by the High court. (ii) (a) where further shares are allotted to a person / group of persons in accordance with the provisions of rehabilitation packages approved by BIFR. (b) In case, such persons are promoters or belong to promoter group as defined in Clause 6.4.2(m) of Chapter VI of these guidelines, the lock-in provisions shall continue to apply unless otherwise stated in the BIFR order. (iii) where further shares are allotted to All India public financial institutions in accordance with the provision of the loan agreements signed prior to August 4, 1994.

<u>SEBI Guidelines for issue of Debentures</u>

SEBI have given various guidelines for the issue of debentures. Following are the few important guidelines

1. Guidelines will be applicable for the issue of convertible and non-convertible debentures by public limited as well as public sector companies.
2. Debentures can be issued for the following purposes:
    - For starting new undertakings
    - Expansion or diversification
    - For modernization

- Merger/amalgamation which has been approved by financial institutions
- Restructuring of capital
- For acquiring assets
- For increasing resources of long-term finance

3. Issue of debentures should not exceed more than 20% of gross current assets and also loans and advances.
4. Debt-equity ratio in issue of debentures should not exceed 2:1. But this condition will be relaxed for capital intensive projects.
5. Any redemption of debentures will not commence before 7 years since the commencement of the company.
6. For small investors for value such as Rs. 5,000, payments should be made in one installment.
7. With the consent of SEBI, even non-convertible debentures can be converted into equity.
8. A premium of 5% on the face value is allowed at the time of redemption and in case of non-convertible debentures only.
9. The face value of debentures will be Rs.100 and it will be listed in one or more stock exchanges in the country.
10. Secured debentures will be permitted for public subscription.

Listing of Shares

A stock exchange does not deal in the securities of all companies. Only those securities that are listed can be bought and sold at the stock exchange. For the purpose of listing of securities, a company has to apply to the stock exchange. The stock exchange after receiving application from the company will decide whether to list the securities of the company or not.

Documents required for the listing the shares according to Securities Contracts (Regulation) Act, 1956,

- Certified copies of MOA and AOA
- Prospectus or Statement-in-lieu of prospectus

- Directors report, balance sheet, agreement with managing directors, selling agents, underwriters etc.,
- Certified copy of consent of the controller of capital issue.
- Specimen copy of share certificates, debenture certificate and letters of allotment, acceptance, renunciation etc.,

Advantages of Listing

a) It provides continuous market for securities.

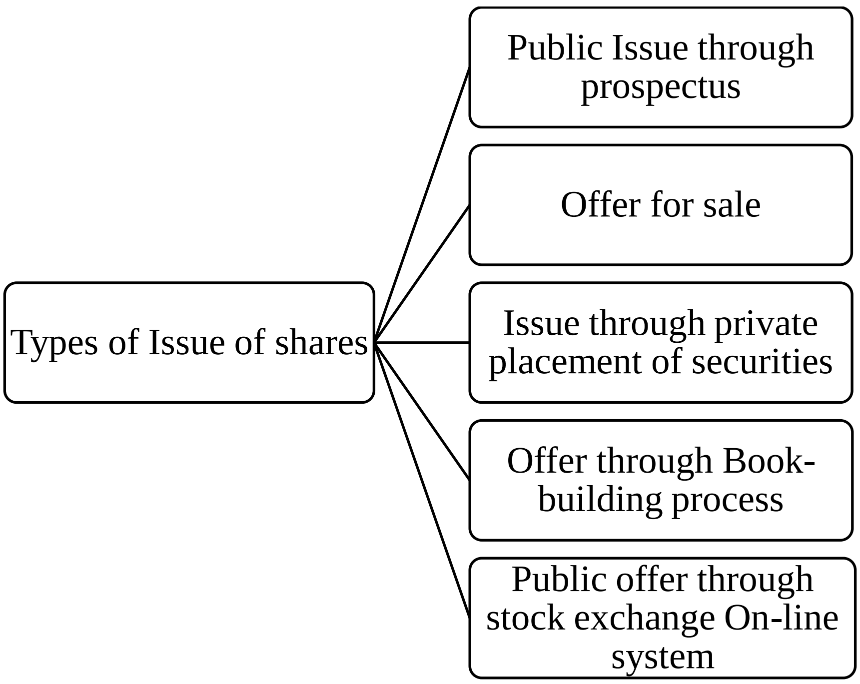
b) It enhances the goodwill of the company.

c) It provides indirect check against manipulation by the management.

Types/ Methods/ Kinds of Issue of shares

Both equity shares as well as preference shares can be issued in the primary market and secondary market. (Primary market is a place where the shares are bought and sold for first time; Secondary market is a place where already issued shares are bought and sold)

According to the SEBI guidelines, the securities can be offered for sale in the primary market in different ways. Each method of issue has got its procedure and mechanism. The different methods or types or kinds of issue are as follows



1. Public issue through prospectus: This method is the common and popular method of issue of securities. The securities are offered to the investors through a detailed statement of terms and conditions known as prospectus. The prospectus is also known as the offer documents. The issue by prospectus method is adopted when the company wants to issue fixed number of securities at a fixed price. The application forms together with the copy of prospectus are distributed among the public investors, who offer to the company to buy a specific number of securities. In case of over-subscription, the securities are allotted to the investors, in consultation with the stock exchange where the securities are proposed to be listed.

Drawbacks of this method are as follows,

- It is an expensive method
- High cost on advertisement, flotation, brokerage and underwriting are involved.
- The contents of abridged prospectus are less than the regular prospectus.

2) Offer for sale: In some cases, the companies do not offer the securities directly to the investors. Instead, the securities are issued to an issue house or a merchant banker who will subsequently offer the securities for sale to the investors. Sometimes, the existing shareholders may offer to offload their holding to the investors. The difference between the issue price by the company and the offer price by the issue house is the gain to the latter.

3) Issue through private placement: In this case, the issuing company does not offer the securities to investors in general. Instead, the securities are offered to selected big institutional clients only. the institutional investors may be selected in conformity with the merchant banker. The terms and conditions are agreed between company and the institutional buyer. SEBI guidelines are not applicable in case of private placement, because there is no public offer involved.

4) Offer through book building process: Public issue of securities through the book building process is a relatively new concept for Indian capital market. In case of book-building the company decides the funds to be raised. The number of securities and issue price are decided by the demand and supply forces. In this case, offers are invited from the public, stating the price as well as the number of shares, the investors are ready to buy.

On the basis of bids received from the investors, the issue price is decided by the company. At the price, all the eligible investors are issued securities. It is to be noted that in normal case the price of securities will be known to the public in advance, but in case of book building the issue price will be disclosed after the closure of the book. The order book remains open for a minimum period of days and the securities are issued at the same price under the placement portion and net offer to public. Companies issuing securities through book building declare a price band (limit) within which the final price is decided. There are specific guidelines issued by SEBI in respect of book building issues. Company issuing securities through book building process is required to issue red herring prospectus.

5) Public offer through stock exchange On-line system: SEBI has allowed to offer shares through the online system of stock exchanges. In this case, the issuing company has to fulfil the general requirements of public offer as well as some other conditions. They are as follows,

- The company has to enter into an agreement with a stock exchange which has an online system. It has to appoint the requisite merchant bankers.
- The company shall announce the process of application are to be submitted through stock brokers. The brokers enter the application in the online system as a buy order.
- On the closure of issue, the stock exchange and the merchant banker ensure that there is a fair and proper allotment of shares.
- The successful applicants may get shares in physical form or dematerialized form.

Book building

Book building is the process of determining the quantum of shares to be issued and the price at which the shares are to be issued on a feedback from the potential investors based upon their perception about the company.

It refers to the process of generating, capturing and recording investors demand for shares during initial public offering in order to support efficient price discovery.

Why Book building process is better than fixed price mechanism?

The book building process brings through the flexibility to the pricing of IPOs (Initial Public Offerings). Prior to the introduction of book building, a lot of IPOs were either underpriced or overpriced. This created problems when the issue was underpriced, the company was losing possible capital. On the other hand, if the issue was overpriced it would not be fully subscribed. With the introduction of book building process, such events no longer happen and the primary market functions more efficiently.

Process of Book building

Appointment of Investment Banker

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Collecting Bids

↓

Price discovery

↓

Publicizing

↓

Settlement

The detailed process of book building are as follows,

1. **Appointment of investment banker:** The first step starts with appointing lead investment banker. The lead investment banker conducts due diligence. They propose the size of capital issue that must be conducted by the company. Then they also propose a price band for the shares to be sold. If the management agrees with the propositions of the investment banker, the prospectus is issued with the price range as suggested by the investment banker. The lower end of the price range is known as the floor price whereas the higher end is known as ceiling price. The final price at which securities are indeed offered for sale after entire process of book building is called cut-off price.

2. **Collecting bids:** Investors in the market are requested to bid to buy the shares. They are requested to bid the number of shares that they are willing to buy at varying price levels. These bids along with the application money are supposed to be submitted to the investment bankers. It must be noted that it is not a single investment banker. It must be noted that it is not single investment banker who is engaged in the collection of bids. Rather, the lead investment can appoint sub-agents to tap into their network especially for receiving the bids from a larger group of individuals.

3. **Price discovery:** Once all the bids have been aggregated by the lead investment banker, they begin the process of price discovery. The final price chosen is simply the weighted average of all bids that have been received by the investment banker. This price is declared as the cut-off price. For any issue which has received substantial publicity and which is being anticipated by the public, the ceiling price is usually the cut-off price.

4. **Publicizing:** In the interest of transparency, stock exchanges all over the world require that companies make public the details of the bids that were received by them. It is the lead investment banker's duty to run advertisements containing the details of the bids received for the purchase of share for a given period of time. The regulators in many markets are also entitled to physically verify the bid applications, if they wish to.

5. **Settlement:** Finally, the application amount received from the various bidders has to be adjusted and shares have to be allotted. For instance, of a bidder has bid lower price than the cut-off price then the call letter has to be sent asking for the balance money to be paid. On the other hand, if a bidder has bid a higher price than the cut-off, a refund cheque has to be sent to him. The settlement process ensures that only the cut-off amount is collected from the investors in return to the shares sold to them.

Partial book building

In this process, instead of inviting bids from general public, investment bankers invite bids from the leading institutions. Based on their bids, a weighted average of the prices is created and cut-off price is decided. This cut-off price is then offered to the retail investors as a fixed price. Therefore, the bidding only happens at institutional level.

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Assignment 02

Section A

1. What is Share Capital?
2. What is Shares?
3. Define Preference shares.
4. What do you mean by Debentures?
5. What is Equity share?
6. State the meaning of redeemable preference shares.
7. What is secured debentures?
8. What do you mean by fixed charge and floating charge on asset?
9. What is listing of shares? State the documents required for listing of shares.
10. What is Partial Book building?

Section B

1. State the rights enjoyed by preference shareholders.
2. Distinguish between shares and debentures.
3. What is book building? Explain the process of book building.
4. Briefly explain the advantages and disadvantages of Debentures.
5. Explain the types of preference shares.
6. Explain the different types of debentures.

Section C

1. What is share capital? Explain the merits and demerits of issuing Share capital.
2. Enumerate the differences between equity shares and preference shares.
3. Briefly explain the various types of issue of shares.
4. Describe the SEBI guidelines relating to issue of equity shares.
5. Explain the SEBI guidelines relating to Preferential issue.