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Issue of Shares

The capital obtained by issue of shares is known as share capital. The capital of a company is divided into small units called shares. Each share has its nominal value. For example, a company can issue 1,00,000 shares of Rs. 10 each for a total value of Rs. 10,00,000. The person holding the share is known as shareholder. There are two types of shares normally issued by a company. These are equity shares and preference shares. The money raised by issue of equity shares is called equity share capital, while the money raised by issue of preference shares is called preference share capital.

(a) Equity Shares Equity shares is the most important source of raising long term capital by a company. Equity shares represent the ownership of a company and thus the capital raised by issue of such shares is known as ownership capital or owner's funds. Equity share capital is a prerequisite to the creation of a company. Equity shareholders do not get a fixed dividend but are paid on the basis of earnings by the company. They are referred to as 'residual owners' since they receive what is left after all other claims on the company's income and assets have been settled. They enjoy the reward as well as bear the risk of ownership. Their liability, however, is limited to the extent of capital contributed by them in the company. Further, through their right to vote, these shareholders have a right to participate in the management of the company.

Merits

The important merits of raising funds through issuing equity shares are given as below:

(i) Equity shares are suitable for investors who are willing to assume risk for higher returns;

(ii) Payment of dividend to the equity shareholders is not compulsory. Therefore, there is no burden on the company in this respect;

(iii) Equity capital serves as permanent capital as it is to be repaid only at the time of liquidation of a company. As it stands last in the list of claims, it provides a cushion for creditors, in the event of winding up of a company;

(iv) Equity capital provides credit worthiness to the company and confidence to prospective loan providers;

(v) Funds can be raised through equity issue without creating any charge on the assets of the company. The assets of a company are, therefore, free to be mortgaged for the purpose of borrowings, if the need be;

(vi) Democratic control over management of the company is assured due to voting rights of equity shareholders.

Limitations

The major limitations of raising funds through issue of equity shares are as follows:

(i) Investors who want steady income may not prefer equity shares as equity shares get fluctuating returns;

(ii) The cost of equity shares is generally more as compared to the cost of raising funds through other sources;

(iii) Issue of additional equity shares dilutes the voting power, and earnings of existing equity shareholders;

(iv) More formalities and procedural delays are involved while raising funds through issue of equity share.