

Debentures: Meaning, Features, Advantages, Disadvantages



ALL YOU NEED
TO KNOW
**ABOUT DEBENTURES, ITS TYPES,
ADVANTAGES & DISADVANTAGES**

For:
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Meaning:

If a company needs funds for extension and development purpose without increasing its share capital, it can borrow from the general public by issuing certificates for a fixed period of time and at a fixed rate of interest. Such a loan certificate is called a debenture. Debentures are offered to the public for subscription in the same way as for issue of equity shares. Debenture is issued under the common seal of the company acknowledging the receipt of money.



Features of Debentures:

The important features of debentures are as follows:

1. Debenture holders are the creditors of the company carrying a fixed rate of interest.
2. Debenture is redeemed after a fixed period of time.
3. Debentures may be either secured or unsecured.
4. Interest payable on a debenture is a charge against profit and hence it is a tax deductible expenditure.
5. Debenture holders do not enjoy any voting right.
6. Interest on debenture is payable even if there is a loss.

Advantage of Debentures:

Following are some of the advantages of debentures:

- (a) Issue of debenture does not result in dilution of interest of equity shareholders as they do not have right either to vote or take part in the management of the company.
- (b) Interest on debenture is a tax deductible expenditure and thus it saves income tax.
- (c) Cost of debenture is relatively lower than preference shares and equity shares.
- (d) Issue of debentures is advantageous during times of inflation.
- (e) Interest on debenture is payable even if there is a loss, so debenture holders bear no risk.

Disadvantages of Debentures:

Following are the disadvantages of debentures:

- (a) Payment of interest on debenture is obligatory and hence it becomes burden if the company incurs loss.
- (b) Debentures are issued to trade on equity but too much dependence on debentures increases the financial risk of the company.
- (c) Redemption of debenture involves a larger amount of cash outflow.
- (d) During depression, the profit of the company goes on declining and it becomes difficult for the company to pay interest.

Different Types of Debentures:

A company can issue different types of debentures for raising funds for long term purposes.

Different forms of debentures are given and discussed below:

Ordinary Debenture:

Such debentures are issued without mortgaging any asset, i.e. this is unsecured. It is very difficult to raise funds through ordinary debenture.

Mortgage Debenture:

This type of debenture is issued by mortgaging an asset and debenture holders can recover their dues by selling that particular asset in case the company fails to repay the claim of debenture holders.

Non-convertible Debentures:

A non-convertible debenture is a debenture where there is no option for its conversion into equity shares. Thus the debenture holders remain debenture holders till maturity.

Partly Convertible Debentures:

The holders of partly convertible debentures are given an option to convert part of their debentures. After conversion they will enjoy the benefit of both debenture holders as well as equity shareholders.

Fully Convertible Debenture:

Fully convertible debentures are those debentures which are fully converted into specified number of equity shares after predetermined period at the option of the debenture holders.

Redeemable Debentures:

Redeemable debenture is a debenture which is redeemed/repaid on a pre-terminated date and at predetermined price.

Irredeemable Debenture:

Such debentures are generally not redeemed during the lifetime of the company. So, it is also termed as perpetual debt. Repayment of such debenture takes place at the time of liquidation of the company.

Registered Debentures:

Registered debentures are those debentures where names, address, serial number, etc., of the debenture holders are recorded in the register book of the company. Such debentures cannot be easily transferred to another person.

Unregistered Debentures:

Unregistered debentures may be referred to those debentures which are not recorded in the company's register book. Such a type of debenture is also known as bearer debenture and this can be easily transferred to any other person.



Thank you