HAVE AN IDEA ABOUT EQUITY

Equity is a share in the ownership of a company. It represents a claim on the company's assets and earnings. As you acquire more stock, your ownership stake in the company increases. The terms share, equity and stock mean the same thing and can be used interchangeably. As you acquire more stock, your ownership stake in the company increases.

Holding a company's stock means that you are one of the many owners (shareholders) of a company, and, as such, you have a claim (to the extent of your holding) to everything the company owns. Yes, this means that technically, you own a portion of every piece of furniture; every trademark; every contract, etc. of the company.
As an owner, you are entitled to your share of the company's earnings as well as any voting rights attached to the stock.

Another extremely important feature of equity is its limited liability, which means that, as a part-owner of the company, you are not personally liable if the company is not able to pay its debts. In case of other entities such as partnerships, if the partnership goes bankrupt, the partners are personally liable towards the creditors/lenders and they may have to sell off their personal assets like their house, car, furniture, etc., to make good the loss. In case of holding equity shares, the maximum value you can lose is the value of your investment. Even if a company of which you are a shareholder goes bankrupt, you can never lose your personal assets.

Reasons for issuing equity

To expand its business, a company, at some point, needs to raise money. To do this, it can either borrow by taking a loan or raise funds by offering prospective investors a stake in the company --- which is known as issuing stock. A company usually borrows from banks and/ or financial institutions. This is called 'debt financing'.

On the other hand, issuing stock is called 'equity financing'. While raising loans is used for temporary cash requirements (such as borrowing to fund a project), issuing stock is used to raise funds of a permanent nature. While a lender gets interest for the loan given to the company.

Characteristics of equity

Equity is unsecured and a high risk-return investment

When you invest your money in a debt investment such as a bank deposit, bonds, etc., you are promised a fixed amount of interest on your investment and return of capital. This isn't the case with an equity investment. By becoming an owner, you bear the risk of the company not being successful. However, the rewards for bearing this risk are high. You, as an equity shareholder, are entitled to a share in the profits of the company's business as well as any appreciation in the perceived value of the shares.

The risks and rewards of investing in equity are clearly apparent from the Bombay Stock Exchange Sensitive Index (BSE Sensex), which is a popular stock market index. This index reflects the movement of the share prices on the stock markets. The Sensex rises and/or falls continuously during trading hours. Rises indicate gains and falls indicate losses. True equity money is unsecured and directly reflects the faith of the investor in the business, its management and the commitment of its principals to it.

Equity remains in perpetual existence

The perpetual existence of a company implies that the death, disability, retirement or termination of a shareholder, director or officer, will not affect the existence of the company. For an equity shareholder, this is convenient since he does not need to renew/renegotiate the terms of his investment (like in the case of a fixed tenure debt investment). He also has the option to sell his equity holding through the stock exchange if he no longer wants to remain invested in the company.

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Income from equity investing

Capital appreciation
Equity shares of companies are listed and traded on a stock exchange (the Bombay Stock Exchange or the National Stock Exchange). The market prices of these shares are continuously moving up or down depending on the interest in the company's stock, it's business potential, etc. As an equity shareholder, you can profit/lose from the market price rise/ fall. For instance, if you have purchased the equity shares of Company ABC at Rs 25 per share and the market price of the share rises to Rs 30, you can sell the shares at this price to make a profit. This is called 'capital appreciation'. However, if the market price falls to below Rs 25, you would lose. This loss would be notional till you actually sell at this price and book the loss.

Bonus shares
When you purchase shares of a company, you become a shareholder of the company. When the company is doing well, it may declare a 'bonus issue'. This means that the company will issue fresh equity shares to its existing shareholders, for free. As a shareholder, you will be entitled to receive bonus shares in proportion to your holding in the company. For instance, if the company declares a bonus in the ratio of 1:2 (this means it will issue one share for every two shares you hold) and if you hold 100 shares, you will be entitled to 50 shares as a bonus. When you sell your bonus shares in the stock market, the market price at which you sell your bonus, minus brokerage charges and necessary taxes (Service Tax, Securities Transaction Tax, etc.), will be your profit i.e. capital appreciation. In this case, there will be no cost of purchase since you have received the bonus for free. For instance, if the company declares a 'bonus issue' in the ratio of 1:2 (this means it will issue one bonus share for every two shares you hold) and if you hold 100 shares, you will be entitled to 50 shares as a 'bonus shares'. The cost of these shares will be nil. In this case, if you sell your bonus shares in the market at say, Rs 35, your capital appreciation will be the entire Rs 35 per share minus brokerage, taxes, etc.

Rights shares
Another way a company offers benefits to its shareholders is by offering 'rights shares'. This means that the company will offer fresh equity shares to its existing shareholders at a price, which is lower than the current market price of the share. For instance, if the current market price of the company's share is Rs 35, it will offer shares at below this price, say Rs 25. As a shareholder, you will be entitled to receive 'rights shares' in proportion to your holding in the company. For instance, if the company declares a 'rights issue' in the ratio of 1:2 (this means it will issue one share for every two shares you hold) and if you hold 100 shares, you will be entitled to 50 shares as a 'rights shares'. This implies that to obtain the 'rights shares', you will have to pay Rs 1,250 (50 shares you are entitled to x Rs 25 per share). In this case, if you sell your rights shares in the market at say, Rs 35, your capital appreciation will be Rs 10 per share minus incidental selling costs.

However, if you don't want to subscribe to the rights offered to you, you can sell your rights entitlements. The price that you receive to sell your rights entitlements will depend on the rights offer price, the current market price and the demand for the company's shares. For instance, taking the above example forward, if you decide to sell your rights entitlements of 50 shares and you receive Rs 2.50 per share, you will get a total of Rs 125. This will be your profit after deducting incidental selling expenses.

Dividend income
Companies report their profits earned on a quarterly basis. Based on the quantum of profits, companies declare dividends to distribute a portion of these profits to their shareholders. Dividends are declared as a percentage of the share's face value. For instance, if

a company declares a dividend of 10 per cent and its share has a face value of Rs 10, it implies that it will pay Re 1 per share as dividend (Rs 10 x 10 per cent). As a shareholder, you will be entitled to dividend to the extent of your share holding. For instance, in this case if you hold 500 shares, you will get a dividend of Rs 500 (500 shares x Re 1 per share). However, dividend income is uncertain. Companies don't declare dividends regularly. Dividends are declared only when there are profits available for distribution.