VIDYA BHAWAN BALIKA VIDYA PITH

शक्ति उत्थान आश्रम लखीसराय बिहार

Class 11 commerce   Sub. BST. Date 21.01.2021

Teacher name – Ajay Kumar Sharma

Debentures

Debentures are an important instrument for raising long term debt capital. A company can raise funds through issue of debentures, which bear a fixed rate of interest. The debenture issued by a company is an acknowledgment that the company has borrowed a certain amount of money, which it promises to repay at a future date. Debenture holders are, therefore, termed as creditors of the company. Debenture holders are paid a fixed stated amount of interest at specified intervals say six months or one year. Public issue of debentures requires that the issue be rated by a credit rating agency like CRISIL (Credit Rating and Information Services of India Ltd.) on aspects like track record of the company, its profitability, debt servicing capacity, credit worthiness and the perceived risk of lending. A company can issue different types of debentures (see Box C and D). Issue of Zero Interest Debentures (ZID) which do not carry any explicit rate of interest has also become popular in recent years. The difference between the face value of the debenture and its purchase price is the return to the investor.

Merits

The merits of raising funds through debentures are given as follows:

(i) It is preferred by investors who want fixed income at lesser risk;

(ii) Debentures are fixed charge funds and do not participate in profits of the company;

(iii) The issue of debentures is suitable in the situation when the sales and earnings are relatively stable;

(iv) As debentures do not carry voting rights, financing through debentures does not dilute control of equity shareholders on management;

(v) Financing through debentures is less costly as compared to cost of preference or equity capital as the interest payment on debentures is tax deductible.

Limitations

Debentures as source of funds has certain limitations. These are given as follows:

(i) As fixed charge instruments, debentures put a permanent burden on the earnings of a company. There is a greater risk when earnings of the company fluctuate;

(ii) In case of redeemable debentures, the company has to make provisions for repayment on the specified date, even during periods of financial difficulty;

(iii) Each company has certain borrowing capacity. With the issue of debentures, the capacity of a company to further borrow funds reduces.