FINANCE AT A GLANCE

Interest Expense and Dividends

Lesson 28

Interest on borrowed funds is an expense, but it differs from most of the other expenses. Most expenses are incurred in order to stimulate revenue generation. Interest expense by itself does not stimulate revenue generation. It is an expense incurred for using money from external sources.

From the point of view of the external providers of funds (the creditors), interest is their return for the lending exercise.

Dividends , on the other hand, are returns given to the owners of a company (the shareholders) to compensate them for the investing exercise. Dividends are not considered expenses. They are deducted from what remains, if any, of the revenue after subtracting all of the expenses. A dividend can be viewed as the portion of the net profit, which, instead of being reinvested into the business, is given out to the shareholders.

Interest Expense is shown in the income statement. Dividends are not expenses and do not appear in the income statement. The disclosure of Dividends is done by way of another statement, which will be presented in a future lesson.

Interest expenses normally come with stipulated dates of payment to the creditors, and are ought to be paid, in order to avoid violating the terms of borrowing. Dividends, on the other hand, need not be paid, if there are no profits to pay them from, or if the shareholders agree among themselves to put the entire net profit back into the business.

Until then,

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