B.Com 2nd Semester

Unit -2 Chapter – I

Right issue

Questions :-

1. **What is Right Issue ?**

   Ans : **A rights offering (rights issue) is a group of rights offered to existing shareholders to purchase additional stock shares, known as subscription warrants, in proportion to their existing holdings. These are considered to be a type of option since it gives a company's stockholders the right, but not the obligation, to purchase additional shares in the company.**

   In a rights offering, the subscription price at which each share may be purchased is generally discounted relative to the current market price. Rights are often transferable, allowing the holder to sell them in the open market.

2. **Explain the advantages of right issue.**

   Ans : **Some of the most important advantages of rights issues of a company are as follows:**

   1. ***Control in the hands of existing shareholders:***

      Control of company is retained in the hands of existing shareholders. Issue of rights shares makes possible equitable distribution of shares without disturbing the established equilibrium of shareholdings, because rights shares are offered to the persons who on the date of rights issue are the holders of equity shares of the company, proportionately to their equity shares on that date.

   2. ***No dilution in the value of existing shares:***

      The existing shareholders do not suffer on account of dilution in the value of their holdings if fresh shares are offered to them, because the value of shares is likely to fall with fresh issue. This decrease in the value of the shares will be compensated by getting new shares at a price lower than the market price. They are likely to suffer on account of the dilution in the value of their holdings if fresh shares are offered to the general public.

   3. ***Expenses Saved:*** **The expenses of public issue can be saved through right issue.**

   4. ***Better Image:***

      Image of the company is bettered when rights issues are made from time to time and existing shareholders remain satisfied.

   5. ***More Certainty of getting shares:***

      There is more certainty of getting shares, when fresh issue is made to the existing share holders, instead of general public.

   6. ***No Misuse by directors:***

      Directors cannot misuse the opportunity of issuing new shares to their friends and relatives at low price and at the same time retaining more control in their hands when right shares are issued because in right issue shares are offered proportionately to the existing shareholders according to their existing holdings.

3. Explain the Disadvantages of right issue.

Ans :

1. ***Inappropriate Use of Funds:***

   While many companies use the funds raised from rights issue for growth and expansion plans but there is another side of the coin too and that is many companies use funds raised from rights issue for window dressing their balance sheet. In simple words, some companies misuse the funds raised through this route which ultimately has an adverse effect on the share price and shareholders of the company.

2. ***No Guarantee of Profits:***

   There is a time lag between the announcement of the rights issue by the company and shareholders getting shares in their trading account and if in that period share price of the company falls than there is no use of rights issue as far as the shareholder is concerned. Hence, for example, suppose the stock price of Amazon is $200 and company comes with the right issue at $180 but after the announcement share price of Amazon goes to $180 or below $180 than shareholders do not get any benefit from the right issue.

3. ***Dilution of Shareholders Stake:***

   If the shareholder does not subscribe to the right issue than it will lead to dilution of shareholders stake because after the rights issue the stock price trades at ex-rights price and if shareholder does not wants to dilute his or her stake than he or she should subscribe to rights issue if he or she does not want to dilute his or her stake in the company.

4. Mention the objectives of right issue.

Ans :

1. **To retain the power of control in the hands of the existing shareholders.**
2. **To benefit the existing shareholders in terms of lower price for their long association with the company.**
3. **The uncertainty that the shares will not be subscribed by the general public, is avoided if rights issue is made.**
4. **To prevent the loss to the existing shareholders on account of dilution of the value of their shareholdings.**

5. Explain the procedure for issue of right share.

Ans : Following is the procedure for issue of shares on right basis-

1. **Notice of Board Meeting:**

   Firstly, notice calling the Board Meeting shall be issued to all the Directors at least 7 days before the date of Board Meeting along with the agenda and other related note as required under section 173 of the Companies Act, 2013 read with the Secretarial Standard-1.

2. ***Holding of Board Meeting:***

   On the date specified in the notice, the Board Meeting shall be convened and the Board will consider and approve the following:

- **Proposal of issue of shares on right basis**
- **Price at which shares to be issued including Premium, if any**

- **Draft Letter of Offer for Right Issue**
- **Terms of Right Issue**
- **Record Date**
- **Any other ancillary matter**

3. ***Filing of MGT-14:***
   In case of public Companies the resolution approving the issue of shares on Right basis shall be filed with the concerned Registrar of Companies in E-Form-MGT-14 within 30 days of passing of such resolution.

4. ***Issue of Offer Letter:***
   The Offer Letter shall be dispatched by registered post or by speed post or through electronic mode to all the existing equity shareholders of the Company, at least three days before the opening of the issue.
   However, as per the recent exemptions given to private Companies, if the 90% or more shareholders of the private Company give their consent then in such case the period lesser then the specified above shall be applicable.
   Share Application Form shall also be attached with the Offer Letter.

5. ***Tendering Period:***
   The Right Issue Offer shall be open for at least 15 days but shall not remain open for more than 30 days from the date of the offer, if the offer is not accepted within the time prescribed, than such offer shall be deemed to have been declined.
   However, as per the recent exemptions given to private Companies, if the 90% or more shareholders of the private Company give their consent then in such case the period lesser then the specified above shall be applicable.

6. ***Right of Renunciation:***
   Unless the articles otherwise provide, the Right Issue Offer shall be deemed to include a right to renounce the shares offered in favor of any other person. The Offer Letter shall also contain this statement.

7. ***Decline of Offer:***
   If any shareholder, to whom the Right Offer is made, declines the offer or does not accept the offer, than in such cases, the Board shall have the power to dispose of such shares offered, in any manner, which is in the best interest of the Company and the Shareholders.

8. ***Receipt of Funds:***
   The Shareholders, who accept the offer, shall pay the amount as indicated in the Offer Letter or the amount to the extent of shares accepted, as the case may be to the Company, at the time of accepting the offer.
   It is pertinent to note here that such shares must be issued within 60 days of the receipt of the funds.

9. *Issue of Notice of Board Meeting and Convening of Board Meeting:*

After closure of the issue the Board Meeting shall be Convened on due notice as per the details prescribed above to consider and approve the allotment of shares.

10. *Allotment in case of Foreign Shareholder:*

If there is any foreign shareholder, than receipt of funds towards issue of shares from such foreign shareholder shall amount to FDI, hence the Company shall also be required to file Form FC-GPR with the RBI within 30 days of the allotment of the shares. (For detailed note on issue of shares to foreign person, kindly write me back to my mail id given at the end.)

11. *Filing of Return of Allotment:*

After allotment, the Company is required to file a return in the E-Form- PAS-3 with the concerned Registrar of Companies along with the complete list of Shareholders within 30 days of allotment of shares.

12. *Issue of Share Certificate:*

After allotment the Company shall issue the share certificate as per the provisions and the time prescribed under section 46 of the Companies Act, 2013.

6. What is meant by value of a right in relation to right share ?

Ans : According to Sec. 81 of the Companies Act, 1956, a company, if it so desires, can increase its share capital by issuing new shares. In that case, the existing shareholders must be given the priority of purchasing those shares according to their paid-up value. Since the existing shareholders have got such right to purchase the newly issued shares, they are called Right Shares.

In order to make a proper valuation of right relating to Right Shares, the market value of the old holdings and the total issue price of the new holdings must be added and the same must be divided by the total number of new and old holdings. Value of right will be the difference between the result that is obtained and market value of shares. Hence,

$$\text{Value of Right} = \frac{\text{Number of Right Shares}}{\text{Total Holdings (i.e. Holdings = Old + New)}} \times (\text{Market Value} - \text{Issue Price})$$

7. Discuss the procedure of calculating value of right ?

Ans : There are two methods of calculating value of right:

Method I

Step 1. Calculate Market Value of Shares (held by Shareholder) x

Step 2. Calculate Price of New Shares (to be paid to company) x

Step 3. Total Price (Add the value of Step 1 and Step 2) x x

Step 4. Calculate Average Price or (Theoretical or Market Price) = Total Price/No. of Shares

Step 5. Calculate Value of Right = Market Price – Average Price

Method II

Instead of using 5 steps of Method I, we can use following formula directly to calculate value of right.

Value of Right = Number of new shares/ Total number of all shares x (Market Price—Issue price of new share)