Types of Shares in a Company

1.0 Introduction

Shares are a form of ownership in a company. A share gives its owner an ownership right over the assets, profits, and sometimes even the voting rights of a company. According to the companies Act[1], "share" means share in the share capital of a company and includes stock except where a distinct between stock and shares is expressed or implied.

Understanding shares is key to knowing how businesses grow, and how one can benefit from such business. Shares also known as stock or equity, represent a stake of ownership in a company and entitles a shareholder to a portion of profits.

2.0 Ordinary shares or Equity shares

These are the most common/basic and widely traded shares issued by a company, they represent the most fundamental form of ownership by a company and come with a combination of rights and risks for shareholders. An ordinary share represents a fraction of ownership in the corporation that issues it. As an owner, the shareholder gets a vote in the company's major decisions, decided at its shareholder meetings.

a) Ownership Rights.

Ordinary shareholders have a right to vote on company matters, these include voting on board members, approving major business decisions such as mergers and acquisitions and even business proposals such as compensation and renumeration for company executives. The number of votes typically correspond to number of shares owned, with one vote per share being the most common scenario.

b) Profits or Dividends

Ordinary shares may receive a portion of the company profits in form of dividends, however unlike preference shares, dividends on ordinary shares are not guaranteed. The company's board of directors decides on whether or not to distribute dividends or not, any number of dividends depends on the company's profitability.

c) Capital Appreciation

Ordinary shares have the potential for capital appreciation meaning their price can increase over time, this happens when a company performs well, or when company's future prospects are bright or when there is a general increase in interest in the company shares.

d) Risks Associated with ordinary Shares

1. **No guaranteed dividends**: the company may choose to reinvest its profit for growth or simply not have enough profit after covering expenses.
2. **Company performance**: The value of ordinary shares is tagged to companies' performance, if a company struggles financially, its stock price could decline and shareholders could lose money.

[1] Section 2 of the Companies Act 2012

3. **Market Volatility**: the value of ordinary shares can fluctuate due to factors beyond a company's control, such as economic conditions interest rates, exchange rates and investor sentiments.
4. **Lower priority in Liquidation**: In the unfortunate event of a company going into liquidation, ordinary or common shareholders are last in line to receive any assets after debts are paid and preference shareholders compensated.

Ordinary Shares are suitable for investors who have a long-term investment horizon, can tolerate some risk, are looking for potential capital appreciation and a possibility of dividend income. Its therefore crucial for one to consider their investment goals and risk tolerance before investing in ordinary shares.

2.0 Preferential shares or preferred Stock

2.1 Introduction

They are a special class of shares that offer certain advantages such as priority on dividends and potential repayment claims, but preferential shareholders don't have voting rights.

They are classified into class A, B and C. A class of shares is a type of listed company stock that is differentiated by the level of voting rights shareholders receive. For example, a listed company might have two share classes, or classes of stock, designated as Class A and Class B. Owners of companies that have been privately owned and go public often create class A and B share structures with different voting rights in order to maintain control and or to make the company a more difficult target for a takeover[2].

Class A: Top tier shares coming with more voting power, say 10 votes per share, preferential dividend rights, meaning they get paid first or receive higher dividends. They are usually held by company founders and insiders to maintain control. They might get a larger share of dividends if the company's articles of association provide so.

Class B: These come with fewer voting rights and are commonly held by public investors. They are second in line to class A shares for a pay out and they hold a lower dividend payout. Class B shares are issued by corporations as a class of common stock with fewer voting rights and lower dividend priority than Class A shares. The dual-class structure might be instituted if the original owners of the company wanted to sell the majority of their stake in the firm but still maintain control and make key decisions.

Class C- They carry no voting rights but may carry higher dividends, profit distribution is similar to ordinary shares in terms of dividends but with no say in running of company affairs.

2.2 Advantages of Preferential Shares

a) Priority dividends

The shareholders receive dividends first if a company declares them, the dividend amount is usually fixed but some shareholders may have dividends that can fluctuate.

b) Limited voting rights or no Voting rights

They typically don't have voting rights in a company matters such as election of directors or approval or mergers and acquisitions. This is in contrast to ordinary shareholders.

c) Higher Claim on Assets in Liquidation

If a company goes bankrupt and liquidates its assets, preference share shareholders have a higher a claim on company's assets that ordinary shareholders. This means preference

[2]https://www.investopedia.com/terms/c/class.asp

shares are more likely to get some of their investment back than common/ordinary shareholders.

2.3 Why one should choose to buy Preference shares

1. **Stable income:** The fixed dividend on preference shares can provide a stable stream of income for investors
2. **Reduced risk**. The priority claim on assets on liquidation can reduce risk compared to an investment in common shares.

2.4 Some Considerations before Investing in Preference shares

1. Limited upside potential: The fixed price on preference shares may not keep pace with inflation and the price of preference shares may not appreciate as high as the price of ordinary shares in cases of a company's business growth.
2. Lack of voting rights: Since they generally don't have voting rights, they don't have a say on how a company's business is run.

Over all preference shares are good for investors looking for a stable stream of income and reduced level of risk. However, it is important to consider the limitation of preference shares before taking a decision to invest in them.

3.0 Differential Voting Rights Shares (DVRS)

These shares entitle investors to most of the benefits of equity shares like such as dividends and capital appreciation. However, DVR shareholders have fewer voting rights compared to ordinary shareholders.

3.1 Advantages of DVRS

a) Higher dividends:

To compensate for the lower voting rights, company's often offer higher dividend payouts, these can be attractive to income focused investors.

b) Lower Price

They trade at a lower price due to lower voting rights, this can be attractive to investors looking for a good value.

c) Liquidity.

They offer good liquidity since they can be traded on the stock exchange

3.2 Disadvantages of DVRS

Lower voting rights: The holders don't much say in company decisions like appointing directors and approving mergers.

Price volatility. DVRS are subject to price volatility due to market down turns

Limited availability. Not all companies offer DVRS they are more common in

Negative Perception. DVRS Can sometimes be used negatively by investors and as it raises concerns about control and transparency

3.3 Who should Prioritize acquiring DVRS

1. **Income Investors** who prioritize receiving regular dividends, DVRS with a higher pay outs can be a good option
2. **Value investors**: if you think a company is undervalued and a discount on DVRs is attractive, they might be worth considering

3. **Long term investors** who are less concerned with voting rights and whose focus is on capital appreciation and dividends

Before investing in DVRS Conduct research on the company and its financial health, understand the voting rights structure and how it defers from ordinary shares, consider your investment goals and risk tolerance before making any decisions.

4.0 Treasury Shares

Refers to a portion of a company stock that were issued and subsequently re-acquired by a company. They are held by a company in its own treasury and they don’t have voting rights nor do they have dividends.

Companies can acquire treasury shares through

a) Buy backs from the main market,
b) Forfeiture due to failure of shareholders to meet certain conditions,
c) Donations: occasionally, shareholders might donate shares to a company

4.1 Why would a company buy back its own shares? There are several strategic reasons

- **Increased share value**. By reducing the number of shares outstanding, the company can increase the value of the remaining shares.
- **Improve financial ratios**: Share backs can improve earnings per share, return on equity
- **Utilise Excess cash**. Companies with excess cash might decide to buy back shares rather than venture into new projects or pay dividends. However, the buyback may also be a sign of luck of opportunity to invest in profit making ventures.
- **Prevent take overs**: reducing the number of shares on the market can help prevent hostile take overs.

4.1 Re issue of treasury shares.

Companies can re issue treasury shares for so many reasons:

a) To raise capital,
b) Employee compensations by using shares for stock options or other employee benefits’ plans.
c) Mergers and acquisitions. As part of a payment in acquiring other companies

Treasury shares are treasury tools that company can use for various strategic purposes from managing their capital structure to rewarding employees