Unit – II (Incentive Equity, Buy Back, and valuation of shares and goodwill)

Right share : Right shares are the shares that are issued by a company for its existing shareholders. A rights issue is a way by which a listed company can raise additional capital. However, instead of going to the public, the company gives its existing shareholders the right to subscribe to newly issued shares in proportion to their existing holdings. The existing shareholders have their right to subscribe to these shares unless some special rights reserve them for some other persons.

Advantages of the Rights Issue of Shares :

- The shares are offered to the shareholders at the discounted price to encourage them to purchase the rights issue.
- The company saves a significant amount of money, such as underwriting fees, advertisement cost and so on.
- The control of the company remains in the hands of the existing shareholders. This is because the shares are only issued to those shareholders who on the date of rights issue are the holders of the shares.
- There is an equitable distribution of the shares and the same proportion of the voting rights.

Disadvantages of the Rights Issue of Shares :

- The company may not be able to raise more funds and fail to achieve their target. This may happen if the existing shareholders of the company are not too keen to invest more.
- The value of each share may get diluted if there are an increased number of shares issued.
- If a well-established company is going for the rights issue of the shares, then it goes on to create a negative market sentiment. It is assumed that the company is struggling to run its business operations smoothly.

Bonus share : Bonus shares are additional shares given to the current shareholders without any additional cost, based upon the number of shares that a shareholder owns. Bonus shares are issued to the shareholders without any additional cost.

Advantages of bonus share :

1. There is no need for investors to pay any tax on receiving bonus shares.
2. Issuing bonus shares helps to increase the issued share capital of the company.
3. It takes more money from the cash reserve than issuing dividends does.
4. It is beneficial for the long-term shareholders of the company who want to increase their investment.
5. Bonus shares give positive sign to the market that the company is committed towards long term growth story.
6. Bonus shares increase the outstanding shares which in turn enhances the liquidity of the stock.

Disadvantages of bonus issues :

1. Dividends should be paid according to the number of shares increased.
2. Over capitalization may appear due to the issues.

3. It encourages to speculate the stock.

Buy back of share : A share buyback means that the company uses cash on its balance sheet to repurchase its own shares. It is one mechanism by which a company returns capital to its equity investors.

Reasons for Buy-back of share :

1. To improve Earnings per share.
2. To achieve optimum capital structure.
3. To enhance consolidation of stake in company.
4. To increase value of share by reducing its supply.

Goodwill : Goodwill is a long-term (or noncurrent) asset categorized as an intangible asset. Goodwill arises when a company acquires another entire business. The amount of goodwill is the cost to purchase the business minus the fair market value of the tangible assets, the intangible assets that can be identified, and the liabilities obtained in the purchase.

Features of goodwill :

1. Goodwill has no physical existence.
2. Concept of goodwill has relevance only for going concern concept.
3. Goodwill is an intangible asset.
4. Goodwill of a firm represents the excess of real net worth of assets over their book value.
5. It cannot be separated from the business like a physical asset can.
6. Its value is not relative to any investment amounts or costs.
7. Goodwill has the ability to generate additional income for the business firm like any other assets.

Valuation of shares : Valuation of shares is the process of knowing the value of companys shares. Share valuation is done based on quantitative techniques and share value will vary depending on the market demand and supply.