Capitalization Job Interview Questions And Answers

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Capitalization Interview Questions And Answers Guide.

Question - 1:

Do you know the theories to determine the amount of capitalization?

Ans:

The two main theories which are involved with the amount of capitalization are as follows:-
1) Cost Theory - In this theory the value of the company is decided by adding certain factors such as:-
(i) Cost of fixed assets i.e. Machinery, mechanical items
(ii) Working capital i.e. the capital which is required for continuous operation of the company
(iii) Cost of establishment of business promotion i.e. Expenses in doing the advertisements
These factors allow the promotion team to know the amount of capital which has to be raised to fulfill the promotion job. The true income of the company is been found out by its earning not by its investment in other states. For example if some assets becomes out of date and some idle then the earnings will fall but that fall of capital won't affect the investment made by the company in other company's business.
2) Earnings Theory: In this theory true value of an enterprise depends on its earnings capacity. The value of the company capitalization will be same as the estimated earning of the company. To find out this a company has to prepare a profit and loss account and then check regularly to see the effect of their sales over the years to find out how correct there estimations are. The earnings will be compared to the actual earning and the adjustment will be made according to that. The promotion team will then see the up and down of the earnings and then overall decision will be taken on management and how to simulate the earning to increase the revenue of the company.
For example if there is a company which has an estimated average profit of Rs. 25,000 in first few years and earning a return of 5% on their capital. The capitalization will be: (25,000*100)/5 = Rs. 5, 00,000

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Question - 2:

Explain Earnings Theory?

Ans:

In this theory true value of an enterprise depends on its earnings capacity. The value of the company capitalization will be same as the estimated earning of the company. To find out this a company has to prepare a profit and loss account and then check regularly to see the effect of their sales over the years to find out how correct there estimations are. The earnings will be compared to the actual earning and the adjustment will be made according to that. The promotion team will then see the up and down of the earnings and then overall decision will be taken on management and how to simulate the earning to increase the revenue of the company.
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Question - 3:

Explain Cost Theory?

Ans:

In this theory the value of the company is decided by adding certain factors such as:-
(i) Cost of fixed assets i.e. Machinery, mechanical items
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Question - 4:

Tell me what is over capitalization? What are its causes?

Ans:

Capitalization of a company neither should be low or high. It should be suitably available at the time of need. Over capitalization is a state in which the earning which are not sufficient to give a good return on the amount of share capital which has been issued. This is where when total owned and borrowed capital exceeds the fixed and current assets (it shows losses on the assets side). The company which comes under this state is like a person who can't carry his own weight properly. The company which comes under this kind of influence has many difficulties and not likely to be active until the state is been corrected. The causes of over capitalization are as follows:
1) Idle Funds: Company may have funds which might not have been used properly e.g. Money invested in such projects that are giving very low profits.

2) Over-valued : Fixed assets may be having higher cost than that of its actual cost.
3) Value degradation : Fixed assets may have been taken when the prices were high and when the prices have fallen the value of it may have fallen but then also the value for the company will be high only.
4) Inadequate Depreciation provision: Fixed assets might not have adequate provision.

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Question - 5:

Do you know what is capitalization? What is its importance?

Ans:

Capitalization is a term which has different meanings in both financial and accounting context. Capitalization in accounting means the cost to buy an asset which is included in the price of the asset whereas in financial terms it is the cost which is required to buy an asset which includes price of a particular asset and it also include the retained earnings of a company with stock debt and long term debt. There are two kinds of capitalization which are called as Over-capitalization and another is called as Under-capitalization. Capitalization is very import aspect in determining the value of the company in the market which is based on the economic structure of the company. This aspect depends on the previous records and economics of the company. This also shows a particular behaviour of the companies' structure and allows them to create a plan to do the marketing.

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Question - 6:

What are the causes of undercapitalization?

Ans:

The effect of undercapitalization can be summarized as:-
(i) The payment of excessive interest on borrowed capital can lead to under capitalization as we have to pay more interest on the capital which has been borrowed from some other dealers around.
(ii) Under capitalization can also cause companies to use their old and out of date equipment because of inability to buy new items or purchase new items.
(iii) Under capitalization allows the companies to run on low cost because of that they are unable to have high cost of production due to use of old machinery. It is also a cause of improper financial planning. It is difficult to raise the capital if any company comes under this sort of situation. There are several different causes that exist such as:-
- It makes a company growing financially with short-term capital, rather than having permanent capital to spend on goods and on purchasing.
- It doesn't allow a secure transaction of bank loan at critical time.
- In during the predictable business risk it also fails to obtain the insurance cost.
- It also has to go through many adverse macroeconomic conditions

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Question - 7:

What is undercapitalization?

Ans:

Under capitalization is any situation which restricts the business companies to acquire the funds which they need. Under capitalization is also a state like over capitalization where the owned capital of the business is much less than the borrowed capital. It also means that the owned capital of the company is not up to the scale and its operation and business depends on the borrowed money. This also comes as a result of over-trading. Under capitalization has many factors involved with it and it is indicated by:
(i) Low proprietary Ratio
(ii) Current Ratio
(iii) High Return on Equity Capital

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Question - 8:

What is Inadequate Depreciation provision?

Ans:

Fixed assets might not have adequate provision.

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Question - 9:

What is Value degradation?

Ans:

Fixed assets may have been taken when the prices were high and when the prices have fallen the value of it may have fallen but then also the value for the company will be high only.

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Question - 10:

What is Over-valued?

Ans:

Fixed assets may be having higher cost than that of its actual cost.

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Question - 11:

What is Idle Funds?

Ans:

Company may have funds which might not have been used properly e.g. Money invested in such projects that are giving very low profits.

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Question - 12:

Explain what sort of remedies is available for companies to overcome the situation of over capitalization?

Ans:

There are different sorts of remedies available for over capitalization which are as follows:-
1) The company can overcome Over-capitalization by reducing its capital so as to obtain a satisfactory relationship between proprietors' funds and net profit.
2) The company can overcome this phase by spending the money wisely and in those areas where they can get some profits.
3) The company can also overcome this by utilizing the money which has been idle in the bank and put up in some investment and has not been used till now.
4) The company can also overcome this by removing the over-valuation policy by bringing down the values of assets to their proper values.

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Question - 13:

Tell me what is the effect of overcapitalization on following parties?
a.) Company
b.) Shareholders
c.) Consumers
d.) Society

Ans:

a.) Company
(i) It has a big impact on the company because of low profits the companies reputation is harmed.
(ii) The promotion of the company because difficult to do and the shares of the company can't be easily marketed.
(iii) Borrowings from other parties become hard due to decline of earnings by the company and due to this the reputation of the company goes down which in turn makes the company looses its credibility.
(iv) Company indulge in malpractices to retain its image for example manipulation of accounts to show high earnings.
(v) Company under the influence of low capital cuts down the expenditure on maintenance, replacement of assets and do the necessary cost cutting for example removal of the stuff etc.
b.) Shareholders
As the companies profit decreases the rate of earning of shareholders also decreases as they both are directly proportional to each other. Due to this problem only the market price of the share also go down. Due to over capitalization the shareholders positions become uncertain and their profits or earnings also been cut down. Share value also decreases and they can't be marketed correctly.
c.) Consumers
Consumers are the people who are buying the company shares so to cover up the companies earning the management indulges in wrong doing to increase or decrease the capital in quality on the paper. Return on the capital becomes low which gives the impression to the customer that the resource which company is using is not utilized in a right manner. Consumer starts questioning the credibility of the company due to their low earnings as the company fail to pay its creditors on time. It also has an effect on working conditions and payment of wages and salaries also lessen.
d.) Society
It has an effect on the society by speculating about the company which are under-performing and those people who buy the shares always remain in panic as what will happen to their investments which they have done. It has also an effect on working conditions and payment of the group of people working in the company which are going through this phase. The salaries of other groups in the companies also lessen down due to this.

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Question - 14:

Explain what are the indications of existence of undercapitalization in a company?

Ans:

Undercapitalization is when the actual capitalization is lower than its proper capitalization as it is given by its earning capacity. Undercapitalization is indicated by the condition above and when the rate of earning is very high in effect to the returns which other companies get which are in the same industry as others. This is also indicated when a company does not have sufficient capital to conduct normal business operations and they have to pay the people from whom they have taken. When a company doesn't generate enough cash flow to access the forms then it is said to be undercapitalized.

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Question - 15:

Explain what are the effects of undercapitalization on following parties?
a.)Company
b.)Shareholders
c.)Consumers
d.)Society

Ans:

a.) Company
The under capitalization in this one effect the company to bring the greater reputation for them and with greater earning their market shares also increases. Higher rate of earning also allow higher competition in the market. The demand of workers to do good quality product also rises due to flow of high profits.
b.) Shareholders
The effect of under capitalization on the company is much more as the company's profits increases as the earning goes up but the market value goes down due to increase of share rise company's profitability increases. As a result, rate of earnings go up. The financial reputation also increases due to having capital in the hands of the company. In the company in this situation the shareholders can also enjoy high dividend due to raise in profits and saving of money.
c.) Consumers
This situation affects consumer by having their interest getting affected as they think that company is over charging them on the products as the company is having high probability of raising more profits by doing their bit. So, consumers here are on the receiving end as they have to pay up more to buy a product which has cost included of marketing and advertisements and other promotional agendas.
d.) Society
Society is getting affected by the high earning and high profitability and high market price of shares and there can be unhealthy talks in stock market about the company which is having all these with them. Generally public expect high prices of product from high profits of a particular company. Company also maintains

stock to keep the money secretly which allow them to pay lower taxes to the government. Public also raises the high expectations from the companies which got high profits to raise the innovation bar and to provide good facility and high end technology of the product in the market.

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Question - 16:

Tell me what remedies are available for companies to overcome undercapitalization?

Ans:

Remedies are the solutions which are available for the companies to overcome the problem of undercapitalization this can be done by using two factors. These factors are as follows:-
1) Splitting up the shares will reduce the dividend per share and don't give more to one only but equally to everyone and the high earning can be utilized properly.
2) Issue bonus shares to the company members who are currently associated with the company as well as the shareholders stake by doing this both the dividend per share and earnings per share will reduce.

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Question - 17:

Explain Balanced Capitalization?

Ans:

Capitalization is a collection of share capital, loans, reserves and debentures. It represents permanent investment in companies and it also removes the need of long-term loan plans. It is used to show the reality of the industry by promoting competition, development, profit and investment between individuals, companies and businesses. Balance capitalization is part of this Capitalization only where it is compared to the relative importance, value and other things to make it proportionate in every sense. In balance capitalization debits and credits should be equal on both sides and the share should be shared among all in equal proportions.

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Question - 18:

Can you please explain the difference between Overcapitalization & undercapitalization?

Ans:

- Overcapitalization is a state where earnings are not sufficient to justify the fair return on the amount of share capital which has been issued by the company whereas undercapitalization is a state where the capital which is owned by the business is much less than the borrowed capital.
- Overcapitalization happens when the actual profits of a company are not enough or sufficient to pay interest to the creditors whereas undercapitalization happens due to over-trading and when the company earn high profits as compared to other industry.
- Overcapitalization shows the rate of return as declining entity whereas undercapitalization shows the rate of return as increasing entity.

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Question - 19:

Explain what are watered stock / watered capitals? What are the reasons which lead to this situation?

Ans:

Watered stock/capital is that stock which is issued with a value much higher than the value of assets which a company own. It can be caused by excessing stock dividends, overvalued assets and large operating losses. The assets can have these features including values which are directly related to accounts or through excessive issue of stock. It is an asset with an inflated value which is not real but has the artificial significance. The reasons which lead to this situation are the excess price of paid for an asset. For example if a company pays 25,000 on account of goodwill, which if valued Rs. 20,000 then the capital which is watered to the extent of Rs. 2,000. During the time of promotional activities water enters the capital in the initial period of time.

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Question - 20:

Can you please explain the difference between watered capital and overcapitalization?

Ans:

- Watered capital is called so because the flow of money can be seen at the time of promotional events only and then money flows like water with the capital in the initial period at the time of promotion whereas Over capitalisation can be calculated after the company has worked for some years and at the end only.
- Over capitalization can be caused by watered capital whereas water capital is not caused by overcapitalization and it can be calculated at the time when the company is taking the promotional event in hand.

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