Debenture

Debenture denote borrowing by a company and represent its loan capital. Debenture holders are creditors of the company. A debenture is a document or certificate issued by a company as proof of the money lent to it by the holder. It is an acknowledgement of debt as well as an undertaking to repay the specific sum with interest on or before the prescribed date. A debenture is a certificate issued by a company under its common seal as acknowledgement of debt with or without a charge on the company's assets. Interest on debenture is paid at a fixed rate and it is payable periodically until the maturity and repayment of debentures. Debentures carry no voting rights but they generally involve a charge on the company's assets.

DISTINCTION BETWEEN SHARES AND DEBENTURES

1. Status of holders
2. Yield
3. Nature of return
4. Collection of funds
5. Security
6. Conditions of issue
7. Claim as to return
8. Voting rights
9. Redeem ability
10. Order of repayment
11. Taxation

Kinds of debenture

1. Naked and Mortgage debentures: Naked or unsecured debentures are not secured as no property is pledged or mortgaged on their issue. Mortgage or secured debentures are issued by creating a fixed or floating charge on the company's assets.
2. Redeemable and Irredeemable debentures
3. Bearer and Registered debentures: Bearer debentures can be transferred by mere delivery as no record of such debentures is kept in the Register of Debenture holders. No legal formalities are required for their transfer and no formal notice or intimation to the company is necessary. But registered debentures are recorded in the Register of Debenture holders. Interest is payable only to the registered holder.
4. Convertible and non-convertible debentures

Advantages of debentures

1 Trading on Equity: Interest on debentures is paid at a fixed rate. As a result every increase in profits can lead to higher rate of dividend to equity shareholders.

2. Economical: Raising of funds through debentures is cheaper as compared to shares. Debenture are a safer investment and, therefore, they can be issued at a rate of interest lower than the rate of dividend. Underwriting commission, brokerage, etc. are also comparatively low.

3. Appeal to cautious investors: Debentures can be issued to raise capital from those investors who want a fixed and regular income without undue risk. Debentures provides greater security and a fixed return unaffected by the company's profits. They often carry a charge or mortgage on the company's assets.

4. Flexibility: A company can issue redeemable debentures to meet its medium term needs. It can repay to debentures money when it does not need them any more. In this way, it can avoid the danger of over-capitalisation.
5. Tax relief: Interest paid on debentures is allowed as a deduction while computing the taxable income of the company. This results is saving in income-tax.
6. No interference in management: Debentureholders do not enjoy voting rights and as a result they do not interfere in the management of the company. The shareholders can retain the control in their hands by purchasing debentures.

Disadvantages of debentures

1. Fixed burden on earnings: Interest on debentures has to be paid irrespective of profits. During periods of depression, it may become a heavy burden on the company's earnings.
2. Loss of prestige: Issue of debentures generally involves a charge on assets. As a result the credit-standing and borrowing capacity of the company is reduced.
3. Charge on Assets: In order to sell debentures, a company has normally to create a charge or mortgage on its assets in favour of debentureholders.
4. Limited appeal: Debentures are not an attractive investment for most of the investors. They carry no voting rights, no right to share in the prosperity of the company and limited marketability.