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Author:

Srishti

Symbiosis Law School, Noida

2nd Year, BBA LL.B.

THE RIGHTS AND LIABILITIES OF EQUITY VS. PREFERENCE SHAREHOLDERS

Abstract

Companies in India are established and governed by the Companies Act, 2013. In India there are mainly two types of companies that are established, namely public companies and private companies. People are more inclined to open Private Limited firms as they tend to have fewer restrictions and more benefits than the other. A share is a unit of ownership in a company and has an exchangeable value that is influenced by market forces.[1] Section 43 of the Companies Act, 2013 distinguishes between the two types of shares, namely Equity shares and Preferential shares. There are a lot of differences between them and as a prospective buyer or a shareholder it is important to understand their difference in order have complete and thorough knowledge before investing their money in the shares. This paper aims at highlighting the rights and liabilities of an equity shareholder versus a preference shareholder in a comparison form.

Introduction

In General terms, A share is an indication of a unit of ownership in a particular company. A shareholder, is any person, company, or institution that owns at least one share of a company's stock. Being a shareholder of a company implies that the person is an investor who is holing a percentage of ownership of the issuing company. Shareholders play an important role in the framing and profits of the company. As owners they enjoy the benefits of the company's successes in the form of increased stock valuation and also are subject to a lot of obligations as they are the risk takers as well if a company goes bankrupt. As ownership and control are separated, shareholders do not partake in the business's daily activities. The number of

[1] https://groww.in/p/difference-between-equity-and-preference-shares/

shareholders in a company depends completely upon the type of company which someone is opening. For example, if it is a one-person company then only one person is required whereas, if it is a private limited company then two persons are needed and a minimum of seven persons are required for a private limited company. There are two types of shareholders:

Equity Shareholders

They are considered as the main shareholders in a company. Equity shares also ordinary shares as the bulk of the shares that are issued by a particular company. They are transferable and traded actively by investors in stock markets as they are the main source of raising the funds for the firm. As an equity shareholder, one is not only entitled to voting rights on company issues, but also has the right to receive dividends.[2] However, the profits on the issued dividends are not fixed. Equity shareholders are at maximum risk owing to the various factors along with the market volatility affecting the stock markets. This also depends on the amount of investment. All equity shareholders are collectively owners of the company and they have the authority to control the affairs of the business. Ownership in the company is depending on the percentage of shares the person holds. Classification Of Equity Shares can be done on 3 bases, first one being on Share Capital, where it is further divided into Authorised Share Capital, Issued Share Capital, Subscribed Share Capital and Paid-Up Capital. The second is on the Basis of Definition. Its classification being into Bonus Shares, Rights Shares, Sweat Equity Shares, and Voting and Non-Voting Shares. Lastly on the basis of Returns classified into Dividend Shares, Growth Shares and Value Shares.

Preference shareholders

The capital raised by a company through the issuance of preference shares is known as preference share capital. Preference shareholders get the profit of the company in form of dividends before equity shareholders at a fixed dividend rate. Preference shareholders do not have the authority to control the affairs of the company. In case of company insolvency issues, Preference shareholders are paid first from company assets.[3] The shares have a fixed rate of dividend and have the preferential rights to avail profits and claim assets during liquidation. The dividends paid on preference shares are not deducted from taxes and, redeeming such shares creates a financial burden on the company and erodes its capital Shares are ranked between debt and equity in terms of priority and repayment of capital. Similar to equity shares, preference shareholders are also partial owners of a company but they are not entitled to voting rights and hence do not really possess the power to control or influence company-oriented decisions. Preference Shareholders cannot claim over the bonus shares. Also, the management has the power to declare the dividend on preference shares and it is not mandatory in case of loss. Preference Shares are classified into four types namely; Cumulative and Non-Cumulative

[2] https://www.indiainfoline.com/share-market-guide/what-are-shares-and-types-of-shares
[3] https://neerajbhagat.com/blog/index.php/equity-shares-vs-preference-shares-under-companies-act-2013/

Preference shares, Participating and Non-Participating Preference shares, Convertible and Non-Convertible Preference shares and lastly Redeemable and Irredeemable Preference shares.

It is evident that both shares are very different from each other and have their own sets of advantages and drawbacks. After knowing what are shares and its types, it is important for any person to understand the rights and liabilities involved after becoming any type of shareholder by starting their investment journey in stock markets. This paper aims at doing a comparative research on the rights ensured and liabilities of both equity and preference shareholders.

The Rights Equity vs. Preference Shareholders

Rights	Equity Shares	Preference Shares
Right to Vote	Equity shareholders take part in the management of the company as they enjoy normal voting rights.	Preference shareholders unlike equity shareholders only have restricted voting rights which means that they can only vote on matters that directly interests them.
Right to Call for General Meetings	Equity shareholders have the right to call the meetings.	As per section 48 of Companies Act, 2013, preference shareholders have the right to call class meetings. [4]
Legal Action Against Directors	Equity shareholders can bring legal action against a director if any act was done by the director in any manner which is prejudicial against the affairs of the company in accordance to the Companies Act, 2013	Preference shareholders can bring legal action against a director if any act was done by the director in any manner which is prejudicial against the affairs of the company in accordance to the Companies Act, 2013

[4] https://www.mca.gov.in/Ministry/pdf/CompaniesAct2013.pdf

Right to The Dividend	Equity shares do not have right to receive dividend and if they receive dividends then the rate of dividend is fluctuating and after payment of all other debts. Shareholders are not entitled to avail arrears of dividends.	Under preference shares, based on time, cumulative or non-cumulative, shareholders are entitled for the dividend with a fixed rate. Shareholders are likely to avail arrears of dividend along with current year's dividend.
Appointment of Directors	Equity shareholders have the right to vote during general meetings. Appointment of Directors is done by passing an ordinary resolution.	Section 47(2) of the 2013 Act removes the limitation of exercising voting rights and entitles the preference shareholder to vote on every resolution placed before the company in general meetings only if the dividend on such preference share is unpaid for a period of 2 years or more.
Right to Dispose of Shares	Only equity shareholders are considered to be owners so only they have the right to dispose shares.	No preference shareholders can be the owners of the Company unless their preference shares get converted into equity shares.
Right to Inspect Registers, Books, And Financial Records	Equity Shareholders have a right to inspect registers, books, and financial records of the company whenever they deem its necessary.	Preference shareholders cannot simply exercise this right.
Pre-emptive Right	Only Equity Shareholders have pre-emptive rights.[5]	No pre-emptive rights are given to preference shareholders. It does not matter even if they are convertible or not.
Winding Up of The Company	During liquidation, the shareholders will have residual right over the assets even after the repayment to preference shares of the company.	Preference shareholders will have first right over the assets after the repayment of debts.
Rights of participation in management	Equity share comes with the power to participate in the company's management.	Preference share does not extend management rights.
Bonus Shares	These shares are entitled to receive bonus against existing shareholdings.	These shares do not offer bonus against existing shareholdings.

[5] https://www.icsi.edu/media/portals/86/geeta%20saar/Geeta_Saar_26_Rights_Issue_-1.pdf

Liabilities of Equity and Preference Shareholders

Since a company itself is a separate legal entity, very few risks are involved with becoming a shareholder in a company. The separate legal status of the company implies that even if the shareholders company has debts, the shareholders will not be responsible for those debts regardless of them being incurred before or during their membership of the company.

This does not mean the shareholders have no responsibilities or duties towards the company. For Example;

- They have a duty to be active in participation and stay in touch with other members of the company so that they can see the work progress of the company.
- Shareholders are not entitled to anything except for their ownership interest in the company.
- Shareholders should consult on the matters of finance and other topics in order to understand the company and its position and competition in the market.
- Shareholders are also not responsible for the company's debt. However, if a company is liquidated, creditors are first in line to have their debts paid, then bondholders, and then common shareholders. However, an exemption to this is that a shareholder is liable to pay the company for any amount unpaid on their shares.[6]

Conclusion

Shareholders play a very important role in the smooth functioning of the company. They have various rights and liabilities varying on the types of shares they hold. These rights may vary depending on the company's shareholder agreement and company constitution and with every right, comes a corresponding responsibility which the shareholder must carry out diligently.[7] Balance between both is necessary. Along with all that it is important to understand that the stock market is very volatile and investing in a good company is important the money involved are huge. One should have complete and thorough knowledge before investing their money in the shares as they should know which type of shares would be better for them according to the risk-taking capability of their own. In order to become a successful investor or owner, one should be a prudent buyer and understand all the rights granted and liabilities involved.

[6] https://blog.ipleaders.in/shareholders-rights-duties

[7] https://indianlawportal.co.in/rights-liabilities-of-shareholders/