Section - 1

Ans 2 over - Capitalisation refers to that state of affairs where earnings of a company do not justify the amount of capital invested in its business.

According to Gerstenberg, "A company is over - capitalised when its earnings are not large enough to yield a fair return on the amount of stock and bonds that have been issued, or when the amount of securities outstanding exceeds the current value of the assets".

In the words of Bonneville, Dewey and Kelly, "When a business is unable to earn fair rate on its outstanding securities, it is over capitalised.

Simply stated, over - capitalisation means more capital than actually required and therefore, in a over capitalised concern, the invested funds are not properly used. It is, therefore, quite clear that over - capitalisation may be explained in terms of earnings as well as cost of assets.

In terms of earnings, over -

Capitalisation arises when the earnings of the Company are not sufficient to give a normal return on Capital employed by it. Let us take an example.
Suppose, a Company earns Rs 5,00,000 and the normal rate of return expected is 10%. Then Capitalisation at Rs. 50,00,000 would be (5,00,000 x100/10) = (Rs. 50,00,000) a fairly Capitalised situation.

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