Ans=2

Undercapitalisation

In the words of Gerstenberg, A company may be under capitalised when the rate of profits it is making on the total capital is exceptionally high in relation to the return enjoyed by similarly situated companies in the same industry, or when it has too little capital with which to conduct its business.

In simple words, we can say that under capitalisation the reverse phenomenon of over capitalisation, and occurs when a company's actual ~~[illegible]~~ capitalisation is lower than its proper capitalisation as warranted by its earning capacity. The term under capitalisation should be never be considered synonymous with inadequate capital. The real value of an under-capitalised company is more than its book value. the profits are higher than warranted by the book value of its assets. Such a company can pay a higher rate of dividend and the market value of its shares is much higher than its face value.

Remedies of Under Capitalisation

Under capitalisation can be corrected by taking any of the following remedial measures:

1. Fresh Issue of Shares:
2. Issue of Bonus shares:
3. Increasing the Par value of the shares:
4. Splitting stock:

a. Fresh Issue of Shares :-

If the under capitalisation is due to inadequancy of capital, then it can be corrected by the issue of fresh shares, the company may also redeem its long-term debt by the issue of fresh State capital.

b. **Issue of Bonus Shares:**

The company may issue bonus shares by capitalising its accumulated earnings. This is the most commonly used and effective method of correcting under-capitalisation. It reduces earning per share after the bonus issue.

c. **Increase the par value of Shares:**

The company may revalue its assets and increase their values. In lieu, thereof, the par value of the shares may also be increased. This will result into reduction of earnings per rupee of share value but the amount of dividened per share will be remain same.

d. **Splitting stock:-**

Another effective of method of correcting under-capitalisation is to split up the existing stock into large number of shares reducing the value of each share. It neither affect the total earning of the company nor the total amount of capital of company but still dividend per share will reduce.