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Avinash Kumar



Avinash Kumar has completed his Ph.D. in International Investment Law from the Dept. of Law & Governance, Central University of South Bihar. His research work is on "International Investment Agreement and State's right to regulate Foreign Investment." He qualified UGC-NET and has been selected for the prestigious ICSSR Doctoral Fellowship. He is an alumnus of the Faculty of Law, University of Delhi. Formerly he has been elected as Students Union President of Law Centre-1, University of Delhi. Moreover, he completed his LL.M. from the University of Delhi (2014-16), dissertation on "Cross-border Merger & Acquisition"; LL.B. from the University of Delhi (2011-14), and B.A. (Hons.) from Maharaja Agrasen College, University of Delhi. He has also obtained P.G. Diploma in IPR from the Indian Society of International Law, New Delhi. He has qualified UGC – NET examination and has been awarded ICSSR – Doctoral Fellowship. He has published six-plus articles and presented 9 plus papers in national and international seminars/conferences. He participated in several workshops on research methodology and teaching and learning.

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LEGAL AND FINANCIAL DIMENSIONS OF SHARE CAPITAL IN INDIA: AN ANALYTICAL STUDY

AUTHORED BY - ANJALA NAZRIN SUBAIR

INTRODUCTION

Corporate finance serves as the cornerstone of every modern business enterprise. It encompasses the planning, procurement, management, and utilization of funds necessary for the functioning and growth of a company. Among the several sources of finance, share capital occupies a central position as it represents the permanent capital contributed by shareholders who, in return, acquire ownership rights in the company. Under the Companies Act, 2013, share capital is an essential component of a company's financial structure, determining both its ownership pattern and its ability to mobilize resources for business expansion.

Since a company is a separate legal entity distinct from its shareholders, it cannot raise capital on its own. Therefore, it relies on individuals and institutions to invest funds in exchange for shares that confer ownership, control, and entitlement to profits. The concept of share capital thus embodies both the ownership interest of investors and the financial foundation of the company. Understanding the nature, classification, and legal framework of share capital is crucial for every corporate manager, investor, and policymaker. It also plays a decisive role in maintaining corporate governance, transparency, and investor confidence, all of which are integral to a healthy capital market and an efficient financial system.

Nature of Share Capital

Share capital refers to the total funds a company obtains by issuing shares to its owners. It acts as a permanent source of finance and reflects the shareholders' ownership interest in the business. Each share represents a fraction of ownership, giving its holder specific legal rights and obligations. Unlike borrowed funds, share capital is not repayable during the company's existence; instead, it remains invested until liquidation, providing stable and long-term financial support. Shareholders assume the primary risk of the company's operations. They gain profits in the form of dividends and increased share value but also face potential losses when the company underperforms. This element of risk distinguishes share capital from debt financing. Additionally, the number of shares a person owns determines their influence in

decision-making and voting within the company. Hence, share capital not only supplies financial resources but also establishes the basis of ownership and managerial control. Legally governed by the Companies Act, it ensures transparency, investor protection, and corporate responsibility. A solid and well-structured share capital base also enhances a company's financial reputation and ability to attract external loans.

Classification and Types of Share Capital

Share capital represents the total funds a company accumulates by issuing shares to its investors. It serves as a permanent financial foundation and symbolizes the shareholders' ownership interest in the company. Every share denotes a unit of ownership, giving its holder specific rights and obligations as defined by law. Unlike borrowed capital, share capital is not repaid during the company's life; it remains invested until liquidation, offering a consistent and long-term source of finance. Shareholders act as the principal bearers of business risk. When profits arise, they benefit through dividends and increased share value, whereas during losses, their investment may decline. This risk-bearing nature sets share capital apart from other financing forms. Furthermore, the extent of shareholding determines an individual's influence and voting strength in corporate decisions. Thus, share capital functions not only as a means of raising funds but also as a measure of ownership and managerial authority. It is legally governed by the Companies Act, ensuring accountability and the safeguarding of investors' interests. The stability and adequacy of a company's share capital often enhance its financial standing and ability to raise external credit.

Equity Share Capital: Meaning, Rights, and Role

Equity share capital constitutes the fundamental element of a company's ownership structure. Equity shareholders are regarded as the actual proprietors of the enterprise and exercise ultimate authority over corporate governance through their voting rights. They participate in the election of directors, the formulation of strategic policies, and the decision-making processes concerning significant corporate affairs. In contrast to preference shareholders, equity shareholders are not entitled to a predetermined dividend; rather, their returns are contingent upon the financial performance and profitability of the company. This variability in income renders equity shareholders simultaneously the most privileged and the most exposed category of investors.

During the process of liquidation, equity shareholders receive residual claims only after the

settlement of all outstanding liabilities, including payments to creditors and preference shareholders. Consequently, while they bear a higher degree of financial risk, they also possess a proportionally greater potential for reward. Equity share capital functions as a permanent, non-repayable source of finance, thereby contributing to the long-term financial strength and stability of the organization. Furthermore, a substantial equity base enhances a company's creditworthiness and facilitates the procurement of additional capital through debt instruments or debentures. The tradability of equity shares on stock exchanges also augments liquidity, enabling shareholders to convert their holdings into cash and realize the market value of their investment.

Preference Share Capital: Features and Significance

Preference share capital constitutes a hybrid source of corporate financing that integrates features of both equity and debt instruments. Holders of preference shares enjoy specific advantages over equity shareholders in two primary aspects: firstly, they are entitled to a fixed dividend rate, which must be paid prior to the distribution of any dividends to equity shareholders; and secondly, they possess precedence in the repayment of their capital contribution in the event of the company's liquidation. Generally, preference shareholders do not possess voting rights, except under exceptional conditions—such as when dividend payments have been in arrears for two successive years.

The principal merit of preference share capital lies in its ability to facilitate the raising of funds without causing dilution of managerial control, as preference shareholders exert only limited influence on corporate governance. From the investor's standpoint, it offers a stable and predictable source of income accompanied by relatively low risk, appealing to individuals who value financial security over speculative profit. For the issuing company, preference share capital provides structural flexibility, as dividends are payable solely out of profits, unlike interest obligations on debt which must be met irrespective of profitability. Consequently, preference share capital serves as an essential financial instrument that harmonizes the interests of both risk-seeking and risk-averse investors while strengthening the firm's overall capital framework.

Types of Preference Shares and Legal Framework

Under the Companies Act, 2013, preference shares may be classified into several categories based on the specific rights and obligations associated with them. Cumulative preference

shares grant shareholders the right to claim dividend arrears in subsequent years if such dividends are not paid in any financial year. Conversely, non-cumulative preference shares do not carry this entitlement, and shareholders forfeit their right to unpaid dividends if no declaration is made for a particular accounting period. Redeemable preference shares are repayable after a stipulated duration; however, in accordance with Section 55 of the Act, redemption must occur within twenty years, except for infrastructure companies, which are permitted an extended redemption period of up to thirty years. Irredeemable preference shares, once a valid financial instrument, are now prohibited under Indian corporate law.¹

Additional classifications include participating preference shares, which allow shareholders to receive a portion of surplus profits beyond the fixed dividend, and non-participating preference shares, which limit entitlements strictly to the predetermined rate of return. Certain preference shares are convertible, enabling their transformation into equity shares after a defined period, while non-convertible preference shares remain unchanged throughout their tenure. Collectively, these varieties of preference shares provide a versatile mechanism for balancing investor expectations with corporate financing objectives, thereby enhancing flexibility and adaptability in capital structure decisions.

Legal Provisions Regarding Allotment of Shares

The allotment of shares refers to the formal procedure through which a company accepts applications from potential investors and issues shares in their favor, thereby establishing a contractual relationship between the company and the shareholder. This process is regulated by the provisions of the Companies Act, 2013 and the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018. The authority to allot shares rests with the board of directors and may be exercised only when explicitly permitted by the company's Articles of Association or through a resolution passed at a general meeting of shareholders.

A company is not permitted to proceed with the allotment unless it has received the minimum subscription stated in its prospectus within thirty days from the date of issue. Furthermore, a minimum of five percent of the nominal value of each share must be received as application money in cash. Upon completion of the allotment, the company is legally required to submit a

¹ Companies Act, 2013, Section 55

Return of Allotment (Form PAS-3) to the Registrar of Companies within thirty days, specifying the names of the allottees, the number of shares allotted, and the amount received as consideration. In the case of listed entities, the allotment process must be concluded within fifteen days from the closure of the issue; failure to do so necessitates the refund of subscription money to investors. These regulatory provisions collectively ensure that the share allotment process remains transparent, equitable, and protective of the rights of both corporate entities and their investors.

Allotment of Shares for Non-Cash Consideration

While shares are predominantly issued for monetary consideration, corporate law also authorizes their issuance for non-cash consideration under specific circumstances. A company may allot shares to vendors in exchange for tangible or intangible assets such as property, machinery, or equipment acquired for business purposes. Similarly, promoters, consultants, or other professionals may receive shares as compensation for the services rendered to the company. In cases involving amalgamation or merger, the newly formed or transferee entity may issue shares to the shareholders of the transferor company in exchange for their existing holdings, thereby maintaining continuity of ownership.

To uphold transparency and protect stakeholder interests, such non-cash allotments are subject to stringent regulatory provisions. Pursuant to Section 62(1)(c) of the *Companies Act, 2013* and Rule 13 of the *Companies (Share Capital and Debentures) Rules, 2014*, the consideration for non-cash issuance must be appraised by a registered valuer to determine its fair market value. Furthermore, the allotment requires approval through a special resolution passed in a general meeting and must be reported to the Registrar of Companies via Form PAS-3. Compliance with applicable stamp duty laws and appropriate disclosure in the company's financial statements are also mandated. Collectively, these legal safeguards ensure that such transactions are executed in a fair, transparent, and accountable manner, thereby preserving the confidence of both shareholders and creditors.

Importance of Prospectus in Equity Finance

A prospectus is a formal public document issued by a company to invite subscriptions for its shares or debentures. It serves as an essential mechanism in equity financing, functioning to bridge the informational asymmetry between the corporate entity and potential investors. Through a prospectus, the company discloses comprehensive information regarding its

business operations, strategic objectives, management structure, financial performance, risk exposures, and the specific terms of the securities being offered. Such detailed disclosure enables investors to make informed judgments while promoting transparency and credibility in the fundraising process.

The statutory framework governing the issuance of a prospectus is outlined in Sections 23, 26, and 35 of the *Companies Act, 2013*, supplemented by the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018. These provisions define the mandatory contents, structure, and compliance requirements of a prospectus, and impose stringent penalties for any misstatement or omission of material facts. A well-prepared and accurate prospectus not only enhances investor confidence but also facilitates the effective mobilization of equity capital by reinforcing trust in the company's governance and disclosure practices. Furthermore, it clarifies key aspects such as dividend policy, voting rights, and shareholder privileges, thereby establishing the prospectus as a cornerstone of corporate finance and investor protection.

Role of SEBI and Regulatory Compliance

The Securities and Exchange Board of India (SEBI) functions as the apex regulatory authority governing the securities market in India. It plays a critical role in promoting transparency, safeguarding investor interests, and fostering equitable practices in corporate fund-raising activities. Through the Issue of Capital and Disclosure Requirements (ICDR) Regulations, 2018, SEBI prescribes comprehensive norms for the issuance, allotment, and disclosure of securities, including provisions relating to time limits, pricing mechanisms, and refund obligations.

SEBI's prior approval is a prerequisite for all public issues, and it rigorously oversees compliance with the listing requirements stipulated by recognized stock exchanges.² By enforcing stringent standards concerning prospectus disclosure, preventing insider trading, and maintaining efficient investor grievance redressal systems, SEBI ensures adherence to high standards of corporate governance. Its vigilant regulatory presence fosters investor confidence and contributes significantly to the stability, integrity, and efficiency of India's capital markets.

² Securities and Exchange Board of India (ICDR) Regulations, 2018, Regulation 23

Case Laws and Judicial Interpretations

Judicial precedents play a pivotal role in shaping corporate finance law, particularly regarding the duties of directors and the protection of investors. One of the earliest and most significant decisions in this field is **New Brunswick and Canada Railway Co. v. Muggeridge (1860)**,³ where the court held that a company's prospectus must contain complete and truthful disclosures. Any concealment of material facts or misrepresentation would amount to fraud, and the directors responsible could be held personally liable. This judgment established the foundation for the principle of *utmost good faith* in the issue of securities.

Another landmark case, **Peek v. Gurney (1873)**⁴, reinforced this principle by holding that directors who knowingly issued a misleading prospectus could be sued for deceit. The decision emphasized that a prospectus is not a mere formality but a binding representation to investors. In India, courts have repeatedly upheld similar principles under Section 35 of the Companies Act, 2013. For instance, in **Rex v. Kysant (1932)**⁵, the company's failure to disclose losses while declaring dividends from capital reserves led to criminal prosecution of its directors. These cases underline that transparency and honesty are the cornerstones of investor protection and corporate accountability. Judicial interpretations have thus reinforced that corporate financing must always align with fairness, full disclosure, and ethical conduct.

Comparative Study: Indian and Global Perspective

Corporate finance laws across major jurisdictions share common regulatory principles while reflecting their unique institutional frameworks. In the United Kingdom, the *Companies Act 2006* establishes the primary legal foundation governing share capital issuance, prospectus disclosures, and shareholder rights. The Financial Conduct Authority (FCA) oversees compliance with prospectus and listing regulations, ensuring that companies provide accurate and comprehensive information to investors. Under the Act, companies are required to prepare a statement of capital and initial shareholdings, disclose class rights attached to each share, and adhere to obligations of truthful representation when raising capital. The UK framework attaches significant importance to corporate governance, emphasizing directors' fiduciary duties, including the obligation to act in the best interests of the company and to avoid misleading investors through omissions or misstatements.

³ (1860) 1 Dr. & Sm. 38

⁴ (1873) LR 6 HL 377

⁵ All ER Rep 331

In the United States, the regulatory structure is anchored in the *Securities Act of 1933* and the *Securities Exchange Act of 1934*, administered by the Securities and Exchange Commission (SEC). These statutes mandate the principle of “full and fair disclosure”, requiring public companies to furnish exhaustive and accurate information in their prospectuses and periodic filings before issuing securities. The U.S. system also exhibits greater flexibility in capital structuring through instruments such as convertible preferred shares, stock warrants, and hybrid securities, reflecting a more market-driven environment.

By contrast, the Indian regulatory system, while influenced by British legal traditions, has evolved with an emphasis on investor protection and corporate accountability tailored to local market dynamics. The Securities and Exchange Board of India (SEBI) adopts a proactive and preventive approach, focusing on rigorous disclosure norms, investor education, and surveillance mechanisms. Collectively, the alignment of Indian laws with global best practices reflects the country’s commitment to maintaining a transparent, reliable, and internationally competitive capital market.

Modern Developments in Corporate Financing

The field of corporate finance in India has evolved rapidly in recent decades, shaped by technological advancement, digitalization, globalization, and sustainability initiatives. The expansion of online public offerings and digital fundraising methods has transformed the traditional equity financing model. Companies now raise capital through Initial Public Offerings (IPOs), Follow-on Public Offers (FPOs), and Rights Issues that leverage electronic book-building and online trading platforms, ensuring efficiency and wider investor reach.

Further innovations such as Qualified Institutional Placements (QIPs) and Preferential Allotments have accelerated access to capital from institutional investors, reducing procedural complexities. The surge of venture capital, private equity, and angel networks has provided substantial funding avenues for start-ups and innovation-driven enterprises, while the private credit market—valued at approximately USD 30 billion in 2025—has emerged as a strong alternative financing channel. Similarly, convertible securities and Employee Stock Option Plans (ESOPs) have gained prominence as mechanisms to align management and employee interests with long-term corporate performance.

Contemporary trends also illustrate the growing focus on ethical and sustainable investing. The

rise of ESG (Environmental, Social, and Governance)-oriented funds and green bonds underscores a global transition toward responsible finance. Indian regulators have responded through frameworks such as the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, which mandate disclosures on environmental and social impacts to enhance accountability.

Moreover, increased adoption of artificial intelligence (AI), automation, and data analytics in financial decision-making has improved risk management and treasury operations, reflecting India's broader digital transformation agenda. Overall, the trajectory of modern corporate finance in India demonstrates a shift from a purely profit-centric approach to one centered on transparency, sustainability, and stakeholder value creation, positioning the country as a frontrunner in global capital market modernization

Challenges and Issues in Share Capital Management

Despite significant advancements in regulatory reform, multiple structural and behavioral challenges continue to hinder efficient management of share capital in India. Market volatility remains one of the foremost concerns, as fluctuations in economic and policy conditions often disrupt investor confidence and influence the pricing and subscription of securities. Recent studies indicate that volatility—measured through the India VIX—shows an inverse relationship with stock prices, as heightened uncertainty triggers risk aversion among investors. Behavioral factors such as herd behavior, overconfidence, and reaction to media sentiment further amplify these market swings, leading to inconsistent valuations and unstable capital flows.

Corporate mismanagement also persists as a systemic issue. Instances where promoters issue shares or preference capital to consolidate control or divert funds have raised concerns about fairness toward minority shareholders. While SEBI's surveillance mechanisms have improved, enforcement challenges remain, particularly in detecting insider trading and ensuring full compliance with disclosure norms. Regulatory gaps often impact smaller firms, which struggle with the complexities of filing returns, valuation of non-cash consideration, and maintaining transparent prospectuses, occasionally resulting in penalties or issue cancellations.

Furthermore, the advent of technological innovations such as algorithmic trading, blockchain-based transactions, and digital crowdfunding has created new layers of complexity for financial

governance. They offer efficiency and accessibility yet simultaneously pose risks related to data security, market manipulation, and regulatory oversight. Ensuring equilibrium between innovation and investor protection has thus become a major policy priority.

To sustain market integrity and investor trust, Indian corporations must strengthen internal governance mechanisms, valuation transparency, and ethical conduct. Regulators, on the other hand, must continue refining frameworks that combine technological adaptability with robust investor safeguards, fostering a stable and equitable capital market environment suitable for sustainable economic growth.

CONCLUSION

In conclusion, share capital is not merely a financial instrument but a symbol of ownership, accountability, and trust in the corporate world. It forms the bedrock upon which the financial structure of every company is built. The **Companies Act, 2013** and SEBI regulations have established a comprehensive legal framework that governs the issue, allotment, and management of share capital. Through clear classifications — equity and preference — and through rigorous disclosure requirements for prospectuses, Indian law ensures that investors are well-informed and protected against malpractices.

However, the effectiveness of these laws depends largely on their implementation and on the ethical standards upheld by corporate leaders. To strengthen the system further, companies should adopt transparent accounting practices, conduct regular audits, and engage independent directors actively in oversight. Regulatory authorities must continue to modernize disclosure requirements to match global standards and technological advancements.

As India's capital markets expand and integrate with global systems, the principles of fairness, accountability, and transparency must remain at the core of corporate finance. Share capital, when managed with integrity and foresight, not only fuels corporate growth but also contributes to national economic development. In the evolving financial landscape, a balanced approach between investor protection and market innovation will ensure sustainable and inclusive corporate progress.

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