SHAREHOLDERS' EQUITY FORMATION AND ASSESSMENT

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Abstract:In the „life" of an economic entity intervenes from the very beginning the formation of an initial capital which is, always, the share capital. Subsequently, this shareholders' equity should increase by many ways, a fact which would mean that the economic entity has a „healthy" activity, but the reality of the Romanian economy shows us that it is not always like this. Due to multiple causes, which also include management decisions, the shareholders' equity registers also negative values which, theoretically, is not normal as this means that you function on "credit" and then steps should be taken so that the value of the assets becomes positive. To prevent such a situation it is recommended to assess the components of the own assets in order to make the best management decisions which result in positive own assets. The right value ascertained subsequent to assessment also shows us the ways by which the own assets may be increased, either from own sources of the entity or by its external ones.

Keywords: share capital, stock, shares, net asset, shareholders' equity.

1. Introduction

Any economic entity, irrespective of its organization form (company, association, foundation, state unit) needs capital which is an importants elements of the patrimony and which stands at the basis of such entities' development.

The capital is mainly expressed under a monetary form and it initially represents an obligation of the economic entity towards those who contributed to the set up of the share capital, the first capital in their "life".

Usually, the capital represents the resources which stand at the basis of the economic entities' activity running. By the help of the capital, the entity procures the means which are necessary to operate its activity like equipment, buildings, means of transport, raw stocks and materials, goods etc.

In a wider sense is known the permanent capital which is a basic component of the balance sheet liabilities dedicated to the financing of the patrimonial assets (the wealth) in a sustainable manner. Such capitals are formed upon the entity set up and, along time, it increases or decreases and, when the activity is discontinued, such capitals are liquidated.

Instead, the shareholders' equity are meant to set out the financial resources set up by the owners, shareholders or partners' equity in their position of capital investors, self-financing, which may occur by profit capitalization, from other non-refundable sources provisioned by law. Actually, those capitals are identified as the individual or share capital as well as the bonuses related to the capital, the reserves of the entity, the balances or the capital gain out of the assets re-assessment, the results carried over of the preceding financial exercises, the exercise result, the subsidies for investments, the own funds with a determined effect and the regulated accruals.

The Order no.1802/2014 of the Ministry of Public Finances, which approved the accounting regulations harmonized with the Directive IV of the European Economic Community and with the International Accounting Standards, defines the shareholders' equity as the shareholders' residual interest in the assets of a company after the deduction of all its debts.

2. Shareholders' equity structure

The stable financing sources of the economic values set up as assets of the economic entity are determined by the capital accounting structure. The 'stable' determiner marks the presence of those sources at the disposal of the economic entity for a period in excess of one year. Such a feature represents one of the elements which pleads for their designation also by the notion of permanent capitals.

The shareholders' equity represents the entirety of the capitals owned by individuals or by the shareholders which are entered in the balance sheet liabilities as well as the sources created or received during the economic entity functioning and they come in the following structure:

- share capital;
- capital related bonuses;
- reserves coming from re-assessment;
- reserves;
- result of the exercise;
- result carried over;
- shareholders' equity;
- subsidies for investments;
- regulated accruals.

The complex structure of the capitals determines the use of a system of accounts capable of providing for the registration, follow-up and audit, in a distinct manner, of the specific elements of their composition. The freedom of action which is specific to the market economy also presumes the diversification of the ways by which an economic entity may attract new capitals or it may vest its own capital in a profitable manner.

In the structure of the chart of accounts, class I is dedicated to the stock accounts in which may be found, by groups, the synthetic accounts of the 1st degree and, where case may be, the synthetic accounts of the 2nd degree, the component elements of the capitals. (Ghișe, 2011)

3. Shareholders' equity assessment

The assessment of the shares or of the capital stock of and economic entity leads to the assessment of the entity itself.

The stocks are deeds which give their owners the rights to participate in the set up of the entity capital, the latter becoming co-owners of it.

The value of the stock (shares) is assessed by reference to:

- The market on which such stock is negotiated;
- The company patrimony, as indicator of the potential accumulations;
- The results of the entity, as indicator of the potential accumulations;
- Medium term perspectives, as indicator of the economic growth;
- The company image in front of the third parties;
- The manner in which the company masters its technology;
- The quality of the personnel.

The share capital is assessed in accountancy at its face value which is represented by the amounts mentioned on the stock or on the shares. The the measure of the stock or shares value is established from the economic entity set up by its memorandum of association and bears the denomination 'face value'. This represents a fraction of the entity's capital established in equal measures and serves to the calculation of the share capital. (Peterescu, 2011)

3.1. Assessment at the face value

The face value is the value set up by the memorandum of association of the entity and with which the said entity is registered with the qualified bodies. This value may be increased or decreased only under certain terms established by law and it is printed on the entity stock.

Face value = share capital/Number of stock (shares)

For the share capital, such a value is indicated on the stock and shares in their position of securities. The term of share capital designates the face value of the capital in the case of a company, irrespective of its form (joint stock company, limited liability company etc.)

The assessment of the share capital at its face value imposes the calculation and distinct entry of the share premiums (issuance, contribution and merger premiums).

As the stock by which the shareholders' equity is represented are securities negotiable in the financial administration system of the companies, other categories of values are associated to the face value, such as the market value (fair market value), profitability value (financial value, output value) and the patrimonial value (the mathematical (intrinsic) value).

3.2. Assessment at the market value (stock exchange value, fair market value)

The market value is a purchase – sale value of the stock set up by the stock exchange on the basis of the demand – offer ratio called quotation or stock exchange rate.

Generally, in the case of the companies whose stock is listed we will have:

The market value (market capitalization) = Number of stock x stock exchange rate

The market price of one stock is determined by the dividends expected by the shareholders, the company financial stability, the situation of the company assets, the general situation of the capital market and the limit of the interest ratio at that moment, opposable to the financial-banking market.

When the interest ratio is high, the joint stock companies represent a high risk for investors because they will prefer temporary investments under the form of bank deposits and holdings.

The stock market appraises a company not by the value of its present patrimony but by the forecasts related to its evolution and future gains.

For a company which aims at a capital increase by contributions in cash, in close connection with the market value and the nominal value of the stock is the issuance price or the assets rate which has to be paid by all the persons who subscribe the stock at the moment of its issuance. This may be equal to the face value – *supra pari* rate or lower than the face value – *sub pari* rate.

At the same time, a good image on the market provides for a high price and an easy placement of the instruments which allows for the achievement of sufficient resources under favorable terms. Thus, the matter of the stock assessment on a market is an important variable of the financing policy for a company which intends to resort to capital increase.

3.3. Assessment by the profitability value

This assessment method comes under two forms, i.e.:

a) *The financial value* – given by the ratio between the dividend distributed for one stock and the average rate of the interest on the market:

Financial value = Dividend distributed for one stock/average rate of the interest on the market

The interest rate is the one corresponding to the fixed gain instruments (bonds) and the dividend taken into account may be represented either by the average of the dividends distributed during the last 5 years or by the dividend distributed at the end of the completed financial year.

b) *The output value* – given by the ratio between the dividend distributed for one stock and the average rate of the interest on the market:

Output value = (the dividend distributed for one stock + the profit quota for one stock incorporated in the reserves)/the average rate of the market interest

The output value is a variant of the financial value in which the undistributed benefits are also taken into account.

3.4. Assessment by the patrimonial value

The patrimonial value of the economic entity is calculated starting from the patrimonial situation. This presumes the accounting mathematical value (which is equal to the ratio between the accounting net asset and the number of stock), the intrinsic mathematical value (which is equal to the ratio between the intrinsic net asset and the number of stock) and the liquidation value (which results from the forced sale of the entity). This method consists of the calculation of the instruments starting from the patrimonial situation entered in the financial statements. In this sense, we have the mathematical-accounting value, the intrinsic mathematical value and the liquidation value.

The mathematical-accounting value of the instruments or the balance sheet value is equal to the net accounting statement or the accounting net asset related to the number of stock:

Mathematical accounting value = Accounting net asset/Number of stock

The accounting net asset is calculated according to the formula:

ANC = Real asset – Debts

or

ANC = shareholders' equity – nominal assets

Real asset = balance sheet asset – nominal assets

The composition of the nominal assets includes the following structures:

- Company set up expenses, including those with the stock issuance;
- Settlement assets and assimilated;
- Premiums related to the bonds reimbursement.

The addition between the real asset and the nominal asset represents the total of the company assets. (Popa, 2011)

The intrinsic net asset is given by the following formula:

Intrinsic net asset=accounting net asset + accruals for risks and expenses – subscribed not deposited capital

4. Conclusion

As we said in the beginning, in the "life" of an economic entity and especially in that of a joint stock company it is important to know the value of the shareholders' equity as this is an economic indicator which shows us the company "state of health". Besides the stock which compose the share capital, the high value of those capitals is also given by the fixed assets which may be land, buildings, equipment etc. they do nothing but bring extra value to those capitals. At the same time, in cases of decreased liquidity of the company, these fixed assets may make the object of a sale which restores the company liquidity and it follows that, at a subsequent date, the company purchases again those fixed assets necessary to the activity development.

Concurrently, the fixed assets which enter in the structure of the shareholders' equity may also be used to access credits or funding lines for the activity operation.

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