

Debt, Equity and Hybrid securities – A Comparative study

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Abstract

The present study is carried out to identify the key differences among debt, equity and hybrid securities. To make it easy a comparative chart has been presented regarding the differences among debt, Equity and hybrid security. This study also focus on investors perception regarding investment in equity shares, debt and hybrid securities. SPSS version of 22.0 had been employed for tabulation and analysis of data. For the present study is carried out on the investors of debt, Equity and Hybrid securities.

Key words: Debt, Equity and Hybrid securities, Investment, Capital Market

1. Introduction

A well disciplined financial system of a country will play a major role in growth of a good capital market. There are so many instruments that are traded in capital market. Preference shares, Equity shares, debentures, warrants, commodities, mutual funds are some major financial instruments that are traded in Indian Capital Market. Capital is playing a vital role raising capital for business organization. Capital is the basic requirement of every business organization to fulfill their financial needs. To raise funds they are using equity and debt as main financial instruments. These are traditional financial instruments with distinct features. Both instruments have their own advantages and limitations. The other important financial instrument is Hybrid security with both the features of Debt and Equity.

Debenture or Debt is a medium or long term financial instrument used by the companies to borrow money. These debts are usually for a fixed period and for fixed interest rate that can be payable yearly or half yearly. These are the most common way for company to borrow money. The main features of debt include fixed interest rate, no voting rights for debenture holders, debenture holders are considered as creditors of the company, priority of payment of interest and fixed maturity period.

Equity shares are the main source of finance of a firm issued to the general public. The persons who hold the equity shares are called as equity share holders. It includes the key factors like equity share holders do not enjoy any preferential right with regard to repayment of capital and dividend. They are entitled to

residual income of the company, but they enjoy the right to control the affairs of the business and all the equity shareholders collectively are the owners of the company.

Hybrid securities are fixed income instruments that combine the elements of shares and debt. Hybrid securities tend to offer a higher return than pure fixed income securities such as bonds but a lower return than pure variable income securities such as equities. Preference shares, Convertible debt and capital notes are considered as hybrid securities with features like steady and defined income, chance of converting securities into ordinary shares, priority of payment and others. Hybrid securities typically pay a certain proportion of the face value of the security as a return in each time period until the security matures. Unlike bonds, which return their full face value at maturity, hybrid securities return an amount different from their face value. Hence hybrid securities are considered riskier than pure fixed income securities.

Equity, debt (simple bonds) and hybrid securities are playing a major role in raising fund by the companies. They have different features from one another. Their distinct natures are compared in the chart as below:

SI. No	Distinguishing feature	Equity	Debt	Hybrid securities
01	Nature of fund	Owner's fund	Borrower's fund	Act as capital as well as debt
02	Payment priority of principal amount	Last priority at the time of liquidation	Principal amount is paid after a fixed maturity period	Have fixed maturity period but after some time it may turned into the nature of ordinary shares.
03	Nature of Income generated	Dividend	Fixed interest	Fixed or floating return. Interest/dividend
04	Convertibility	No chance for convertibility	No option for convertibility	There is option for convertibility into equity shares
05	Level of Risk	Comparatively high	Comparatively less	In between equity and debt
06	Status of Holders	Owners	Creditors	Initially the holders are considered as creditors and then they turned into owners
07	Liquidity	High liquidity	Less liquid than equity	Less liquid than equity and debt due to involvement of persons

2. Review of literature

Review of literature has been undertaken with two important objectives. The first objective is to obtain a comprehensive idea about the topic of the present study, including theoretical frame work, different dimensions of the problem, etc. The second objective is to identify the research gap that exists at present, based on the review of literature of earlier studies and to show that the present study is not a topic on which someone has already worked. Besides, it also aims at showing how this study is an attempt to fill the research gap that exists at present.

Samir K. Barua, V Raghunathan, Jayanth R. Varma and N Venkateshwaran(1994)⁰¹ in their study “**Analysis of the Indian Securities Industry: Market for Debt**” told about Indian capital market situation for trading of debt. Debt is one of the major financial instruments that can be used for raising fund. The situation prevailing in the Indian capital market is sharply different from that prevailing in the other capital markets in the world. With the commencement of trading of debt instruments by the national stock exchange, the secondary market of the Indian debt market is expected to achieve a significant level of activity. In this paper, the authors provide a detailed study about Indian debt market.

Julia T. Boltar(1995)⁰² in her article “**The characterization of Hybrid securities**” said that traditionally, a company may raise capital by debt or by equity. Debt involves the borrowing of money, where as equity involves the issuing of shares. A company may borrow money by issuing debentures. A debenture is a formal acknowledgement of debt by a company and the debenture holder is a creditor of the company for the amount of the loan and interest. Another way of raising capital is issuing Hybrid Securities. Hybrid securities are combination of both debt and equity instruments. This article presented about the characteristics of Hybrid securities in detail.

Dr. Asma Salman and Nauman Munir(2012)⁰³ in their article “**Choice between debt and equity and its impact on business performance**” said that financing decision will play a major role in deciding the future of a business firm. This article exhibits about how those business firms choose in between debt and equity and how that decision will effect on performance of their business? A cement company is selected to examine the effects of debt and equity. Results show that equity financing has more positive effect on business performance for the particular sample.

Hema P. Gwalami and Dr. D. B. Bharathi(2015)⁰⁴ in their article “**An analytical study of the awareness level of corporate Bond market in India among retail investors**” said that increasing the liquidity in bond market is very important factor for investment. Various efforts in the forms of reforms, change in guidelines and making availability of the required infrastructure has been made in the direction but still the efforts does not seem to give the expected results when it comes to the participation of retail investors in corporate bond market India. One of the major reasons of the non-participation has been lack of sufficient awareness on the part of retail investors. This paper try to measure the awareness level about the corporate bonds and also the reason for non – participation of retail investors in corporate bond market.

Nilesh Kulkarni (2017)⁰⁵ in his article “**A comparative study of Investor preferences with reference to Debt and Equity while constructing a portfolio in Mumbai region**” opined that any nation’s productive capacity mainly depends on the capital formation. Good savings rate coupled with good capital mobilization are the key macro – economic variables, which play a significant role in economic growth. In today’s highly competitive environment, different kinds of investment avenues or options are available to the investors. All investment modes have their own advantages and disadvantages. In this paper, an attempt is to study the various investment options preferred by the investors of Mumbai, and the study also tried to analyze the investor’s preferences particularly towards investment in equity and debt funds when other investment avenues are also available in the market.

G.C Venkataiah and Prof. B. K. Surya Prakash Rao(2018)⁰⁶ in their research work “**Investor’s perception towards various investment avenues- A study in Vijayawada city, Andhra Pradesh**” analyses the perception of investors towards various investment avenues. The main objective of the study is to measure the impact of demographic factors on the investors choice of investment and to analyze the decision of the investors towards various investment avenues across gender followed by an attempt to elucidate the factors that influences the investors preferential selection of various investment options.

3. Research Gap

Few more studies both by the individuals and the groups have been undertaken, both at the national and international levels. Some researchers worked on Hybrid securities separately. Some work also been done on comparative study of debt and equity. However a comprehensive review of these studies shows that much work is carried on bond market, equity shares features, debt and equity’s impact on performance of business. But the present study focuses on establishing the meaningful relationship between the conventional financial instruments debt and equity and hybrid securities and also the study has been undertaken on the perception of the investors. However, it is an attempt to fill the literature gap which is existing at present.

4. Objective of the Study

The objectives of the present study are as below:

1. To compare the features of debt, equity and Hybrid securities.
2. To study the investor’s perception regarding debt, equity and Hybrid securities in incorporating them in investment portfolio.

5. Scope of the study

The present study covers the features associated with debt, equity and Hybrid Securities. It also covers investor’s perception regarding factors influence to invest in equity, debt and Hybrid securities in Shivamogga District.

6. Research Hypothesis

Hypothesis Number	Research Hypothesis
H ₀₁	There is insignificant relationship between participating in surplus profit and investment in equity shares.
H ₀₂	There is no association between equity share's nature of price fluctuation and speculation share market.
H ₀₃	The payment priority has a positive impact on investing in debenture.

7. Research Methodology

Research methodology is a practice of studying how research is to be carried out scientifically. This section deals with the description of the study area, sampling procedure employed, the nature and sources of data, various tools and techniques employed to accomplish the objectives of the study.

The selected sample size is 500.

8. Debt, Equity and Hybrid Securities: An Analysis

The data analysis for present study was done quantitatively with the help of statistics. These data will provide more details about respondent's perception regarding investing in Debt, Equity and Hybrid securities.

Table - 1: Garrett ranking of respondent's perception regarding Level of Risk

Particulars		Overall		
		Total Score	Mean Score	Rank
Investment in Equities		21895	43.79	5
Investment in Debentures		26690	53.38	2
Investment in Hybrid securities	Convertible Debenture	13920	55.68	1
	Preference Shares	12330	49.32	3
	Capital Notes	11525	46.10	4

Source: Primary Data

Analysis and Interpretation:

This table shows respondent's perception regarding level of risk regarding investing in equity, debt and in Hybrid securities. Due to lack of investors in hybrid securities in the selected area, number of respondents in hybrid securities is limited to 250. The highest mean score is 55.68 for investment in Convertible Debentures and the lowest mean score is 43.79 for investment in equity shares. From the above table it is clear that convertible debenture has the lowest level of risk with mean score of 55.68 due to fixed return, Payment priority and option to convert into equity shares. According to respondents Equity shares has highest level of risk with mean score of 43.79 due to floating return, irredeemable principal amount and last priority of payment at the time of liquidation of company.

Table – 2: Garrett Ranking of respondent's perception regarding Investment in Equity Shares

Particulars	Overall		
	Total Score	Mean Score	Rank
Investment in equity shares leads to get high return	30275	60.55	2
Purchasing equity shares allows to participate in surplus profit	32105	64.21	1
Equity shares have high risk than other investment avenues	27185	54.37	3
The term of equity shares are perpetual hence it is very risky	24925	49.85	5
Fluctuating returns along with no returns situation make investors not to believe more on equity shares	23965	47.93	6
Equity shares are suitable only for high risk bearer	23595	47.19	7
Equity shares fluctuating price nature leads to speculation in the share market	26795	53.59	4

Source: Primary Data

Analysis and Interpretation:

The above table is about respondent's perception regarding investing in equity shares. According to this table respondents say they highly believe on surplus profit that generated in the company to invest in equity shares with mean score of 64.21. High return of equity shares is also attracting them hence it stands next with mean score of 60.55. Respondents are giving less importance for the statement equity shares are suitable only for high risk bearers with mean score of 47.19.

Table – 3: Garrett Ranking of respondent's perception regarding Investment in Debentures

Particulars	Overall		
	Total Score	Mean Score	Rank
Investment in debentures lead to get fixed income	28605	57.21	1
Investing in debentures allows to get back principal amount after maturity	27505	55.01	3
Debentures is one of the capital market instrument which have less risk	28060	56.12	2
Debentures is one of financial instrument which don't have any right in company's management	25175	50.35	5
The payment priority regarding interest as well as principal amount make a debenture most trust worthy instrument	26545	53.09	4
Debentures are not suitable for high return expecting investors	24715	49.43	6

Source: Primary Data

Analysis and Interpretation:

The above table shows the investor's perception regarding investing in debentures. According to this respondents are highly influenced by the fixed rate of interest to invest in debentures with mean score of 57.21 followed by the less risk factor with mean score of 56.12.

Table – 4: Garrett Ranking of respondent's perception regarding Factors Influencing Investment of Hybrid Securities

Particulars	Overall		
	Total Score	Mean Score	Rank
Steady and defined income to the investors of Hybrid Securities	13620	54.48	1
High rate of return as compared to simple Bonds	12755	51.02	5
The chance of converting Hybrid Securities in to ordinary shares	13345	53.38	2
To get tax advantage	11395	45.58	9
Low interest rate compare to standard bonds	11995	47.98	6
Priority of payment of dividend than ordinary shareholders	13165	52.66	3
May have fixed maturity period	11765	47.06	7
Hybrid securities have less risk	12825	51.30	4
Hybrid Securities are suitable for moderate return expecting investors with moderate risk	11610	46.44	8

Source: Primary Data

Analysis and Interpretation:

The above table shows the investors perception regarding factors influencing to invest in hybrid securities. According to respondent's perception they highly influenced by the steady and defined income offered by hybrid securities with mean score of 54.48. The chance of converting Hybrid securities into ordinary shares stands next with mean score of 53.38 and it is followed by priority of payment of dividend than ordinary shares with mean score of 52.66.

9. Result of Hypothesis

H₀1: There is insignificant relationship between participating in surplus profit and investment in equity shares.

H_a1: There is significant relationship between participating in surplus profit and investment in equity shares.

Table – 5: Purchasing equity shares allows participating in surplus profit

Factors	r – value	Remark	Result
Investment in equity shares lead to get high return	.048	Weak Positive	Accepted
Equity shares have high risk than other investment avenues	-.258**	Weak Negative	Rejected
The term of equity shares are perpetual hence it is very risky	-.102*	Weak Negative	Rejected
Fluctuating returns as well as no return situation make us not to be believe more on equity shares	-.038	Weak Negative	Rejected
Equity shares are suitable only for high risk bearer	.032	Weak Positive	Accepted
Equity shares fluctuating price nature leads to speculation in the share market	.144**	Weak Positive	Accepted

** . Correlation is significant at the 0.01 level; * . Correlation is significant at the 0.05 level

Source: Primary Data

Investment in equity shares not only leads to get high returns but also had high risk along with fluctuating returns which are suitable for high risk bearer where fluctuating price leads to speculation in the share markets. As such, the relationship between participation of surplus profit and other factors of investment in equity shares was studied and found that surplus profit had positive relation with high returns, risk bearing and price nature which led to speculation in share market with r value at 0.048, 0.032 and 0.144 respectively. While, other factors inducing investment in equity shares like equity shares to be perpetual and fluctuating returns or no returns leading not to believe in equity shares had negative relationship with r value be at -0.102 and -0.038 respectively.

H₀₂: There is no association between equity share's nature of price fluctuation and speculation share market.

H_{a2}: There is association between equity share's nature of price fluctuation and speculation share market.

Table – 6: Equity shares fluctuating price nature leads to speculation in the share market

Factors	r – value	Remark	Result
Investment in equity shares lead to get high return	.196**	Weak Positive	Accepted
Purchasing equity shares allows to participate in surplus profit	.144**	Weak Positive	Accepted
Equity shares have high risk than other investment avenues	.056	Weak Positive	Accepted
The term of equity shares are perpetual hence it is very risky	.218**	Weak Positive	Accepted
Fluctuating returns as well as no return situation make us not to be believe more on equity shares	.201**	Weak Positive	Accepted
Equity shares are suitable only for high risk bearer	.144**	Weak Positive	Accepted

** . Correlation is significant at the 0.01 level; * . Correlation is significant at the 0.05 level

Source: Primary Data

The test of relationship of the nature of price fluctuation of equity shares with speculation in share market revealed that all factors had positive relation indicating that price fluctuation had positive but weak relationship with factors like investment in equity shares leading to get high return ($r = 0.196$), purchasing of equity shares allowing to participate in surplus profit ($r = 0.144$), equity share having higher rate of risk compared to other avenues ($r = 0.056$), equity shares being perpetual leading to risk nature ($r = 0.218$), equity shares featured with fluctuating returns as well as no returns leading to less level of belief on equity shares ($r = 0.201$) and equity shares suitable only for high risk bearers ($r = 0.144$).

H₀₃: The payment priority has a positive impact on investing in debenture.

H_{a3}: The payment priority has a negative impact on investing in debenture.

Table – 7: The payment priority regarding interest as well as principal amount makes a debenture most trust worthy instrument

Factors	r – value	Remark	Result
Investment in Debenture lead to get fixed income	.345**	Weak Positive	Accepted
Investing in Debenture allows you to get back principal amount after maturity	.095*	Weak Positive	Accepted
Debenture is a one of the capital market instrument which have less risk	.002	Weak Positive	Accepted
Debenture is a one of financial instrument which don't have any right in company's management	.185**	Weak Positive	Accepted
Debentures are not suitable for high return expecting investor	.004	Weak Positive	Accepted

** . Correlation is significant at the 0.01 level; * . Correlation is significant at the 0.05 level Source: Primary Data

Further, the relationship between payment priority and investment in debenture showed the existence of positive relationship between these two as the r value for factors regarding investment in debenture like investment in debenture leading to get fixed income ($r = 0.345$), investment in debenture allowing to get back the principal amount after maturity ($r = 0.095$), debenture being one of the capital market instrument with less risk ($r = 0.002$), debenture being a financial instrument without any right in company's management ($r = 0.185$) and debenture not suitable for high return expecting investor ($r = 0.004$) through being weak but having positive relationship with payment priority.

10. Findings based on Objectives

The following are findings based on objectives of the study.

- With mean score of 64.21 purchasing equity shares leading to participate in surplus profit and investment in equity shares leading to get higher returns are the most widely accepted perception of the majority of the respondents which decides investment in equity shares.
- On the other hand, fluctuating returns along with no returns situation making investors not to believe more on equity shares and equity shares suitable only for high risk bearer are the least accepted factors in deciding investment in equity shares.
- Majority of the respondents that is 57.21 widely accepted that investment in debentures leading them to get fixed income and debentures being one of the capital market instruments having less risk are the significant determinant factors to invest in debentures.
- At the same time, debentures as financial instrument not having any right in company's management and debentures not suitable for high return expecting investors are the least determinant factors in investing in debentures.

- 53.38 and 55.68 mean score respondents respectively expressed that level of risk is found to be at lower rate in investment in debentures and in hybrid securities regarding convertible debenture.
- While it is felt to be at higher rate regarding investment equities and in hybrid securities particularly in capital notes.
- With 54.48 mean Steady and definite income to the investors of hybrid securities followed by the chances of converting hybrid securities into ordinary shares and priority of payment of dividend than ordinary shareholders are the widely accepted factors by majority of the respondents in influencing investment of hybrid securities.

11. Major Suggestions of the study

The major suggestions to investors, issuers and government are presented as below

- Equity shares are one of the financial instruments with high return and high risk. Hence is suitable for those investors who are ready to take high risk to enjoy high return.
- Debt is a long term financial instrument offered by the company to raise fund. It is suitable for those investors who want invest their money safely.
- Hybrid security is complex in nature; hence the investor has to invest only after complete study of products.
- The issuing company has to some initiative measures to educate the investors regarding the pros and cons of new investment opportunities.
- Government has to undertake a good number of awareness programmes to eradicate the ignorance of the public regarding investing in share market.

12. Conclusion

The present study is carried out with the primary objective of comparing the three main financial instruments like debt, equity and hybrid securities that are traded in capital market, hoping to clarify the confusions among these three instruments. The comparative study is made mainly on the basis of their features. Equity shares are owner's stock issued by the company to collect capital and Debt is long term financial instrument issued by the company to raise fund in the form of loan, whereas Hybrid securities are the financial instruments with both nature of debt and equity. The investor has to study in detail about the investment option before investment. All these three instruments are very important in their own way in generating income for investors.

13. References

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