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RESTRICTIONS AND THEORETICAL BACKGROUND FOR JOINT-STOCK COMPANY EQUITY

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Abstract: *This article considers approaches to the economic content of the concept of equity, as well as the theoretical and scientific analysis of the definitions (perspectives) and their functions. The research carried out identified and studied 5 groups of approaches and characteristics related to the essence (meaning) of equity; additionally a scientific foundation for the notion of "equity of the joint-stock company" has been laid down*

Keywords: equity, joint-stock company, net assets, a self-financing source.

JEL classification: M 40, M 49

The economic and financial activity of a joint-stock company is conditioned by the existence of the factors of development, among which the capital holds an essential place.

The concept of capital has been and is still the focus of the economic theory and practice. The content and area of the concept "equity" generate considerable debates both of political-ideological and methodological-scientific nature.

At present, further to a thorough and extensive approach to the concept "capital", there has been identified a variety of economic terms, among which "capital" is also to be found.

Due to the fact that users of the terms, inclusive of the concept "capital", do not always approve of the content and the area of coverage of these notions, the economic domain often generates two situations:

1) *Using some different terms to identify similar economic contents*, particularly: statutory capital or social capital, financial capital or equity, economic capital or the value of available assets etc.

2) *Using the same term for different economic contents*: for ex., the university professor Lazar Cistelecan, in the preface of the work "The cost of capital", written by Gheorghe Gavrilas, mentions that "the capital represents an economic category with a historic nature defined as a stock of values or as assets that can be involved in the economic circuit, thus generating income for holders/owners" [10, p.9]. At the same time, we can further refer to the opinion of the scientific researcher Camelia Oprean who believes that "the concept of capital entails the range of assets held/owned by an individual or by a society" [18, p.28].

These definitions imply that capital equals the extent of the assets of an entity. Furthermore, a group of Romanian scientific researchers, under the guidance of the university professor Mihai Ristea, state that "a company's capital as sustainable sources of financing represents the value equivalent of the resources invested in assets by owners (equity) or third parties (long- term and medium- term debts)" [23, p.69].

On the other hand, the Romanian university associate professor Radu Baluna states that "capital represents the value equivalent of the resources invested in assets by owners (equity) or third parties (long-term debts and short-term debts)" [1, p.33]. The same opinion is shared by the Romanian economists Marius Dumitru Paraschivescu and Florin Radu, who define capital as "the number of sustainable sources of financing that a company can apply to purchase assets required for existence and functioning during its lifecycle" [21, p.21]. The same opinion is supported by the Romanian university lecturer Ion Bucur who considers that "generally speaking, capital, in accounting, represents all the medium and long-term sources that a company can apply during its activity" [6, p.83].

The above-mentioned imply that the notion of capital is tackled under two different aspects: as a form of manifestation and a source of financing or from the perspective of assets and liabilities in the balance sheet. Thus, the Romanian economist Mihaela-Brindusa Tudose mentions that "upon the start-up, the company has two types of capital: economic capital and statutory capital", "i.e. the capital that different

natural persons or legal entities contribute with" [29, p.20].
In our opinion, from the financial and accounting point of view, the general notion of capital entails sources of asset financing that include: one's own sources (equity) and borrowed sources (long-term debts and current debts). That is the reason why it is very important to research conceptual approaches to the content of equity, because the latter represents a sustainable source of financing of the joint-stock company.
When analyzing item 4.57 of the General conceptual framework for financial reporting [7], we can state that the definition of the term "capital" tackles two concepts: the financial concept and the physical concept. According to the financial concept, capital is synonymous with the net assets or the company's equity. According to the physical concept, capital represents the production capacity of the company, expressed, for example, in units of production per day. By a method of analogy, these concepts are also defined in paragraph 98 of the Conceptual foundations for developing and submitting financial reports [2]. In this context, a group of Romanian scientific researchers, under the supervision of the university lecturer Mihai Ristea, mentions that "the financial capital is a concept belonging to company's finances and assets", but "the physical capital originates from the category of permanent capital (equity + long-term debts) and implies physical reconstructions of the capacity to exploit capital" [23, p.31].
Depending on these two concepts of capital - financial and physical, the General conceptual framework for financial reporting [7] and the Conceptual foundations for developing and submitting financial reports [2], respectively, distinguish the concepts of retaining capital, i.e. retaining the financial capital and retaining the physical capital. The concepts of retaining capital sustain primarily the fact that any ground used for evaluation must enable retention of the capacity to finance capital.
According to the above-mentioned accounting documents, an entity from the Republic of Moldova must opt for the most adequate concept in accordance with the needs of the users of the financial situations. Moreover, it should be mentioned that the National Accounting Standard (NAS) "Equity and debts" [26], NAS "Presenting the financial situations" [27] and the General Plan of Accounts [22] which are implemented as of January 1, 2014, tackles the concept of retaining financial capital that enables us to state that joint-stock companies from the Republic of Moldova have the possibility to apply only this concept.
Specialty literature and bills on laws include various approaches to the essence of equity. In our opinion, these approaches can be divided into five groups which define equity and are depicted in Figure 1.

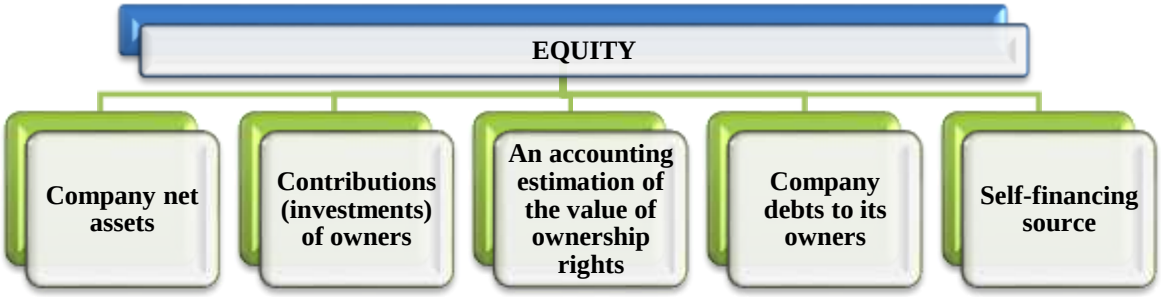


Figure 1: Approaches to the essence of equity
Source: Developed by authors based on bibliography sources

The first group of approaches is the most widely-spread and is part of the General Conceptual Framework for financial reporting as well as the law regulations from the Republic of Moldova and other countries. So, as per paragraph 45 lit.(c) of the Conceptual Foundations for developing and submitting financial reports , "equity is what remains after liabilities have been deducted from company assets" [2]. A similar definition of equity can be found in item 5 of the NAS "Equity and debts" [26] and in item 21, line 2 of the NAS "Presenting financial situations" [27]. We must point out that according to paragraph 98 of the Conceptual foundations for developing and submitting financial reports, "capital is the synonym for net assets or the company's own resources" [2]. As per the stipulations of Article 39, line 2 of the Law on joint-stock companies no. 1134-XIII dated April 2, 97, "the source of net assets is the company's equity" [14]. In accordance with item 4.4. lit. (c) of the General conceptual Framework for financial reporting, "equity represents the residual interest in a company's assets after all its liabilities have been deducted" [7]. The same definition of equity can be encountered in the Accounting Framework developed by the Financial Accounting Standard Board (FASB) from

USA and in the conceptual Accounting Framework from Great Britain designed by the Accounting Standard Board (ASB) [24, p.74-79].

We observe that the above-mentioned approaches identify similar definitions of the term "equity". Thus defined, equity is looked upon as a synonym for net assets, calculated as the difference between the value of the total assets and the total liabilities. In such a way, this approach defines equity via a relation of calculation and not by means of some elements of identification related to profit yielding. It results that the nature of residual element that derives by definition, is applied only to evaluate equity, i.e. the value of equity registered in the balance sheet depends on the evaluation of assets and liabilities.

Consequently, we can state that the approach to equity as a residual element is not an ideal one; it does not enable us to state that by such a definition, equity is a sum of monetary means that the owners will collect upon the liquidation of the joint-stock company. The problem is that the net assets based on accounting values may not coincide with the net assets calculated as per market prices. Normally, the accrued amount of the equity can accidentally correspond to the market value of the shares of the joint-stock company or to the sum that can be collected by selling the available assets piece by piece or the whole company to ensure continuity.

The second group of approaches related to the notion of equity as owners' contributions is applied by a group of Romanian scientific researchers under the guidance of the university professor Mihai Ristea that states that "equity represents the value equivalent of the resources invested in assets and for which the company does not have to provide an equivalent in goods or services to a third party" [23, p.71]. Likewise, the Romanian economists N.Sighigea, N.Dracea, D.Berceanu, T.Ciurezu mention that "equity represents the company shareholders' or partners' investment, at first through direct contributions, as the initial statutory capital which is further increased as the company develops. Later, an indirect contribution is made in the form of self-financing through full or partial allocation of dividends" [25, p.17]. A similar viewpoint is shared by the Romanian scientist Gheorghe D. Bistriceanu and his colleagues who believe that the financial definition of equity is "the monetary amount contributed by partners or shareholders in addition to the amount yielded as a result of the company's own activity and retained to ensure the economic capital" [4, p.83].

In our opinion, the equity is not made up only of the owners' contributions, because it entails elements of a different nature too, for ex., the differences /postings after reevaluating fixed assets, subsidies, retained profit, reserves.

The approaches belonging to *the third group* related to the notion of equity as an accounting estimation of the value of ownership rights, are applied by the Romanian economist Gheorghe Gavrilas who mentions that "the equity is that share of the capital held by the business person that is owned by him, because it belongs to the shareholders and is the result of capitalizing the invested capital" [10, p.97]. The same viewpoint is shared by the Romanian scientific researchers Marius Dumitru Paraschivescu and Florin Radu, who define equity as "the amounts that are not due upon final calculations, and belong to the owners. Equity is raised through owners' contributions, self-financing or other financial resources" [21, p.18]. In this context, the Romanian economist, Bojian Octavian claims that "equity is the share of the capital made available to the company by the owners: entrepreneurs as individual entities, associates or shareholders and belongs, by law, to the owners, thus it is not reimbursable" [5, p.137].

Consequently, we can state that in compliance with item 238 of the Accounting regulations adjusted to the European standards, of the Order of the Minister of Public Finances from Romania, no. 3055 dated October 29, 2009, equity is defined as "the shareholders' claims on a company's assets after all debts have been deducted" [20]. Furthermore, we can add that a joint-stock company shareholders' power over the business is exercised via the shares they hold. As per the stipulations of Article 12, paragraph 1 of the Law on joint-stock companies, the shares "entitle the owners (shareholders) to take part in the company's administration, receive dividends as well as a part of the company's assets in case of its liquidation" [14]. Additionally, we share the opinion of the Moldovan economist A.Suhovici who claims that "the attractiveness of share investments , from the perspective of shareholders' rights, is and will further be the decisive factor for the development of the domestic joint-stock companies" [28, p.131]. So, the advocates of this approach towards equity emphasize the owners' rights on company's assets.

The fourth group of approaches refers to the notion of equity as the company's debt to its owners and is supported by the Russian scientists V.V.Covalev and Vit.V.Covalev who treat equity as the company's long-term debts to its owners [9, p.41]. Likewise, the Romanian economist Camelia Iuliana Lungu

points out that “equity is, to some extent, associated with obligations, i.e. the company's obligations towards investors” [15, p.117]. This approach can also be found in the Law on joint-stock companies. As per the stipulations of Article 24 paragraph 4 of the respective law “on the assets owned by the company and ownership can be exercised upon, the shareholder has legal obligations” [14]. The joint-stock company's debt to investors is reflected in the stipulations of the Articles 25,49 and 98 of the Law on joint-stock companies ,according to which the joint-stock company must pay dividends, and in case of its liquidation, equity owners must be paid damages as per the ultimate value of liquidation after all creditors' settlements have been made [14].

The approaches of *the fifth group* have a functional vision and treat equity as a source of self-financing. This view is supported by the French scientists Jacky Maille and Michel Remilleret, who consider equity to be “funds that are always available to the company. On the other hand, equity is a guarantee for banks and company creditors. Moreover, these funds are used with external liabilities to finance the company” [12, p.26]. A similar definition of equity is provided by the Moldovan scientists A.Nederita, N.Tiriulnicova who state that “equity represents all sources of self-financing for the economic and financial activity of the company” [17, p.328]. In the opinion of a group of Moldovan scientific researchers under the guidance of the associate professor L. Grigoroi, “equity reflects self-financing of the economic assets that the economic entity owns that entails all the economic resources of the entity” [11, p.258]. In this context, the well-known scientist Erich A.Helfert from Austria mentions that “shareholders' equity represents the net sum of contributions of different groups of shareholders to company's financing, as well as retained profits in the form of dividends” [13, p.19]. Thus, as per item 179, paragraph 1 of the Order of the Ministry of Economy and Finance from Romania, no. 1969/2007 dated 09.11.2007 “the capital and reserves (equity) represent all the sustainable sources of financing available to the legal entity with no right of ownership, after deducting all the debts” [19].

Researches published in economic literature and legal regulations lead to the conclusion that the notion of equity is very complex and each approach tackles this notion from different viewpoints that further yield their own characteristics. At the same time, *we believe that treating equity as a source of self-financing is the most fundamental, because equity is always made available to the joint-stock company and is used along with the borrowed sources/funds to finance its economic and financial activity.*

Furthermore, in order to provide a deeper economic content for the concept of equity, it is necessary to examine the main characteristics of equity which are depicted in Figure 2. The characteristics recommended by the authors distinguish equity as the subject of economic management; accrued economic value; source of income; subject of market economy relations; risk bearer.

Summing up the information given in Figure 2, we conclude that the approaches under discussion reveal the characteristics of equity from different perspectives that are closely interrelated and call for a full treatment in order to generate a more ample definition of the joint-stock company's equity.

Taking into account the above-mentioned so far, we can point out the fact that, at present, there are different views on the concept of equity. This concept is applied with various meanings both in scientific literature and economic practice. To achieve a minimum of scientific accuracy, it is necessary to emphasize the perspective that equity is defined from. In our opinion, one can distinguish the following views to define the joint-stock company's equity: accounting, legal, economic and financial.

From *legal perspective*, the joint-stock company's equity can be seen as all the ownership rights that shareholders have and enjoy. This definition may further be supported by the opinion of the Romanian scientific researcher Mihaela-Brandusa Tudose, who considers that legally, equity “represents the first sign of guarantee for third parties” [29, p.25].

From *accounting perspective*, the joint-stock company's equity represents the joint-stock company's own sources of financing, registered in the liabilities of the balance sheet and raised through shareholders' contribution, self-financing and other non-reimbursable sources.

We believe that there is an obvious connection between the accounting and the legal perspectives as accounting has always been, more or less, marked by legal concepts. For instance, the structure of the statutory capital shows each shareholder's contribution to the joint-stock company's statutory capital and determines the conditions under which power is exercised and the net profit is distributed.

From *economic perspective*, the joint-stock company's equity is an economic category that can be regarded both from its origin point of view (statutory capital and supplementary capital, reserves, retained profit (uncovered loss), other elements of equity) and from the perspective of profit distribution. In this context, the Romanian economist Dorel Berceanu claims that “using shareholders’

equity leads to an economic constraint, i.e. the firm must reward financially its shareholders or associates, as a reason for an ultimate possibility to finance through equity. This remuneration is carried out through dividend payment" [3, p.213].

From *financial perspective*, the joint-stock company's equity reveals the possibilities to finance the company's economic and financial activity by means of its own sources of financing. Thus, the above interpretations indicate that there are different perspectives to define the joint-stock company's equity.

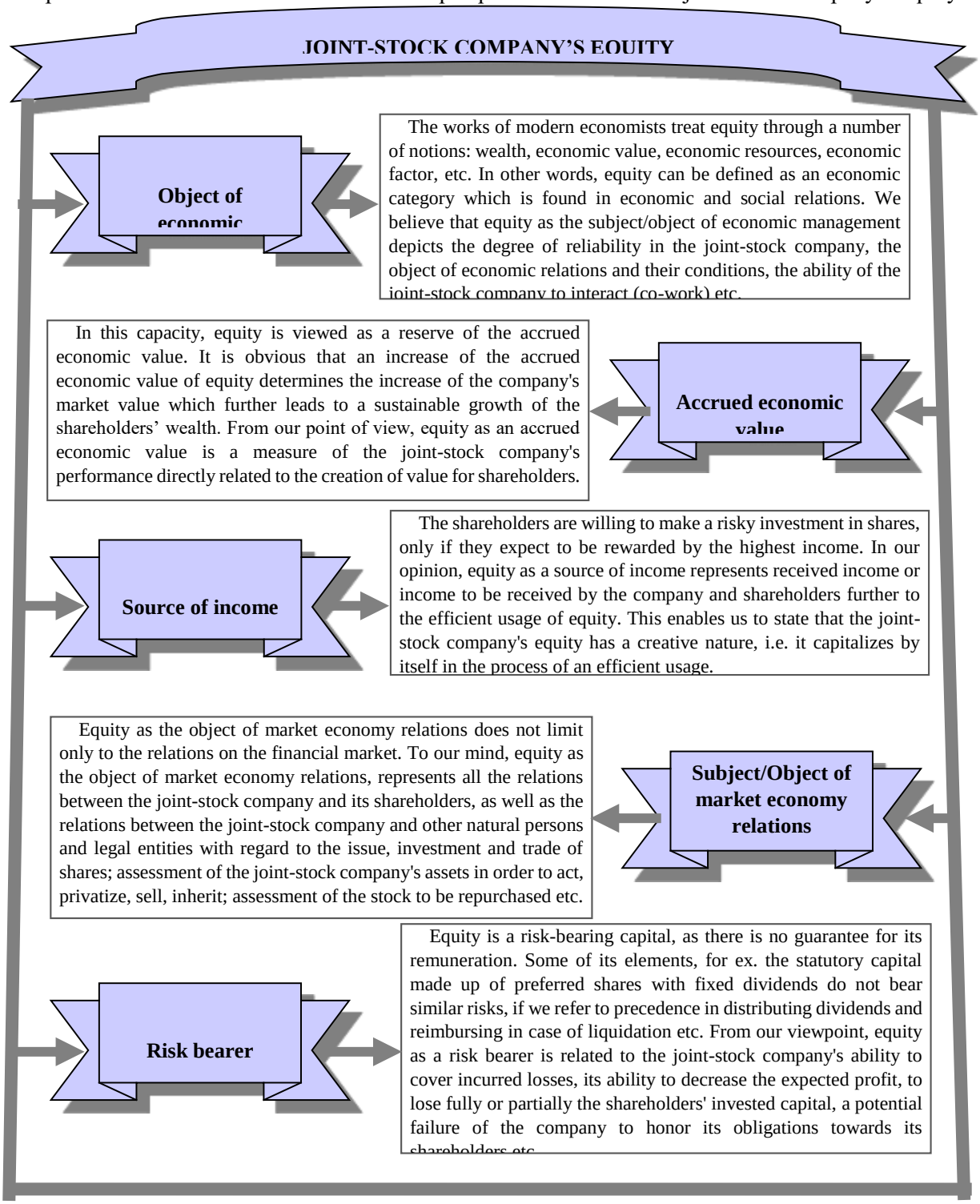


Figure 2: The main characteristics of the joint-stock company's equity

Source: Drawn up by the authors

In our opinion, the choice of the perspective to treat equity must comply with information users' objectives. The content of equity may be considered accurately referring to the fundamental functions

that are carried out by equity and further researched. Thus, the Romanian economist Gheorghe Manolescu states that "equity has two functions: to finance a part of the investment; to serve as security for the company's creditors who finance the remaining part" [16, p.240].

A larger approach to the functions of equity is applied by the Russian scientist O.V.Efimova who distinguishes four functions of equity: *operational* - to ensure ongoing activity; *security* – to protect creditors' capital and cover losses; *distribution* – to participate at profit distribution; *regulatory* – to enable certain subjects (legal entities and natural persons) to run the entity [8, p.252].

From our viewpoint, the essential function of the joint-stock company's equity is to ensure the joint-stock company's financial autonomy, because it allows for freedom of action, allocates the joint-stock company a high degree of independence with regard to the choice of investments, enables a lower degree of indebtedness, and implicitly, lower financial costs, allows for access to the capital market and draws investors etc.

Conclusions

Summing up the above-related concerning the approaches to the essence of equity, the main characteristics of equity, the perspectives to define equity and its functions, we suggest to include the following aspects into the definition of the joint-stock company's equity:

- firstly, it **represents an economic category**;
- secondly, **equity is one of the sources of long-term financing of the joint-stock company's economic and financial activity**;
- thirdly, it is necessary to emphasize the fact that **equity is raised through shareholders' contributions, self-financing and other non-reimbursable sources**;
- fourthly, it must **ensure financial autonomy and the joint-stock company's increased profitability**;
- in the fifth place, it must **determine the increase of the joint-stock company's market value, respectively, the increase of the market value of the company's listed shares and/or maximization of shareholders' earnings**.

Thus, in our opinion, the term under consideration can be defined as follows: **the joint-stock company's equity as an economic category represents one of the sources of long-term financing, made up of shareholders' contributions, self-financing and other non-reimbursable sources with a view to ensuring financial autonomy, increased profitability and the company's market value**.

Finally, we would like to point out that in the process of selecting the strategy for the joint-stock company's development and in search of sources of financing for the company's economic and financial activity, one must be fully aware of the importance given to the economic content and the domain of the concept of a joint-stock company's equity.

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