CAIIB

Advanced Business & Financial Management

Module B : Chapter 7

Equity Capital

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What is Equity Capital?

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Equity

['e-kwə-tē]

The amount of money that would be returned to a company's shareholders if all of the assets were liquidated and all of the company's debt was paid off in the case of liquidation.

- **Money brought in by owner/shareholders + Profits earned but not distributed.**

FEATURES

- Divided into units called **Equity Shares**. Each unit has the same value: **nominal value**.
- Equity holder has two types of financial rights:
  1. the **right to income** (dividend) and the
  2. **right to retaining surplus assets** in case of liquidation.
- Additionally, they also have **voting rights** (except of Differential Voting Right shares).
- All subscribers to the Equity shares are governed by a common document called **Memorandum and Articles of Association.**
- The Equity Shareholder can **exit at will** by following the prescribed rules.
- If the company is listed, the liquidity of the Equity Shares increases.
- Equity shares can be priced at the nominal value or at a **premium** or **discount**.
- Also, subject to extant regulations and-guidelines, Equity Capital can be enhanced, reduced, subdivided, bought back or issued free of cost.
- Shareholders can also pledge and borrow against the shares because an equity share is a **marketable and valuable security**.

Important Terms

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Authorised Capital or Nominal Capital

- The maximum amount of capital that the company is authorised to issue which can be in any instalments as the Board decides.
- This is prescribed by the Memorandum and Articles of Association of the Company and in case of any change, the company has to go to the shareholders as prescribed in the Act.

Issued Share Capital

- The part of authorised capital which is issued to public for subscription.
- This includes shares issued for cash and for consideration other than cash.

Subscribed Share Capital

- It is the portion of the issued share capital that is subscribed to by the public.
- It also includes the face value of the company's shares issued for consideration other than cash.
- It is possible that all the shareholders, who have been called upon to subscribe to the capital, may not respond and therefore the actual subscribed capital may be less than the called up one.

Called-Up Share Capital

- This is part of the Issued Capital that the company has called up from the shareholders.
- The call can be one or more subject to the extant regulations and need of funds by the company.

Paid -up Share Capital

- The amount of money a company has received from shareholders in exchange of shares.
- However, even after subscription, some may skip or delay the actual payment and, in such case, the paid-up capital can still be lesser than the subscribed capital.

Calls in Arrears

- Part of the called up or subscribed capital which the company can follow up and rightfully collect when the shareholders fail to pay the full or part amount.

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Important Terms

Unpaid Share Capital

- The amount finally determined as unpaid for which the management can take suitable decision.

Forfeited Shares

- Part of the subscribed capital which is not fully paid as required and the company forfeits the amount so that it can be reissued, subject to the regulations.

Why Equity Over Long Term Loans?

- The equity holders are not required to be paid compulsorily any reward or interest.
- Unlike loans, there is no repayment involved.
- It provides the risk capital which otherwise is difficult to source.
- It gives to the holder a sense of ownership.
- Higher amount of equity provides higher level of safety and confidence to the lenders.

- Cost of capital is considered to be higher than the cost of a other source of capital.
- Cost of raising funds is generally higher due to expenditure on advertisements, brokerage, underwriting commission and a host of compliance costs.
- Real cost of servicing the equity capital can be higher than a debt because the dividend to be paid is out of the post-tax profits
- Dilution of control on the ownership and ultimately the management.

Thank You

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