Stockholder's equity: paid in capital

Types of Businesses

1. **Sole proprietorship**: Run and managed by single member
2. **Partnership:** Run and management by small number of persons under partnership act, and the liability in partnership is unlimited:
3. **Joint Stock Company:**

- A **corporation** is a form of business organization that is recognized under the law as a *separate legal entity*, with rights and responsibilities *apart from those of its owners*.
- The assets of a corporation belong to the corporation *itself*, not to the stockholders.
- The corporation is responsible for its own debts and must pay income taxes on its earnings.
- As a separate legal entity, a corporation has status in court; it may enter into contracts, and it may sue and be sued as if it were a person

Advantages	Disadvantages
1. *Stockholders are not personally liable for the debts of a corporation.* This concept is called *limited personal liability* and often is cited as the greatest advantage of the corporate form of organization.	1. *Heavy taxation.* Corporate earnings are subject to **double taxation**. First, the corporation must pay *corporate income taxes* on its earnings. Second, stockholders must pay *personal income taxes* on any portion of these earnings that they receive as *dividends*.
2. *Transferability of ownership.* Ownership of a corporation is evidenced by *transferable shares of stock*, which may be sold by one investor to another.	2. *Greater regulation.* Corporations are affected by state and federal laws to a far greater extent than are unincorporated businesses.
3. *Professional management.* The stockholders own a corporation, but they do not manage it on a daily basis. To administer the affairs of the corporation, the stockholders elect a *board of directors*. The directors, in turn, hire professional managers to run the business.	3. *Cost of formation.* An unincorporated business can be formed at little or no cost. Forming a corporation, however, normally requires the services of an attorney.
4. *Continuity of existence.* Changes in the names and identities of stockholders do not directly affect the corporation. Therefore, the corporation may continue its operations *without disruption*, despite the retirement or death of individual stockholders.	4. *Separation of ownership and management.* If stockholders do not approve of the manner in which management runs the business, they may find it difficult to take the united action necessary to remove that management group.

→ Public and private limited company:

→ Functions of the board

→ Common stock and preferred stock:

→ Types of preferred stock:

Primary sources of corporate equity →

Total stock holders' equity =

Common stock

+ Preferred stock

+ Additional paid in capital [excess of price over par value]

+ Retained earnings

Book value per share of common stock:

Book value per share is the amount of net assets represented by each share of stock.

→ Net Assets= Total Assets – Total Liabilities

→ Total stockholder's equity= Total Assets – Total Liabilities

→ **Book value per share** = **net Assets per share** = **Stockholders equity per share.**

Formula to calculate Book value per share

= Total Stockholder’s equity/ Number of shares

Stockholders’ equity:	
Common stock, $1 par value (4,000 shares issued and outstanding)	$ 4,000
Additional paid-in capital	40,000
Retained earnings	76,000
Total stockholders’ equity	$120,000

The book value per share is *$30;* it is computed by dividing the stockholders’ equity of $120,000 by the 4,000 shares of outstanding stock.

Note: It is worth mentioning here that book value per share is always computed at common stock and if preferred stock is included in equity we shall first subtract it and then calculate book value per share.

Second important is that if any amount of dividend on preferred stock is outstanding and not paid yet we shall also subtract it from total equity before the calculation of book value per share.

For example:

Stockholders' equity:	
8% preferred stock, $100 par value, 10,000 shares authorized, issued, and outstanding	$1,000,000
Common stock, $10 stated value, authorized 100,000 shares, issued and outstanding 50,000 shares	500,000
Additional paid-in capital: common stock	750,000
Total paid-in capital	$2,250,000
Retained earnings.	130,000
Total stockholders' equity	$2,380,000

Because of a weak cash position, Hart Company has paid no dividends during the curren year. As of December 31, dividends in arrears on the cumulative preferred stock total *$80,000.*

Solution

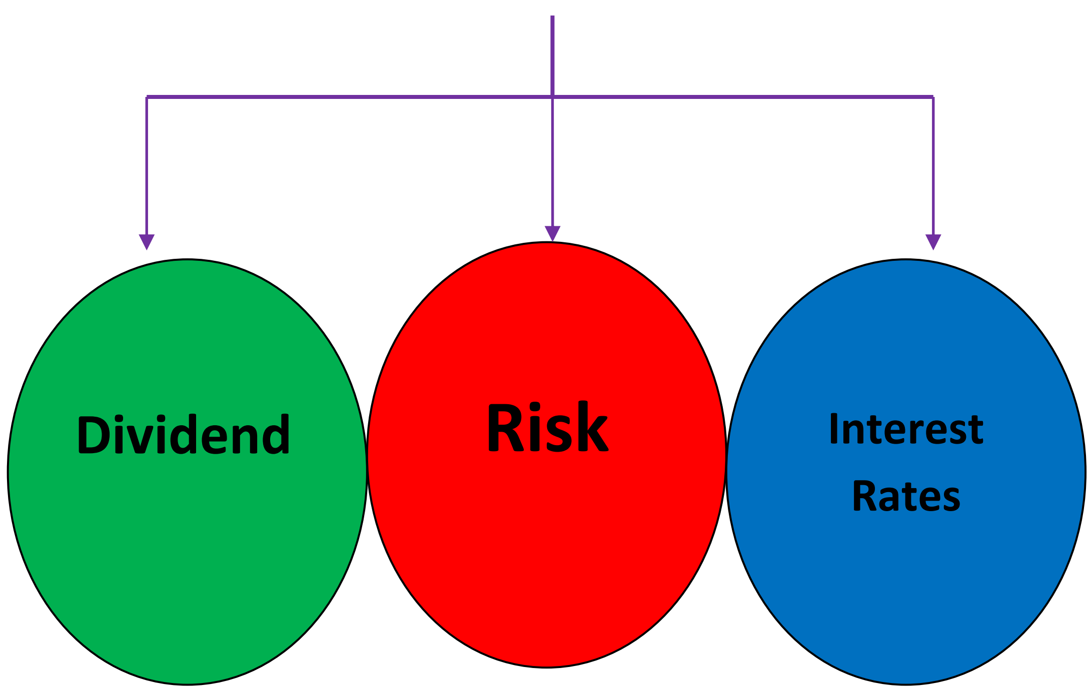
Total stockholders' equity.		$2,380,000
Less: Equity of preferred stockholders:		
Par value of preferred stock	$1,000,000	
Dividends in arrears	80,000	1,080,000
Equity of common stockholders		$1,300,000
Number of common shares outstanding		50,000
Book value per share of common stock ($1,300,000 ÷ 50,000 shares)		$26

Market Value of sahre

“After shares of stock have been issued, they may be sold by one investor to another. The price at which these shares change hands represents the *market price* of the stock”.

Change in market price has no impact on financial position of company, but change in market value or market price matters a lot for shareholder

Determinants of market value

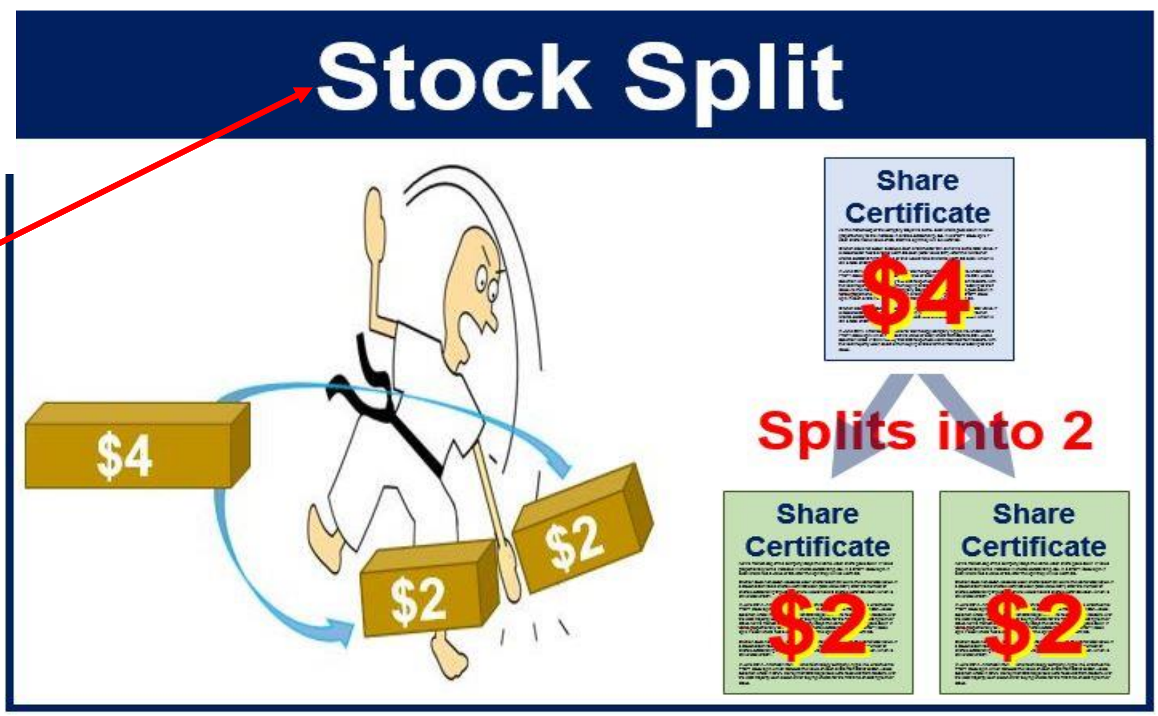


Book Value and Market Value

Book value is a historical concept, representing the amounts invested by stockholders plus the amounts earned and retained by the corporation. If a stock is selling at a price *above* book value, investors believe that management has created a business worth more than the historical cost of the resources entrusted to its care. This, in essence, is the sign of a successful corporation.

On the other hand, if the market price of a stock is *less than* book value, investors believe that the company's resources are worth less than their cost while under the control of current management. Thus the relationship between book value and market price is one measure of investors' *confidence in a company's management.*

What is Stock Split?



Treasury Stock:

When a company buys its own shares from market, but does not cancel or redeem these shares.

These shares are not entitled حقدار to receive dividends and vote.

Normally these are purchase to use as stock options for employees in the employee compensation program.

Journal Entry when company purchases treasury stock

Date	Details	Debit	Credit
00	Treasury Stock	XXX	
	Cash		XXX

It is debit not because it is "Asset", but because it is contra equity account, this is why in balance sheet we do not writ it in debit side but subtract it from equity.

Stockholders' equity:	
Common stock, $5 par value, authorized 250,000 shares, issued 100,000 shares (of which 1,600 are held in treasury)	$ 500,000
Additional paid-in capital: common stock	900,000
Total paid-in capital	$1,400,000
Retained earnings	600,000
Subtotal	$2,000,000
Less: Treasury stock (1,600 shares of common, at $90 cost)	144,000
Total stockholders' equity	$1,856,000

Reissuance of treasury stock:

If more than the price it was purchased at, it is increase in corporation's paid-in capital.

If less than the price it was purchased at, it is decrease in corporation's paid-in capital.