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Issue and Redemption of Debentures

Meaning of Debentures

Debenture: The word ‘debenture’ has been derived from a Latin word ‘debere’ which means to borrow. Debenture is a written instrument acknowledging a debt under the common seal of the company. It contains a contract for repayment of principal after a specified period or at intervals or at the option of the company and for payment of interest at a fixed rate payable usually either half-yearly or yearly on fixed dates. According, to section 2(12) of The Companies Act,1956 ‘Debenture’ includes Debenture Stock, Bonds and any other securities of a company whether constituting a charge on the assets of the company or not.

Bond: Bond is also an instrument of acknowledgement of debt. Traditionally, the Government issued bonds, but these days’ bonds are also being issued by semi-government and non-governmental organisations. The terms ‘debentures’ and ‘Bonds’ are now being used inter-changeably. Distinction between Shares and Debentures

Ownership: A shareholder is an owner of the company whereas a debenture holder is only a loan creditor. A share is a part of the owned capital whereas a debenture is a part of borrowed capital.

Return: The return on shares is known as dividend while the return on debentures is called interest. The rate of return on shares may vary from year to year depending upon the profits of the company but the rate of interest on debentures is pre-fixed. The payment of dividend is an appropriation out profits, whereas the payment of interest is a charge on profits and is to be paid even if there is no profit.

Repayment: Normally, the amount of shares is not returned during the life of the company, while the debentures are issued for a specified period and the amount of debentures is returned after that period. However, an amendment in 1998 to The Companies Act, 1956 has permitted the companies to buy back its own shares from the market, particularly, when the price of its share in the market is lower than the book value.

Voting Rights: Shareholders enjoy voting rights whereas debentureholders do not normally enjoy any voting right. Issue on Discount: Both shares and debentures can be issued at a discount.

However, shares can be issued at discount in accordance with the provisions of Section 79 of The Companies Act, 1956 which stipulates that the rate of discount must not exceed 10% of the face value.

Security : Shares are not secured by any charge whereas the debentures are generally secured and carry a fixed or floating charge over the assets of the company.

Convertibility: Shares cannot be converted into debentures whereas debentures can be converted into shares if the terms of issue so provide, and in that case these are known as convertible debentures