

# Debentures

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## Description of Module

Items	Description of Module
Subject Name	Law
Paper Name	Corporate Finance
Module Name /Title	Debentures
Module No.	VIII

Debentures:

**Objective:** After reading this module, the learners will have a clear picture of :

To meet the financial requirements a company resort to borrowings. Such borrowings may be short-term and long term. Long term borrowings may be debentures, bonds, term loan from banks, public deposits etc. Issue of debentures is very common source to raise borrowings.

### Learning Outcomes:

Thus the debenture holders are the creditors of the company and get interest at a fixed rate, whether the company makes a profit or not. They have no concern with the management and control of the company.

### Introduction:

Quite often the money raised through the issue of shares is found inadequate to meet the growing financial requirements of business. Hence, to meet the financial requirements a company resort to borrowings. Such borrowings may be short-term and long term. Short term borrowings are overdraft, bills payable etc. Long term borrowings may be debentures, bonds, term loan from banks, public deposits etc. Issue of debentures is very common source to raise borrowings.

### Definitions of Debentures:

The word 'debenture' is used to signify—"A written acknowledgement of a debt by a company under its seal, and generally containing a provision as to payment of interest and repayment of principal." Debentures carry interest at a certain percent. As it is a loan taken by company, it is repaid after a specified period or at the option of the company as per terms of the issue.

**Debenture:** According to Tophan Debenture is a document given by a company as evidence of a debt to the holder, usually arising out of a loan and most commonly secured by the charge.

According to Section 2(30) of the companies Act 2013 debenture includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on assets of the company or not.

### **Characteristics or Features of Debentures:**

Following are the main features of debentures:

- (i) A debenture is a written acknowledgement of debt taken by the company.
- (ii) Debentures are issued in the form of a certificate.
- (iii) Debentures are issued under the seal of company.
- (iv) A debenture holder is promised periodic payment of interest at a fixed rate and repayment of principal amount after specific period.
- (v) Debentures are generally secured by a fixed or floating charge on assets of the company.
- (vi) Funds raised by the issue of debentures are of long term.
- (vii) It carries the promise to pay interest at a definite rate at regular intervals.
- (viii) Debenture holders do not have right to vote in the meetings.

Thus the debenture holders are the creditors of the company and get interest at a fixed rate, whether the company makes a profit or not. They have no concern with the management and control of the company.

### **Purpose of issuing debentures:**

As stated above companies raise huge amount of long term loans by issuing the debentures.

According to guidelines issued by Security Exchange Board of India (SEBI) a company can issue the debentures for the following objectives:

- (a) For meeting expenditure on modernization of plant.
- (b) Expansion and diversification of plant.
- (c) For meeting long term requirements of working capital.

(d) For setting up new projects.

### **Features or Characteristics of Debenture:**

1. **Form of Certificate:** Debenture is usually in the form of certificate issued under the seal of the company. It is an instrument in writing.
2. **Acknowledgement:** The certificate of debenture is generally an acknowledgement of indebtedness.
3. **Seal:** it issued the companies seal.
4. **Series of issued:** It is one of a series issued to a number of lenders.
5. **Period:** It usually specifies a particular period or date as the date of repayment.
6. **Create Charge:** It generally create a charge on the some part of property.
7. **Voting Right:** Debenture carries no voting Rights.

### **Kinds or classes of Debentures:**

1. **Classification according to negotiability:** On the basis of transferability, debentures can be classified into two types namely bearer debentures and registered debentures.

i. **Bearer Debentures:** These debentures are also known as unregistered debentures. As these debentures are payable to bearer they are called bearer debentures. These can be transferred. And value is not affected. These are regarded as negotiable instruments,

Case: Calcutta safe deposit co ltd v Ranjit Mathurdas Sampat (1971) in Calcutta high court that a person to whom a bearer instrument is transferred becomes its holder. If the payment is denied to him he will be entitled to all the rights of a creditor.

ii Registered Debentures: Debentures which are payable only to registered holders are called registered debentures. A holders is one whose name appears both on the debenture certificate and in the company's register of debentures.

### **2. Classification according to security:**

i. **Unsecured Debentures:** These securities are also called Simple or naked debentures. Debentures which are not secured by any charge on the assets of the company are called unsecured debentures.

ii **Secured Debenture:** Debentures which are issued with a charge on the assets of the company are called secured debentures. These are also called mortgage debentures. The charge may be fixed charge or a floating charge.

### **3. Classification according to permanence:**

i **Redeemable Debentures:** Debentures which are repayable after a certain period are called redeemable debentures. On the expiry of the term of the loan.

ii Irredeemable Debentures: Those debentures which are not repayable at the end of a definite period. Usually these debentures are repayable. When the company goes into liquidation.

### **4. Classification according to convertibility:**

Convertible Debentures: These debentures are given an option to the holders to convert them into preference or equity shares at stated rates of exchange after certain period.

a. Fully convertible debentures: Fully convertible debentures are those debentures are converted into equity shares of the company.

b. Partly conversion is optional at the discretion of debenture holders.

5. Classification according to priority:

a. First debenture: These are debentures which are to be repaid in priority to other debentures.

B.Second Debenture: These are the debentures which are to be paid after the first debentures have been redeemed.

Nature of Debentures: The debenture in a company shall be moveable property and transferable.

6. Debenture v Share:

i. share are part of capital where debenture constitute a loan.

ii. Shareholders are the owners of the company whereas debenture holders are creditors of the company.

iii Shareholders enjoy voting rights whereas debenture holders do not have any voting right

iv Dividends can be paid to the share holders only out of the profits of the company but interest on debentures is payable even if there are no profits.

V Debentures generally have a charge on the assets of the company but share do not carry any such charge.

Vi The rate of interest is fixed in case of debentures where as an equity shares the dividend may vary from year-to-year.

Vii Interest on debentures gets priority over dividend on shares.