BONUS SHARES AND RIGHT ISSUE

SUBJECT: CORPORATE ACCOUNTING

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BONUS

A company may distribute a part of abnormal profit or surplus profit to its shareholders and it is called "Bonus".

Methods of Distribution of Bonus

- By cash payment (cash bonus)
- By issuing bonus shares (fully paid)
- By making partly paid shares into fully paid up shares

CASH BONUS

A company pays bonus in cash under the following circumstances:

- When company has sufficient and extra amount of cash.
- When company does not want to raise the rate of dividend.
- When bonus issue is not possible due to limitation of authorized capital.

BONUS SHARES OR CAPITAL BONUS U/S 63

- Bonus shares are those shares which are issued by a company free of cost to the existing shareholders of a company out of its large reserves created out of past profits.
- Without paying cash, the existing shareholders get additional shares.
- Bonus share is a share in kind. It is a gift on pro-rata basis.
- In case of bonus issue, the company reserves or profits are converted into capital.
- Bonus issue is called *Capitalization of Profits or Capitaization of Reserves.*

CIRCUMSTANCES ISSUING BONUS SHARES

- Company wishes to capitalize its huge undistributed profits.
- Due to insufficiency of cash reserves, company issue bonus shares without adversely affecting its working capital.
- When value of fixed assets exceeds its capital of a company, the difference is capitalized by bonus issue.
- To avoid problems like demand by the workers for higher wages.
- When market value of shares far exceeds the paid up value of the shares.

EFFECTS OF ISSUE OF BONUS SHARES

- **Increase in the number of ordinary shares**: Increase in total no. of shares and decrease in reserves & surpluses.
- **Net worth is un affected** : Due to share capital increases and reserves decreased by same amount.
- **Reduced dividend per share** : Due to increase in no. of shares dividend per share reduced.
- **No effect on the assets** : Due to bonus issued by shares, no payment of money is occurred. Therefore asset side of the balance sheet remains unaffected.

CONDITIONS FOR ISSUE OF BONUS SHARES

- Issue should be authorized by the Articles.
- The proposal of the Board of Directors regarding issue of bonus shares should be approved by the members in the general meeting.
- Company should have sufficient profits and reserves to permit the issue of bonus shares.
- Bonus issue should satisfy the guidelines issued by SEBI.
- The partly paid-up shares, if any outstanding on the date of allotment, should be made fully paid-up.

TYPES OF BONUS ISSUE

- ✓Fully paid bonus shares
- ✓Partly paid bonus shares

Note:

Reserves created by revaluation of fixed assets are not capitalized.

STOCK SPLIT

- The process of reducing the face value of the shares (stock) of a company by dividing one share into two or more parts.
- The object of stock split is to make the shares affordable to small investors.
- This will increase the amount of trading in the shares.
- This will also improve liquidity.

RIGHT SHARES OR RIGHT ISSUE U/S 62

- An issue of shares in which existing shareholders have a pre-emptive right to subscribe for the new shares is called 'Right Issue'.
- The existing shareholders may accept or reject the right.
- Shareholder who do not wish to take up the right shares can sell their rights to another person.
- If the shareholder neither subscribe the shares nor transfer their rights, then the company can offer the shares to public.

VALUE OF RIGHT

- Usually a company offers right issue at a price which is lower than the market price of the shares. This legal right is advantageous to existing shareholders.
- Money value of such advantage is called the value of right.
- Otherwise known as value of pre-emptive right.
- It is a gain an existing shareholder makes while exercising his right.

Vale of Right = Market Price of the Share – Average Price of a Share