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Equity and Debts

Investment in Corporate Sector

Suppose, you want to **invest** in a corporate sector. What options do you have?

You have **two** options for **investment -** invest in **stocks/equity/share** or invest in **bonds/debentures** of the company.

First option points to **Equity instrument,** whereas the second option to **Debt instrument**.

Equity Instrument

If you **buy** an **equity** instrument (i.e., **shares**), then you will be a (kind of) **owner** of the company, known as **stakeholder** or **shareholder**. The company is not **liable** to you. If the company generates **profit,** then you will get a **part** of it (as **dividends**, will explain later), and if generates **loss,** then you too have to **bear** it.

You buy a **share** by paying an amount to the **company**, you don't get anything in return except the **claim** of being a **stakeholder** or **shareholder**. You will be only **profited (**i.e, benefited), when the company provides **dividends** to its **shareholders**.

Debt Instrument

If you buy a **debt instrument** (i.e., **bonds, debentures**), then you will be a **liability** of the company, and you won't be the (kind of) **owner** of it. Whether the **company** generates **profits** or make **loss** in its business, it is **bound** to provide you the **investment** you made as **bonds** or **debentures,** with **interest**.

You buy a **bond**, you will get **monthly/quarterly** (whatever the payment time is) **return** from the **company**, where you invested. But you will never be a **stakeholder**.

Now, try to summarize the **differences** of **equity** and **debt** instruments -

	Equity	Debt
Nature	**Equity,** or **Stock** are **securities** that are a **claim** on the **earnings** and **assets** of a **corporation**.	**Debt** instruments are **assets** that require a **fixed payments** to the **holder**, usually with **interest.**
Use	Allows a **company** to **acquire funds**, often for **investment**, without incurring **debts**	Issuing a **bond** (debt instrument) increases the **debt burden** of the **bond issuer** because contractual **interest payments** must

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		be paid – unlike **dividends**, they cannot be reduced or suspended
Ownership	Those who **purchases** equity instruments (e.g., stocks) gain **ownership** of the business, whose **shares** they hold. In other words, they gain the **right to vote** on the issues important to the firm. In addition, they have **claims** on the **future earnings.**	**Bond** holders do not gain **ownership** in the business or have any **claims** to the **future profits** of the borrower. The **borrower**'s only obligation is to **repay** the **loan** with **interest**
Risks	**Share holders** gets **profits** or **losses**, as and when business makes it, making it **highly risky**	**Bonds** are **less risky –** should the **company** run into **trouble**, **bond holders** are paid first, before other expenses are paid.
Earnings	**Investors** only earns when company issues **dividends**, that happens when the **company** wants to share the **profit** to their **share holders**	**Returns** are **periodic** and almost fixed. **Coupons**or monthly **interest** is earned.
Raising Capital	Raising capital using **equity** is that the **company**who issues **shares** need not pay any money to the **share holders**.	Raising capital using **debt** is a **burden** to the **company**, as they have to pay the **interest**monthly
Instruments	**Shares, Dividends**	**Bonds, Debentures, Certificates, Mortgages, Leases, Notes**, or other **agreements** between a lender and a borrower

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Dividends and Debentures

Now come to **dividends** and **debentures**. Don't get **confused** on these two. **Dividends** isa **equity** instrument, whereas **debenture** is a **debt** instrument.

Dividends - When a **company** generates **profits,** it can use that amount whether as **reinvestment** in the company (to extend business, or buy new equipment, etc.), or as to **share** among the **stakeholders** / **shareholders,** or both.
If it shares the **profit** among the **shareholders**, then it is known as **Dividends** (generally denoted as **Dividends Per Share**, or **DPS**). Shareholders gets dividends on **per share** basis.

Debentures - It is a kind of **debt instrument,** but without **collateral.** You will buy a **debenture** only because you **believe** that the issuer (may be a company or government) will

not **default** on its **payment** to you. They will not provide any **security** as **collateral** for your investment. The **reputation** of the **issuer** is enough for you to buy a **debenture**.

The best example could be a **Treasury Bill (T-Bill)**, issued by **government**. You know that **government** will never **default** on payment, so you buy a **T-Bill**, which is a **debenture**. (I shall elaborate **T-Bill** in next blog

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