UNDERSTANDING SHARE CAPITAL: A COMPREHENSIVE GUIDE TO CORPORATE FINANCING

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ABSTRACT

This article provides a comprehensive analysis of share capital, a key element of corporate finance. It categorizes the different types of share capital, such as authorized, issued, subscribed, called-up, and paid-up capital, highlighting their distinct features and interrelationships. The research also focuses on the legal framework surrounding share capital in India, particularly the Companies Act 2013 and SEBI regulations, which set essential guidelines for corporate compliance and the protection of investors. Additionally, the study looks into current challenges in share capital management, specifically considering how digitalization affects the processes of share issuance, trading, and monitoring. Through a thorough analysis, the article illustrates that share capital is central to a company's financial framework, enabling operational funding while distributing both profits and liabilities to shareholders. The results underscore the necessity of well-organized share capital in improving corporate reliability, attracting investment, and supporting sustainable economic growth. This research offers important perspectives for companies, investors, and regulatory entities on the effective understanding and management of share capital in today's business landscape.

KEYWORDS

Share Capital, The Companies Act, Investment, Funding, Shareholders

INTRODUCTION

'Company' is the title given to a legal entity created by law, that is registered under the Companies Act and has a certain number of members that form a part of the company. Companies can be broadly categorized into public companies and private companies among other types. The key difference between the two is in the way the capital required for the operations of the company is raised. The former issues shares to the public to invest in, while the latter's means of raising capital are limited to a select group of investors. The functioning of a company is reliant on its financial capital and there are several ways for companies to amass such capital. One such way of raising funds is through share capital. To understand what share capital is, it is inherent to understand what a share is. A 'share' has been defined as a share in the share capital of a company[1]. In other words, it is a portion or slice of the whole

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[1] R.L. Gupta and M.Radhaswamy, *Advanced Accountancy* 4.1-4.22 (Sultan Chand and Sons, 11th edn.)

company's value, and it gives the holder of such shares, corresponding ownership and associated specific rights. One may own 10 shares of a certain company or 20 or even 200, depending on individual investment. The value of these shares issued is up to the discretion of the company post ascertaining their capital requirement. Such shares owned by various people, either specific investors in the case of a private company or the public in addition to investors in the case of a public company, put together collectively form the share capital of a company. Essentially, share capital can be defined as the amount of money that a company raises as its capital through issuing shares to multiple investors. The significance of share capital is demonstrated in the way it bolsters the corporate structure[2]. Besides acting as a major source of funding, it allows companies to spread financial risk among several investors, facilitates the company's growth, and enhances the credibility and financial standing of the company. A well-structured share capital also helps attract new investors as a company's profits also manifests as gains for the investors through dividends on their invested shares. To understand share capital better, it is essential to explore the classification of different types of share capital based on nature, stage of subscription, and other such factors. Broadly, it is composed of authorized capital, issued capital, subscribed capital, called-up capital, and paid-up capital. These are elaborated further in the article.

AUTHORIZED CAPITAL

Authorized capital, also known as, registered capital or nominal capital, is the limit on the maximum amount that can be raised legally through the issuance of shares. This limit is to be mentioned in a legal document called the Memorandum of Association (MOA) and the company is required to strictly comply with the said limit. Essentially, the authorized capital represents the ceiling on the amount that can be raised by the company either during its formation or at any time when a requirement arises. This is as mentioned in section 2(8) of the Companies Act, 2013. In case of a situation where the company looks to expand its capital beyond the limit of its authorized capital in the MOA, there are legal procedures including conducting a board meeting, filing with the registrar of the companies, and approval from the board members and shareholders that the company needs to follow to modify the MOA for the same. Unless such a change is made, this limit cannot be exceeded. The amount mentioned as authorized capital is only a limit. By no means is a company required to raise that much amount

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[2] John Armour, "Share Capital and Creditor Protection: Efficient Rules for a Modern Company Law" 63 *Modern Law Review* 355-378 (2000).

compulsorily. It can issue shares of lesser value if it meets the necessities of the company at the said time, the sole purpose of the limit is to provide a cap on the total amount that can be raised anytime in the future. Another crucial role of authorized capital is its support in providing a sense of security of the company's growth potential to attract investors. This also increases transparency in terms of funding.

ISSUED CAPITAL

This represents the capital that is offered to the public for subscription.[3] The difference between authorized capital and issued capital represents the unissued capital that may be issued in the future. The issued capital has to always be lesser than or equal to the amount stated as authorized capital as stated in the company's memorandum of association. Issued capital plays a key role in that it directly relates to the company's ownership stakes. These shares, when invested in by founders, private investors or the general public, depending on whether the company is public or private, grant partial ownership to those who will own these shares. Issued capital also poses as an indicator of the company's credibility as it depicts the company's ability to attract investors.[4] When the value of the issued capital is almost that of the authorized capital, this paints a picture of the interest of various parties in investing in that company. The process of issuing such a capital begins with the approval of the board of directors and extends till the offering via IPO, private placement, or other methods. To elucidate the types of share issues: firstly, "IPO or initial public offering is the first time the shares of a company are sold to the public investors and subsequently listed on the stock market". [5] secondly, rights issue is where shares are offered to prevailing shareholders at a discounted price. Thirdly, bonus shares which are also issued to existing shareholders usually as a form of reward for their additional earnings. Lastly, private placement, which is most prevalent in private companies, where the shares are only issued to a select group of investors. The issue price is applicable to all investors uniformly except in the case of composite issues, where the company can have different prices for rights issue and public issue. The instructions to pay differ for varying total value of issues, i.e. If the

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[3] R.L. Gupta and M.Radhaswamy, *Advanced Accountancy* 4.1-4.22 (Sultan Chand and Sons, 11th edn.)

[4] Claire Boyte-White, "Issued Share vs. Subscribed Share Capital: What's the Difference?," Investopedia, < https://www.investopedia.com/ > (accessed 10 Jan.2025)

[5] Jason Draho, *The IPO Decision: Why and How Companies Go Public* 1-4.

value of issued capital is less than 50 crores, the share price has to be paid in full during subscription and cannot be divided into instalments, whereas if the value exceeds 500 crores, the company can only call up to 25% of the total issue per call.

SUBSCRIBED CAPITAL

Subscribed capital represents a portion of the issued capital that potential shareholders have agreed to purchase from the company’s treasury and also the part allotted to the directors of the company, often as part of the company’s initial public offering (IPO). The shareholders may or may not receive the total number of shares they have subscribed to, thus, subscribed capital does not present a guarantee of shares. While subscribing to an IPO, one is required to pay a partial or complete value of the share depending upon the guidelines of the company, and in case they get allotted fewer shares than they had subscribed for, either the amount paid is compensated in the allotted shares in case of partial payment or refunded in case of complete payment. There is a minimum requirement of a mandatory 90% subscription to each issue of capital to the public within 120 days of opening the issue. If this criterion is not met, the company must refund the amount of the subscription. On the flip side, oversubscription is a phenomenon where, as the name suggests, the number of shares subscribed to exceeds the number of shares issued. In such a case there exists a basis of allotment. Either the share distribution will be proportionate based on the number of shares applied for or a lottery system will be used to allot shares randomly so that every subscriber has an equal chance of acquiring their share of shares.

CALLED-UP CAPITAL

This refers to that part of the subscribed capital which has been called up by the company for payment. The key difference between subscribed and called-up capital is that the former is what the investors have agreed to invest in, and the latter is what the company has requested. Companies often issue partially paid shares, i.e. The called-up capital can be lesser than the issued capital based on the company's requirements at that point of time. If so, the remaining amount which is the differential of issues and called-up capital is called unpaid capital and this can be called upon later in the future, allowing strategic financial flexibility. The primary reason for the existence of this stage is so that the companies need not collect the full value of the issued amount at one go. Suppose a company issues shares of the value of Rs. 10 per share and only calls for Rs. 6 per share and the total number of shares issued are 10000, the called-up capital will be of value Rs. 60000 and the uncalled capital will be Rs. 40000. Out of the former,

the amount which is actually paid for will form the paid-up capital which is explained further in the below section. There is a given process that any company needs to follow to call for capital and this starts from issuance of shares which is followed by publishing the calling-up notice which includes all essential information such as amount per share and terms of payment. The next step in the process is to ensure shareholder or investor compliance as well as legal and regulatory compliance. Another important step in the process is for companies to mention their called-up capital in their financial statement as this attracts a greater number of investors thus helping increase the total paid-up value. The procedure to pay also includes processes where, after the shares are allotted, the amount due on allotment is transferred to the share capital account. Allotment letters will be sent to the applicants and post paying, call notices will be sent to the shareholders who make the payment.

PAID-UP CAPITAL

Paid-up capital refers to that part of the called-up capital that has been paid for entirely by the shareholders. Essentially, paid-up capital is the last stage in collecting share capital that arises post issuing, subscribing, and calling for payment. The paid-up capital can be of the same value as called-up capital or less. This phenomenon where the paid-up capital is lesser in value arises when certain shareholders default on paying the allotment or call money, and this amount defaulted is known as calls-in-arrear. Such calls-in-arrear is deducted from the called-up capital to obtain the paid-up capital. Since, unlike authorized or issued capital, paid-up capital is the actual and final capital received/collected by the company it is a true reflection of the company's economic standing. Subsequently, higher the value of paid-up capital, greater the credibility and financial position of the company. A low paid-up capital compared to the called-up capital reflects the unwillingness of people to invest in the company. Fully paid shares also provide shareholders with ownership of a part of the company and certain rights. There was previously a requirement of a certain minimum paid-up capital, but as of today, there exists no minimum requirement as the Companies Act amendment removed the same in 2015. The paid-up capital also goes on the balance sheet of companies which is further used by people in determining whether or not they want to invest in the said company.

FORFEITED SHARES

This is the name given to those shares that the shareholders have defaulted paying for during allotment or call. It arises in case of partial payment and in such a case, the amount that is already paid for is credited to the paid-up capital and is reflected under the same section the

company's balance sheet. Shares forfeited on non-payment of calls can be re-issued by the company whenever it finds it convenient to do so.

SHARES FOR VENDORS

While share capital is when companies issue shares in exchange of cash that they require for their projects and other purposes, there is one other type of share that is issued to vendors. The consideration for such a share is not cash, but it is traded for the assets which the company purchases from such vendors.

PROSPECTUS

"every public issue of shares must be accompanied by an issue of prospectus and every private placement by a statement in lieu of prospectus". The prospectus is essentially an exhaustive, legally required document that contains elaborate details about the company, issue, issue highlights, risk factors, history of the company, and terms of the present issue among others. To put it in simpler terms, it is like an instruction manual for the investor to read before subscribing to a share. The lead manager of the issue is who prepares the prospectus, and it must be registered with the registrar of companies before releasing it. The four types of prospectus are deemed prospectus, red herring prospectus, shelf prospectus, and abridged prospectus and this is as mentioned under the Companies Act 2013. The share application is yet another document that also provides details regarding the procedure to apply for shares. The prospectus coupled with the share application is an invitation to offer. Not only is the prospectus useful for the investors to understand the company and the nature of the shares issued, but it also provides information to the regulatory bodies.

LEGAL FRAMEWORK

It is of paramount importance to be acquainted with the legal provisions concerning share capital is crucial for a holistic understanding. To begin with, as mentioned multiple times in this article, we take a look at 'The Companies Act of 2013'[6]. The Companies Act provides the regulatory framework for companies to issue and collect share capital. This is covered in sections 43 to 72 of the act. The act defines share capital as "the amount of money invested in a company to carry out its operations. It also includes the rights and liabilities attached to shares." In addition to the definition, the act also mandates a clear distinction between authorized, issued, subscribed, and paid-up capital through section 43. Section 61 allows

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[6] *The Companies Act, 2013 (as amended upto 2020)*

companies to modify their share capital by increasing the authorized share capital, consolidating or subdividing shares, or canceling shares that have not been issued. These modifications must be sanctioned by the company's memorandum of association and must be approved by the shareholders. Under sections 62 and 63, the rules and procedures to be followed while issuing shares are clearly stated. One should peruse through relevant sections of the Companies Act in detail before investing in any company. The benefits of having a well-structured act in place are multifaceted. Aside form regulating share capital, it helps protect shareholders' rights, encourages further investment, increases accountability of the company and ensures transparency and disclosure through its policies. The Registrar of Companies (ROC) is the primary authority responsible for overseeing compliance with the Companies Act. If any dispute under the act arises, one can also file a petition with the national company law tribunal or even approach the court.

An old act known as the Capital Issues (Control) Act was abolished in 1947 and the regulation of public issues now rests with the Securities Exchange Board of India (SEBI). One of the objectives of setting up this board is "to provide a degree of protection to investors and safeguard their rights and interests so that there is a steady flow of savings into the market". SEBI has framed certain guidelines on capital issues and other matters and these guidelines are to be complied with strictly by companies mainly during the issuance of shares. These guidelines came into force from 29th May 1992. Some significant features of these regulations having a bearing on public issues include, "firstly, for the first time certain types of companies are allowed to raise fresh capital by freely pricing their shares in consultation with the lead managers to the issue. However certain companies can issue shares only at par. Secondly, where the issue is made at a premium, the company concerned should disclose in the prospectus the net asset value of the company, the low and high prices of shares for the last two years and a justification for the price of issue. Thirdly, the percentage of public offer in order to entitle a company for being listed on a stock exchange has been drastically reduced from 60% of each class of security issued by the company to 25%. These are only a few of the many guidelines mentioned". SEBI also holds the right to modify and interpret the guidelines.

CONTEMPORARY ISSUES

Digitalization of the economy plays a key role in contemporary issues in share capital. With the expansion of the economy coupled with digital advancements, the reliance on technology-driven platforms to mobilize share capital is increasing by the day. This may be beneficial to the company as it allows the company to streamline the issuance and payment of shares through platforms that are easy to navigate through for prospective investors. Transparency is yet another additional benefit wherein, through increasing digitalization, investors can access databases and balance sheets of companies online easily and effectively so as to make informed financial decisions. The future of share capital is most likely to see continued and increasing integration of technology.[7]

CONCLUSION

In conclusion, share capital is the fulcrum of a company's financial structure as it provides the required means for the company to carry out its operations and promote its growth. It is one of the most effective means as it ensures the distribution of profits through dividends as well as the distribution of liability among shareholders and investors. Understanding the various aspects including types of share capital and the legalities associated with it is pivotal for one before investing in the shares of a company. Share capital also shapes how the public and marketplace view the company in terms of its finances as highlighted above in the article. A well-structured share capital benefits companies, investors, and the economy alike, paving the way for sustainable progress. Digitalisation also impacts how share capital functions and this impact is looked at positively with the evolution of share capital.

REFERENCE

[7] Paddy Ireland, Dave Kelly, *et.al.*, "The Conceptual Foundations of Modern Company Law" 14 *Modern Law Review* 150-155 (1987).

1. R.L. Gupta and M.Radhaswamy, *Advanced Accountancy* 4.1-4.22 (Sultan Chand and Sons, 11th edn.)
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