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Gainful move (also see in Jpeg)

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PREFERENCE SHARES

Gainful move

The listing of preference shares provides companies more resources to fund growth

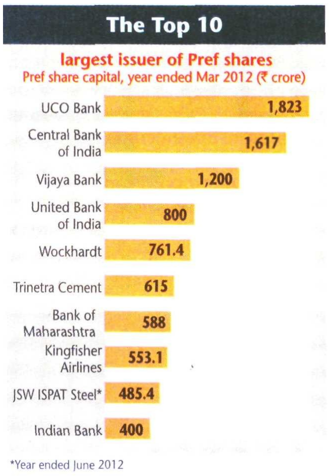
SEBI's board meeting on 8 March has allowed issue and listing of non-convertible redeemable preference shares (NCPS) on the bourses. In the specified securities, NCPS were not covered under SEBI (issue & listing of debt securities) Regulations, 2008 and, hence, NCPS will now be covered under eligible securities for listings. Even non-listed companies can issue NCPS.

This is a good move as it will help India Inc to raise resources to fund their growth, SEBI'S guidelines suggest that, while issuing through public offerings, the preference shares should have minimum tenure of three years and minimum rating of 'AA-' to safeguard the interest of the investors. If the preference shares are issued through private placement, the new rule says that the minimum investment threshold limit is Rs.10 lakh, so that only informed investors can take exposure to the private placements of preference shares.

But will private placement of NCPs attract FIIs? From the perspective of FEMA, foreign investment in NCPS would be considered external commercial borrowings (ECBs) and would be subject to the FEMA ECB regulations. "The portfolio investment scheme for FIIS set out in Schedule 2 of the FEMA Foreign Investment Regulations permits FIIs to invest in equity shares, compulsorily convertible preference shares and compulsorily convertible debentures (but not non-convertible or optionally instruments).

Schedule 5 of the same regulation permits FIIs to invest in certain other specified types of securities, including listed non-convertible debentures, but again does not cover preference shares. Accordingly, one would expect to see amendments in these regulations to enable investment in listed NCPS through the FII route," advises Christopher Krishnamoorthy, associate partner, Majmudar & Partner, international lawyers.

This should open up one more avenue for the investors, especially when fixed income instruments are becoming more popular, due to volatile stock market conditions. "I believe this is a positive step from the SEBI," suggests D.R. Dogra, MI), CARE Ratings. "This will improve liquidity on the instruments and attract new investors. As of now, not many



preference shares are rated but, after these guidelines, the business of rating preference shares will increase".

Preference shares were popular instruments but they lost their relevance and popularity after the Harshad Mehta scam. In those days, many companies used to issue redeemable preference shares and also convertible preference shares. About 300 companies have preference shares capital in their books, with the outstanding capital exceeding Rs.17,500 crore. The largest issuers of preference shares capital are banks, as they help meet the banks' Tier I capital requirement. "As per Basel III norms, banks can issue non-equity instruments such as 'perpetual non-cumulative preference shares' and 'innovative perpetual debt instruments', which are in compliance with the specified criteria for inclusion in additional Tier I capital," declares SEBI, in its press release. But though such shares are popular in overseas markets, so far they have not been listed in India.

Right to dividend

So, what is a preference share? Is it 'debt' or 'equity'? For all practical purposes, it is a debt instrument, despite the fact that it forms a part of the share capital. Then, why issue preference shares, rather than debt? It is equity, but safer than common equity. A preference share carries the right to dividend at a fixed rate with it, irrespective of the amount of profits earned by the company. For equity share holders, the rate of dividend fluctuates. So, equity shareholders can look forward to more dividend when company's profits goes up, but preference shareholders do not get more dividend. However, preference share holders have preferential rights to repayment of capital, in case the company gets wound up. Also, unlike equity shares, preference shares do not carry any voting rights with it, except on matters that directly affect their rights in the company.

In the recent past, many of the companies have issued preference shares to the promoters to improve the liquidity situation of the company, especially when they were passing through rough patches, to ease the liquidity conditions. The listing of preference shares would give investors easy access to liquidity as and when money is needed.

This will also help expand the corporate fixed deposit market. But Kishor Ostwal, CMD, CNI Research says, "Coupon rate will be decisive factors for preference shares instrument to be successful. If the coupon rate is not attractive, preference shares may get traded at the discount on the exchanges, exposing the investors to a loss of capital".

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