

Debenture

**Meaning of Debenture:**

In addition to raising capital by issuing shares, a company requiring long-term funds may borrow money by issuing debentures. A debenture issued by a company is usually in the form of a certificate, given under the seal of the company. It is a written acknowledgment of a debt taken by the company and is issued under the seal of the company.

A debenture certificate contains the terms of the repayment of the principal sum on a specified date and the terms of payment of interest at a fixed rate.

**Characteristics or Features of Debentures:**

**Written Acknowledgment of Debt:**

A debenture is issued by a company in the form of a certificate, which is a written acknowledgment of the debt taken by the company.

**Issued Under Company Seal:**

A debenture is issued under the seal of the company, making it a formal and legally binding document.

**Repayment Contract:**

It contains a contract for the repayment of the principal sum at a specified date.

**Maturity Date:**

As per the Companies Act 2013, no company is allowed to issue debentures having a maturity date of more than 10 years from the date of issue. However, a company engaged in infrastructure projects can issue debentures for more than 10 years but not exceeding 30 years.

**Coupon Rate:**

Usually, debentures are issued with a specified rate of interest, known as the 'Coupon Rate'. A debenture holder receives interest on their debentures at this specified rate, as mentioned in the certificate. Payment of interest is typically made every six months, whether the company makes a profit or not.

**Secured by Company Assets:**

A debenture is generally secured by a charge on the assets of the company. This means that if the company is unable to repay the debentures as per the terms of issue, the debenture holders can move the court and realize their money by selling the assets of the company.



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### Long-Term Nature:

Funds raised by issuing debentures are of a long-term nature, and usually, the debentures are repaid after a long period, such as seven, ten, or twelve years. As such, the loan raised by the issue of debentures is also called 'Loan Capital'.

### Types or Kinds of Debentures:

#### Secured or Mortgage Debentures:

- These debentures are secured either on particular assets of the company (fixed charge) or on all assets of the company in general (floating charge). Fixed charge restricts the company from dealing with mortgaged assets, whereas floating charge allows the company to use the assets.
- If the company cannot repay the debentures on the due date, the debenture holders can realize their money from the mortgaged assets.
- First mortgage debentures have the first claim on the charged assets, and second mortgage debentures have the second claim. In India, debentures are necessarily secured.

#### Unsecured or Naked Debentures:

These debentures are not given any security. The holders of such debentures are treated as unsecured creditors during the liquidation of the company. Such debentures are not very common nowadays, so unless otherwise stated, a debenture is presumed to be secured.

#### Registered Debentures:

Names and addresses of the holders of these debentures are recorded in the company's register called the "Register of Debentureholders." These debentures are not freely transferable. The principal amount and interest on such a debenture are paid to the person whose name appears in the company's register.

#### Bearer Debentures:

Names and addresses of the holders of these debentures are not recorded in the company, and these debentures are transferable by delivery. Payment of principal and interest is made to the bearer of such debentures. Coupons are attached to these debentures, and interest is paid to the person who produces the coupons at the specified bank.

#### Redeemable Debentures:

These debentures are repaid by the company either in lump sum at the end of a specified period or by installments during the lifetime of the company. Most debentures are generally of this type.



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**Irredeemable or Perpetual Debentures:**

These debentures are not repayable by the company during its lifetime and are repayable only at the time of the company's liquidation.

**Solved example**

**Ques 1:** XYZ Ltd. issued 1,000 debentures of Rs. 100 each at 10% annual interest. Calculate the interest payable at the end of the year if all debentures are issued at par.

- Issue Date: January 1, 2023
- Maturity Period: 5 years
- Interest Rate: 10% annually

Calculate the interest payable by XYZ Ltd. at the end of the first year.

**Solution:** we need to calculate the annual interest payable by XYZ Ltd. on the debentures issued.

Here are the details provided:

Number of Debentures Issued: 1,000  
Face Value of Each Debenture: Rs. 100  
Interest Rate: 10% annually

Calculation:

Total Amount of Debentures Issued:  
Total Amount = Number of Debentures × Face Value per Debenture

Total Amount = 1,000 × 100

Total Amount = Rs. 1,00,000

Annual Interest Payable:

Annual Interest = Total Amount × Interest Rate

Annual Interest = 1,00,000 × 10%

Annual Interest = 1,00,000 × 0.10

Annual Interest = Rs. 10,000

Conclusion:

The interest payable by XYZ Ltd. at the end of the first year is Rs. 10,000.

**Assignment**

**Ques 1:** ABC Ltd. issued 2,000 secured debentures of Rs. 500 each at a 12% annual interest rate. The company pays interest semi-annually. Calculate the interest payable after six months.

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- Issue Date: April 1, 2023
- Interest Rate: 12% annually
- Interest Payment Frequency: Semi-annually

Determine the interest payable by ABC Ltd. after the first six months.

**Ques 2:** LMN Ltd. issued 5,000 unsecured debentures of Rs. 200 each at an 8% annual interest rate. If the debentures are issued at a discount of 5%, calculate the total amount raised and the annual interest payable.

- Issue Date: July 1, 2023
- Discount Rate: 5%
- Interest Rate: 8% annually

Calculate:

- The total amount raised by LMN Ltd.
- The annual interest payable on the issued debentures.

**Ques 3:** PQR Ltd. issued 3,000 debentures of Rs. 1,000 each at a 9% annual interest rate, payable quarterly. Calculate the interest payable each quarter.

- Issue Date: October 1, 2023
- Interest Rate: 9% annually
- Interest Payment Frequency: Quarterly

Determine the interest payable by PQR Ltd. each quarter.



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