FINANCE AT A GLANCE

The components of SHAREHOLDERS' EQUITY — Lesson 11

Shareholders' equity is made up of Capital stock and Retained earnings.

Capital stock
Capital stock refers to the original sum of money that was put into the business by the owners (ie shareholders), plus any add-on money invested in the business over the course of time.

The capital stock is denominated in terms of shares. If the capital stock is worth $6 million, and there are 1 million shares, then 1 share is worth $1. The value per share is set at the time of establishment of the company, as stipulated in its articles of incorporation. An owner whose contribution is worth $2 million holds 2 million shares.

Capital stock increases whenever the current shareholders put in more money, or whenever new shareholders are invited to join by putting in their money.

Retained earnings
When a company makes profit, it may distribute some of the profit to its shareholders. The portion of the profit distributed to the shareholders is called *dividends*. The remaining portion after distributing dividends is called *Retained earnings.* This term is self-explanatory. It is the portion of profit (or earnings) that is *retained* in the business.

Retained earnings can be regarded as a "pool" of funds from which future dividends can be paid. If a company does not make profit, it will not have this pool of funds from where dividends can be drawn.

Each year that a company makes money, profit is accumulated in the Retained earnings. When it issues dividends, the value of retained earnings decreases.

Whenever a company has a loss, the value of retained earnings is lowered.

If a company has not made any profit at all, but rather has sustained losses over the years, it has a negative retained earnings, called *accumulated deficit.*

At this point we are ready to present the balance sheet with all of its components that we covered. We shall look at this in the next lesson.

Until the next e-lesson,

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