

E-contents

Course M.Com Part II

Paper IX

Topic: Debentures

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Debentures

Debentures are a debt instrument used by companies and government to issue the loan. The loan is issued to corporates based on their reputation at a fixed rate of interest. Debentures are also known as a bond which serves as an IOU between issuers and purchaser. Companies use debentures when they need to borrow the money at a fixed rate of interest for its expansion. Secured and Unsecured, Registered and Bearer, Convertible and Non-Convertible, First and Second are four types of Debentures. Let us learn more about Debentures in detail.

In layman's term, a Debenture is the acknowledgment of the debt the organization has taken from the public at large. They are very crucial for raising long-term debt capital. A company can raise funds through the issue of debentures, which has a fixed rate of interest on it. The debenture issued by a company is an acknowledgment that the company has borrowed an amount of money from the public, which it promises to repay at a future date. Debenture holders are, therefore, creditors of the company.

Advantages and Disadvantages of Debentures

Advantages of Debentures

- Investors who want fixed income at lesser risk prefer them.
- As a debenture does not carry voting rights, financing through them does not dilute control of equity shareholders on management.
- Financing through them is less costly as compared to the cost of preference or equity capital as the interest payment on debentures is tax deductible.

- The company does not involve its profits in a debenture.
- The issue of debentures is appropriate in the situation when the sales and earnings are relatively stable.

Disadvantages of Debentures

- Each company has certain borrowing capacity. With the issue of debentures, the capacity of a company to further borrow funds reduces.
- With redeemable debenture, the company has to make provisions for repayment on the specified date, even during periods of financial strain on the company.
- Debenture put a permanent burden on the earnings of a company. Therefore, there is a greater risk when the earnings of the company fluctuate.

Types of Debenture

1. Secured and Unsecured:

Secured debenture creates a charge on the assets of the company, thereby mortgaging the assets of the company. Unsecured debenture does not carry any charge or security on the assets of the company.

2. Registered and Bearer:

A registered debenture is recorded in the register of debenture holders of the company. A regular instrument of transfer is required for their transfer. In contrast, the debenture which is transferable by mere delivery is called bearer debenture.

3. Convertible and Non-Convertible:

Convertible debenture can be converted into equity shares after the expiry of a specified period. On the other hand, a non-convertible debenture is those which cannot be converted into equity shares.

4. First and Second:

A debenture which is repaid before the other debenture is known as the first debenture. The second debenture is that which is paid after the first debenture has been paid back.