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Equity finance means the owner, own funds and finance. Usually small scale business such as partnerships and sole proprietorships are operated by their owner through their own finance. Joint stock companies operate on the basis of equity shares, but their management is different from share holders and investors.

Merits of Equity Finance:

Following are the merits of equity finance:

(i) Permanent in Nature: Equity finance is permanent in nature. There is no need to repay it unless liquidation occur. Shares once sold remain in the market. If any share holder wants to sell those shares he can do so in the stock exchange where company is listed. However, this will not pose any liquidity problem for the company.

(ii) Solvency: Equity finance increases the solvency of the business. It also helps in increasing the financial standing. In times of need the share capital can be increased by inviting offers from the general public to subscribe for new shares. This will enable the company to successfully face the financial crisis.

(iii) Credit Worthiness: High equity finance increases credit worthiness. A business in which equity finance has high proportion can easily take loan from banks. In contrast to those companies which are under serious debt burden, no longer remain attractive for investors. Higher proportion of equity finance means that less money will be needed for payment of interest on loans and financial expenses, so much of the profit will be distributed among share holders.

(iv) No Interest: No interest is paid to any outsider in case of equity finance. This increases the net income of the business which can be used to expand the scale of operations.

(v) Motivation: As in equity finance all the profit remain with the owner, so it gives him motivation to work more hard. The sense of inspiration and care is greater in a business which is financed by owner's own money. This keeps the businessman conscious and active to seek opportunities and earn profit.

(vi) No Danger of Insolvency: As there is no borrowed capital so no repayment have to be made in any strict time schedule. This makes the entrepreneur free from financial worries and there is no danger of insolvency.

(vii) Liquidation: In case of winding up or liquidation there is no outsiders charge on the assets of the business. All the assets remain with the owner.

(viii) Increasing Capital: Joint Stock companies can increase both the issued and authorized capital after fulfilling certain legal requirements. So in times of need finance can be raised by selling extra shares.

(ix) Macro Level Advantages: Equity finance produces many social and macro level advantages. First it reduces the elements of interest in the economy. This makes people free of financial worries and panic. Secondly the growth of joint stock companies allows a great number of people to share in its profit without taking active part in its management. Thus people can use their savings to earn

monetary rewards over a long time.

Demerits of Equity Finance:

Following are the demerits of equity finance:

(i) **Decrease in Working Capital:** If majority of funds of business are invested in fixed assets then business may feel shortage of working capital. This problem is common in small scale businesses. The owner has a fixed amount of capital to start with and major proportion of it is consumed by fixed assets. So less is left to meet current expenses of the business. In large scale business, financial mismanagement can also lead to similar problems.

(ii) **Difficulties in Making Regular Payments:** In case of equity finance the businessman may feel problems in making payments of regular and recurring nature. Sales revenues sometimes may fall due to seasonal factors. If sufficient funds are not available then there would be difficulties in meeting short term liabilities.

(iii) **Higher Taxes:** As no interest has to be paid to any outsider so taxable income of the business is greater. This results in higher incidence of taxes. Further there is double taxation in certain cases. In case of joint stock company the whole income is taxed prior to any appropriation. When dividends are paid then they are again taxed from the income of recipients.

(iv) **Limited Expansion:** Due to equity finance the businessman is not able to increase the scale of operations. Expansion of the business needs huge finance for establishing new plant and capturing more markets. Small scales businesses also do not have any professional guidance available to them to extend their market. There is a general tendency that owners try to keep their business in such a limit so that they can keep affective control over it. As business is financed by the owner himself so he is very much obsessed with chances of fraud and embezzlement. These factors hinder the expansion of business.

(v) **Lack of Research and Development:** In a business which is run solely on equity finance, there is lack of research and development. Research activities take a long time and huge finance is needed to reach a new product or design. These research activities are no doubt costly but eventually when their outcome is launched in market, huge revenues are gained. But problem arises that if owner uses his own capital to finance such long term research projects then he will be facing problem in meeting short term liabilities. This factor discourages investment in research projects in a business financed by equity.

(vi) **Delay in Replacement:** Businesses that run on equity finance, face problems at the time of modernization or replacement of the capital equipments when it wears out. The owner tries to use the current equipments as long as possible. Sometimes he may even ignore the deteriorating quality of the production and keeps on running old equipment.

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[Arfan Ul Haq](#) - About Author:

Arfan Ul Haq is an Asian author. He writes articles about a [online economics course](#), a [development and planning economics](#) and a [lorenz curve and gini coefficient](#).

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