

# **RIZVI COLLEGE OF ARTS SCIENCE & COMMERCE**

**SECRETARIAL PRACTICE**

**SYJC**

## **SOURCES OF CORPORATE FINANCE**



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# Chapter2: Sources of Corporate Finance

- ❑ The finance needed by business organization is termed as 'capital'.
- ❑ Capital formation is a process of collection of capital from various sources according To financial plan of company.
- ❑ A joint stock company, which is a modern form of business organization and being a large undertaking, requires huge capital for business. This huge capital collection or capital formation has special significance in the management of joint stock company.



# Defining Shares

## Legal Definition

As per Section 2 (84) of the Companies Act 2013, **Share means a share in the share capital of a company and includes stock**'.

## Shareholder Status

An individual who acquires shares becomes a 'shareholder' or 'member', holding a stake in the company's ownership.



Shares allow for broad ownership, enabling multiple individuals to invest in a company's capital.



# Key Features of Shares

## Meaning and Ownership

- A share represents the smallest divisible unit of a company's total company's total share capital.
- Shareholders are the owners of these units, signifying their ownership in the company.

## Identification and Title

- Unless dematerialised, each share carries a distinctive number for identification, noted on the share certificate.
- A share certificate, bearing the company's common seal, serves as documentary proof of share ownership.

# Understanding Share Value and Rights

## Value of a Share

- **Face Value:** The nominal value stated on the share certificate and in the Memorandum of Association.
- **Issue Price:** The actual price at which the company initially sells its shares to the public.
- **Market Value:** The fluctuating price determined by supply and demand dynamics in the stock market.

## Shareholder Rights

Shareholders are granted several key rights, including:

- Receiving dividends from company profits.
- Inspecting statutory books and records.
- Attending and voting at shareholders' meetings.

# Share Characteristics Overview



## Capital Contribution

Shares serve as a fundamental source of capital, facilitating business expansion and operations.



## Proof of Ownership

Share certificates provide tangible evidence of an investor's stake in the company.



## Market Valuation

Share prices fluctuate based on market demand, reflecting investor sentiment and company performance.



## Voting Rights

Many shares grant holders the right to vote on company decisions, influencing governance.

# Income, Transferability, and Types of Shares

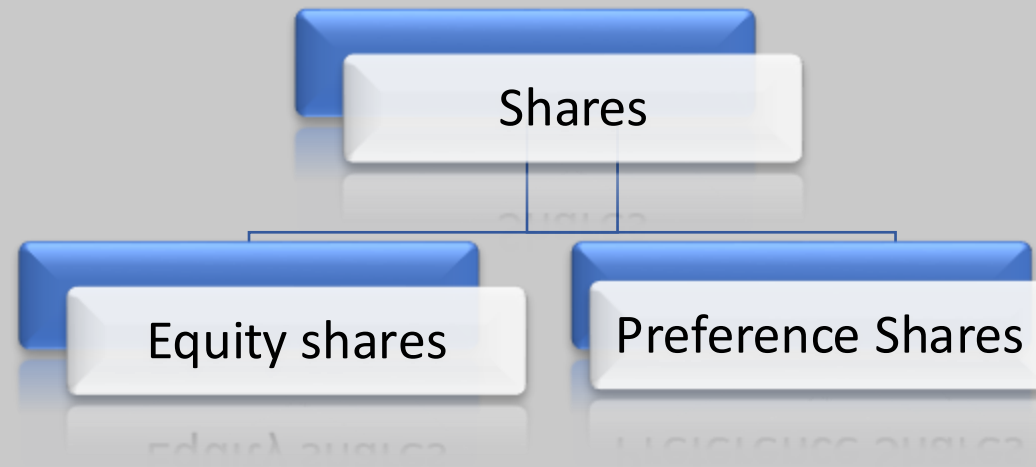
## Income and Transferability

- **Income:** Shareholders are entitled to a portion of the company's net profit, known as a dividend.
- **Transferability:** Shares of public limited companies can be freely be freely transferred in accordance with the company's Articles Articles of Association.
- **Property of Shareholder:** Shares are considered movable property belonging to the shareholder.

## Kinds of Shares

Under Section 43 of the Companies Act 2013, companies can issue two primary types of shares:

- **Equity Shares:** These represent ownership and voting rights, with rights, with variable dividends.
- **Preference Shares:** These offer fixed dividends and priority in priority in repayment during liquidation.



- Equity shares with voting right
- Equity shares with differential voting right

- Cumulative Preference shares
- Non - Cumulative Preference Shares.
- Participating Preference Shares.
- Non-participating Preference Shares.
- Convertible Preference Shares.
- Non- Convertible Preference Shares.
- Redeemable Preference Shares.
- Irredeemable Preference Shares.

# EQUITY SHARES

Equity shares are also known as ordinary shares.

Companies Act defines equity shares as 'those shares which are not preference shares

The above definition reveals that :

- The equity shares do not enjoy preference for dividend.
- The equity shares do not have priority for repayment of capital at the time of **winding up of the company**



## INCOME STATEMENT

Income before interest and tax [EBIT]	3,00,000
(-) Interest	(50,000)
Earning before tax (EBT)	2,50,000
(-) Tax	(75,000)
Earning after tax (EAT)	1,75,000
(-) preference dividend	(75,000)
Profit available for equity shareholder	1,00,000
/ no on shares	1,00,000
Earning per share	1

# Understanding Equity Shares: Shares: Key Features

Equity shares represent ownership in a company, offering unique features and benefits to investors. Let's delve into their characteristics.



# Core Features of Equity Shares

1

## Permanent Capital

Equity capital is a long-term, permanent source of funds, of funds, only redeemable upon company winding-up or winding-up or share buyback.

2

## Fluctuating Dividends

Dividend rates vary with company profits; shareholders shareholders cannot compel declaration, leading to to uncertain income.

3

## Shareholder Rights

Includes voting rights, profit sharing, book inspection, inspection, and the ability to transfer shares.

4

## No Preferential Rights

Equity shareholders are paid dividends only after preference shareholders.

# INFLUENCE AND RISK IN EQUITY SHARES



## 5. Controlling Power

Equity shareholders are the "real masters" due to exclusive voting rights, enabling them to elect directors and participate in company management.

## 6. Risk Bearing

They bear maximum risk, acting as "shock absorbers" during financial crises. Falling income directly impacts dividend rates and market value.

## 7. Residual Claimants

As owners, they are residual claimants, receiving all earnings after expenses and taxes.

## 8. No Charge on Assets

Equity shares do not create any charge over comp

# Growth and Valuation Aspects

9.

## **Bonus Issue**

Free shares issued from accumulated profits, proportionate to existing holdings, growing capital investment.

10.

## **Right Issue**

Priority offer of newly issued shares to existing shareholders for capital expansion.

11.

## **Face Value**

Typically low, ranging from ₹ 1 to ₹10 per share.

12.

## **Market Value**

Fluctuates with demand, supply, profitability, and dividend declarations.

13.

## **Capital Appreciation**

Increases in share market value due to company profitability and reputation.

# Understanding Preference Shares: A Comprehensive Overview

Preference shares offer distinct advantages over ordinary equity shares, primarily through preferential rights concerning **dividends** and **capital repayment**. Ideal for cautious investors, they promise steady returns and a degree of capital safety, making them a unique financial instrument within a company's capital structure.



# Key Features of Preference Shares

1

## Dividend Priority

Preference shareholders receive dividends before ordinary shareholders. This fixed rate of return is predetermined at the time of issue, ensuring a predictable income stream.

2

## Capital Repayment

In the event of company liquidation, preference shareholders have a prioritised claim on capital repayment, safeguarding their initial investment against potential losses.

3

## Fixed Returns

Dividends on preference shares are paid at a fixed rate, offering offering stability. However, payments are contingent on company company profits and director's discretion.

4

## Temporary Capital

Unlike ordinary shares, preference shares are redeemable after a after a specified period. They are typically issued by established established companies seeking additional, safe capital without without diluting control.

## Additional Characteristics of Preference Shares

- 5 Stable Market Value**

Due to their fixed dividend rate, preference shares generally exhibit low market value fluctuation, offering limited capital appreciation compared to ordinary shares.
- 6 Limited Voting Rights**

Preference shareholders usually lack normal voting rights, participating only in decisions directly impacting their preferential terms, such as changes in repayment or dividend arrears.
- 7 Investor Risk Profile**

These shares appeal to risk-averse investors prioritising capital safety and consistent returns, particularly beneficial during economic downturns when interest rates are low.
- 8 Higher Face Value**

Preference shares typically have a higher face value, often £100, distinguishing them from ordinary shares.
- 9 No Bonus/Rights Issues**

Preference shareholders are generally not eligible for bonus or rights issues, limiting their participation in certain corporate actions.

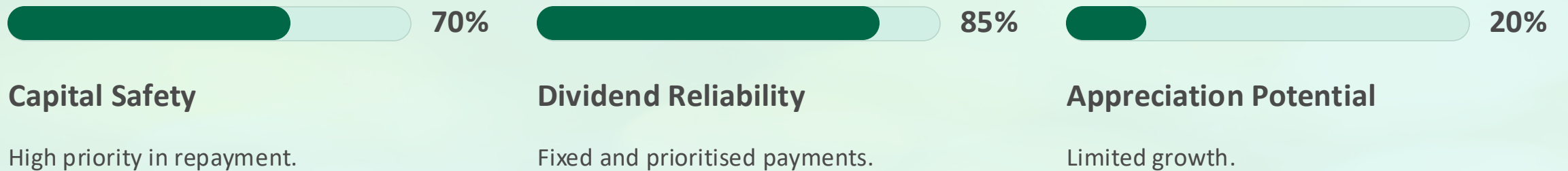
# Why Invest in Preference Shares?



Preference shares are ideal for investors seeking **stability and predictable income**. Their preferential rights to dividends and capital repayment provide a buffer against market volatility. This makes them a compelling option for those prioritising wealth preservation over aggressive growth.

# Risk & Returns

Preference shares are generally considered less risky than ordinary shares, offering a more predictable return profile. Their fixed dividend and fixed dividend and capital repayment priority provide a level of security, particularly during market downturns. However, this stability often comes at the expense of significant capital appreciation.



# The Cautious Investor's Choice



Preference shares are particularly attractive to investors who prioritise **safety of capital and steady, predictable returns**. They are a sound choice for those looking to mitigate risk in their portfolio, especially during periods of economic uncertainty or market volatility.

This investment vehicle appeals to conservative individuals who value consistent income over aggressive growth, making it a cornerstone for a balanced and secure financial strategy.

# Key Takeaways & Next Steps

## Understanding Preference Shares

These shares offer preferential rights for dividends and capital repayment, providing a safer investment avenue.

## Benefits for Investors

Ideal for cautious investors seeking fixed, steady returns and capital safety, particularly in volatile markets.

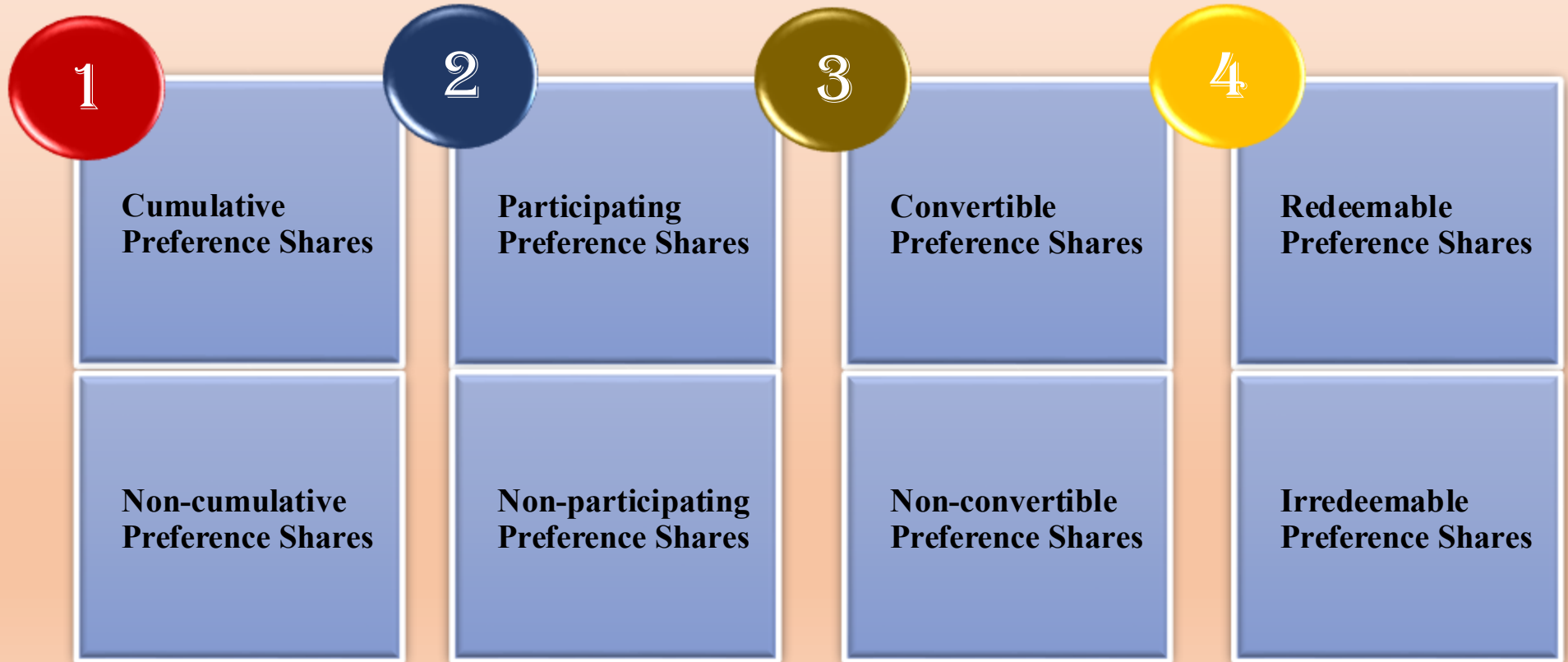
## Strategic Role

Preference shares serve as a stable component of a company's capital structure, often used for additional, secure funding.

## Consider Your Portfolio

Evaluate how preference shares align with your financial goals, risk tolerance, and overall investment strategy.

# TYPES OF PREFERENCE SHARES



# EXAMPLE

<b>10% Preference Shares - 200,000</b>	<b>Every year dividend payable is Rs. 20,000</b>
YEAR	PROFIT/ LOSS
2017	50,000 (Profit)
2018	Loss (NO dividend)
2019	Loss (NO dividend)
2020	100,000

# DEBENTURES

- The term debenture has come from the Latin word ‘debere’ which means to ‘owe’.
- The term debenture has not been defined clearly under Companies Act.
  - Sec 2(30) of the Companies Act 2013, only states that, ‘the word debenture includes debenture stock, bonds and any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not’.
  - Under the existing definition, debenture includes debenture stock. Debenture means a document which either creates or acknowledges debt. Ordinarily, debenture constitutes a charge on some property of company, but there may be a debenture without any such charge.
- **Palmer defines** : “A debenture as an instrument under seal evidencing debt, the essence of it being admission of indebtedness.”
  - **Topham defines** : “A debenture is a document given by a company as evidence of debt to the holder, usually arising out of loan, and most commonly secured by charge.”
  - According to the above definitions, debenture is an evidence of indebtedness. It is an instrument issued in the form of debenture certificate, under the common seal of the company.



# Understanding Debentures: Key Key Features

This presentation will explore the essential characteristics and operational aspects operational aspects of debentures, providing a comprehensive overview for for stakeholders.

## Core Features of Debentures



### Promise

A debenture represents a formal promise by a company to repay to repay a specified sum of money to the holder, acknowledging its debt obligation.



### Face Value

Debentures typically carry a high denomination, commonly £100 commonly £100 or multiples thereof, reflecting their nature as significant debt instruments.



### Time of Repayment

Each debenture certificate specifies a clear due date for repayment, ensuring clarity regarding the principal amount's maturity.



### Priority of Repayment

Debenture holders have a preferential claim on capital repayment over other company claimants, safeguarding their investment.

## Additional Features of Debentures

### Assurance of Repayment

As long-term debt instruments, debentures provide a strong assurance of repayment on their stipulated due date.

### Fixed Interest

Debentures guarantee a fixed rate of interest, paid periodically, regardless of the company's profitability. This is a non-negotiable liability.

### Authority to Issue Debentures

According to Section 179(3) of the Companies Act 2013, the Board of Directors possesses the statutory power to issue debentures.



# Key Parties in a Debenture Transaction



## Company

The issuing entity that borrows capital from investors.



## Trustees

Appointed if debentures are offered to to over 500 individuals. They act as intermediaries, safeguarding debenture debenture holders' interests through a a Trust Deed.



## Debenture Holders

The investors who provide the loan and receive a Debenture Certificate as proof of their investment.

The Trust Deed meticulously outlines the company's obligations, debenture holders' rights, and the trustees' powers, ensuring a clear framework a clear framework for all parties involved.

# Debenture Holder Rights & Security

## Status of Debenture Holders

Debenture holders are recognised as **creditors** of the company. Interest is consistently paid at a fixed rate, at regular intervals, until the debenture is fully redeemed.

## No Voting Rights

As per Section 71(2) of the Companies Act 2013, debentures carry no voting rights. Holders cannot vote at general meetings, ensuring separation of debt and equity control.

## Security

Debentures are typically secured by a fixed or floating charge on the company's assets. This provides recourse for debenture holders to recover their funds if the company defaults on payments or repayment.



# Issuance and Marketability

Debentures are versatile financial instruments with clear guidelines for issuance and robust transferability, enhancing their appeal to investors.



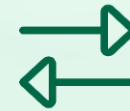
## Issuers

Both private companies and public limited companies are authorised to issue debentures, offering flexibility across corporate structures.



## Listing

For transparency and liquidity, debentures must be listed with at least one recognised stock exchange, facilitating secondary market trading.



## Transferability

Debentures can be readily transferred through a formal instrument of transfer, providing investors with ease of exit and liquidity.

# Benefits of Debentures

Debentures offer significant advantages for both issuers and investors, making them a cornerstone of corporate finance.

## For Companies (Issuers)

- Access to long-term capital without diluting ownership.
- Predictable cost of financing due to fixed interest rates.
- Flexible repayment structures can be tailored.
- Interest payments are tax-deductible expenses.

## For Investors (Holders)

- Stable and predictable income stream from fixed interest interest.
- Lower risk compared to equity due to priority of repayment.
- Security through charged assets provides a safety net.
- Easy transferability ensures liquidity.

# TYPES OF DEBENTURES

ON THE BASIS  
OF SECURITY

**SECURED  
DEBENTURES**

**UNSECURED  
DEBENTURES**

ON THE BASIS  
OF TRANSFER

**REGISTERED  
DEBENTURES**

**BEARER  
DEBENTURES**

ON THE BASIS  
OF  
REPAYMENT

**REDEEMABLE  
DEBENTURES**

**IRREDEEMABLE  
DEBENTURES**

ON THE BASIS  
OF  
CONVERSION

**CONVERTIBLE  
DEBENTURES**

**NON-  
CONVERTIBLE  
DEBENTURES**

# DISTINGUISH BETWEEN SHARE & DEBENTURES

Points	Shares	Debentures
1. Meaning	A share is a part of share capital of a company. It is known as ownership securities.	A debenture is a certificate of loan taken by a company. They are also known as creditorship securities.
2. Status	A holder of shares is the owner of company. Therefore, share capital is owned capital.	A holder of debenture is creditor of the company. Debenture capital is loan capital or borrowed capital.
3. Nature	It is permanent capital. It is not repaid during the life time of the company.	It is temporary capital. Generally it is repaid after a specific period.
4. Voting / Right	Shareholders being owners enjoy normal voting rights in general meeting. They participate in the management of the company.	Debentureholders being creditors, do not have any voting right. They can not participate in the management of the company.
5. Return on Investment	Return on shares is called dividend. Equity shareholders receive dividend at fluctuating rate whereas preference shareholders receive dividend at fixed rate.	Return on debenture is called interest. It is fixed at the time of issue. Interest is paid even when 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 Company's property.

Points	Shares	Debentures
7. Time of Issue	Shares are issued in the initial stages of the company formation.	Debentures are issued at a later stage, when the company has properties to offer as security.
8. Suitability	Shares are suitable for long term finance.	Debentures are suitable for medium term finance.
9. Types	<p>Shares are classified into</p> <ul style="list-style-type: none"> <li>a) Equity shares</li> <li>b) Preference</li> </ul>	<p>Debentures are classified as :</p> <ul style="list-style-type: none"> <li>a) Registered Debentures</li> <li>b) Bearer Debentures</li> <li>c) Secured Debentures</li> <li>d) Unsecured Debentures</li> <li>e) Redeemable Debentures</li> <li>f) Irredeemable Debentures</li> <li>g) Convertible Debentures</li> <li>h) Non - convertible Debentures</li> </ul>
10. Position on liquidation	On liquidation of a company, share holders rank last in the list of claimants.	Debentureholders being creditors, rank prior to shareholders for repayment on liquidation of company.

# DISTINGUISH BETWEEN EQUITY SHARES & PREFERENCE SHARE

Points	Equity Shares	Preference Shares
1. Meaning	Shares that are not preference shares are called equity shares i.e. these shares do not have preferential right for payment of dividend and repayment of capital.	Preference shares are Shares that carry preferential right as to payment of : a) Dividend and b) Repayment of capital.
2. Rate of Dividend	Equity shares are given dividend at fluctuating rate depending upon the profits of the company.	Preference shareholders get dividend at fixed rate.
3. Voting Right	Equity shareholders enjoy normal voting right. They participate in the management of their company.	Preference shareholder do not enjoy normal voting right. They can vote only on matters affecting their interest.
4. Return of Capital	Equity capital can not be returned during the life time of the company. (except in case of buy back)	A company can issue redeemable preference shares, which can be repaid during the life time of the company.
5. Nature of capital	Equity capital is known as 'Risk Capital.'	Preference capital is 'Safe Capital' with stable return.
6. Nature of investor	The investors who are ready to take risk invest in equity shares.	The investors who are cautious about safety of their investment, invest in preference shares.

Points	Equity Shares	Preference Shares
7. Face value	The face value of equity shares is generally ` 1/- or ` 10/- it is relatively low.	The face value of preference shares is relatively higher i.e. ` 100/- and so on.
8. Right and bonus issue	Equity shareholder is entitled to get bonus and right issue.	Preference shareholders are not eligible for bonus and right issue.
9. Capital appreciation	Market value of equity shares increases with the prosperity of company. It leads to increase in the value of shares.	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 fluctuating rate of dividend and no guarantee of refund of capital.	Preference shares are subject to less risk. It is because of fixed rate of dividend and preferential right as regards to dividend and repayment of capital.
11. Types	<p>Equity shares are classified into :</p> <ul style="list-style-type: none"> <li>a) equity shares with normal voting right.</li> <li>a) equity shares with differential voting right.</li> </ul>	<p>Preference shares are classified as :</p> <ul style="list-style-type: none"> <li>a) Cumulative Preference Shares</li> <li>b) Non-Cumulative Preference Shares</li> <li>a) Convertible Preference Shares</li> <li>b) Non-Convertible Preference Shares</li> <li>a) Redeemable Preference Shares</li> <li>b) Irredeemable Preference Shares</li> </ul>



**THANK YOU!**