B.Com 2nd Semester

Unit -2 Chapter – 2

Issue of Bonus Shares

Questions :-

1. **What is Bonus Issue ?**

   Ans : A bonus issue, also known as a scrip issue or a capitalization issue, is an offer of free additional shares to existing shareholders. A company may decide to distribute further shares as an alternative to increasing the dividend payout . For example, a company may give one bonus share for every five shares held.

   Bonus issues are given to shareholders when companies are short of cash and shareholders expect a regular income. Shareholders may sell the bonus shares and meet their liquidity needs. Bonus shares may also be issued to restructure company reserves. Issuing bonus shares does not involve cash flow. It increases the company's share capital but not its net assets.

2. **Explain the objectives of Issue of Bonus Shares.**

   Ans : Objects of Bonus Issue:

   Bonus shares are usually made by company for following reasons:

   (i) *Inexpensive:* Issue of bonus shares is an inexpensive mode of raising capital by which the cash resources of company are conserved.

   (ii) *More Marketable:* Issue of bonus shares reduces the market price of the shares, thus rendering them more marketable.

   (iii) *Indicator of Good Prospects:* Issue of bonus shares is an indication to the investors that the company has good prospects.

3. **Mention the types of Bonus Issue.**

   Ans : Types of Bonus Issue:

   (i) *Fully Paid Bonus Shares:* When bonus shares are distributed free of cost in proportion of holding, it is called Fully Paid Bonus Shares.

   (ii) *Partly Paid Bonus Shares:* When bonus is applied for converting partly paid shares into fully paid shares, it is called Partly Paid-up Bonus Shares.

4. **Name the sources from which fully paid bonus shares can be issued.**

   Ans : Source of Bonus Issue:

   Fully paid-up bonus shares can be issued out of following sources:

   (i) Capital redemption reserve

   (ii) Security premium (realised in cash)**

(iii) Capital reserve* (realised in cash)
(iv) Profit and loss account
(v) General reserve
(vi) Investment allowance reserve
(vii) Sinking fund for redemption of debentures (after redemption)
(viii) Development rebate reserve.

***Capital reserve not realised in cash cannot be utilised for issuing bonus shares e.g. capital reserve created by revaluation of fixed assets.**

**** Security premium not realised in cash cannot be utilised for issuing bonus shares.**

5. Name the sources which can be utilised for making partly called up shares fully paid up.

Ans : Source of Bonus Issue:

Partly paid-up bonus shares can be issued from the following sources:

(i) Capital Reserve* (realised in cash)
(ii) Profit and loss account
(iii) General reserve
(iv) Investment allowance reserve
(v) Development rebate reserve
(vi) Sinking fund for redemption of debentures (after redemption)

Note:

1. Security premium account and capital redemption reserve account cannot be utilised for issuing partly paid bonus shares.
2. If a choice is to be made between revenue reserves and capital reserves; the capital reserves are normally utilised first as far as legally permissible.

6. Mention the circumstances which warrant issue of bonus shares:?

Ans : The following circumstances warrant issue of bonus shares:

(i) *Accumulated large reserves:* When a company has accumulated large reserves (whether capital or revenue) and it wants to capitalize these reserves by issuing bonus shares.

(ii) *Not in a position to give cash bonus:* When the company is not in a position to give cash bonus because it adversely effects its working capital.

(iii) *Value of fixed assets far exceeds the amount of capital:* When the value of fixed assets for exceeds the amount of capital.

(iv) *Higher rate of dividend is not advisable:* When the higher rate of dividend is not advisable for the distribution of the accumulated reserves because shareholders will demand the same rate of dividend in future, which the directors may not be able to give. To get rid of this difficulty, bonus shares are issued to facilitate the payment of the regular dividend from year to year.

(v) *Big difference between the market value and paid-up value:* When there is a bit value of the shares of a company i.e. market value of shares far exceeds the paid up value of the shares. A company issuing bonus shares is better placed in the market. There is a sharp rise in the price of equity shares following the declaration of bonus issue.

7. Explain the SEBI GUIDELINES on the issue of bonus shares ?

Ans : There are no guidelines for issuing bonus shares by the private companies or unlisted public companies has been issued by the SEBI (Disclosure and investor protection) Guidelines, 2000. However, the listed public companies for issuing bonus shares to the shareholders must comply with the guidelines issued by the SEBI (disclosure and Investor Protection) Guidelines, 2000.

The requirements of the guidelines of SEBI are given below:

A) *Right of FCD/PCD holders:* No company shall pending the conversion of FCDs/PCDs issue any shares by way of bonus unless similar benefit is extended to the holders of FCDs/PCDs, through reservation of shares in proportion to such convertible part of FCDs/PCDs. The shares so reserved may be issued at the time of conversion of such debentures on the same terms on which the rights or bonus issues were made.

B) *Out of free reserves:* the bonus issue shall be made out of free reserves built out of genuine profits or share premium collected in cash only.

C) *Revaluation of fixed assets:* reserves created by revaluation of fixed assets should not be capitalised. If assets are subsequently sold and the profits are realized, such profits could be utilised for capitalization.

D) *Bonus issue not to be in lieu of dividend:* The declaration of bonus issue, in lieu of dividend, should not be permitted.

E) *Fully paid shares:* Bonus issue shall not be made, unless the partly paid shares, if any, existing are made fully paid up.

F) *No default in respect of deposit/debentures:* the company should not have defaulted in payment of any interest or principal in respect its fixed deposits and interest on debentures or redemption of debentures.

G) *Statutory dues of the employees:* the company should not be defaulted in payment of its statutory dues to the employees such as contribution to PF, gratuity, bonus, minimum wages, workmen's compensation, retrenchment, payment to contract labour etc.

H) ***Implementation of proposal:*** **The bonus issue shall be implemented within a period of 15 days after the date of approval of the BoD; it does not require the shareholders' approval for capitalization of profits or reserves for making bonus issue as per the AoA of the company.**

However, if the company is required to get the shareholders' approval as per AoA of the company for capitalization of profits or reserves, the bonus issue shall be implemented within 2 months from the date of the meeting of the BoD.

I) ***Provision in the AoA:*** **the AoA of the company should provide the provision for the capitalization profits, i.e. it must authorize the bonus issue, if not, and steps should be taken to alter the AoA suitably.**

J) ***Authorised capital:*** **consequent upon bonus issue if the subscribed or paid up capital of the company exceed the authorised capital, then a resolution shall be passed by the company at its GM for increasing its authorised capital to that extent.**

K) ***Certificate:*** **A certificate duly signed by the issuer company and countersigned by the statutory auditor or the company secretary in practice to the effect that the provisions of the guidelines has been complied with shall be forwarded to the SEBI**

8. Explain the advantages and disadvantages from the investors and company's point of view.

Ans : ADVANTAGES OF BONUS SHARES FROM INVESTOR'S POINT OF VIEW

1. **The investor doesn't need to pay any tax upon receiving the bonus shares.**

2. **It is specifically beneficial for the investors who believe in the long-term story of the company and want to increase their investment in the same.**

3. **Issuing additional shares and using cash for the business growth of the company increases the investor's belief in operations of the company.**

4. **If the company starts paying the cash dividend in the future, the investor receives more because he holds a number of shares in the company due to past policy of paying a stock dividend.**

DISADVANTAGES OF BONUS SHARES FROM INVESTOR'S POINT OF VIEW

1. **Not all investors may be interested in receiving the shares as a dividend; some may want liquidity for fulfilling other objectives. When such investors sell their bonus shares for generating liquidity, their stake in the company is reduced.**

2. **The stock dividend doesn't give any extra wealth to the shareholders because share price drops by a proportionate amount to keep the market capital of the company same as before.**

ADVANTAGES OF BONUS SHARES FROM COMPANY'S POINT OF VIEW

1. **Bonus issue allows the company to conserve cash for reinvesting back into the business.**

2. **It has a signaling effect and gives a positive sign to the market that company believes in its long-term growth story.**

3. **Sometimes, the company may not be in a position to pay any cash, so bonus issue is the only means to satisfy the shareholders' desire for a dividend.**

4. **Increasing the number of outstanding shares through a bonus issue increases the participation of smaller investors in the company's shares and hence enhances the liquidity of the stock.**

5. **The Increase in the issued share capital increases the perception of company's size.**

DISADVANTAGES OF BONUS SHARES FROM COMPANY'S POINT OF VIEW

1. **Bonus issue increases the number of outstanding shares of the company and this will decrease the future EPS and cash dividend yield. This can have a negative impact on the market's perceived value of the company.**

2. **The company doesn't receive any cash upon issuing bonus shares. So, the company's ability to raise money by follow-on offerings is reduced.**

3. **The cost of administering a Bonus Share Plan is more than that of paying a cash dividend. This cost can add up over the years if the company keeps on issuing bonus shares.**

9. Distinguish Right Shares and Bonus Shares .

Ans : Differences between Right Shares and Bonus Shares:

The basis for Comparison between Rights Issue and Bonus Issue	***Rights Shares***	***Bonus Shares***
Meaning	**Shares available to existing shareholders equal to their holdings which can be bought at a discounted price for a definite period of time.**	**These are shares issued by the company to the existing shareholders in a specific proportion of their holdings, free of cost.**
Creation	**These are additional shares created**	**Created out of accumulated profits and reserves.**
Purpose	**To raise new/fresh capital for the company.**	**To bring the market price of the shares within attractive ranges.**

Minimum Subscription	It is mandatory	It is not necessary.
Renounce	Rights can be renounced either completely or partially	No such option exists
Paid-Up Value	Either fully paid or partly paid	Always fully paid up.

10. Mention the Benefits of Issue of Bonus Shares .

Ans :

1. To Encourage retail participation, increase of the equity base of the Company.
2. Increase in number of shares by bonus issue, reduces the price per share. It becomes easy for an investor to buy shares of that particular company.
3. Bonus shares is sign of good health of the Company. It is a signal that Company is in position to service its larger equity.
4. The Investor doesn't need to pay any tax upon receiving the bonus shares.
5. Issuing additional shares and using cash for the business growth of the Company increases the investor belief in the operation of the Company.
6. Bonus issue allows the company to conserve cash for reinvesting back into the business.
7. Issue of bonus share increases the number of outstanding shares and participation of smaller investor in the Company shares and hence enhances the liquidity.
8. Increase in Issued share capital increases the perception of Company size.

11. Explain the Conditions for Issue of Bonus shares as per the COMPANIES ACT 2013.

Ans : A company may issue fully paid bonus shares, subject to the following conditions:

1. The Company must be authorized by Articles of Association of the Company to issue bonus shares, if not than the company must alter its Articles of Association as per the provisions of section 14 of the Companies Act, 2013.
2. Whether the Authorized share capital of the Company is sufficient for issue of bonus Shares, if not than authorized share capital of the company has to be increased to create adequate number of shares.
3. The Board of Directors in their meeting has to recommend the issue of Bonus shares.
4. The Company shall authorize bonus issue of shares in its General Meeting.
5. The Company has not defaulted in repayment of the deposits.
6. The Company has not defaulted in debt securities.
7. The Company has not defaulted in respect of payment of statutory dues of the employees such as contribution to PF, Gratuity and Bonus.
8. The existing shares are fully paid up .All partly paid up shares are to be made fully paid prior to the announcement of any bonus shares.

12. Explain in detail Procedure/Checklist for Issue of Bonus Shares.

Ans :

1. Source out of which the bonus issue is to be made
   a) Current profit value.
   b) Current Reserve value.
   c) Current Securities Premium Account.

2. Quantum of Issue

a) No. of Shares.

b) Nominal Value per shares

c) Total shares

3. Issuing Notice of Board meeting (at least 7 days before the meeting of the Board) as per section 173(3)of Companies Act, 2013.

4. Holding the Board Meeting

a) For Recommending Issue of Bonus shares.

b) For deciding the ratio of shares offering to the shareholders.

c) For Fixing the Date of General Meeting for seeking the consent of the members

i. For issue of bonus shares.

5. Sending the Notice of EGM to all the directors, members and auditors of the Company, along with the Explanatory statement, (at least 21 clear days) before the EGM meeting, for considering the special business of issue of bonus shares.

6 . Filing E Form MGT-14 with the Registrar of Companies within 30 days of passing of the Board Resolution for issue of bonus share

Attachments to E Form MGT-14

a) Board Resolution for Issue of shares.

7. Convening EGM for passing of the Ordinary Resolution for seeking the approval of the members for issue of bonus shares.

8. Issuing the notice of Board meeting (at least 7 days before the Board meeting) as per provision of section 173(3) of Companies Act, 2013.

9. Holding the Board meeting for passing Board Resolution for allotment of shares.

10. As per Rule (12)(6) of the Companies (Prospectus and Allotment of Securities)Rules, 2014 , E Form PAS-3 has to be filed within 30 days of passing of Board Resolution for allotment of shares along with fees as specified in Companies (registration of Offices and Fees) Rules, 2014.

Attachment to E Form PAS-3

a) Ordinary Resolution passed by the members in EGM, for Bonus issue of shares.

b) Board Resolution passed by the Board of Directors , for allotment of shares

c) List of Allottees.

11. Issue of Share Certificates

The Company shall issue share certificate to the shareholders within 2 months from the date of allotment of shares.

12. Making Entries in Register of Members.