Chapter 2: Sources of Corporate Finance

EXERCISE Q.1 [PAGES 34 - 37]

Exercise 1 | Q 1.01 | Page 34

Select the correct answer from the options given below and rewrite the statement.
______ is a smallest unit in the total share capital of the company.

1. Debenture
2. Bonds
3. **Share**

SOLUTION

Share is a smallest unit in the total share capital of the company.

Exercise 1 | Q 1.02 | Page 34

Select the correct answer from the options given below and rewrite the statement.
The benefit of Depository Receipt is ability to raise capital in ______ market.

1. National
2. Local
3. **International**

SOLUTION

The benefit of Depository Receipt is ability to raise capital in **International** market.

Exercise 1 | Q 1.03 | Page 34

Select the correct answer from the options given below and rewrite the statement.
______ are residual claimants against the income or assets of the company.

1. Bondholders
2. **Equity Shareholders**
3. Debenture holders

SOLUTION

Equity Shareholders are residual claimants against the income or assets of the company.

Exercise 1 | Q 1.04 | Page 34

Select the correct answer from the options given below and rewrite the statement.
______ participate in the management of their company

1. Preference shareholders
2. Depositors
3. **Equity shareholders**

SOLUTION

Equity shareholders participate in the management of their company

Exercise 1 | Q 1.05 | Page 34

Select the correct answer from the options given below and rewrite the statement.

______ shares are issued free of cost to existing equity shareholders.

1. **Bonus**
2. Right
3. Equity

SOLUTION

Bonus shares are issued free of cost to existing equity shareholders.

Exercise 1 | Q 1.06 | Page 34

Select the correct answer from the options given below and rewrite the statement.

The holder of preference share has right to receive ______ rate of divided.

1. **fixed**
2. fluctuating
3. lower

SOLUTION

The holder of preference share has right to receive **fixed** rate of divided.

Exercise 1 | Q 1.07 | Page 34

Select the correct answer from the options given below and rewrite the statement.

Accumulated dividend is paid to ______ preference shares.

1. redeemable
2. **cumulative**
3. convertible

SOLUTION

Accumulated dividend is paid to **cumulative** preference shares.

Exercise 1 | Q 1.08 | Page 34

Select the correct answer from the options given below and rewrite the statement.

The holder of ______ preference shares have right to convert their shares into equity shares.

1. cumulative
2. **convertible**
3. redeemable

SOLUTION

The holder of **convertible** preference shares have right to convert their shares into equity shares.

Exercise 1 | Q 1.09 | Page 34

Select the correct answer from the options given below and rewrite the statement.

Debenture holders are ______ of the company.

1. **creditors**
2. owners
3. suppliers

SOLUTION

Debenture holders are **creditors** of the company.

Exercise 1 | Q 1.10 | Page 34

Select the correct answer from the options given below and rewrite the statement.

______ is paid on borrowed capital.

1. **Interest**
2. Discount
3. Dividend

SOLUTION

Interest is paid on borrowed capital.

Exercise 1 | Q 1.11 | Page 34

Select the correct answer from the options given below and rewrite the statement.

Debenture holders get fixed rate of ______ as return on their investment.

1. **Interest**
2. Dividend
3. Discount

SOLUTION

Debenture holders get fixed rate of **Interest** as return on their investment.

Exercise 1 | Q 1.12 | Page 34

Select the correct answer from the options given below and rewrite the statement.

Convertible debentures are converted into ______ after a specific period.

1. **equity shares**
2. deposits
3. bonds

SOLUTION

Convertible debentures are converted into **equity shares** after a specific period.

Exercise 1 | Q 1.13 | Page 34

Select the correct answer from the options given below and rewrite the statement.

Retained earnings are ______ source of financing.

1. **internal**
2. external
3. additional

SOLUTION

Retained earnings are **internal** source of financing.

Exercise 1 | Q 1.14 | Page 34

Select the correct answer from the options given below and rewrite the statement.
The holder of bond is ______ of the company.

1. secretary
2. owner
3. **creditor**

SOLUTION

The holder of bond is **creditor** of the company.

Exercise 1 | Q 1.15 | Page 34

Select the correct answer from the options given below and rewrite the statement.
Company can accept deposits from public, minimum for ______ months.

1. **six**
2. nine
3. twelve

SOLUTION

Company can accept deposits from public, minimum for **six** months.

Exercise 1 | Q 1.16 | Page 35

Select the correct answer from the options given below and rewrite the statement.
Company can accept deposits from public, maximum for ______ months.

1. 12
2. 24
3. **36**

SOLUTION

Company can accept deposits from public, maximum for **36** months.

Exercise 1 | Q 1.17 | Page 35

Select the correct answer from the options given below and rewrite the statement.
A depository receipt traded in ______ is called American Depository receipt.

1. London
2. Japan
3. **U.S.A**

SOLUTION

Company can accept deposits from public, maximum for **U.S.A** months.

Exercise 1 | Q 2 | Page 35

Match the pairs.

Group 'A'	Group 'B'
a) Equity Share Capital	1) Agreement
b) Debenture Trustees	2) Capitalisation of Profit
c) Preference Shareholders	3) Bold Investor
d) Debenture Certificate	4) Venture Capital
e) Bonus Shares	5) Document of Ownership
	6) Capitalisation of Loan
	7) Safe Capital
	8) Instrument of Debt
	9) Trust Deed
	10) Cautious Investor

SOLUTION

Group 'A'	Group 'B'
a) Equity Share Capital	1) venture Capital
b) Debenture Trustees	2) Trust Deed
c) Preference Shareholders	3) Cautious Investor
d) Debenture Certificate	4) instruments of debt
e) Bonus Shares	5) Capitalisation of profit

Exercise 1 | Q 3.01 | Page 35

Write a word or a term or a phrase which can substitute the following statement.
The ‘real masters’ of the company.

SOLUTION

The ‘real masters’ of the company. - **Equity shareholders**

Exercise 1 | Q 3.02 | Page 35
Write a word or a term or a phrase which can substitute the following statement.
A document of title of ownership of shares.

SOLUTION

A document of title of ownership of shares. - **Share Certificate**

Exercise 1 | Q 3.03 | Page 35
Write a word or a term or a phrase which can substitute the following statement.
The holders of these shares are entitled to participate in the surplus profit.

SOLUTION

The holders of these shares are entitled to participate in the surplus profit.
- **Participating Preference Shares**

Exercise 1 | Q 3.04 | Page 35
Write a word or a term or a phrase which can substitute the following statement.
A party through whom the company deals with debenture holders.

SOLUTION

A party through whom the company deals with debenture holders. - **Debenture trustees**

Exercise 1 | Q 3.05 | Page 35
Write a word or a term or a phrase which can substitute the following statement.
Name the shareholders who participate in the management.

SOLUTION

Name the shareholders who participate in the management. - **Equity Shareholders**

Exercise 1 | Q 3.06 | Page 35
Write a word or a term or a phrase which can substitute the following statement.
The value of share which is written on the share certificate.

SOLUTION

The value of share which is written on the share certificate. - **Face value**

Exercise 1 | Q 3.07 | Page 35
Write a word or a term or a phrase which can substitute the following statement.
The value of share which is determined by demand and supply forces in the share market.

SOLUTION

The value of share which is determined by demand and supply forces in the share market. - **Market Value**

Exercise 1 | Q 3.08 | Page 35

Write a word or a term or a phrase which can substitute the following statement.
The value of share which is determined by demand and supply forces in the share market.

SOLUTION

The value of share which is determined by demand and supply forces in the share market. - **Retained earnings**

Exercise 1 | Q 3.09 | Page 35

Write a word or a term or a phrase which can substitute the following statement.
It is an acknowledgement of loan issued by company to depositor.

SOLUTION

It is an acknowledgement of loan issued by company to depositor. - **Deposit Receipt**

Exercise 1 | Q 3.10 | Page 35

Write a word or a term or a phrase which can substitute the following statement.
A Dollar denominated instrument traded in USA.

SOLUTION

A Dollar denominated instrument traded in USA. - **American Depository Receipt (A.D.R.)**

Exercise 1 | Q 3.11 | Page 35

Write a word or a term or a phrase which can substitute the following statement.
The Depository Receipt traded in country other than the USA.

SOLUTION

The Depository Receipt traded in country other than USA. - **Global Depository Recipient (G.D.R.)**

Exercise 1 | Q 3.12 | Page 35

Write a word or a term or a phrase which can substitute the following statement.
Money raised by company from public for minimum 6 months to maximum 36 months.

SOLUTION

Money raised by company from public for minimum 6 months to maximum 36 months. - **Public Deposits**

Exercise 1 | Q 3.13 | Page 35

Write a word or a term or a phrase which can substitute the following statement.
Credit extended by the suppliers with an intention to increase their sales.

SOLUTION

Credit extended by the suppliers with an intention to increase their sales. - **Trade Credit**

Exercise 1 | Q 3.14 | Page 35

Write a word or a term or a phrase which can substitute the following statement.
The credit facility provided to a company having current account with bank.

SOLUTION

The credit facility provided to a company having current account with bank. - **Overdraft**

Exercise 1 | Q 4.1 | Page 35

State whether the following statement is true or false.
Equity share capital is known as venture capital.

1. **True**
2. False

SOLUTION

Equity share capital is known as venture capital. - **True**

Exercise 1 | Q 4.2 | Page 35

State whether the following statement is true or false.
Equity shareholders enjoy fixed rate of dividend.

1. True
2. **False**

SOLUTION

Equity shareholders enjoy fixed rate of dividend. - **False**

Exercise 1 | Q 4.3 | Page 35

State whether the following statement is true or false.
Equity shareholders are described as ‘shock absorber’ when company has financial crisis.

1. **True**
2. False

SOLUTION

Equity shareholders are described as ‘shock absorber’ when company has financial crisis. - **True**

Exercise 1 | Q 4.4 | Page 36
State whether the following statement is true or false.
Debenture holders have right to vote at general meeting of the company.

1. True
2. **False**

SOLUTION

Debenture holders have right to vote at general meeting of the company. - **False**

Exercise 1 | Q 4.5 | Page 36
State whether the following statement is true or false.
Bond holders are owners of the company.

1. True
2. **False**

SOLUTION

Bond holders are owners of the company. - **False**

Exercise 1 | Q 4.6 | Page 36
State whether the following statement is true or false.
Depository bank stores the shares on behalf of GDR holder.

1. **True**
2. False

SOLUTION

Depository bank stores the shares on behalf of GDR holder. - **True**

Exercise 1 | Q 4.7 | Page 36
State whether the following statement is true or false.
Financial institutions underwrite the issue of securities.

1. **True**
2. False

SOLUTION

Financial institutions underwrite the issue of securities. - **True**

Exercise 1 | Q 4.8 | Page 36
State whether the following statement is true or false.
Cash credit is given against hypothecation of goods or any security

1. **True**
2. False

SOLUTION

Cash credit is given against hypothecation of goods or any security. – **True**

Exercise 1 | Q 4.9 | Page 36

State whether the following statement is true or false.

Trade credit is major source of long term finance.

1. True
2. **False**

SOLUTION

Trade credit is major source of long term finance. - **False**

Exercise 1 | Q 5.1 | Page 36

Find the odd one.

1. Debenture
2. Public deposit
3. **Retained earnings**

SOLUTION

Retained earnings

Exercise 1 | Q 5.2 | Page 36

Find the odd one.

1. Face value
2. Market value
3. **Redemption value**

SOLUTION

Redemption value

Exercise 1 | Q 5.3 | Page 36

Find the odd one.

1. Share Certificate
2. Debenture Certificate
3. **ADR**

SOLUTION

ADR

Exercise 1 | Q 5.4 | Page 36

Find the odd one.

1. **Trade Credit**
2. Overdraft
3. Cash Credit

SOLUTION

Trade Credit

Exercise 1 | Q 6.1 | Page 36
Complete the sentence.
The finance needed by business organisation is termed as ______

SOLUTION

The finance needed by business organisation is termed as **Capital**

Exercise 1 | Q 6.2 | Page 36
Complete the sentence.
The convertible preference share holders have a right to convert their shares into ______

SOLUTION

The convertible preference share holders have a right to convert their shares into **Equity shares.**

Exercise 1 | Q 6.3 | Page 36
Complete the sentence.
Equity shareholders elect their representatives called ______

SOLUTION

Equity shareholders elect their representatives called **Board of Directors.**

Exercise 1 | Q 6.4 | Page 36
Complete the sentence.
Bonus shares are issued as gift to ______

SOLUTION

Bonus shares are issued as gift to **Equity shareholders.**

Exercise 1 | Q 6.5 | Page 36
Complete the sentence.
The bond holders are ______ of the company.

SOLUTION

The bond holders are **creditors** of the company.

Exercise 1 | Q 6.6 | Page 36
Complete the sentence.
Depository receipt traded in a country other than USA is called ______

SOLUTION

Depository receipt traded in a country other than USA is called **Global Depository Receipt.**

Exercise 1 | Q 6.7 | Page 36

Complete the sentence.

First Industrial policy was declared in the year ______

SOLUTION

First Industrial policy was declared in the year **1948**

Exercise 1 | Q 6.8 | Page 36

Complete the sentence.

When goods are delivered by supplier to customer on basis of deferred payment it is called as ______

SOLUTION

When goods are delivered by supplier to customer on basis of deferred payment it is called as **Trade Credit.**

Exercise 1 | Q 7 | Page 36

Select the correct option from the bracket.

Group 'A'	Group B'
a) Equity shares	1) ____________
b) ____________	2) Dividend at fixed rate
c) Debentures	3) ____________
d) ____________	4) Accumulated corporate profit
e) Public Deposit	5) ____________

(Fluctuating rate of dividend, Preference shares, Interest at fixed rate, Retained earnings, Short term loan)

SOLUTION

Group 'A'	Group B'
a) Equity shares	1) **Fluctuating rate of Dividend**
b) **Preference shares**	2) Dividend at fixed rate
c) Debentures	3) **Interest at fixed rate**
d) **Retained earnings**	4) Accumulated corporate profit

e) Public Deposit	5) **Short term loan**

Exercise 1 | Q 8.01 | Page 36
Answer in one sentence.
What is a share?

SOLUTION

Share is the smallest unit of the capital of the company.

Exercise 1 | Q 8.02 | Page 36
Answer in one sentence.
What are Equity Shares?

SOLUTION

Equity shares are ordinary shares which are not preference shares. Equity share is a risky capital.

Exercise 1 | Q 8.03 | Page 37
Answer in one sentence.
What are preference shares?

SOLUTION

Preference shares are those shares which carry preferential rights to receive dividend and return of capital.

Exercise 1 | Q 8.04 | Page 37
Answer in one sentence.
What are retained earnings?

SOLUTION

Retained earnings are the earnings of the company which are retained (reinvested) in the business.

Exercise 1 | Q 8.05 | Page 37
Answer in one sentence.
What is a debenture?

SOLUTION

Debenture means acknowledgment of debt. Debenture is a borrowed capital.

Exercise 1 | Q 8.06 | Page 37
Answer in one sentence.
What is a bond?

SOLUTION

Bond is an interest bearing certificate issued by the government.

Exercise 1 | Q 8.07 | Page 37
Answer in one sentence.
In which country can ADR be issued?

SOLUTION

American Depository Receipt (ADR) can be issued in USA.

Exercise 1 | Q 8.08 | Page 37
Answer in one sentence.
In which country can GDR be issued?

SOLUTION

Global Depository Receipt (GDR) can be issued in any country other than USA.

Exercise 1 | Q 8.09 | Page 37
Answer in one sentence.
What are convertible debentures?

SOLUTION

The debentures which are converted into equity shares are known as convertible debentures.

Exercise 1 | Q 8.10 | Page 37
Answer in one sentence.
What are cumulative preference shares?

SOLUTION

Cumulative preference shares are those shares on which dividend goes on accumulating (adding).

Exercise 1 | Q 9.1 | Page 37
Correct the underlined word and rewrite the following sentence.
Owned capital is temporary capital.

SOLUTION

Owned capital is **permanent** capital.

Exercise 1 | Q 9.2 | Page 37
Correct the underlined word and rewrite the following sentence.
Equity shares get dividend at fixed rate.

SOLUTION

Equity shares get dividend at **fluctuating** rate.

Exercise 1 | Q 9.3 | Page 37

Correct the underlined word and rewrite the following sentence.

Preference shares get dividend at fluctuating rate.

SOLUTION

Preference shares get dividend at **fixed** rate.

Exercise 1 | Q 9.4 | Page 37

Correct the underlined word and rewrite the following sentence.

Retained earnings is an external source of finance.

SOLUTION

Retained earnings is an **internal** source of finance.

Exercise 1 | Q 9.5 | Page 37

Correct the underlined word and rewrite the following sentence.

Debenture holder is owner of the company

SOLUTION

Debenture Holder is **creditor** of the company.

Exercise 1 | Q 9.6 | Page 37

Correct the underlined word and rewrite the following sentence.

Bond is a source of short term finance.

SOLUTION

Bond is a source of **long** term finance.

Exercise 1 | Q 9.7 | Page 37

Correct the underlined word and rewrite the following sentence.

Depository Receipt traded in USA is called as Global Depository Receipt.

SOLUTION

Depository Receipt traded in USA is called as **American Depository Receipt.**

EXERCISE 2 [PAGE 37]

Exercise 2 | Q 1 | Page 37

Explain the following term/concept.

Borrowed Capital

SOLUTION

(a) Borrowed capital is that capital that is borrowed from creditors. It is also known as debt capital. Interest has to be paid on borrowed capital whether the company makes a profit or not.

(b) The company borrows capital when the owned capital is not sufficient. The company can raise borrowed capital in the form of: Debentures, Public Deposits, Bonds, etc.

Exercise 2 | Q 2 | Page 37
Explain the following term/concept.
Owned capital

SOLUTION

(a) The capital raised by the company with the help of owners (shareholders) is called owned capital or ownership capital. Owned capital is regarded as permanent capital, as it is returned only at the time of winding up of the company.

(b) Owned capital can be raised in the form of Shares, i.e, Equity and Preference Shares, and Retain Earning.

Exercise 2 | Q 3 | Page 37
Explain the following term/concept.
Ploughing back of profit

SOLUTION

(a) Retained earnings are the earnings of the company which are retained (reinvested) in the business. The sum of those profits accumulated over years is re-invested in the business, rather than distributing it as a dividend to shareholders.

(b) It is the simple and cheapest method of raising funds. It is an important source of internal financing. Thus, it is also known as 'Self Financing' or 'Ploughing Back of Profits'.

Exercise 2 | Q 4 | Page 37
Explain the following term/concept.
Overdraft

SOLUTION

(a) An overdraft implies only to the existing current account holder. Therefore, it is a credit facility granted by a bank to current account holders. Under an overdraft facility, the bank allows its customer to overdraw an amount, up to a particular limit, i.e. to withdraw more than the amount of credit balance in his current account.

(b) Generally, a low rate of interest is charged by bank, and collateral securities usually accepted for an overdraft facility.

Exercise 2 | Q 5 | Page 37

Explain the following term/concept.

Trade credit

SOLUTION

(a) Trade Credit refers to the facilities or credit extended by the manufacturer, wholesalers, and suppliers of goods to the purchaser but receives payment after the credit period from the date of purchase. Manufacturers, wholesalers, and suppliers of goods or materials are called Trade Creditors'.

(b) This practice is done by a business concern with an intention to increase its sales or turnover, generate additional business and maintain good relations with the purchasers.

EXERCISE 3 [PAGE 37]

Exercise 3 | Q 1 | Page 37

Study the following case/situation and express your opinion.

The Balance-sheet of a Donald Company for the year 2018-19 reveals equity share capital of Rs. 25,00,000 and retained earnings of Rs. 50,00,000.

a. Is the company financially sound?
b. Can the retained earnings be converted into capital?
c. What type of source retained earning is?

SOLUTION

a. As per the Balance Sheet of a Donald Company, it has sufficient equity share capital and retained earnings. Thus, the company is financially sound. There is no financial problem of the company.

b. Yes. the Company has a sufficient amount of retained earnings. Therefore, the retained earnings of the company can be converted into capital.

c. Retained earnings is owned or internal source of financing. Every year the company keeps aside some part reserve out of profit which is used by the company. Thus, retained earnings is also known as 'ploughing back of profit.

Exercise 3 | Q 2 | Page 37

Study the following case/situation and express your opinion.

Mr. Satish is a speculator. He desires to take advantage of growing market for company's product and earn handsomely

a. According to you which type of share Mr. Satish will choose to invest?
b. What does he receive as return on investment?
c. State any one right which he will enjoy as a shareholder.

SOLUTION

a. According to me, Mr. Satish should invest in Equity shares. So that he can take the overall benefit of the profits and also enjoy all the rights and can participate in the management of the company.

b. He may receive the dividend as a return on investment. But, the dividend received by the equity shareholder is fluctuating. It depends on the profit of the company.

c. The right which he will enjoy as a shareholder are as follows:

   Right to vote: It is the basic right of equity shareholders through which they elect directors, alters Memorandum and Articles of Association, etc.

   Right to share in profit: It is an important right of equity shareholders. They have the right to share in profit when distributed as dividends.
   Right to inspect books: Equity shareholders have the right to inspect statutory books of their company.

   Right to transfer shares: Equity shareholders enjoy the right to transfer the shares as per the procedure laid down in the Articles of Association.

EXERCISE 4 [PAGE 38]

Exercise Q.4 | Q 1 | Page 38

Distinguish between the following.
Equity shares and Preference shares.

SOLUTION

Equity Shares	Preference Shares
1. Meaning: Equity shares have no priority right while receiving dividend and repayment of capital at the time of winding up of the company.	Preference shares carry preferential right in respect of dividend payment and repayment of capital in winding up of the company.
2. Rate of dividend: Equity share holders are given dividends at fluctuating rates depending upon the profits of the company.	Preference share holders get dividends at fixed rate.

3. Voting right: Equity shareholders enjoy normal voting rights. They participate in the management of their company.	Preference shareholders do not enjoy normal voting rights They can vote only on matters affecting their interest.
4. Nature of capital: Equity share capital is permanent capital. It is known as 'Risk capital'.	Preference share capital is 'safe capital' with stable retum.
5. Nature of investor: Investors who are ready to take the risk to invest in equity shares.	To get an immediate return, an investor invests in working capital. Investor gets comparatively less return.
6. Face value: The face value of equity shares is generally Rs. 1/- or Rs. l0/- It is relatively low	The face value of preference shares is relatively higher i.e. Rs.100/- and so on
7. Types: **Equity shares are classified into** a) equity shares with normal voting right b) equity shares with differential voting right	**Preference shares are classified as** a) Cumulative preference shares b) Non-cumulative preference shares c) Convertible preference shares. d) Non-convertible preference shares e) Redeemable preference shares. f) Irredeemable preference shares. g) Participating preference shares h) Non-participating preference shares
8. Benefit of right shares and bonus shares: Equity shareholder is entitled to get the right shares and bonus shares.	Preference shareholders are not eligible for the right shares and bonus shares.
9. Capital appreciation: The market value of equity shares increases with the prosperity of the company. It leads to an increase in the Value of shares.	The market value of preference shares does not fluctuate. So there is no possibility of capital appreciation.
10. Risk: Equity shares are subject to higher risk. That is because of the	Preference shares are subject to less risk. It is because of the fix rate of dividends

fluctuating rate of dividend and no guarantee of refund of capita	and preferential rights as regards dividend and repayment of capital.

Exercise 4 | Q 2 | Page 38

Distinguish between the following.
Share and Debenture.

SOLUTION

Shares	Debentures
1. Meaning: It is the smallest unit in the total share capital of the company.	A debenture is an instrument under seal evidencing the debt.
2. Nature It is permanent capital. It is not repaid during the lifetime of the company.	It is a temporary capital. Generally, it is repaid after a specific period.
3. Status: Share capital is ownership capital. A shareholder is the owner of the company.	Debenture capital is borrowed / loan capital. A debenture holder is a creditor of the company.
4. Voting rights: Shareholder being owner enjoys voting rights. Shareholders participate in the management of the company.	The debenture holder being the company's creditor does not have any Voting rights. He cannot participate in the management of the company.
5. Return on investment: Shareholders are paid a dividend. Equity shareholders receive a dividend at a fluctuating rate whereas preference shareholders receive a dividend at a fixed rate.	Debenture holders are paid interest at fixed rate. Interest is paid even when the company has no profit.
6. Security: Share capital is unsecured capital. No Security is offered to the shareholder.	Debenture capital being loan capital is secured by creating a charge on its property.
7. Time of issue: Shares are issued in the initial stage of the company.	Debentures can be issued at the later stage when the company has securities to offer.

8. Types: Shares are classified into two: a) Equity shares b) Preference shares	Debentures are classified as a) Registered debentures b) Bearer debentures. c) Secured debentures d) Unsecured debentures e) Redeemable debentures t) Irredeemable debentures g) Convertible debentures h) Non-convertible debentures.
9. Position on liquidation: On liquidation of a company, shareholders rank last in the list of claimants.	Debenture holders being creditors rank prior to shareholders for repayment on liquidation of the company.
10. Suitability: Shares are suitable for long term finance.	Debentures are suitable for medium-term finance.

Exercise 4 | Q 3 | Page 38

Distinguish between the following.
Owned capital and borrowed capital.

SOLUTION

Owned Capital	Borrowed Capital
1 Meaning: It is that capital that is contributed by shareholders.	It is that capital is borrowed from creditors. It is also known as debt capital.
2. Sources: This capital is collected by issue of equity shares and preference shares.	It is collected by way of issue of debentures, fixed deposits, a loan from a bank/financial institution, etc.
3. Return on Investment: The shareholders get dividends as income on their investment. The rate of dividend is fluctuating in the case of equity shares but fixed in the case of preference shares.	The debt capital holders get interested as income on their investment. Interest is paid at a fixed rate.

4. Status: The shareholders are owners of the company.	The debt holders are creditors of the company
5. Voting right: The equity shareholders enjoy normal voting right at the general meeting.	The creditors do not enjoy voting rights at the general meeting.
6. Repayment of Capital: The shareholders do not enjoy priority over creditors. They are eligible for repayment of Capital only after making payment to creditors at the time of winding up of the company.	The creditors get priority over the shareholders in case of return of the principal amount at the time of winding up of the company.
7. Charge on assets: The shareholders do not have any charge on the assets of the company.	The secured debenture holders have a charge on assets of the company.

EXERCISE 5 [PAGE 38]

Exercise 5 | Q 1 | Page 38

Answer in brief.

What is public deposit?

SOLUTION

a. Public deposits are an important source of financing short term requirements of a company. When companies generally receive deposits from the public for the period ranging from 6 months to 36 months, it is known as Public Deposits'.
b. Under this method, the general public is invited to deposit their savings with the company for a varied period. Interest is paid by companies on such deposits. The rate of interest is higher than those allowed by commercial banks.
c. The company issues 'Deposit Receipt to the depositor. The term deposit is mentioned in the Deposit Receipt'. A deposit Receipt is an acknowledgement of the debt by the company.
   Deposits are unsecured loans offered to the company.
d. It is considered a risky investment but investors can earn a high return on public deposits. Deposits are either secured or unsecured loans offered by the company.

Exercise 5 | Q 2 | Page 38
Answer in brief.
What is Global Depository Receipt?

SOLUTION

a. Global Depository Receipt (GDR) is an instrument in which a company located in a domestic country issues one or more of its shares or convertible bonds outside the domestic country.

b. The issue of Global Depository Receipt is one of the most popular ways to tap the global equity markets. A company can raise foreign currency funds by issuing equity shares in a foreign country.

c. Indian company issues shares to an intermediary called Depository'. This depository bank issues GDR to investors against these shares.

d. The GDR represents a fixed number of shares. This GDR is then sold to people in a foreign country. The GDR is traded like regular shares. The prices fluctuate depending upon demand and supply and it is listed on a stock exchange.

e. **The exchange on which GDR is traded are as follows:**

 • London Stock Exchange
 • Luxembourg Stock Exchange
 • NASDAQ
 • Singapore Stock Exchange
 • Hong Kong Stock Exchange

- **Following are the advantages of GDRs:**

  (a) GDR provides access to foreign capital markets.
  (b) A company can get itself registered on an overseas stock exchange or over the counter and its shares can be traded in more than one currency.
  (c) GDR increases the shareholders base of the company,
  (d) With GDR, the non-residents can invest in shares of the foreign company. It can be freely transferred.

- **Following are the disadvantages of GDRs:**
  (a) Violating any regulation can lead to serious consequences against the company.
  (b) Dividends are paid in domestic countries' currency which is subject to volatility in the forex market.
  (c) It is mostly beneficial to High Net Worth Individual (HNI) investors due to their capacity to invest a high amount in GDR.
  (d) GDR is one of the expensive sources of finance.

Exercise 5 | Q 3 | Page 38

Answer in brief.
What is trade credit?

SOLUTION

1. Trade Credit refers to the facilities or credit extended by the manufacturer, wholesalers, and suppliers of goods to the purchaser but receives payment after the credit period from the date of purchase.

2. Trade credit is not a cash loan. It results from a credit sale of goods/services, which has to be paid at a future date after the sales take place.

3. This practice is done by a business concern with an intention to increase its sales or turnover, generate additional business and maintain a good relationship with the purchasers.

4. Suppliers sell the goods and allow 30 days or more for the bill to be paid. They even offer a discount, if bills are cleared with 30 days.

Following are the advantages of Trade Credit:

A. It is the cheapest and easiest method of raising short term finance. The terms and conditions are not rigid, i.e, they are flexible.

B. The supplier (creditor) is able to generate a higher volume of sales. The flexibility in purchasing encourages customers to make larger purchases when prices are right.

C. Trade credit allows the purchasers to place purchase orders without the need to pay upfront. This allows purchasers to use funds to pay long term debts and other critical payments.

D. Trade credit has no cost involved, no interest is payable for using the credit.

E. Due to the business relationship involved, the terms and conditions attached to trade credit are simple and not rigid. Also, there is no need for an agreement for trade credit.

Exercise 5 | Q 4 | Page 38

Answer in brief.

What are the schemes for disbursement of credit by bank?

SOLUTION

(a) Commercial banks play an important role in providing short term finance to business concerns. They have become the primary source of financing working capital of the business.

(b) In India, the primary source of financing working capital is bank credit and trade credit.

(c) Commercial bank assists corporate enterprises:
• By granting term loans to companies
• By underwriting the issue of securities of the company.
• By subscribing to shares and debentures of the company.

Disbursement of credit by bank
Overdraft
Cash credit
Cash loans
Discounting of Bills of Exchange
The above disbursement of credit by commercial banks are as follows:

(a) Overdraft: An overdraft implies only to the existing current account holder. Therefore, it is a credit facility granted by a bank to current account holders. Under an overdraft facility, the bank allows its customers to overdraw an amount, up to a particular limit, i.e. to withdraw more than the amount of credit balance in his current account. Generally, a low rate of interest is charged by a bank, and collateral securities usually accepted for an overdraft facility.

(b) Cash credit:
It is an important form of providing finance to business organisations. Cash Credit is given against the pledge of goods or by providing alternative securities. A cash Credit account is operated on similar lines as the overdraft facility. On the security margin, the amount of cash credit is sanctioned by the bank and the borrower can withdraw the amount from his current account up to this limit as and when the company needs. Interest is charged on the actual amount outstanding and not the amount of credit limit sanctioned by the bank.

(c) Cash loans: Commercial Banks credit the account of the borrower with the amount of loan. The borrower has to pay interest on the entire amount sanctioned by the bank as a loan. If the amount of loan is paid in installments, the interest to be paid will be on the actual balance outstanding.

(d) Discounting of Bills of Exchange: Bills of Exchange is an acknowledgment received by the seller (drawer) from the buyer (drawee) promising to pay him a certain amount on a specific date. The drawer of the bill can receive money from drawee on the due date. The drawer can receive money before the due date by discounting of bills. This is nothing but selling the bills to the bank. The drawer gets money immediately from the bank against the bill. The bank gives money to the drawer less than the face value of the bill. The amount received less is called a discount. They are accepted by banks and cash is advanced against them. Thus, the Bill of Exchange is Trade Bills.

Exercise 5 | Q 5 | Page 38
Answer in brief.
State the features of Bonds.

SOLUTION

Meaning:
A bond is a debt security. It is a loan. A bond is a formal contract to repay the borrowed money with interest. It is an interest bearing certificate issued by the government, semi-government, or business firms to raise capital. The person holding such an instrument is known as a bondholder. He becomes the creditor of the company.

Definition:
According to Webster Dictionary,
"A bond is an interest bearing certificate issued by the government or business firms, promising to pay the holder a specific sum at a specified date".

Features of Bonds are as follows:

(a) Nature of finances: A bond is a debt or loan finance. It represents long term finance of the company.
Generally, the bonds are issued for a long period. For instance, 5 years, 10 years, and so on.

(b) Status of investor: The bond holders are the creditors of the company. Being creditors and non-owners, they do not enjoy any voting rights.
They are not entitled to participate in general meetings and in the management of the company.

(c) Return on bonds:
Bonds are issued bearing a fixed rate of interest. So, the bondholders get a fixed rate of interest.
It is payable at regular intervals, but it may be paid on maturity also.

(d) Repayment: Bonds have a specific maturity date because a bond is a formal contract to pay the borrowed money. Thus, the repayment of the principal amount is due on the maturity date.

EXERCISE 6 [PAGE 38]

Exercise 6 | Q 1 | Page 38
Justify the following statement.
Equity shareholders are real owners and controllers of company.

SOLUTION

Justification:

a. Equity shares are ordinary shares.
   These are the shares that constitute the major part of the total share of the

company. The person holding equity share is known as 'Equity Shareholder'.

b. Equity Shareholders are the real owners of the company and bear the ultimate risk associated with ownership.

c. They are often described as "Real Master of the company. They enjoy control over the company. They have voting rights and can participate in the management of the company.

d. Thus, it is rightly justified that, equity shareholders are the real owners and controllers of the company.

Exercise 6 | Q 2 | Page 38

Justify the following statement.
Preference shares do not carry any voting rights.

SOLUTION

Justification:

a. Preference Shares are those shares which enjoy certain privileges and preferential rights over equity shares. The person holding preference share is known as 'Preference Shareholder'.

b. Preference Shareholders do not have normal voting rights like equity shares.

c. However, they can vote on any such matter which directly affects their interest as investors.

d. Thus, it is rightly justified that, preference shares do not carry any voting right.

Exercise 6 | Q 3 | Page 38

Justify the following statement.
The debentures are secured by a charge on assets of the company

SOLUTION

Justification:

a. Secured debentures are the debentures which are secured by some charge on the assets or property of the company.

b. The charge may be either a fixed charge or a floating charge.

c. In case of a fixed charge, specific assets are mortgaged as security for the debentures.

d. Under floating charges, the debenture holders have a claim overall assets of the company.

Thus, it is rightly justified that, debentures are secured by a charge on assets of the company.

Exercise 6 | Q 4 | Page 38
Justify the following statement.
Retained earning is simple and cheapest method of raising finance.

SOLUTION

Justification:

a. Retained earnings are the earnings of the company which are retained (reinvested) in the business.

b. The sum of those profits accumulated over years is re-invested in the business, rather than distributing it as a dividend to shareholders.

c. The company can utilize such reserves for financing various projects such as expansion, diversification, etc.

d. It is an important source of internal financing. Thus, it is also known as 'Self Financing' or 'Ploughing Back of Profits'.

Thus, it is rightly justified that, retained earnings is the simple and cheapest method of raising finance.

Exercise 6 | Q 5 | Page 38
Justify the following statement.
Public deposit is good source of short term financing.

SOLUTION

Justification:

a. Public deposits are an important source of financing short term requirements of the company. In other words, the company accepts public deposits for meeting short term needs.

b. When companies generally receive deposits from the public for the period ranging from 6 months to 36 months, it is known as 'Public Deposits'.

c. It is considered a risky investment but investors can earn a high return on public deposits. Deposits are either secured or unsecured loans offered by the company.

d. Thus, a public deposit is a good source of short term financing

Exercise 6 | Q 6 | Page 38

Justify the following statement.

Bond holder is creditor of the company.

SOLUTION

Justification:

a. A bond is a debt security. It is a loan. A bond is a formal contract to repay the borrowed money with interest.

b. It is an interest bearing certificate issued by the government, semi-government, or business firms to raise capital.

c. The person holding such an instrument is known as a bond holder. He becomes the creditor of the company.

d. As a bond holder is the creditor of the company, he does not enjoy any voting rights and cannot participate in the management of the company.

Thus, it is rightly justified that, the bond holder is a creditor of the company

Exercise 6 | Q 7 | Page 38

Justify the following statement.

Trade credit is not cash loan.

SOLUTION

Justification:

a. Trade Credit refers to the facilities or credit extended by the manufacturer, wholesalers, and suppliers of goods to the purchaser but receives payment after the credit period from the date of purchase.

b. Manufacturer, wholesalers, and suppliers of goods or materials are called "Trade Creditors'

c. Trade credit is not a cash loan. It results from a credit sale of goods/services, which has to be paid at a future date after the sales take place.

d. This practice is done by a business concern with an intention to increase its sales or turnover, generate additional business and maintain a good relationship with the purchasers. Thus, it is rightly justified that, trade credit is not a cash loan.

Exercise 6 | Q 8 | Page 38

Justify the following statement.

Different investors have different preferences.

SOLUTION

Justification:

a. The investors are the persons who invest the capital in the company. They can invest in equity share capital or preference share capital.
b. The investors who can take the risk, invest in equity shares. They are known as the ultimate risk bearer.
c. The investors who are cautious, conservative, interested in the safety of capital, generally invest in preference shares.

Thus, it is rightly justified that, different investors have different preferences.

Exercise 6 | Q 9 | Page 38
Justify the following statement.
Equity share capital is risk capital.

SOLUTION

Justification:

a. The person holding equity share capital is known as 'Equity Shareholder'.

b. The dividend received by equity shareholders is fluctuating. Also, if a company does not earn profit in a particular year then equity shareholders will not get any dividend.

c. Hence, Equity shareholders bear the maximum risk in the company. They are described as 'Shock absorbers' when a company has a financial crisis.

Thus, it is rightly justified that, equity share capital is risk capital.

EXERCISE 7 [PAGE 38]

Exercise 7 | Q 1 | Page 38
Answer the following question.
What is share and state it's features?

SOLUTION

Meaning:
The share capital of a company is divided into many units of small denominations. Each such unit is called as a share.

In other words, a share is a small part of the total capital of a company. A person holding such shares is known as shareholders.

Definition:
According to section 2 (84) of the Companies Act, 2013 "Share means a share in the share capital of the company and includes stock".

Following are the features of Shares:

1. Meaning: Share is the smallest unit in the total share capital of a company.

2 Ownership: The owner of the share is called a shareholder. It shows the ownership of a shareholder in the company

3 Distinctive Number: Unless dematerialised, each share has a distinct number for identification. It is mentioned in the Share Certificate.

4. Evidence of title: A share certificate is issued by a company under its common seal. It is a document of title of ownership of shares. A share is not any visible thing. It is shown by share certificate or in the form of Demat share.

5. Each share has a value expressed in terms of money. There may be:

(a) Face value: This value is written on the share certificate and mentioned in the Memorandum of Association.

(b) Issue price: It is the price at which the company sells its shares.

(c) Market Value: This value of a share is determined by demand and supply forces in the share market. Rights A share confers certain rights on its holder such as the right to receive the dividend, the right to inspect statutory books, the right to attend shareholders' meetings, and the right to vote at such meetings, etc.

7. Income: A shareholder is entitled to get a share in the net profit of the company. It is called a dividend.

8. Transferability: The shares of a public limited company are freely transferable in the manner provided in the Articles of Association

9. Property of Shareholder: Share is a movable property of a shareholder.

10. Kinds of Shares: A Company can issue two kinds of shares:
(a) Equity shares.
(b) Preference shares.

Exercise 7 | Q 2 | Page 38
Answer the following question.
What is an equity share? Explain it's features.

SOLUTION

Meaning:
Equity shares are also known as 'ordinary shares'. For legal reasons, a company can not exist without equity shares.

Definition:
Companies Act 1956 defines equity share as "those shares which are not preference shares."

Features of Equity shares are as follows:

1. Permanent capital:
Equity shares are irredeemable shares. The amount received from Equity Shares is not refundable by the company during the lifetime. Equity shares become redeemable only in the event of winding up of the company. Equity shareholders provide long term and permanent capital to the company.

2. Fluctuating Dividend:
Equity shares do not have a fixed rate of dividend. The rate of dividend depends upon the amount of profit earned by the company. If the company earns more profit, the dividend is paid at a higher rate. On the other hand, if there is insufficient profit, the Board of Directors may postpone the payment of dividends. The shareholders can not compel them to declare and pay the dividend. The income of equity shares is irregular and uncertain. They get dividends which are always fluctuating.

3. No preferential right:
Equity shareholders do not enjoy preferential rights with respect to the payment of dividends. It means equity shareholders are paid dividends only after the dividend on preference shares has been paid. At the time of winding up of the company also, the equity shareholders are paid in the last. They are the last claimants. If no surplus amount is available after paying debts and preference shares, equity shareholders will not get anything. Thus, equity shareholders stand second in case of getting dividends on their shares as well as getting back their capital at the time of liquidation of the company.

4. Rights:
Equity shareholders enjoy certain rights. These include

a. The right to share in profit, when distributed as a dividend, is the most important right of equity shareholders. If the company is successful and makes a handsome profit, they have the advantage of a large dividend.
b. The right to vote is the basic right of equity shareholders by which they elect directors, amend Memorandum, Articles, etc.
c. Right to inspect books of account of their company of which they are owners.
d. The right to transfer shares is one of the most important rights of the shareholder.

5. Control:
The control of the company is vested in equity shareholders. They are often described as real masters of the company. It is because they enjoy the exclusive voting rights. The voting rights of equity shareholders are protected as far as possible. Equity shareholders may exercise their voting rights by proxies, without attending a meeting in person. The Act provides the right to cast vote in proportion to the number of shareholdings.
Equity shareholders participate in the management of the company. They elect their representatives called Directors on the Board for the management of the company.

6. Risk:
Equity shareholders bear maximum risk in the company. They are described as ‘shock absorbers’ when a company has a financial crisis. If the income of the company falls,

the rate of dividends also comes down. Due to this, the market value of equity shares goes down resulting in capital loss. Thus, equity shareholders are the main risk-takers.

7. Residual claimants:
Equity shareholders are owners and they are residual claimants to all earning after expenses, taxes, etc. have been paid. Although equity shareholders are the last claimants they have the advantage of receiving entire earnings that are leftover.

8. Face value:
The face value of equity shares is low, in comparison to preference shares. It is generally Rs.l0/- per share or even Rs.1/- per share.

9.Market Value :
There is more fluctuation in the market value of equity shares in comparison to other securities. Therefore, equity shares are more appealing to the speculators.

10. Bonus Issue:
Bonus shares are issued as a gift to equity shareholders. These shares are issued free of cost to existing equity shareholders. These are issued out of accumulated profits. Bonus shares are issued in proportion to the shares held. Thus capital investment of (ordinary) equity shareholder tends to grow on its own. This benefit is available only to the equity shareholder.

Exercise 7 | Q 3 | Page 38
Answer the following question.
Define preference shares. What are the different types of preference shares?

SOLUTION

As the name Indicates, these shares have certain privileges and preferential rights distinct from those attaching to equity shares. The shares which carry the following preferential rights are termed as preference shares.

a. A preferential right as to the payment of dividends during the lifetime of the company.
b. A preferential right as to the return of capital in the event of winding up of the company.

1. Cumulative preference shares:
Cumulative preference shares are those shares on which dividend goes on accumulating until it is fully paid. This means, if the dividend is not paid in one or more years due to inadequate profit, then such unpaid dividend gets accumulated. The accumulated dividend is paid when the company performs well. The arrears of dividends are paid before making payment to equity shareholders The preference shares are always cumulative unless otherwise stated in the Articles of Association. It means that if the dividend is not paid in any year or falls short of the prescribed rate, the unpaid amount is carried forward to next year, and so on until all arrears have been paid.

2. Non-cumulative preference shares:
Dividend on these shares does not accumulate. This means the dividend on shares can be paid only out of profits of that year. The right to claim dividends will lapse if company does not make a profit in that particular year. If the dividend is not paid in any year, it is lost.

3.Participating preference shares:
The holders of these shares are entitled to participate in surplus profit besides preferential dividends. The surplus profit which remains after the dividend has been paid to equity shareholders up to a certain limit is distributed to preferenCe shareholders.

4.Non-participating preference shares:
The preference shares are deemed to be non-participating if there is no clear provision in the Articles of Association. These shareholders are entitled only to a fixed rate of a dividend prescribed in the issue.

5. Convertible preference shares:
These shareholders have a right to convert their preference shares into equity shares. The conversion takes place within a certain fixed period.

6. Non-convertible preference shares:
These shares cannot be converted into equity shares.

7. Redeemable preference shares:
Shares that can be redeemed after a certain fixed period are called redeemable preference shares. A company limited by shares, if authorized by Articles of Association, issues redeemable preference shares. Such shares must be fully paid. These shares are redeemed out of divisible profit only or out of a fresh issue of shares made for this purpose.

8. Irredeemable preference shares:
Shares that are not redeemable i.e. payable only on the winding up of the company are called irredeemable preference shares. As per the Companies Act (Amendment made in 1988), the company cannot issue irredeemable preference shares.

Exercise 7 | Q 4 | Page 38
Answer the following question.
What are preference shares? State it's features

SOLUTION

As the name Indicates, these shares have certain privileges and preferential rights distinct from those attaching to equity shares. The shares which carry the following preferential rights are termed as preference shares.

a. A preferential right as to the payment of dividends during the lifetime of the company.
b. A preferential right as to the return of capital in the event of winding up of the company.

Features of Preference Shares are as follows:

1. **Preferential dividend :**
   The dividend is payable to preference shareholders before anything else is paid to equity shares. The company must assure its preferential right as to payment of dividends during the life of the company.

2. **Prior repayment of capital :**
   Preference shareholders have a preference over equity shareholders in respect of the return of capital when the company is liquidated. It saves preference shareholders from capital losses.

3. **Fixed return :**
   These shares carry dividends at a fixed rate. The rate of dividend is predetermined. It may be in the form of a fixed sum or may be calculated at a fixed rate. One point must be made clear. The preference shareholders are entitled to a dividend that can be paid only out of profit. Although the rate of dividend is fixed, the directors, in financial prudence, decide that no dividend be paid as there are no profits, the preference shareholders have no claims for the dividend.

4. **Nature of capital:**
   Preference shares do not provide permanent share capital. They are redeemed after a certain period of time. As per the Companies (Amendment) Act 1988, a company can not issue irredeemable preference shares.

5. **Market value :**
   The market value of preference share does not change as-the rate of dividend payable to them is fixed. Capital appreciation is considered to be low as compared with equity shares.

6. **Voting right :**
   The preference shares do not have normal voting rights. They have voting rights in respect of those matters which affect their interests. The preference shares do not enjoy the right of control on the affairs of the company.

7. **Risk :**
   The investors who are cautious, generally purchase preference shares. The safety of capital and fixed return on investment are advantages attached to preference shares. They attract a moderate type of investors. These shares are boon for shareholders during the depression period when the interest rate is continuously falling.

8. **Face Value :**
   The face value of preference shares is relatively higher than that of equity shares. They are normally issued at a face value of Rs. 100/-.

9. **Right or Bonus issue :**
   Preferential shareholders are not entitled to the right or bonus shares.

Exercise 7 | Q 5 | Page 38

Answer the following question.
What is Debenture? Discuss the different types of debentures.

SOLUTION

Meaning:

Debentures have occupied a significant position in the financial structure of the companies. It is one of the main sources of raising debt capital to meet long term financial needs. Debentures represent borrowed capital. The debenture holders are creditors of the company. The debenture holder gets a fixed rate of interest as a return on his investment. The Board of Directors has the power to issue debentures.

The term 'debenture' has come from Latin word 'debare', which means to 'owe".

Definition:

Palmer defines a debenture as -
"an instrument under seal evidencing debt, the essence of it being admission of indebtedness".

Types of Debentures:

1. **Secured debentures :**
   The debentures can be secured. The property of the company may be charged as security for a loan. The security may be for some particular asset (fixed charge) or it may be the asset in general (floating charge). The debentures are secured through 'Trust Deed'.

2. **Unsecured debentures :**
   These are the debentures that have no security. The issue of unsecured debenture is now prohibited by the Companies (Amendment) Act, 2000

3. **Registered debentures :**
   Registered debentures are those on which the name of holders are recorded. A company maintains a register of debenture holders in which the names, addresses, and particulars of holdings of debenture holders are entered. The transfer of debentures, in this case, requires the execution of regular transfer deed.

4. **Bearer debenture :**
   Name of holders are not recorded on the bearer debentures. Their names do not appear on the register of debenture holders. Such debentures are transferable by mere delivery. Payment of interest is made by means of coupons attached to the debenture certificate.

5. **Redeemable debentures :**
   Debentures are mostly redeemable i.e. payable at the end of some fixed period, as mentioned on the debenture certificate. Repayment can be made at a fixed date at the end of a specific period or by installments during the lifetime of the company. The provision of repayment is normally made in a trust deed.

6. **Irredeemable debentures :**
   These kinds of debentures are not repayable during the lifetime of the company. They are repayable only after the liquidation of the company, or when there is a breach of any condition or when some contingency arises.

7. **Convertible debentures :**
   Convertible debentures give the right to the holder to convert them into equity shares after a specific period. Such right is mentioned in the debenture certificate. The issue of convertible debenture must be approved by special resolution in a general meeting before they are issued to the public. These debentures are advantageous for the holder. Because of this conversion right, the convertible debenture holder is entitled to equity shares at a rate lower than market value, and even he participates in the profit of the company.

8. **Non-convertible debentures:**
   Non-convertible debentures are not convertible into equity shares on maturity. These debentures are normally redeemed on the maturity date. These debentures suffer from the disadvantage that there is no appreciation in value.

Exercise 7 | Q 6 | Page 38

Answer the following question.
Define Debenture and explain the features of debentures.

SOLUTION

The word debenture is derived from the Latin word, ‘Debare’ which means to owe something to someone’. A debenture is an acknowledgement of debt issued by a company under its common seal" It also means that debenture is a proof of loan taken by the company on certain terms and conditions.

Features of Debentures are as follows:

1. **Promise :**
   Debenture is a written promise by the company that it owes a specified sum of money to ' holder of the debenture.

2. **Face value :**
   The face value of debenture normally carries high denomination. It is Rs.100/— or multiples of Rs.100.

3. **Time Of repayment :**
   Debentures are issued with the due date stated in the 'Debenture Certificate'. A debenture provides for the repayment of the principal amount on the maturity date.

4. **Interest :**
   A fixed-rate of interest is agreed upon and is paid periodically in case of debentures. The rate of interest that the company offers depends upon the market conditions and nature of the business.

5. **Assurance of repayment :**
   Debentures constitute a long term debt. They carry an assurance of repayment on the due date.

6. **Parties to debentures:**
   There are certain parties to debentures such as-

   a) Company :
   This is the entity that borrows money.

   b) Trustee :
   This is a party through whom the company deals with debenture holders. The company makes an agreement with trustees and debenture holders. It is known as 'Trust Deed'. It contains the obligations of the company, the rights of debenture holders, etc.

   c) Debenture holders :
   These are the parties who provide loans and receive a 'debenture certificate' as evidence of participation.

7. **Rights Of Rights of Debenture holder:**
   Debenture holders have no right to vote at the general meetings of the company.

8. **Terms of issue of debentures :**
   a) Debentures can be issued at par, at a premium, and even at discount.
   b) According to the Companies Act, a company can not issue debentures carrying voting rights.
   c) According to the Companies Act, Sec 292 (1), the Board of Directors has the power to issue debentures.

9. **Security:**
   Debentures can be secured with some property of the company.

10. **Listing:**
    Debentures must be listed with at least one recognized stock exchange.