

## Equity Finance

Equity finance is the money provided by the owners of the business.

### SOLE TRADERS AND PARTNERSHIPS

- ▶ A sole trader will provide money from his or her own savings.
- ▶ A sole trader may find it difficult to raise much money from this source and therefore may take on a partner who brings money into the business.

### LIMITED COMPANIES

A limited company can sell shares, which represent how much of the business the shareholder owns.

There are two types of limited company that define the way that money can be raised through shares.

- ▶ A **private limited company** can sell shares only to designated people and there is a limit how much capital they can raise through this method.
- ▶ A **public limited company** can issue shares to the public. This means anyone can have a share in the company.

It is important to note that once a share is issued, it only raises money for the company the first time it is sold. After that the proceeds any sale of that share goes to the owner of the share. It is like a second hand car. When a BMW is sold second hand, then the money goes to the owner of the car and not BMW.

A company may wish to issue shares because:

- ▶ A large amount of money can be raised through a share issue.
- ▶ Unlike a loan the money does not have to be repaid over a fixed period of time.

A company may issue two types of shares:

- ▶ **Ordinary shares**

- Ordinary shareholders can vote at company meeting.
- The amount of the dividend received varies.

- ▶ **Preference shares**

- Preference shareholders do not have a vote at company meetings.
- The dividend is usually fixed (e.g. 5% of the value of shares held paid as dividend each year).
- Preference shareholders receive their dividend before ordinary shareholders.

Shares are bought because they provide a return to the shareholder. There are two parts to the returns earned by shareholders:

- ▶ **Dividends** paid out on each share held by the company (e.g. companies on the Stock Exchange usually pay out two dividends each year).
- ▶ **Increases in the value of each share** as the company itself grows in value (this is often known as a "capital gain").

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In conclusion:

A business will issue shares to raise large sums of money. By doing this they are “diluting” the ownership which means that the control of the business is spread amongst more people. However they only have to pay dividends and don't have to pay out dividends at all, especially if they make a loss. But a shareholder has the right to vote off a board of directors, if they can gain 50.1% of support of the rest of the shareholders.

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