

Q2 ⇒ Discuss the bad effect of over
~~cap~~ Capitalization.
⇒ effect of over-capitalisation
on company, shareholder,
consumer, workers and society!

(A) EFFECTS on company :-

(i) Destroys the goodwill and credit worthiness :- Over-capitalisation marked by low earning capacity destroys the reputation and goodwill of the company with a deterrent effect on its prospects of business.

(ii) Difficulty in raising additional Funds :-

It causes decline in share values which brings down the credit standing and financial reputation of the company. Thus it finds difficulty in mobilising additional Funds.

(III) Borrowings at higher rate of Interest:-

An over-capitalised company which is not able to raise capital from the shareholders may get loans at higher rate of Interest due to which the position may further deteriorate.

(IV) Resort to Unfair Practices:-

It may force the management of the company to follow Unhealthy practices of window dressing of earnings. For example:- It may not provide sufficient depreciation and also neglect the maintenance and replacement of assets. This will decrease the earning capacity of the company and discourage the genuine Investors from Investing in the company.