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PREFERENCE SHARE ISSUES ON THE RISE

Preference shares are emerging as a popular instrument in the capital market, looking at the increasing number of companies who are opting for this route according to Mr.Prithvi Haldea of PRIME, India's premier research out fit on the primary capital market..

As per PRIME, such issuances have been most pronounced in the private placement segment and almost all of these are for redeemable preference shares. The total amount so raised is estimated in excess of Rs.2000 crore. In the current fiscal, such issues have been made, among others, by Reliance Industries (Rs.200 crore),Gujarat Ambuja Cement (100), IFCI (100), Lupin Laboratories (25), ATCO (14) and Sterling Holiday Resorts (15).

This list excludes scores of other private placements made on a one-to-one basis by the issuers to the promoters, collaborators or institutions. Such one-to-one placements include Siemens (Rs.150 crores), Torrent Power (250), Rallis (35), BSES (35) and Floatglass.

In the previous 2 years, such shares were placed among others, by Birla Global Finance (Rs 10 crore), E.I.D. Parry, United Phosphorous (11), Gujarat Ambuja Cement(30), BSES (39), ICICI (75), Ballarpur (38), Prudential Mouli (50) and Reliance Industries (200).

According to PRIME, in the public issue segment, the activity is on a subdued note. There have been no offerings in the first six months of the current fiscal. However, between the period April 1989 and March 1997, there were 17 public issues. Significantly, all of these were of convertible preference shares, in all raising Rs.216 crore. The issuers, among others, included Alliance Credit (Rs.23 crore), SREI International Finance (48), Fortis Financial (5), Jindal Photo Films (54), Prudential Mouli Sugars (10), Fabworth (32), Uniworth (16) and JCT Fibres (5).

In the rights issue segment also, there has again been no offerings in the first six months of the current fiscal as per **PRIME**. However, between the period April 1989-March 1997, there were 13 rights issues, incidentally all again of convertible preference shares, in all raising Rs.133 crore. These issues, among others, included Parasrampuria Synthetics (Rs.49 crore), Pal Credit (18), Jindal Photo Films (23) and Parasrampuria Industries (11).

The near future, according to **PRIME** data base, has several such issues lined up, almost entirely through the private placement route. Some of these include APR (Rs.50 crore), Ceat Financial (25), Century Textiles (100), GKW (20), ICICI (1000), IIBI (150), ITC Classic Finance (220), JK Corp (50), Nagarjuna Finance (20), Palace Heights Hotels (20), SBI Home Finance (25), SPIC (70) and Thiru Arooran Sugars (15).

According to Mr.Haldea, there are four main reasons for preference shares gradually acquiring a place of pride : the removal of double taxation on dividends, the removal of cap on bank investment in preference shares and debentures, a dull primary market and the easier, inexpensive route of private placement.

For the investors, with the removal of double taxation on dividend, such shares offer tax-free returns. At the same time, the risk to the investors is minimised as the rate of dividend remains fixed irrespective of the performance of the company.

The removal of cap on bank investments in preference shares and debentures has also helped in revival of this instrument.

For the corporate sector, as per Mr.Haldea, preference shares have become attractive because these provide an opportunity to raise reasonably cheap capital in a dull primary market. At an average dividend rate of 10 per cent, the cost of funds works out to about 11 per cent, after paying a 10 per cent dividend tax.

Cumulative preference shares also suit the corporates because the dividend payout can be accumulated and paid when the project starts earning profits. Moreover, preference shares are not taken as part of ordinary equity for the purpose of calculation of earnings per share. As such, there is no fear of equity dilution.

The corporates are increasingly taking advantage of the lack of regulation for private placements, which is also faster and less expensive. The non banking finance companies too are using this route to escape the provisions of deposits and the recent decline in such mobilisation. Such placements enable companies to raise resources without a credit rating or networth-linked restrictions.

The finance ministry has also allowed Indian companies to mobilise foreign investments through issue of preference shares. Such investments will be treated as share capital and not external commercial borrowings.