MBA (Business Economics) II Semester

Paper- Financial Management (203)

UNIT- II Topic- Over-Capitalisation and Under- Capitalisation

Meaning of Over-Capitalisation

Overcapitalization occurs when a company has issued more debt and equity than its assets are worth. The market value of the company is less than the total capitalized value of the company. An overcapitalized company might be paying more in interest and dividend payments than it has the ability to sustain long-term. The heavy debt burden and associated interest payments might be a strain on profits and reduce the amount of retained funds the company has to invest in research and development or other projects. To escape the situation, the company may need to reduce its debt load or buy back shares to reduce the company's dividend payments. Restructuring the company's capital is a solution to this problem.

The phrase 'over-capitalisation' has been misunderstood with abundance of capital. In actual practice, overcapitalized concerns have been found short of funds. Truly speaking, over-capitalisation is a relative term used to denote that the firm in question is not earning reasonable income on its funds.

According to Bonneville, Dewey and Kelly, **"When a business is unable to earn a fair rate of return on its outstanding securities, it is over-capitalized."**

Likewise, Gerstenberg opines that **"a corporation is over-capitalized when its earnings are not large enough to yield a fair return on the amount of stocks and bonds that have been issued."**

Thus, over-capitalisation refers to that state of affairs where earnings of the corporation do not justify the amount of capital invested in the business. In other words, an over-capitalized company earns less than what it should have earned at fair rate of return on its total capital.

To ascertain whether a company is earning reasonable rate of return or not, a comparison of the company's rate of earnings should be made with earning rate of the like concerns. If the company's rate of return is less than the average rate of return, it is indicative of the fact that the company is not able to earn fair rate of return on its capital.

It may not be out of place to mention that a company is said to be over-capitalized only when it has not been able to earn fair income over a long period of time. However, if earning position of a company is adversely affected temporarily, owing to occurrence of abnormal events like

strikes, lockouts' and fire accident it would be misnomer to consider such company in the plight of over-capitalisation. As a matter of fact, over-capitalisation is the consequence of prolonged irregularities.

In this regard it would also be noteworthy that a company having earned relatively low rate of return on its capital incessantly for a long span of time, real value of its assets would always be less than their book value.

While investing money in existing ventures investors are interested to know whether company in question is over-capitalized or not. Similar question arises in the event of amalgamation, merger or reorganization of companies.

How to test over-capitalized situation is difficult but a vital question that needs serious attention. Authorities differ on this issue. According to some scholars, when par value of shares of company is higher than the market value, the company would be in state of over-capitalisation.

As against this, others are of the view that to test the state of over-capitalisation comparison between book value and real value of shares should be made. Where book value of shares is higher than the real value, company, according to them, would be over-capitalized. To understand the concept of over-capitalisation, it would be necessary to have clear view of different values of shares.

Par value of shares refers to face value of shares which is stated in memorandum of association of the company. In this case, shares are neither issued on premium nor at discount. Par value is static in character that remains unaffected by business oscillations.

Market value of shares is the price at which shares of a company are quoted in stock exchange. Generally, market value of shares hinges, in the main, upon internal factors like present and prospective earnings position of the enterprise and its reserves and dividend policy, and external factors such as general price level changes, purchasing power and government economic and industrial policy.

International events also influence market price of shares. In view of these factors, market value of shares oscillates violently. Market value of shares of a corporation can at best be worked out by averaging out the market price of shares of the company ruling in the market over different dates. Book value of shares represents the value which is obtained by dividing the sum of capital stock and surplus accounts of the company by the number of shares outstanding.

Real value of shares is found out by dividing the capitalized value of the company's assets by outstanding number of shares. Real value of shares is too difficult to work out. By multiplying the average earnings of the company by capitalisation rate (average rate of return in the like

business) company's capitalized value (or real value) of assets can be found out which when divided by the number of shares gives real value per share.

Causes of Over-Capitalization

There are various factors responsible for over-capitalized state of a company; important among them being as under:

(1) Promotion of a Company with Inflated Assets:

A company right from its incorporation falls prey to overcapitalization if it has been established with assets acquired at higher prices which do not bear any relation to their earning capacity. Such a situation arises particularly when corporate form of organisation is adopted by converting a partnership firm or when private limited company is converted into public limited firm because in that process assets may be transferred at price higher than their real value with the result that the book value of the corporation will be higher than its real value.

(2) Company Promoted with High Promotion Expenses:

Over-capitalisation may sometimes result because high expenses were incurred in promoting an enterprise and promoters were fabulously paid high price for their promotional services, particularly when the earnings of the company do not subsequently justify the capital employed.

(3) Over-estimating Earnings at the Time of Promotion:

A mistake in initial estimate of earnings may subsequently land a corporation into over-capitalisation since capitalisation based on such an estimate is not justified by income which the firm actually earns. For example, a company's initial earning was estimated at Rs. 10,000 and industry's average rate of return was fixed at 12 percent.

Accordingly, company's capitalisation was decided at Rs. 83,333 (10,000 × 25/3). Subsequently, it was found that company actually earned Rs. 8,000. Evidently in such a case company's capitalisation should have been fixed at Rs. 66,000. Thus, the company will be said to be over-capitalized by Rs. 16,667.

(4) Applying High Capitalisation Rate to Capitalize Earnings:

Despite correct estimate of earnings a company may plunge in state of over-capitalisation if higher capitalisation rate was applied to determine its total capitalisation. For example, a company's earning was estimated at Rs. 10,000 and the industry average rate of return was fixed at 8 percent.

Hence capitalisation rate applied was 12.5 percent. By applying this rate the company's capitalisation was worked out at Rs. 1, 25,000. Subsequently, it was found that industry average rate of return was 10 percent and hence company's fair amount of capitalisation would be Rs. 1,00,000 . Obviously, there is over-capitalisation in the company to the extent of Rs. 25,000.

(5) Company Formed or Expanded During Inflationary Period:

Generally, companies started in the days of inflationary conditions turn into over-capitalized concerns afterward when the inflationary conditions subside because assets were acquired at inflated prices which do not bear any relation with their earning capacity. Alongside this, in anticipation of high earnings during boom period there is strong tendency to fix the capitalisation at high figure.

With slackening of boom conditions followed by declining trends in earning level, companies gradually turn into over-capitalized ones. Even the existing ventures expand the scale of their business to exploit the earning opportunities which will necessitate the raising of further capital. These firms find themselves overcapitalized after the boom period is over.

(6) Shortage of Capital:

Sometimes, over-capitalisation may be the result of shortage of capital. Because of under-estimation of financial requirements a firm may be capitalized at low level. This may cause serious problem to the firm subsequently when it experiences shortage of funds to meet emergent requirements compelling the firm to procure necessary funds at unreasonably high rate of interest.

Consequently, lion share of firm's income may be swallowed by the lenders who come to the firm's rescue in eventuality, leaving little income available for the shareholders. This will naturally bring down the real value of the firm.

(7) Defective Depreciation Policy:

Many companies become over-capitalized because they did not make adequate provision for depreciation, replacement or obsolescence of assets. Inadequate depreciation causes inefficiency in the company which, in turn, results in its reduced earning capacity.

(8) Liberal Dividend Policy:

Liberal dividend policy may also contribute to over-capitalization of a company. Companies following too liberal dividend policy continuously for long period of time shall be definitely deprived of the benefits of retained earnings. Thus, in the first instance such companies fail to

build up sufficient funds to replace old and worn-out assets and consequently, their operating efficiency suffers.

Secondly, these companies may, in times of necessity, be compelled to take recourse to costlier borrowing which, in turn adversely affects their earning position. The combined effects of these may land these companies in state of over-capitalisation.

(9) Fiscal Policy:

Taxation policy of the Government may also be responsible for company's over-capitalisation. Due to negative taxation policy firms tax liability increases and is left with small residual income for dividend distribution and retention purposes. Further, such policy also restricts the benefits to tax deduct-ability on account of depreciation provision. Consequently, operating efficiency of companies suffers drastically and state of over-capitalisation develops in companies.

Consequences of Over-Capitalisation

Over-capitalisation is a state that affects not only the company and its owners but also the society as a whole.

1. Effects on the Company:

The effects of over-capitalisation on the company itself are disastrous in many ways:

(i) Loss of goodwill. In an over-capitalised company, there is a reduced earning capacity resulting in the fall of market price of its shares and thereby shaking up the investor's confidence. A company whose shares sell below the face value may find it difficult to improve its goodwill in the market.

(ii) Poor creditworthiness. Reduced earnings of an over-capitalised concern affect its creditworthiness and as a result, it becomes difficult for it to get loans or credit at cheaper rates of interest.

(iii) Difficulties in obtaining capital. For a company faced with a situation of over-capitalisation, it is very difficult to obtain further capital for its growth and expansion programmes. It is so because the investors have already lost confidence in the company.

(iv) Decline in efficiency of the company. To cover for one loss, other losses are incurred by the company and in the process overall efficiency of the company declines. Such a company usually does not make adequate provisions for depreciation, repairs and renewals, etc., leading to further decline in its efficiency.

(v) Loss of market. Over-Capitalised companies fail to produce goods at competitive costs and, hence, often lose their market to competitors.

(vi) Inflated profits. In order to regain the confidence of its investors, over-capitalised companies generally resort to manipulation of accounts and over-statement of their profits. These inflated profits lead to payments of dividends out of capital.

(vii) Liquidation of company. An over-capitalised company goes into liquidation unless drastic steps are taken to re-organise the whole capital structure, and re-organisation would itself lead to a lot of problems.

2. Effects on Shareholders:

As, shareholders are the real owners of a company, they suffer most on account of over-capitalisation.

Some of the major effects of over-capitalisation on shareholders are:

(i) Reduced dividends. An over-capitalised company will not be able to pay a fair rate of dividend to its shareholders because it is earning a low rate of return (earnings) on its capital. More so, the payment of dividend becomes uncertain and irregular.

(ii) Fall in the value of shares. Low rate of earnings and reduced dividends cause fall in the market value of shares of the over-capitalised company. Thus, shareholders have to suffer a loss in capital due to depreciation of their investments.

(iii) Unacceptable as collateral security. The shares of an over-capitalised company have small value as collateral security. Banks and other financial institutions are reluctant to lend money against such securities. Hence, it is very difficult for the shareholders to borrow money against the security of their shares.

(iv) Loss on speculation, the prices of the shares of an over-capitalised company remain unstable because of speculative dealings in such shares. This malpractice further adds to the losses of the shareholders.

(v) Loss on re-organisation. An over-capitalised company has to often resort to reorganisation and reduction of its capital in order to write off the accumulated losses. This results in the reduction of face value of shares and loss to its owners.

3. Effects on Society:

Over-capitalisation affects not only the company and its owners but also the society as a whole.

(i) Loss to Consumers:

In order to prevent declining trend of income, an over-capitalised concern resorts to increased prices and reduction in quality of its products.. Hence, consumers have to suffer by paying more for the poorer quality.

(ii) Loss to Workers:

An over-capitalised company tends to reduce wages and welfare facilities of the workers to reduce losses of the earnings. No consideration is given to the demands of the workers and some of them even lose their jobs because of layoffs and retrenchment and closure of such units.

(iii) Under or Misutilisation of Resources:

An over-capitalised concern either misutilises or under utilises its resources. Hence, the scarce resources of society are not properly utilised.

(iv) Gambling in Shares:

Another social evil of over-capitalisation is promotion of gambling habits by providing scope for gambling in shares of such a company.

(v) Recession:

Over-capitalisation leads to increased losses, poor quality of products, retrenchment or unemployment of workers, decline in wage rates and purchasing power of labour. This tendency gradually affects the entire industry and the society, and may lead to recession of economy.

Evils or Disadvantages of Over-Capitalisation

(i) Poor Credit-Worthiness:

When a company sells its share at less than their nominal value, i.e., less than at par, it suffers from poor credit-worthiness. Naturally, it becomes very difficult for the company to raise funds by further issue of shares as and when necessary

(ii) Reduction in the Rate of Dividend:

Since the capital is not utilized properly, i.e., the company cannot effectively use its capital employed the rate of return must be low and, consequently, the value of shares in the market may go down. .

(iii) Loss to Shareholders:

The shareholders, under the condition of over-capitalisation, are victimised and put in a very awkward position. In other words, they are in a fix as to whether they should sell the shares or retain it. If they want to sell, they will have to suffer heavily because of the lower price and, again, if they retain them, they will get a very poor rate of return by way of dividend.

(iv) Loss to Employees and Labourers:

The employees and labourers suffer since they cannot receive adequate salaries and wages owing to lower profit.

(v) Loss to Creditors:

Creditors may have to suffer since they may have to accept a lower rate of interest, and suffer permanent loss of capital in case of liquidation.

Remedies of Over-Capitalisation

Effects of over-capitalisation are so grave that the management should take immediate measures to remedy the situation of over-capitalisation as soon as the symptoms of the over-capitalisation are observed.

Various remedial measures such as reduction in bonded debt, reduction of rate of interest paid on debentures, redemption of high dividend preferred shares, reduction of par value of shares and reduction of number of shares are suggested. We shall now examine efficacy of each of these measures as curative to the problem of over-capitalisation.

(1) Reduction in Bonded Debt:

To cut the knot of over-capitalisation, over-capitalized concerns are suggested to reduce the amount of bonded indebtedness to prune the amount of capital in accordance with their earning position. This measure seems to be inexpedient. Redemption of debt needs additional funds which can be procured either from reinvested earnings, or from sale of additional stock.

Since profit of over-capitalized concerns might be extremely low, it would be necessary for them to go to stock market for sale of their securities. They would, however, find it difficult to raise required amount of share capital because public response to their issues might not be very encouraging in view of their reduced earning position and increased financial instability.

Furthermore, shares of such companies are quoted at low prices in stock markets. Consequently, they might be compelled to issue large stock to raise the money. This, instead of remedying the problem, might aggravate it.

(2) Reduction of Fixed Charges on Debt:

It is also suggested that with a view to improving their earning position over-capitalized concerns should slash down the burden of fixed charges on debt. For that matter, existing bond holders will have to be made to agree to accept new bonds carrying lower interest rate in lieu of their old ones. The bondholders might agree to accept the new bonds provided these are issued to them at premium. This again fails to remedy the situation.

(3) Redemption of High Dividend Preferred Stock:

To reduce the burden of fixed charges on the over-capitalized company it is suggested to reduce preferred stock bearing high dividend rate. However, this might also not prove more meaningful because large amount of funds would be needed to redeem the preferred stock, raising of which would increase the amount of capitalisation instead of reducing it.

(4) Reducing Par Value of Shares:

It is often suggested that an over-capitalized concern should reduce the amount of stock outstanding by reducing par value of shares. This is nothing but reorganization of share capital which helps the concern in obscuring the real state of affairs. Supposing a company is capitalized at Rs. 10,00,000 with 5,000 ordinary shares of Rs. 200 per share and the company's average annual earning is Rs. 50,000.

Thus, the company's earnings per share is Rs. 10 and return on total capital employed is Rs. 5. Now, if the company reduces the par value of shares by 50% and transfers the same to surplus account, it would result in increase in return on capital by 100%.

Thus, through simple process of accounting, condition of over-capitalisation can be converted into that of undercapitalization. But it would be difficult to convince the shareholders in this respect. They may believe it to be management trick to dupe them by giving them lower par value stock in exchange for higher value stock though in fact real value of shares is in no way affected.

(5) Reducing Number of Shares:

By reducing number of outstanding shares, efforts are made to correct the outward symptoms of overcapitalization. For example, a company is capitalized with 10,000 shares of Rs. 10/- each. If

the management decides to issue one new share in exchange of four old shares and shareholders agree to accept the decision, number of shares is reduced to 2,500.

As a result of this, earning per share tends to go up by the same proportion. This, in turn, may help the company to improve its credit position in the market and its share values consequently may soar.

In sum, reorganization of share capital either by reducing par value of shares or by reducing number of outstanding shares is the only panacea to the problem of over-capitalisation provided the management succeeds to convince the shareholders about the utility of this step.

Meaning of Under-Capitalisation

Undercapitalization occurs when a company does not have sufficient capital to conduct normal business operations and pay creditors. This can occur when the company is not generating enough cash flow or is unable to access forms of financing such as debt or equity.

Undercapitalized companies also tend to choose high-cost sources of capital, such as short-term credit, over lower-cost forms such as equity or long-term debt. Investors want to proceed with caution if a company is undercapitalized because the chance of bankruptcy increases when a company loses the ability to service its debts.

The phrase 'Under-capitalisation' should never be misconstrued with inadequacy of capital. Truly speaking, this term is used to denote the state of affairs just converse of over-capitalisation.

When a company succeeds in earning abnormally large income consistently for a pretty long time, symptoms of under-capitalisation gradually develop in the company; the most important one being that market value of shares of the company exceeds their book value. Under-capitalisation is an index of effective and proper utilisation of funds employed in the enterprise.

It should be noted in this regard that if a company under exceptionally good conditions makes substantially large earnings in a year or so, it should not be considered that the company is under-capitalized. Over-capitalised concerns have always earning superiority over average concerns engaged in the same line of activity.

Thus, under-capitalisation is indicative of sound financial health and good management of the company. Bonneville and Dewey rightly observed that **"Under-capitalisation is not an economic problem but a problem in adjusting the capital structure".**

Causes of Under-Capitalisation

Potent causes of under-capitalisation in a company are as follows:

(1) Under-Estimation of Initial Earnings

If earnings of new venture were under-estimated and the enterprise was capitalized accordingly, it may find itself in condition of under-capitalisation afterwards when it's actual earning was much more than what was anticipated.

(2) Using Low Capitalisation Rate:

If low capitalisation rate was employed to determine capitalisation of a company, it might plunge in state of under-capitalisation subsequently when it would be found that actual capitalisation rate was much higher than the employed one.

(3) Deflationary Condition:

Companies set up in recessionary condition generally become under-capitalized after recession is over. There are two factors contributing to this tendency. In the first instance, during recession assets are purchased at exceptionally low prices which bear no relation with their income producing capacity. As period of recession abates, earning position of the companies tends to improve.

This would result in increase in real value of assets while book value of assets remains as before and the consequence would be under-capitalisation. Secondly, companies set up in period of recession are capitalized at low figure anticipating low level of business income. But as the period of recession is over, company's earning capacity improves and the result is undercapitalization.

(4) Conservative Dividend Policy:

Company following conservative dividend policy builds up substantially large funds available for replacement and renovation of obsolete assets and for financing developmental and expansion purposes. This thus goes a long way in improving earning position of the company.

(5) Maintaining High Standards of Efficiency:

By employing new techniques of production and rationalization of production activities, operating efficiency of a company can be improved.

Consequences of Under-Capitalisation

On Company:

Although under-capitalisation does not threaten financial stability and solvency of the enterprise, management should not be complacent towards this situation because the company may suffer in the following ways:

(i) Under-capitalisation intensifies the degree of competition which may have telling effect on profit margin of under-capitalized concerns. High earning rate of under-capitalized companies may entice entrepreneurs to set up enterprises in the same line of business who may put up tough fight with the under-capitalized concerns.

(ii) Tax liability of under-capitalized concerns increases in correspondence with increase in volume of profits. Also belts of state control and intervention over these enterprises are tightened.

(iii) Marketability of shares of under-capitalized concerns tends to be narrow because of exceptionally high market price of these shares. Share prices register violent fluctuations and speculators take undue advantage of this situation.

(iv) In view of continued rise in profitability rate workers may demand increase in their wage rates and if their demand is not fulfilled it may cause discontentment among them. Labour-management relation is disturbed which may adversely affect production efficiency of the corporation.

(v) Consumers may feel being fleeced by the management of under-capitalized company who are, it is alleged, thriving at their cost. They may raise hue and cry for reducing price of the product and demand vociferously for the state to intervene and control their operations.

On Share-Holders:

Under-capitalisation is advantageous to shareholders in as much as they get high dividend income regularly. Because of soaring rise in share price of under-capitalized concerns, shareholders' investment in these companies appreciates phenomenally which they may encash at any time.

In another way also, under-capitalisation benefits the shareholders. They can, in periods of necessity, get loans on soft-terms against the security of their shares because of high credit standing of the under-capitalized concerns in the market.

(i) The profitability of the company may be very high. As a result, the rate of earnings per share will go up.

(ii) The value of its equity share in the market will go up.

(iii) The financial reputation of the company will increase in the market.

(iv) The shareholders can expect higher dividends regularly.

On Society:

(i) Under-capitalisation may lead to higher profits and higher prices of shares on the stock exchange. This may encourage unhealthy speculation in its shares.

(ii) Because of higher profits, the consumers feel exploited. They link higher profits with higher prices of the products.

(iii) The management of the company may build up secret reserves and pay lower taxes to the Government.

Disadvantages of Undercapitalization

Undercapitalized companies suffer from the following disadvantages.

(i) Conflict between labour and management. Higher rate of earning encourages workers to demand higher increase in the wages. Management does not meet their demand fully, so the conflict between labour and management starts.

(ii) Consumers' feeling of exploitation. Declaration of dividend at higher rates creates a feeling among Consumers that they are being exploited, because the company instead of decreasing price of the commodity is increasing the dividend rates.

(iii) Manipulation in the value of shares. The management indulges in the manipulation of the value of shares and exploits shareholders.

(iv) Higher rates of taxation. Earnings at higher rate attract the government for levying taxes at higher rates.

Remedies for Under-Capitalisation

To correct condition of under-capitalisation it is inevitable on the part of the company to reorganize its capital structure in such a way that number of shares increases and earning per share is reduced.

For this purpose the following two measures might be helpful:

(1) Capitalisation of Surplus of the Company:

If a company has adequate surplus in hand the whole or a part of it can be capitalized by issue of bonus shares. This will, in no way, affect the quantum of capitalisation. Of course, make-up of capitalisation will undergo marked change. Thus, with issue of bonus shares, share capital will increase and so also the number of shares but surplus of the company will lie reduced by the amount of bonus shares.

In consequence, earnings per share automatically are reduced. Take for example, a company has total capitalisation of Rs. 2,00,000 comprising share capital of Rs. 1,50,000 (divide in 3,000 shares of Rs. 50 per share) and surplus of Rs. 50,000. The company's present earning is Rs. 60,000.

Thus earning per share in this case comes to Rs. 20 per share. Management may save this company against the effects of under-capitalisation by issuing bonus shares. If, for example, it is decided that the company will issue 5,000 bonus shares of Rs. 10 each, share capital in the company will increase from Rs. 1,50,000 to Rs. 2,00,000 and number of shares from 3,000 to 8,000 though of course amount of total capitalisation remains unchanged.

As a result of this, earning per share which was earlier Rs. 20 would, after capitalisation, decline to Rs. 7.50. However, owner's income is no longer affected. They would continue to receive the same amount of income even after recapitalization. This would keep the management free from workers' threats; consumers do not feel being exploited by capitalists.

(2) Splitting Stock:

Another effective way of reorganizing capitalisation of a company to reduce the effects of under-capitalisation is to split up the stock into a large number of shares and reduce the value of each share in accordance with the rate of split up. The effect of this split is that the earnings would be spread over a greater number of shares, Supposing a company is capitalized with Rs. 1,00,000 divided into 1000, its earnings per share would come to Rs. 10.

Management may reduce earnings per share if it so likes by taking recourse to stock split. If, for example, the management decides to reduce par value of shares by 50 percent and increase the number of shares in the same proportion, number of shares in the company would after splitting double to reach 20,000 shares and earnings per share would be halved to Rs. 5.

The shareholders will have no objection to this procedure because they are not going to lose anything. Thus, by this simple device the management can neutralize the effects of under-capitalisation and save the company from any eventuality.

It is evident from the foregoing discussions that both the strategy under-capitalisation and over-capitalisation are undesirable and should be discouraged as far as possible. Over-capitalisation means a great strain on the financial structure of a company, an evil for shareholders and a menace to economic prosperity, and stability of society.

On the other hand, under-capitalisation encourages competition on the part of business rivals, sows seeds of dissension among labourers and creates psychic feeling of being exploited among consumers. On comparison, state of over-capitalisation relatively is more harmful. However, the management should avoid emergence of both these situations and its ideal should be of fair capitalisation.

(3) Under-capitalisation may be remedied by increasing the par value and/or number of equity shares by revising upward the value of assets. This will lead to decrease in the rate of earnings per share.

(4) Management may capitalise the earnings by issuing bonus shares to the equity shareholders. This will also reduce the rate of earnings per share without reducing the total earnings of the company.

(5) Where under-capitalisation is due to insufficiency of capital, more shares and debentures may be issued to the public.

Over capitalization vs under capitalization

1. Comparing the two, it can be concluded that over-capitalisation proves to be more dangerous to the company, shareholders, and the society as a whole. On the contrary, under-capitalisation may encourage competition but it may also stimulate dissatisfaction among the workers and the consumers.

2. Over-capitalisation involves a great-strain on the financial resources of a company whereas under-capitalisation implies high rate of earnings on its shares.

3. The remedial procedure of over-capitalisation is more difficult and expensive as compared to the remedial procedure of under-capitalisation.

4. Under-capitalisation accelerates cut-throat competition amongst companies; results in discontentment among employees and grouse amongst customers; whereas over-capitalisation adversely affects the shareholders and endangers the economic stability and Social prosperity.

5. Over-capitalisation is a common phenomena than under-capitalisation which is relatively a rare phenomena.

6. Over capitalization is a state where earnings are not sufficient to justify the fair return on the amount of share capital which has been issued by the company whereas under capitalization is a state where the capital which is owned by the business is much less than the borrowed capital.

7. Over capitalization happens when the actual profits of a company are not enough or sufficient to pay interest to the creditors whereas under capitalization happens due to over-trading and when the company earn high profits as compared to other industry.

8. Over capitalization shows the rate of return as declining entity whereas undercapitalization shows the rate of return as increasing entity.