Q7

Consider the following statements: Statement I: As regards returns from an investment in a company, generally, bondholders are considered to be relatively at lower risk than stockholders. Statement II: Bondholders are lenders to a company whereas stockholders are its owners. Statement III: For repayment purpose, bondholders are prioritized over stockholders by a company. Which one of the following is correct in respect of the above statements? (a) Both Statement II and Statement III are correct and both of them explain Statement I (b) Both Statement I and Statement II are correct and Statement I explains Statement II (c) Only one of the Statements II and III is correct and that explains Statement I (d) Neither Statement II nor Statement III is correct Official key: A.

UPSC Civil Services Prelims 2025 · General Studies · 2 marks · Economy

Indian economy, budget, schemes - Prelims GS Paper I.

Explanation

(a) Official key

Both II and III are correct and both explain I. Bondholders lend; stockholders own. Bonds rank ahead of equity in repayment. That is why bondholders are generally at lower risk for returns.

(b)

I and II with I explaining II. The direction of explanation is backwards, and III is dropped.

(c)

Only one of II and III correct. Both are correct.

(d)

Neither II nor III. Both corporate-finance lines hold.

Summary

Official Set A key is (a). Bondholders are creditors; stockholders are owners (II). In winding-up, debt is paid before residual equity (III). Fixed coupons and seniority are why bond returns are generally less risky than equity (I). II and III are both true and both explain I. (d) is the trap if you over-think the wording.

Related possible facts

These can be asked in a future Prelims paper.

Bond vs stock

A bond is a loan instrument; a stock is residual ownership. That is the usual II.

Seniority of claims

In insolvency, debt is paid before equity. That is the usual III.

IBC waterfall, section 53

India's statutory order of payment - the law neighbour of Statement III.

Convertible bond

Debt that can become equity. A hybrid that blurs II in advanced questions.

Preference shares

Sit between debt and equity in some waterfalls. Another neighbour.