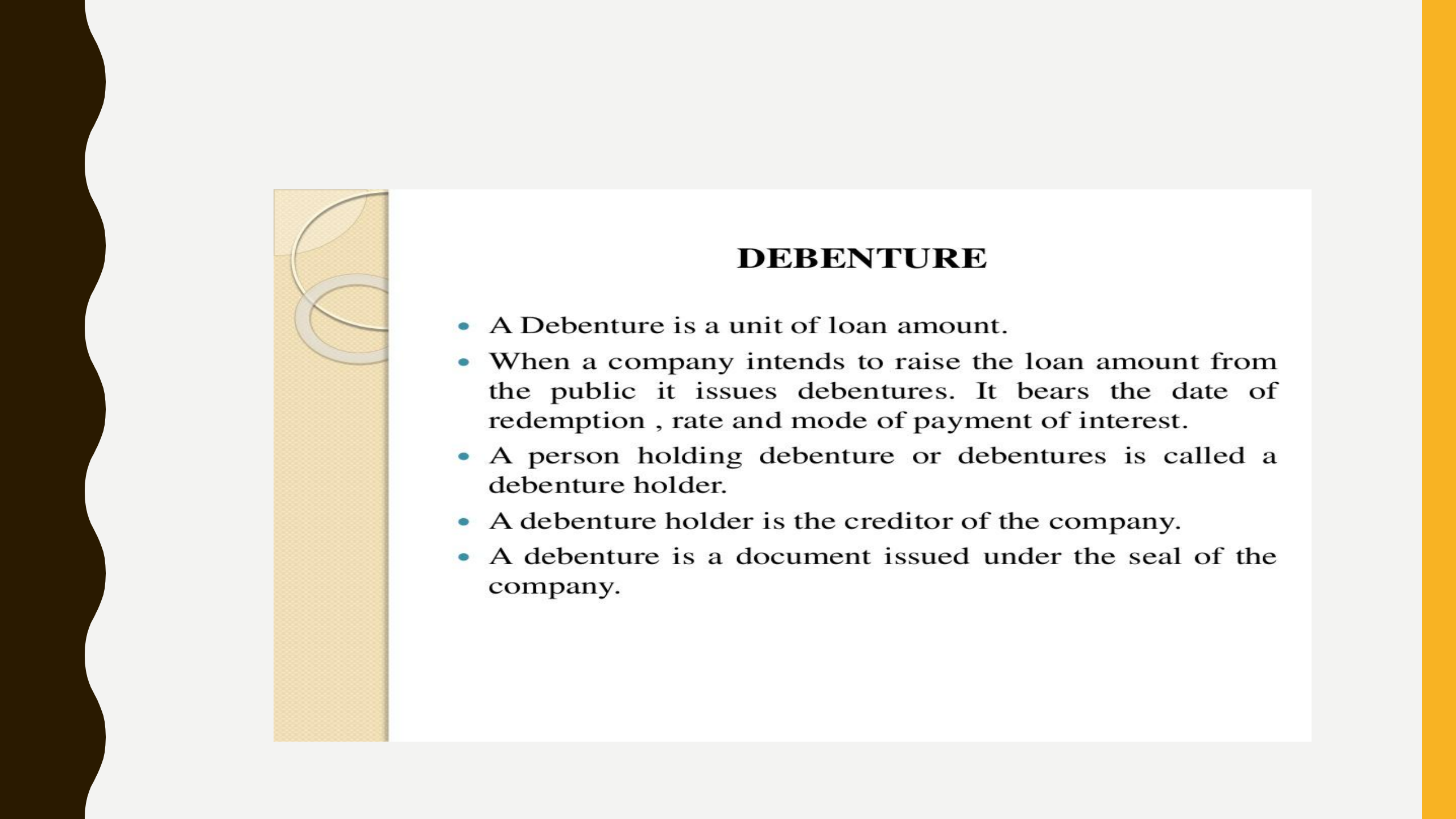


# **REDEMPTION OF DEBENTURES**

**UNIT -II**

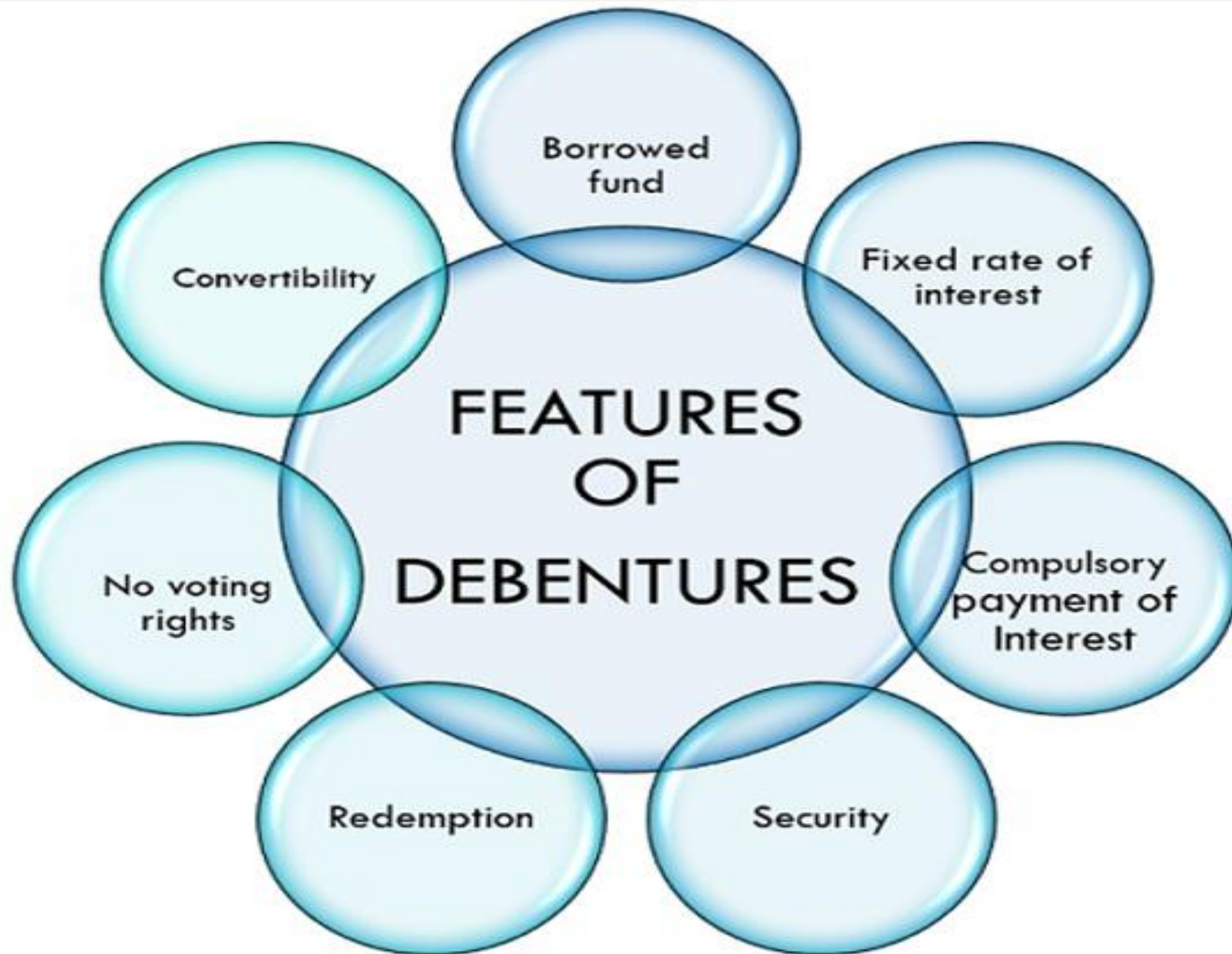


## **DEBENTURE**

- A Debenture is a unit of loan amount.
- When a company intends to raise the loan amount from the public it issues debentures. It bears the date of redemption , rate and mode of payment of interest.
- A person holding debenture or debentures is called a debenture holder.
- A debenture holder is the creditor of the company.
- A debenture is a document issued under the seal of the company.

# MEANING

- **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.





# Debentures

- Advantages to the company
  1. Lower rate of interest
  2. Trading on equity
  3. Freedom in management
  4. Tax benefits
  5. Certainty of finance
  6. Capital from moderate investor
  7. Boon during depression
  8. Controlling over-capitalization
  9. Consolidation of debt-short duration



# Disadvantage of debentures



- To the company
  1. Fixed charge on assets
  2. Fixed burden
  3. Risk of winding-up
- To the investors
  1. No control
  2. No extra profits
  3. Uncertainty

# TYPES OF DEBETURES

## REDEMPTION / TENURE

**Redeemable :** Carry a specific date of redemption on the certificate. The company is legally bound to repay the principal amount to the debenture holders on that date.

**Irredeemable :** Do not carry any date of redemption. No specific time of redemption. Redeemed either on the liquidation or as per the terms.

## CONVERTIBILITY

**Convertible :** Holders have an option of converting their holdings into equity shares. Further classified into two – Fully and Partly Convertible Debentures

**Non Convertible :** Simple debentures with no option of getting converted into equity. Their state will always remain of a debt and will not become equity at any point in time.

## SECURITY

**Secured :** Secured by the charge on some asset or set of assets. Further classified as First Mortgaged and Second Mortgaged Debenture

**Unsecured :** When it is issued solely on the credibility of the issuer. Also known as Naked Debentures.

## TRANSFERABILITY / REGISTRATION

**Registered :** The name, address, and other holding details are registered with the issuing company and the records are updated on transfer.

**Unregistered / Bearer :** Can be transferred by mere delivery to the new holder. They are considered as good as currency notes due to their easy transferability.

## TYPES OF INTEREST RATE

**Fixed :** Have fixed interest rate over the life of the debentures.

**Floating :** Have the floating rate of interest which is dependent on some benchmark rate say LIBOR, PLR etc.

## NO COUPON RATE

**Zero Coupon :** Do not carry any coupon rate. No interest would be received.

**Specific Rate :** All other debentures with a specified rate of interest.

**Secured Premium Notes :** Secured debentures which are redeemed at a premium over the face value of the debentures. These are issued at par and redeemed at the premium.

## MODE OF REDEMPTION

**Callable :** Company have the right to redeem the debentures in between at a premium to the investor.

**Puttable :** Debenture holder can ask the company to redeem their debentures and ask for principal repayment.

**Subordinated :** The debenture is given priority of payment after other debts, when a company goes into liquidation.

**Participating :** It carries interest in three phases.

| <b>BASIS FOR COMPARISON</b>          | <b>SHARES</b>                                                                 | <b>DEBENTURES</b>                                                             |
|--------------------------------------|-------------------------------------------------------------------------------|-------------------------------------------------------------------------------|
| Meaning                              | The shares are the owned funds of the company.                                | The debentures are the borrowed funds of the company.                         |
| What is it?                          | Shares represent the capital of the company.                                  | Debentures represent the debt of the company.                                 |
| Holder                               | The holder of shares is known as shareholder.                                 | The holder of debentures is known as debenture holder.                        |
| Status of Holders                    | Owners                                                                        | Creditors                                                                     |
| Form of Return                       | Shareholders get the dividend.                                                | Debenture holders get the interest.                                           |
| Payment of return                    | Dividend can be paid to shareholders only out of profits.                     | Interest can be paid to debenture holders even if there is no profit.         |
| Allowable deduction                  | Dividend is an appropriation of profit and so it is not allowed as deduction. | Interest is a business expense and so it is allowed as deduction from profit. |
| Security for payment                 | No                                                                            | Yes                                                                           |
| Voting Rights                        | The holders of shares have voting rights.                                     | The holders of debentures do not have any voting rights.                      |
| Conversion                           | Shares can never be converted into debentures.                                | Debentures can be converted into shares.                                      |
| Repayment in the event of winding up | Shares are repaid after the payment of all the liabilities.                   | Debentures get priority over shares, and so they are repaid before shares.    |
| Quantum                              | Dividend on shares is an                                                      | Interest on debentures is a                                                   |

# REDEMPTION OF DEBENTURES

- **Redemption of debentures** refers to the repayment of these **debentures** by the company to the **debenture** holders. So the company will discharge its liability and remove it from the balance sheet. This is a major transaction for the company since the amount of money involved tends to be quite significant.

## Methods of Redemption of Debentures

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graph TD; A[Methods of Redemption of Debentures] --- B[Payment in Lump Sum]; A --- C[Payment in Installments]; A --- D[Purchase in Open Market]; A --- E[Conversion into Shares or New Debentures];
```

Payment in  
Lump Sum

Payment in  
Installments

Purchase in Open  
Market

Conversion into  
Shares  
or New Debentures