

Common Shares Vs Preferred Shares – do you know the difference?



Executive summary

Common and preferred shares are the two types of equity that a shareholder can hold in a corporation. These two investment vehicles have a number of key differences, but the goal of both is for the shareholder to benefit from the future growth and profits of the company.

What you need to know

Common shares are basic shares of a company that represents the equity, or ownership, in the corporation. As owners of the corporation, common shareholders share in the performance of the business, whether that be good or bad. There is always the risk that common shareholders could lose part or all of their investment in the event of the companies' dissolution, as they have the lowest rank in terms of making claims against the company should the company go bankrupt. However, this downside risk is often justified by the upside ability to experience significant investment growth over time. Common shares also have voting rights that are commonly handed out as one vote per share.

Preferred shares can be a form of equity investment, like common shares. However, some money managers consider to be fixed-income investments, as the level of income a preferred shareholder earns is often fixed. Preferred shares normally hold a pre-determined dividend amount that is paid quarterly to the shareholder and preferred shareholders must be paid a dividend prior to any common shareholders. However, unlike other fixed-income vehicles, the corporation is not obligated to pay the dividend and there are no repercussions for them not doing so. Unlike common shares, in the event of the company's dissolution, preferred shareholders receive assets ahead of common shareholders upon liquidation. They also do not typically hold voting rights.

The bottom line

Understanding the difference between common and preferred shares can be important for structuring your business or for picking an investment. It is always prudent to work with a legal and financial professional when making decisions such as these.

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