Learn About Owner's Equity

Owner's Equity on a Business Balance Sheet

BY JEAN MURRAY • Updated September 16, 2019

As a small business owner, you are in a unique circumstance of ownership. You own everything in the business except what you owe to other people. That's great, but do you really know how this ownership, known as "equity" works?

What Is Equity and Owner's Equity?

The term "equity" means something of value or worth. It can also mean ownership. Generally, when looking at equity you want to consider the value of something and how much you owe is on that value. What's left over is equity.

An example: Equity in real estate means the part of the value of a property that's not the loan amount. So, if a property is valued or appraised at

business assets owned by the business owner. It's the amount the owner has invested in the business minus any money the owner has taken out of the company.

Owner's Equity in a Business Balance Sheet

You can find the amount of owner's equity in a business by looking at the balance sheet. On the left are assets, the value of what the business owns. On the right are liabilities (what's owed by the business) and owner's equity (what's left).

An example: If the value of assets in a business is $3.5 million and the total liabilities are $2.5 million, owner's equity is equal to $1 million. This is the basic accounting equation:

ASSETS - LIABILITIES = OWNER'S EQUITY

Owner's equity changes over time. It's included on the business balance sheet at the end of an accounting period — month, quarter, or year.

Owner's equity is one of the three major sections of a balance sheet. It has several sub-sections

- Invested capital. This is the total initial investment for all owners or shareholders.
- Retained earnings - beginning, This is the retained earnings at the beginning of the accounting period.
- Retained earnings - current. This is the retained earnings for the current accounting period.

These three amounts are added together to get the Total Owners' Equity.

Tip: SCORE has a sample business balance sheet in a spreadsheet format that you can use to put together a balance sheet for your business.

SCORE. "Balance Sheet Template." (Download) Accessed Sept. 16, 2019. [1]

Owner's Equity for Business Types

The owner's equity account looks different for different types of businesses.

The term retained earnings only applies to corporations. Other business types show ownership in a different way. Sole proprietorships, partnerships, and LLC's show the amounts in the capital accounts of owners at the end of the accounting period.

What Is an Equity Interest?

An equity interest is an ownership interest in a business entity, from the concept of equity as ownership. Shareholders have equity interest as their purchase of shares of stock in the corporation gives them a share in the ownership of the business. Equity interest is in contrast to creditor interest from loans made by creditors to the business.

How Owner's Equity Grows

Owner's equity increases with (a) increases in owner capital contributions, or (b) increases in profits of the business. The only way an owner's equity/ownership can grow is by investing more money in the business, or by increasing profits through increased sales and decreased expenses. If a business owner takes money out of their owner's equity, the withdrawal is considered a capital gain, and the owner must pay capital gains tax on the amount taken out.

Business Ownership and Capital Accounts

Each owner of a business has a separate account called a "capital account" showing his or her ownership in the business. The value of all the capital accounts of all the owners is the total owner's equity in the business.

An example: Tom begins a business and puts in $1,000 from his personal checking account and a laptop computer valued at $1,000. This $2,000 amount is a capital contribution since Tom has contributed capital in the form of cash and property to the business.

The next month, Tom takes a $500 draw from the business. So his net owner's equity is $1,500 at the end of the second month. If the owner takes more money out of the business than he put in, it results in negative owner's equity.

Tip: This article takes you step-by-step through the process of preparing a balance sheet for a business startup.

Article Sources

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