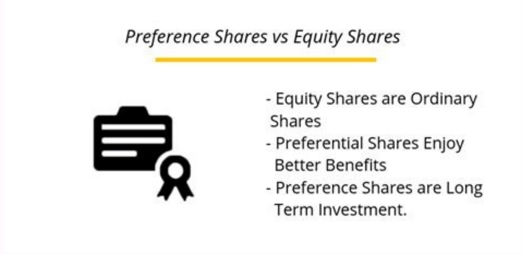
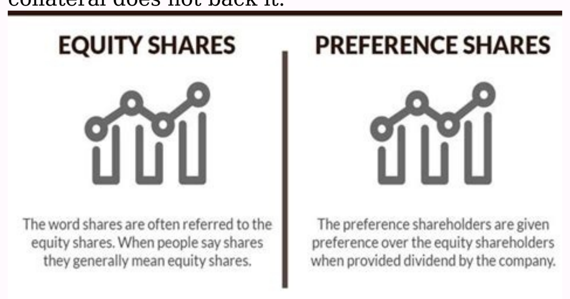
Difference between equity shares preference shares and debentures pdf

Preference shares and debentures are two different types of financial instruments. Preference shares—also referred to as preferred shares—are an equity instrument known for giving owners preferential rights in the event of a dividend payment or liquidation by the underlying company. A debenture is a debt security issued by a corporation or government entity that is not secured by an asset. Preference, or preferred shares give owners preferential dividend payments and equity rights in liquidation.A debenture is a debt security issued by a corporation or government entity that is not secured by an asset.Debentures have higher seniority for liquidation repayment than preferred shares, but may pay lower yields.The relative level of risk is a primary factor differentiating preferred shares and debentures. Preference shares are shares of a company's stock issued to preferential shareholders or stakeholders. Like common stock, preference shares represent ownership in a company. Unlike common stock, preference shares usually do not carry any voting power but give the holder of the preference shares claim on a specific quarterly dividend amount and precedence over common stock in the event of a company liquidation. There are four main types of preference shares that companies may issue: Preference shares are an optimal alternative for risk-averse equity investors. They fall between common equity and corporate bonds on the risk spectrum. Preferred shares can offer a steady flow of dividends similar to an interest payment that is promised to bondholders. Preferred shareholders also rank higher than common stock for liquidation rights, but they still fall after debentures. Companies agree to pay preferred shareholders dividends before dividends to common shareholders. Provisions can also require preferred share dividends in liquidation and may include special rights for share values in liquidation as well.



Debentures are a corporate or government bond that is not secured by an asset. All types of debentures are bonds, but not all bonds are debentures. Secured bonds fall within a class of their own and can be identified by the collateral associated with the bond. The structuring of a debenture makes it riskier than a secured debt instrument because collateral does not back it.



However, on the risk spectrum, debentures have less risk than preferred shares because of their senior liquidation rights. As a debt instrument, debentures are senior to preferred shares if bankruptcy or liquidation were to occur. There are two main types of debentures: Convertible debentures Non-convertible debentures All debentures follow a standard structuring process and have common features. First, a trust indenture is drafted, which is an agreement between the issuing corporation and the trust that manages the interest of the investors. Next, the coupon rate is decided, which is the rate of interest that the company will pay the debenture holder or investor.

Chart of Difference between debenture and Equity Share

Basis of Difference	Debenture	Equity Share
Meaning	The Debenture is the type of loan or debt instrument which is issued in the market to subscribe to the public.	The shares capital which are carrying voting rights, rights to dividends, and ownership known as Equity shares.
Types	It is a type of loan.	It is a type of Capital.
Rate of Return	It has a fixed rate of Return which is known as Interest.	It has a fluctuating rate of return depends on the profit of the year and which is known as a Dividend.
Secured	It **may or may not** be secured against the assets.	it is not secured
Voting Rights	It does not have voting rights.	It does have voting rights.
Convertibility	It can be convertible after maturity into an Equity share.	It can not be convertible.
Risk	Debenture holders are relatively safe.	Shareholders are at a greater risk.
Repayment	will be repaid after a specific period.	it will not be repaid through the whole life of the business.
Priority as to Repayment	In the case of winding up of the company the payment made to debenture holders before the payment of made to equity shareholders.	In the case of winding up of the company the payment of made to equity shareholders at the end.

This rate can be either fixed or floating and depends on the company's credit rating or the bond's credit rating.
Debentures usually garner a higher interest rate payment than secured debt to offset some of the collateral risks. Each debenture agreement will also detail the seniority of repayment in the event of liquidation. Debenture holders will be paid before preferred shareholders but may be subordinate to other types of debt on the company's books such as senior loans. If the funds allow, a debenture holder may receive their full repayment of the bond's principal with interest. Each liquidation is different and will affect the final payout to a debenture holder. Many investors may have the option to choose between a company's preferred shares or debentures. A primary consideration for choosing between preferred shares and debentures depends on risk.

Preferred shareholders are typically promised dividend payments and some liquidation rights. However, shares still trade openly on an exchange with the value primarily dictated by the market. A debenture can be less risky than preferred shares but will also typically have a lower expected return. With a debenture, the owner is promised full repayment of the principal investment plus interest over a specific period. Debentures are also higher on the seniority ranking for reimbursement if a company must liquidate. The following are some of the differences between equity shares and debentures 1. Motive of issue Equity Shares: Equity shares are issued to meet long term financial requirements. Dividend: Dividend are issued to meet long term and medium term financial requirements. 2. Investor preference Equity Shares: Generally equity shares are preferred by adventurous investors with risk bearing capacity. Dividend: Dividend are preferred by cautious investors who are reluctant to take risks. 3.
Return Equity Shares: Returns (dividends) are not fixed. They are dependent on the profits earned. High returns in case of high profits and low return in case of low profits. Dividend: Returns (interest) are fixed in nature. 4. Priority in return Equity Shares: They are residual claimants. They can expect dividends only after interest has been paid on debentures and preference dividend has been paid to preference shareholders. Dividend: Interest has to be paid to them before any dividend can be distributed. 5.

EQUITY VS. PREFERENCE SHARES

BASIS OF DIFFERENCE	PREFERENCE SHARES	EQUITY SHARES
RIGHT TO DIVIDEND	Dividend is paid on Preference shares before it is paid on the Equity shares.	Dividend is paid on the equity shares after it is paid on the preference shares.
RATE OF DIVIDEND	Rate of dividend may be fixed on these shares.	Rate of dividend is proposed by the Board of Directors each year.
REDEMPTION	Preference shares are redeemed on due date.	A company may buy-back its equity shares.
VOTING RIGHTS	Preference shareholders have voting rights only in special circumstances.	Equity shareholders have voting rights in all circumstances.
REQUIREMENT FOR FORMATION	A new company cannot be formed only with preference shares.	A new company can be formed only with the equity shares.
TYPES	There are 8 types of preference shares.	There is no such type of equity shares, however sweat equity shares are covered under this category.

Settlement of claims during liquidation Equity Shares: Their claims will be settled only after the claims of preference shareholders and debenture can be distributed to holders have been settled.
Dividend: Their claims have to be settled before anything preference or equity shareholders. 6. Financial burden Equity Shares: Payment of equity dividends is optional. It is dependent on the discretion of the Board of Directors. Therefore there is no fixed financial commitment. Dividend: Payment of interest on debentures is a fixed financial commitment. 7. Redemption Equity Shares: No redemption until liquidation. Dividend: Redeemable as per terms of issue. 8. Voting rights Equity Shares: Enjoy voting rights Dividend: Do not enjoy voting rights. 9. Reduction of capital Equity Shares: Reduction of Capital is done by reorganization. Dividend: Reduction of Capital is done by repayment. 10. Price Equity Shares: Generally of lower denomination. Dividend: Generally of higher denomination 11. Type of investors.
Equity Shares: Even small investors can invest because of the lower denomination Dividend: Preferred by medium and large investors. Small investors would find it difficult to invest because of the higher denomination 12. Borrowing capacity Equity Shares: Strengthens borrowing capacity. Dividend: Reduces borrowing capacity. 13. Capitalization Equity Shares: There are chances for over-capitalization. Dividend: Lesser chances for over-capitalization. 14. Charge on assets Equity Shares: Does not create charge on the assets. Dividend: Generally creates charge on the assets of the company. Equity Shares are the shares that carry voting rights and the rate of dividend also fluctuate every year as it depends on the amount of profit available to the company. On the other hand, Preference Shares are the shares that do not carry voting rights in the company as well as the amount of dividend is also fixed. One of the major difference between equity shares and preference shares is that the dividend on preference shares is cumulative in nature, whereas the equity share dividend does not cumulates, even if not paid for several years. When a decision has to be taken on the capital structure, one must go for a mix of the two types of shares, in the share capital of the company. And for this, one needs to have a general understanding on the two, so take a read of this article and know the difference. Content: Equity Shares Vs Preference Shares Comparison Chart Definition Key Differences Similarities Conclusion Comparison Chart Basis for ComparisonEquity SharesPreference Shares MeaningEquity shares are the ordinary shares of the company representing the part ownership of the shareholder in the company.Preference shares are the shares that carry preferential rights on the matters of payment of dividend and repayment of capital. Payment of dividendThe dividend is paid after the payment of all liabilities.Priority in payment of dividend over equity shareholders. Repayment of capitalIn the event of winding up of the company, equity shares are repaid at the end.In the event of winding up of the company, preference shares are repaid before equity shares. Rate of dividendFluctuatingFixed RedemptionNoYes Voting rightsEquity shares carry voting rights.Normally, preference shares do not carry voting rights. However, in special circumstances, they get voting rights. ConvertibilityEquity shares can never be converted.Preference shares can be converted into equity shares. Arrears of DividendEquity shareholders have no rights to get arrears of the dividend for the previous years.Preference shareholders generally get the arrears of dividend along with the present year's dividend, if not paid in the last previous year, except in the case of non-cumulative preference shares. Definition of Equity Shares Equity shares are the ordinary shares of the company. The holder of the equity shares are the real owners of the company, i.e. the amount of shares held by them is the portion of their ownership in the company.
Equity shareholders have some privileges like they get voting rights at the general meeting, they can appoint or remove the directors and auditors of the company. Apart from that, they have the right to get the profits of the company, i.e. the more the profit, the more is their dividend and vice versa. Therefore, the amount of dividends is not fixed. This does not mean that they will get the whole profit, but the residual profit, which remains after paying all expenses and liabilities on the company. Definition of Preference Shares Preference Shares, as its name suggests, gets precedence over equity shares on the matters like distribution of dividend at a fixed rate and repayment of capital in the event of liquidation of the company.
The preference shareholders are also the part owners of the company like equity shareholders, but in general, they do not have voting rights. However, they get right to vote on the matters which directly affect their rights like the resolution of winding up of the company, or in the case of the reduction of capital. The following are the types of preference shares: Participating Preference Shares Non-Participating Preference Shares Convertible Preference Shares Non-Convertible Preference Shares Cumulative Preference Shares Non-Cumulative Preference Shares Equity shares cannot be converted into preference shares.
However, Preference shares could be converted into equity shares. Equity shares are irredeemable, but preference shares are redeemable. The next major difference is the 'right to vote'. In general, equity shares carry the right to vote, although preference shares do not carry voting rights.
If in a financial year, dividend on equity shares is not declared and paid, then the dividend for that year lapses. On the other hand, in the same situation, the preference shares dividend gets accumulated which is paid in the next financial year except in the case of non-cumulative preference shares. The rate of dividend is consistent for preference shares, while the rate of equity dividend depends on the amount of profit earned by the company in the financial year.
Thus it goes on changing. Similarities Defined in section 85 of the Indian Companies Act 1956. Both are owned capital of the company.
Conclusion Now, if anyone wants to invest his money in equity shares and preference shares you can do it very easily. For this you, first you should gain complete knowledge about the stock market. Otherwise, there are a lot of chances that you may suffer loss. One thing you must remember while making an investment in any of these is, purchase the shares or stock when the market is down because at that time the prices are generally low and sell them when the market is up as the prices of shares are relatively higher. Similarly, another point of relevance is you must try to go for a long-term investment; it will give you good returns for longer periods. The best form of investment is a mutual fund as the risk is comparatively less than the individual stocks. Do not recklessly believe on any good advice, because there are some investments which will give you high returns, but they are the riskiest ones so think twice before you invest anywhere in the stock market. If you don't want to invest in the mutual funds, then there are still better options for you like, you can directly purchase the stock of any company, when they bring new issue of shares in the form of an Initial Public Offer (IPO), this purchasing is known as buying from the primary market. Before investing money in any company just remember one formula Investigate before you Invest your money in any stocks as there are chances of money loss. If you couldn't find any such direct purchasing, then you can contact a broker to help you in purchasing the securities of the companies which are already listed on the Stock Exchanges like National Stock Exchange or Bombay Stock Exchange. This type of purchasing is known as buying from Secondary Market. It could be a little bit expensive as you have to pay the brokerage charges. But, the broker will help you in opening an account and complete the legal formalities on your behalf. Now, you have to decide that how much you can invest at the inception. After deciding it, you need to deposit some amount as a part of initial investments with your broker who will purchase the securities on your instructions. And so in this way you can easily invest in the securities.