THE USE OF PREFERENCE SHARES BY MALTESE LISTED COMPANIES: A STUDY

BY

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A dissertation submitted in partial fulfilment of the requirements for the award of the Master in Accountancy degree in the Department of Accountancy at the Faculty of Economics, Management and Accountancy at the University of Malta

MAY 2023
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Abstract

TITLE: The Use of Preference Shares by Maltese Listed Companies: A Study

PURPOSE: This study has three main objectives: to establish the extent to which preference shares have been used by Maltese Listed Companies (MLCs); to ascertain the main determinants and barriers to preference share issues in the local capital market; and to determine whether preference shares have a place in the capital structure of MLCs.

DESIGN: A qualitatively-driven mixed-methods approach was adopted. Semi-structured interviews were conducted with 27 participants comprising 23 MLC representatives, a Malta Stock Exchange (MSE) representative, two stockbrokers, and a Big Four financial advisor. An analysis of the financial distress of the local preference share issuers (PSIs) prior to their preference share issues was also conducted through the selection and computation of six ratios and the use of different quantitative approaches for each respective issuer.

FINDINGS: Preference shares were issued by only two MLCs, and it was found that they are largely disregarded as a financial instrument, often being perceived as ‘a last resort’. It was found that preference shares are used for various purposes including to meet financing needs and support corporate growth; avoid dilution of control; exploit favourable market conditions; maintain a balanced capital structure; and enhance debt capacity. Furthermore, evidence was found in support of the financial distress theory, as the two PSIs showed some signs of being in financial distress prior to issuing preference shares. Conversely, the main barriers to preference share issues were deemed to result from the inherent limitations of the local capital market; preference shares’ lack of attractiveness to investors; their perceived complexity; and the lack of knowledge of this hybrid instrument. The study further indicated that many MLCs are willing to consider issuing preference shares in the future if current market conditions improve. Finally, enhanced education on preference shares was deemed necessary to encourage their issuance by MLCs.

CONCLUSIONS: The study concludes that preference shares and their unique features are not yet sufficiently recognised and understood by MLCs. The characteristics of the local market; the complex nature of preference shares; and an apparent knowledge barrier, significantly hamper the widespread use of this means of financing. Therefore, such barriers need to be urgently addressed for preference shares to be secured a place in the financing structure of MLCs.

IMPLICATIONS: This study is the first of its kind in Malta and attempts to foster a greater level of understanding and appreciation of preference shares, as well as their potentially valuable contribution to the local capital market. It also proposes various recommendations as to how preference share issues can be increased.

KEYWORDS: preference shares, preference share issues, Maltese Listed Companies (MLCs), financial.
Dedication

To my beloved family

and

In loving memory of
my late grandma Ersilia
Acknowledgements

I would like to take this opportunity to express my sincere gratitude to all those who have supported me throughout the course of this study.

Firstly, I would like to express my deepest thanks and indebtedness to my dissertation supervisor Dr Lauren Ellul, B.Accty. (Hons), M.B.A. (Exec.) (Edin. and E.N.P.C.), F.I.A., C.P.A., Ph.D. (Birm.), for her constant and invaluable guidance, patience, dedication and expertise during the entire process of this dissertation.

My heartfelt appreciation also goes to Prof. Peter J. Baldacchino, Ph.D. (Lough), M.Phil. (Lough), F.C.C.A., F.I.A., C.P.A, for his expert advice and direction in the very initial stages of this dissertation.

I would also like to thank Prof. Liberato Camilleri B.Ed. (Hons), M.Sc., Ph.D. (Lanc.) for his assistance in the analysis of the statistical data using IBM SPSS software.

Special thanks also go to all the research participants who kindly dedicated their time to contribute to this research area. This study would not have been possible without their participation and valuable insights.

Above all, I would like to express my profound gratitude to my parents, Joseph and Doreen, for their unconditional love and unfailing encouragement throughout my academic years and the completion of this study. I am immensely grateful for all of their sacrifices. Special acknowledgements also go to my sister, Alison, who has been my role model in more ways than one, and to my uncle John for his counsel and inspirational teaching.

I am especially grateful for having shared my academic journey with my twin brother, Bernard. He has been my constant source of support and has been there for me every step of the way. I am incredibly proud of him.

Finally, I owe all my personal and academic achievements to God, without whom I would not have made it thus far.
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<th>Abbreviation</th>
<th>Full Form</th>
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<tr>
<td>AT1</td>
<td>Additional Tier 1</td>
</tr>
<tr>
<td>CA</td>
<td>Companies Act</td>
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<td>CET1</td>
<td>Common Equity Tier 1</td>
</tr>
<tr>
<td>CFO</td>
<td>Chief Financial Officer</td>
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<tr>
<td>EBA</td>
<td>European Banking Authority</td>
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<tr>
<td>FA</td>
<td>Financial Advisor</td>
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<tr>
<td>IAS</td>
<td>International Accounting Standard</td>
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<tr>
<td>IFRS</td>
<td>International Financial Reporting Standard</td>
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<tr>
<td>IPO</td>
<td>Initial Public Offering</td>
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<tr>
<td>ITA</td>
<td>Income Tax Act</td>
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<tr>
<td>MFSA</td>
<td>Malta Financial Services Authority</td>
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<tr>
<td>MiFID</td>
<td>Markets in Financial Instruments Directive</td>
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<tr>
<td>MLC</td>
<td>Maltese Listed Company</td>
</tr>
<tr>
<td>MLCrep</td>
<td>Maltese Listed Company representative</td>
</tr>
<tr>
<td>MSE</td>
<td>Malta Stock Exchange</td>
</tr>
<tr>
<td>MSErep</td>
<td>Malta Stock Exchange representative</td>
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<tr>
<td>PSI</td>
<td>Preference Share Issuer</td>
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<td>T2</td>
<td>Tier 2 Capital</td>
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1.1 Introduction

This introductory chapter establishes the context of the research topic and provides an overview of the purpose and focus of this dissertation. Section 1.2 provides a backdrop to the study and Section 1.3 outlines the need for the study. The research objectives and limitations of the study are presented in Sections 1.4 and 1.5 respectively. Section 1.6 lays out the overall structure of this dissertation.

Figure 1.1: Outline of Chapter 1
1.2 Background to the study

1.2.1 The financing decision

The corporate capital structure decision has been a subject of extensive debate that has captured and continues to capture the interest of countless researchers, economists, and finance managers over the years (De Wet 2006).

"In the same way that artists select from an infinite palette of colors, financiers choose from a broad palette of financial technologies and securities to build the correct capital structure for a business" (Milken 2004, p.77).

Traditional finance literature has often reduced the financing decision to a simple choice between debt and common equity (Pike et al. 2015). However, through financial innovation and an increasingly dynamic business environment, this choice has now become a highly complex selection between a multitude of different and competing instruments, to serve both the financing and investment goals of issuers and investors alike (Damodaran 1999). Amongst the alternative financial instruments available to corporations is the preference share (Bonnevier and Børke 2014).

1.2.2 Defining preference shares

Preference shares, also known as preferred stock in the U.S., are a class of shares that, as their name implies, come with several associated privileges (Parameswaran 2007). Foremost of which is the priority in the receipt of dividends over ordinary shareholders which is often considered to be the preference share’s “defining attribute” (Yarko 2020, p.12). This implies that the dividends promised to preference shareholders must first be paid in full before common shareholders can receive any dividends (Vernimmen et al. 2018). Preference shareholders may also have a prior claim to a company’s earnings and residual assets in the event of liquidation (Bechvaia 2016). Therefore, preference shares rank senior to equity but junior to debt in the corporate capital structure, as shown in Figure 1.2 below:
However, unless otherwise specified, shares are considered to be ordinary and hence, if any preferential rights are to be granted to holders in relation to dividend, repayment of capital, or both, this must be clearly set out in the issuing company’s Memorandum and Articles of Association and Terms of Issue, as must be any other specific rights annexed to such shares (Grima 2022).

Although in legal terms, preference shares form part of the company’s equity base, in practice, they bear considerable resemblance to debt (Santow 1962). In fact, they are hybrid securities, featuring characteristics of both pure equity and pure debt (Liberadzki and Liberadzki 2019).

Like ordinary dividends, preference dividends are a distribution of a company's earnings to its shareholders. Article 192(1) of the Companies Act (CA) 1995 Chapter 386 of the Laws of Malta, states that dividends can only be paid out of a company’s distributable profits and only if declared by the board of directors. However, like debt, preference shares are fixed-income securities, such that preference shareholders are guaranteed a constant income stream, yet are denied the right to enjoy, without limitation, the fruits of the company’s success (Walther 2014).
1.2.3 Features of preference shares

“In spite of its much emphasized ‘hybrid’ nature, preferred stock does carry some peculiar features of its own” (Wong 1989, p.8); the first of which is a fixed rate of dividend (Liberadzki and Liberadzki 2019). Also, typically preference shares carry no voting rights, thereby restricting preference shareholders’ ability to actively influence day-to-day decision-making (Yarko 2020).

As contended by Korsmo (2013, p.1171), there is no “[p]latonic ideal for the preferred stock”, nor is it a "one-size-fits-all” security” but “come(s) in a bewildering variety”. Indeed, preference shares can have a vast array of possible features, and hence “can be viewed along a spectrum from quasi-debt to quasi-equity instruments” (Laurent 2002, p.5). As illustrated in Figure 1.3, a participating, non-cumulative, convertible, and/or irredeemable preference share is similar to equity; whilst a non-participating, non-convertible, cumulative, and/or redeemable preference share is akin to debt (Pike et al. 2015).

![Diagram](#)

**Figure 1.3:** Features of preference shares along the debt-equity continuum

By virtue of its “highly heterogenous” nature, the preference share is a “bespoke security” (Korsmo 2013, p.1171), that can be tailored to best suit the specific financing needs and circumstances of different issuers (Bessa 2017). Indeed, preference shares have flexible features that enable the issuing company to “raise capital by crafting terms” that attract the right investors (Ackerman and Bonvino 2017, p.6).
As a result, “there is no common pattern” to preference share issues as they differ considerably from one company to another (Yarko 2020, p.19), which is why Korso (2013) stresses the importance of exercising caution prior to reaching general conclusions on the motivations and objectives of preference share issues.

The four main features of preference shares are described hereunder.

**Participating/Non-participating preference shares**

Preference shareholders may also participate alongside ordinary shareholders in the distribution of further dividends, above the regular fixed return, or in the distribution of any remaining proceeds in a winding-up (Yarko 2020). Contrarily, non-participating preference shares entitle the holder to no more than the standard fixed dividend (Choudhry 2004).

**Cumulative/Non-cumulative preference shares**

Holders of preference shares may also be entitled to a right to cumulative preference dividends. This means that any unpaid dividend in a given year, shall accumulate and be paid out of future years’ profits, when available, before any dividend is distributed to common shareholders (Liberadzki and Liberadzki 2019). Contrastingly, if the preference shares are non-cumulative, any foregone preference dividend payment is not deferred but lost altogether (Wang 2006).

**Redeemable/Irredeemable preference shares**

Redeemable preference shares are shares that can be bought at a specified time or interval, at the discretion of either the issuing company or the preference shareholder (CA 1995, Article 115[1]). Inversely, irredeemable preference shares have no fixed maturity date by which they must be repaid (Liberadzki and Liberadzki 2019).
Convertible/Non-convertible preference shares

Convertible preference shares are those shares that can, at the request of their holders, be converted into ordinary shares at some future point in time and at a predetermined conversion rate (Choudhry 2004).

1.2.4 Maltese Listed Companies

As with other sources of finance, preference shares can be issued privately or else offered to the public and “subsequently listed on a trading platform operated by a stock exchange. Locally, the Malta Stock Exchange [MSE] provides the infrastructure for the listing of securities” (Rizzo 2022b, p.27). For issuing companies, the capital market is an important source of financing that can be drawn upon at different phases of the business lifecycle (Rizzo 2022b).

The Financial Markets Act (FMA) 1991 (Article 2[1]), Chapter 345 of the Laws of Malta, defines a listed company as:

“a company whose financial instruments have been admitted to listing on a trading venue in accordance with the provisions of this Act”.

The Malta Financial Services Authority (MFSA) acts as the sole regulator for financial services in Malta and also serves as the local Listing Authority. As of 30th September 2022, there were a total of 80 Maltese Listed Companies (MLCs)\(^1\).

Furthermore, as per Articles 89 and 94(3) of the CA (1995), for a publicly listed company to offer preference shares to the public, it must draw up and publish a prospectus, laying down “key information in order to aid investors” in adequately gauging the performance and future prospects of the company, “when considering whether to invest in such securities.”

---

\(^1\) Vide Appendix 1.1
1.3 Need for the study

Whilst the debt-equity choice has been thoroughly analysed in the corporate finance literature, the subject of preference shares has, in contrast, been accorded very little discussion (Bonnevier and Børke 2014). Most capital structure theories, stemming from the pioneering work of Modigliani and Miller (1958), have incorporated preference shares as part of equity or as part of the venture capital framework (Yarko 2020). Few, if any, have recognised preference shares as a separate financial instrument in their own right (Laurent 2002).

Perhaps, this apparent lack of attention can be attributed to the misperception that “preferred stock is something of a relic from an earlier era of corporate finance” (Korsmo 2013, p.1164). However, preference share issues are not an unusual phenomenon in overseas markets, particularly in the U.S. (Rizzo 2021a). The local preference share market, however, has been dormant for several years and has only just recently been revived through a preference share issue by one local listed company (Rizzo 2021a).

Furthermore, existing studies specifically dealing with the use of preference shares by listed companies, are predominantly restricted to the U.S (Bonnevier and Børke 2014). As yet, no similar research endeavours have ever been made in the local context. In light of this, it seems fitting to investigate the role of this unconventional financing vehicle in the corporate finance structure, from the lens of a small island. Therefore, this dissertation seeks to extend the scarce body of literature on preference shares, by providing in-depth insight into the value and use of preference shares in the financing of MLCs.
1.4 Objectives of the study

Having set the scene for this study and established its relevance, this dissertation shall have the following objectives:

a) To establish the extent to which preference shares have been issued by Maltese listed companies.

b) To analyse the major determinants and barriers to such preference share issues.

c) To determine whether preference shares have a place in the capital structure of Maltese listed companies.

1.5 Scope and limitations of the study

Apart from those referred to in Section 1.2.3, other forms of preference shares, including for example, convertible adjustable preferred stock and monthly income preferred stock, fall outside the scope of this dissertation.

The small number of preference share issuers (PSIs) in Malta, limits the inference of industry-wide conclusions from the results of the financial distress analysis undertaken in this study, as well as the potential generalisation of the reasons for which MLCs issue preference shares. Furthermore, most of the existing empirical and theoretical literature on preference shares is outdated and based in the U.S.
### 1.6 Dissertation structure

Figure 1.4 depicts a structured breakdown of this dissertation:

<table>
<thead>
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<th>Chapter 1: Introduction</th>
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<tr>
<td>• This chapter has introduced the research topic to the reader, supplying general background information on the financing decision and the nature and features of preference shares. Thereafter, the need for such a study in the local context, and the scope and limitations of the study were outlined.</td>
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<th>Chapter 2: Literature Review</th>
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<tr>
<td>• This chapter carefully examines the relevant literature appertaining to the research topic under study, addressing, in a sequential manner, all three of the research objectives. It starts with a recount of the history of the use of preference shares, moves on to a comprehensive review of the determinants and barriers to preference share issues, and ends with an evaluation of the potential role of preference shares in the corporate capital structure.</td>
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<th>Chapter 3: Research Methodology</th>
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<tr>
<td>• This chapter explains the research methods adopted to conduct this study, as well as the data analysis techniques utilised and any related limitations.</td>
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<th>Chapter 4: Research Findings</th>
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<td>• This chapter presents the research findings gathered from the semi-structured interviews and the financial distress analysis undertaken in this study.</td>
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<th>Chapter 5: Discussion of Findings</th>
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<td>• This section seeks to investigate the findings resulting from the chosen research methods, establishing a link between what is discussed in current literature and what is revealed in this study.</td>
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<th>Chapter 6: Summary, Conclusions and Recommendations</th>
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<tr>
<td>• This final chapter brings the dissertation to a close by summarising the findings, drawing appropriate conclusions, and suggesting areas for further research.</td>
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*Figure 1.4: Dissertation overview*
CHAPTER 2

LITERATURE REVIEW
2.1 Introduction

This chapter gives a detailed account of the existing local and international literature on the research topic. Section 2.2 provides a historical narrative on the use of preference shares both within and outside Europe, thus addressing the first research objective. Sections 2.3 to 2.5 seek to fulfil the second research objective, by explaining the existing regulations on the use of preference shares, and the motivations and barriers to preference share issues. In meeting the third objective, Section 2.6 deals with the role of preference shares in the corporate capital structure. Figure 2.1 illustrates the way in which this chapter will be sectioned.

![Figure 2.1: Outline of Chapter 2](image-url)
2.2 History on the use of preference shares

2.2.1 The use of preference shares in the U.S. and UK

Preference shares have a “long and rich history” in both the U.S. and the UK (Bechvaia 2016, p.46). According to Evans (1929), the very first preference share issues in the U.S. can be traced to 1836, where Maryland railroad and canal companies, most of which were in financial difficulties, were unable to raise the necessary capital from investors to complete their construction projects. As a result, they appealed for state financial aid, which was only supplied in exchange for stock with a fixed dividend (Moyer et al. 1987). Since then, preference shares continue to remain an important means of financing for many U.S. companies (Kallberg et al. 2013). Yet, the American preferred stock market is still comparatively smaller to the debt and common equity markets (Brzenk and Soe 2015).

Evans (1929, p.49) contends that preference shares originated in England as “the use of ‘new’ shares with a priority or preference of dividend had already been permitted” way back in the 16th century (Baker and Langenfeld 2018). However, as opposed to the U.S., “there is a question as to how active the UK preference share market has been”, given the scant research on the subject in the UK (Laurent 2002, p.4).

2.2.2 The use of preference shares in Europe

European listed companies have not been as keen to resort to this means of raising external capital (Bonnevier and Børke 2014). In Europe, as voiced by Vernimmen et al. (2018, p.436):

“Preference shares remain useful as a vehicle for financial investments in unlisted companies…[f]or listed companies the issue of such products does not seem to have become established practice. [T]his product has virtually disappeared from stock markets.”
Similarly, as documented by Rolfsson and Åkerlind (2018), up until 2006, preference shares had never been issued in the Swedish capital market. However, from 2009 to mid-2016, Brabenec et al. (2020) report that a total of 158 publicly traded companies across the European market issued both preferred and common stocks, with most issuers based in Russia, Germany, Italy and Sweden. The German preference share market is indeed a rather active market, with car automakers like BMW and Volkswagen frequently issuing preference shares (Rizzo 2021a).

Historically, preference shares have been a largely unpopular financial instrument in Malta, with these securities only just having resurfaced in the public market after a 19-year absence, thanks to an Initial Public Offering (IPO) of preference shares by an MLC in 2021 (Rizzo 2021a).

2.2.3 The use of preference shares as a last resort

The Pecking Order Theory developed by Myers and Majluf (1984), contends that companies follow a financing hierarchy, whereby preference shares and/or other hybrid securities are only resorted to after having exhausted the use of debt and “before having to resort to an issue of undervalued ordinary shares” (Laurent 2002, p.20).

In contradiction, Donaldson (1962) and Pinegar and Wilbricht (1989, p.85) argue that preference share financing “of any sort is less appealing than financing with external common stock.” According to Donaldson (1962), most companies adopt the following set of priorities, in order of decreasing desirability:

1. Retained earnings
2. Debt
3. New common stock
4. Preferred stock
Likewise, as cited by Korsmo (2013, p.1164), Graham and Dodd (1962) are highly sceptical about the viability of the use of preference shares, perceiving them to be “fundamentally unsatisfactory”,

“offering many of the respective downsides of equity and debt, and few of the respective upsides.”

In her qualitative study, Laurent (2002) finds that UK firms issued convertible preference shares because they were “the only feasible alternative” given the unavailability of straight debt or equity instruments. Similarly, Bessa (2017) argues that preference shares may serve as a solution of last resort for those firms struggling to survive, as was indeed the case both during and in the aftermath of the 2008 global financial crisis (Bonnevier and Børke 2014).

2.3 Regulating the use of preference shares

This section explains the accounting, taxation, and other regulatory requirements impacting the use of preference shares as a mode of financing.

2.3.1 Accounting regulations - liability vs equity

Preference shares and their classification are regulated by IAS 32 Financial Instruments: Presentation. According to this standard, preference shares can be accounted for either as an equity instrument, a financial liability or as a compound instrument having both a liability and an equity component (Goetz 2018). To determine the appropriate accounting treatment, issuers of financial instruments must apply the definitions contained in the standard, as well as the ‘substance over form’ principle (IAS 32, para.15).

Indeed, the classification of a preference share depends not on its legal form but on its substance, i.e., its contractual rights and obligations (IAS 32, para.15). For instance, mandatory redeemable preference shares having a fixed dividend, in substance represent a ‘contractual obligation to deliver cash’ and hence fall within
the definition of a financial liability (IAS 32, para.18[a]). Contrarily, preference shares without a redemption date should be presented as equity.

Furthermore, this classification also governs whether the preference dividend is recognised as an expense in the profit or loss. Distributions to holders of preference shares classified as equity should be charged directly against equity (IAS 32, para.35), whereas “dividend payments on [preference] shares wholly recognised as liabilities are recognised as expenses in the same way as interest on a bond” (IAS 32, para.36).

2.3.2 Taxation legislation - the tax deductibility of preference dividends

The accounting classification of preference shares will likewise determine the tax deductibility or otherwise of the preference dividend (IAS 32, para.40). Article 14(1)(a) of the Income Tax Act states that tax deductions are allowed only with respect to:

“[B]orrowing costs incurred by such person where the Commissioner is satisfied that they were wholly and exclusively incurred for the purpose of that person’s trade, business, profession or vocation, or on capital employed for the purpose of acquiring income.”

Hence, preference shares classified as a liability as per IAS 32, are considered to provide ‘interest’ to the holders of such instrument and hence such ‘interest’ would be an allowable tax deduction, thereby reducing the corporate tax liability of the issuing company (Fenech 2016). On the other hand, dividends on preference shares recognised as equity in the financial statements of the issuing company, are paid out of post-tax earnings and hence would be non-deductible (Girdler 2018).
2.3.3 MiFID requirements – complex financial instruments

Preference shares traded on a regulated market are also subject to the appropriateness requirements established in Directive 2014/65/EU, more commonly known as the Markets in Financial Instruments Directive (MiFID) II. These requirements prohibit investment firms from providing investment services on an ‘execution-only’ or ‘non-advisory’ basis in relation to complex financial instruments, without “assessing the appropriateness of the service or product for the client” (Rizzo 2018b).

A complex instrument is defined under MiFID II (2014, Article 25[4][a]) as an instrument incorporating a clause, characteristic or structure that cannot be readily and easily understood by investors. Hence, as observed by Rizzo (2018b), local retail investors are likely to be ineligible to invest in such instruments, “unless they are capable of demonstrating that they have sufficient knowledge and experience to understand these features and characteristics.” Non-complex financial instruments are exempt from the requirement of an appropriateness assessment².

According to Article 57 of the Commission Delegated Regulation (EU) 2017/565, straight preference shares issued by companies that are admitted to trading on a regulated market would automatically qualify as a non-complex financial product. Conversely, redeemable and convertible preference shares would be classified as complex financial instruments (Committee of European Securities Regulators CESR/09-558 2009).

2.3.4 Capital adequacy requirements

Banks are subject to various regulatory capital rules which they must abide by. A bank’s total regulatory capital comprises the following three components (The Basel Committee on Banking Supervision 2023):

2 This appropriateness test is a rigorous questionnaire that aims to determine whether investors possess the necessary experience and/or knowledge to understand the nature and risks of the instrument (Rizzo 2018b).
1. Common Equity Tier 1 (CET1)
2. Additional Tier 1 (AT1)
3. Tier 2 Capital (T2)

CET1 capital instruments, under which ordinary shares and retained earnings are classified, are the highest quality regulatory capital a bank can have in terms of loss absorption (Bank for International Settlements 2019). According to the latest European Banking Authority (EBA) list of CET1 instruments of EU institutions\(^3\), preference shares under Maltese law, are eligible as CET1 instruments (EBA 2022).

### 2.4 Motivations for the issuance of preference shares

There are several motivating factors for the issue of preference shares, some of which are firm-specific, whilst others are more generic in nature as they relate to the market and regulatory environment in which an entity operates (Davis 1996, Callahan et al. 2001).

#### 2.4.1 Supporting corporate growth

Houston and Houston (1990, p.48) contend that preference share financing can serve to support corporate growth since most of the PSIs they studied, resorted to this hybrid instrument to acquire assets, “either to expand the asset base, to replace worn-out assets, or both.”

#### 2.4.2 Maintaining a balanced capital structure

One of the primary motives for the issuance of preference shares, acknowledged by Fischer and Wilt (1968) and Elsaid (1969), is to maintain a balanced capital structure. A balanced capital structure signifies a financing structure that achieves

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\(^3\) This is a list of types of capital instruments that qualify as CET1 instruments in each EU Member State.
an optimal balance between a diverse range of debt and equity sources, which maximises the company’s value and minimises the cost of capital (Donaldson 1962, Fischer and Wilt 1968).

2.4.3 Avoiding dilution of control

Preference shares tend to be non-dilutive in nature (Parameswaran 2007), since usually they do not confer any voting rights to their holders. As a result, preference shares are an appealing financial instrument for companies wishing to avoid the dilution of control of existing common shareholders (Howe and Lee 2006), as well as for conservative investors seeking a relatively stable source of income, with only a limited degree of participation in business affairs (Pike et al. 2015, Brabenec et al. 2020).

Issuing non-voting preference shares may also be a reflection of “the desire to avoid uninformed outside stockholder interference” (Bonnevier and Børke 2014, p.38). It is also for this reason that preference shares are sometimes deemed useful as an “antitakeover device” in the capital structure (Houston and Houston 1990, p.44).

2.4.4 Taking advantage of favourable market conditions

Another potential reason for the issuance of preference shares by financial borrowers is to take advantage of favourable market conditions at the time of issue (Elsaid 1969). This was the case for the Swedish company ‘Ratos’, which issued preference shares in 2013, where a low-interest-rate environment coupled with a booming bond market that had pushed bond yields to exceptionally low levels, “left both institutional and retail investors desperately searching for yield” (Bonnevier and Børke 2014, p.43). These circumstances presented Ratos with the opportunity to:

“[…] add a new tool to [its] financing toolbox…[expand] Ratos’ investor base to include fixed income investors, and [enhance]
Ratos’ ability to utilise and time favourable market conditions outside the equity markets” (Bonnevier and Børke 2014, p.44).

Brabenec et al. (2020) remark that publicly listed companies must give greater concern to their market position and thus to the needs of public investors. They believe that the unprecedented period of low-interest rates in Europe, because of the Covid-19 pandemic, has contributed to the increased attraction of preference shares as an investment instrument and accordingly, an enhanced inclination to issue preference shares by listed companies.

2.4.5 Enhancing debt capacity

Fischer and Wilt (1968) and Elsaid (1969, p.114) reveal that a preference share issue may help improve the issuing company’s “borrowing base for subsequent or future debt financing”. One of the finance executives in Elsaid’s (1969) survey of over 300 PSIs, gave insight into the company’s line of reasoning for issuing preference shares:

“The ratio of all debt to underlying equity had reached a point beyond which the company […] would not wish to go. Thus, it was necessary to resort to some form of equity financing, and since there was room in the capital structure for additional preferred stock, this type of issue was selected in preference to common stock” (pp.113-114).

Debt capacity is defined as the “maximum amount of debt finance and hence interest payments” that a company can bear, before incurring the risk of financial distress (Pike et al. 2015, p.439). Donaldson (1962) argued that once a company has utilised corporate debt to the acceptable limit of its debt capacity, such that there is no further room for additional fixed charges, preference shares can be a satisfactory alternative.

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4 The price of preference shares tends to rise with falling market interest rates, rendering them more attractive to potential investors (Swammy 2017).
2.4.6 Achieving desired financial reporting outcomes

Under IFRS, “the accounting rules that distinguish a liability from an equity instrument are very complex” (Shakespeare 2020, p.435). Many research papers provide evidence of companies structuring financing decisions to achieve desired financial reporting outcomes (Levi and Segal 2015, Shakespeare 2020). Levi and Segal (2015, p.820) find that, given a choice,

“[…] managers prefer to issue debt-like hybrid securities that can be classified as equity in order to keep reported debt from increasing, even at the cost of incurring higher issuance fees.”

Therefore, a company may decide to issue preference shares instead of corporate debt for the purpose of lowering its gearing ratios and avoiding breaches in debt covenants (Levi and Segal 2015, Chatfield et al. 2020).

2.4.7 Financial Distress Theory

The theory of financial distress, first posited by Donaldson in 1962, hypothesises that financially distressed companies are more inclined to issue preference shares. Whilst debt creates an annual obligation in the form of an interest payment, preference dividends are distributed at management’s discretion. Hence, unlike interest payments on debt, failure to make timely or full preference dividend payments does not trigger corporate bankruptcy (Chatfield et al. 2020).

Therefore, preference shares offer an important advantage to the issuer at times of adversity; that of dividend flexibility (Wang 2006). This means that when corporate failure is looming on the horizon, by issuing preference shares, the issuing company is free to postpone its preference dividend, only to resume it upon recouping its financial strength (Wong 1989).

Several studies have found empirical evidence in support of this theory. Lee and Figlewicz (1999) deduce that companies having weak balance sheet positions, tend to finance their operations with convertible preference shares. Likewise, Ravid et al. (2007) claim that as a company’s profitability improves, the proportion of preference shares in the company’s capital structure declines. The findings of
Moyer et al. (1987), Bessa (2017), Rolfsson and Åkerlind (2018), and Chatfield et al. (2020), show that PSIs have lower profitability, interest coverage ratios and retained earnings than non-issuers, as well as a higher level of gearing and bankruptcy risk.

Although preference dividends can be freely suspended by the issuing company without causing any adverse legal implications, such action can nevertheless lead to undesirable repercussions, in the form of loss of shareholder confidence and potential damage to the market price of common equity (Suchard and Singh 2006, Chatfield et al. 2020). Therefore,

“[…] as a matter of corporate policy it is necessary for a responsible management to behave as if the preferred dividend were a fixed contractual commitment” (Donaldson 1962, p.125).

In addition, as highlighted by Santow (1962, p.48), the non-payment of cumulative preference dividends “can be just as disastrous in the long-run” as the failure to meet interest payments.

2.4.8 Strengthening regulatory capital – the case of banks

In recent years, financial companies are the most dominant issuers of preference shares (Baker and Langenfeld 2018). Callahan et al. (2001) and Cai (2016) reveal that in the case of financial institutions, namely banks, regulatory requirements on capital adequacy are a dominant influence in their choice of issuing preference shares. “They provide evidence that banks issue preferred stock to increase their relative core capital levels” (Howe and Lee 2006, p.239).
2.5 Barriers to preference share issues

This section addresses the barriers to the issuance of preference shares put forward by various literary sources.

2.5.1 The complex nature of preference shares

In light of their inherent complexity compared to more traditional securities such as ‘plain vanilla’ bonds and ordinary shares, which local investors are more accustomed to (Rizzo 2021a), preference shares are difficult to understand (Vernimmen et al. 2018).

One of the CFOs of the UK companies interviewed by Laurent in her 2002 study (p.26), claimed that the introduction of preference shares to the company’s existing capital structure would be:

“An added complication with too many instruments then having different rights that have to be considered before any decision is taken.”

Likewise, Donaldson (1962, p.126) mentions that companies often seek a simpler capital structure that does not restrain managerial decisions because:

“It is often felt that…a preferred stock issue makes life unnecessarily complicated.”

Indeed, the issuance of this hybrid security may necessitate a special shareholders’ meeting and/or an assessment of the rights of different share classes, whenever dividends are distributed or certain decisions are taken by shareholders, which would otherwise be avoided with a debt or ordinary share issue (Vernimmen et al. 2018, Korchak 2019).
2.5.2 Taxation considerations

Countless foreign academic writers maintain that the greatest downside of preference shares compared to debt is their lack of tax relief because preference dividends are not deductible for income tax purposes (Moyer et al. 1987, Pike et al. 2015). This means that when compared to debt, preference shares are a less tax-efficient means of raising capital for a corporation (Girdler 2018), rendering the preference share route an expensive one relative to corporate debt (Elsaid 1969). For this reason, preference shares are often considered as “debt with a tax disadvantage” and:

“[…] the obvious question is why a firm would ever issue preferred stock, when they could issue debt at a much lower after-tax cost” (Chatfield et al. 2020, p.402).

Indeed, Donaldson (1962) contends that this difference in tax treatment between preference shares and debt appears to be a primary contributor to the decline in the use of preference shares in the U.S. stock market.

Moreover, the tax advantage of debt over preference shares depends on the issuer’s tax status such that this advantage is of greater importance to a profitable rather than a loss-making firm (Ravid et al. 2007). Additionally, if preference shares are deemed to be the best compromise to achieve the objectives of both issuers and investors, issuing firms may still favour preference shares over debt despite their possible tax disadvantages (Laurent 2002).

2.5.3 Potential conflicts of interest

Donaldson (1962) emphasises that the fundamental question that issuing companies must ask when deciding to issue preference shares is whether such a financing choice would be in the best interests of existing common shareholders, in which case “it is the responsibility of management to use preferred when it can reasonably do so” (p.136).

However, Korsmo (2013) and Cai (2016) claim that the use of preference shares gives rise to serious and direct conflicts of interest between ordinary shareholders
and preference shareholders, as “any preference granted to the preferred stockholders must necessarily come at the expense of the common stockholders” (Korsmo 2013, p.1176). Ordinary shareholders may be hostile to preference share issues, causing tension between these two stakeholder groups, especially if the rights granted to preference shareholders are perceived as unfair (Korchak 2019).

2.5.4 Negative market signals

A potential deterrent to the issue of preference shares is the danger of sending a negative signal to the market. By issuing preference shares, a company may indicate that management perceives the future prospects of the company to be bleak or the risk of corporate bankruptcy to be high, as a company with positive earnings is expected to finance with a cheaper instrument like debt (Chatfield et al. 2020).

Linn and Pinegar (1988) and Kallberg et al. (2013) document a negative ordinary share response to the announcement of a preference share issue. This also:

“[…] supports a signalling story where a preferred stock issue conveys new and negative information, either because the company rarely issues hybrid securities, or because lack of transparency makes the issuance motives unclear” (Bonnevier and Børke 2014, p.35).

However, Kallberg et al. (2013) determine that this negative announcement effect decreases with improved transparency and increased creditworthiness of the PSI. Furthermore, Santow (1962) argues that whilst bonds are assured a “warm welcome” by investors there is greater uncertainty surrounding the degree of market acceptance of preference shares (Cai 2016, p.317).
2.6 The role of preference shares in the corporate capital structure

There is an ongoing debate among financial writers on the role that preference shares should or will have in the corporate capital structure. Dewing (1953) predicted that preference shares “would not have a place in the corporate financial structure…because corporations will seek a simpler capital structure” (as cited by Elsaid 1969, p.116).

Fischer and Wilt (1968) take the low number of preference share issues between the period 1950-1965, as an indication that preference shares have failed to convince finance managers of their advantages in times of financial distress. As a result, they adopt a rather pessimistic view on the future outlook of preference shares, stating that: “preferred stock will hold only a minor place in the total corporate financing picture” (Wang 1989, p.15).

Santow (1962, p.50) believes that more companies and investors are becoming aware of the shortcomings of this investment medium and consequently, “the sale of preferred stock will follow a downward path until its appearance in corporate markets will become a rarity.”

In contradiction to these views, Elsaid (1969, p.116) insists that:

“[P]referred stock performs a useful function in the corporate financial plan and, thus, seems to be assured of a continuing place in corporate capital structure.”

When questioned on the future course of preference share financing, respondents of Elsaid’s (1969) study expressed their willingness to incorporate such securities in their future financing strategies. On a similar wavelength, Walther (2014, p.162) strongly asserts that preference shares:

“[…] should be a staple of modern finance, because it offers an unparalleled financial flexibility that helps businesses stay afloat during hard times and thus reduces bankruptcy risk for investors.”

On the local front, the recent revival of preference shares thanks to the preference share issue by one MLC:
“[…] is further testament of the value that could be unlocked by companies through capital markets and bodes well for the continued development and sophistication of the local capital market in general” (Rizzo 2021a).

2.7 Conclusion

This chapter has provided an in-depth review of the literature on the use of preference shares over time and in different countries; the accounting, taxation, and other regulatory considerations concerning preference shares; the main determinants and barriers to preference share issues; and the potential role preference shares may have in companies’ capital structure.
CHAPTER 3

RESEARCH METHODOLOGY
3.1 Introduction

This chapter seeks to describe the research process and instruments adopted, detailing how the necessary data was gathered and subsequently analysed. Figure 3.1 provides an overview of how this chapter will be structured.
3.2 Preliminary research

To gain an initial understanding of the research topic, various local and foreign sources of literature were consulted, comprising peer-reviewed articles, journals, books, dissertations, webpages, regulations, standards, and other relevant publications. Reference was also made to external documents such as prospectuses\(^5\), company announcements, and other media coverage concerning the two Maltese PSIs. Moreover, a preliminary meeting was conducted with a lecturer at the University of Malta to elicit further general insight on the subject.

3.3 Research approach and design

The research design provides “a framework for conducting the study” (O'Dwyer and Bernauer 2014, p.9). There are three possible research approaches: qualitative, quantitative, and mixed-methods research. The selection of an appropriate research approach depends namely on the nature of the research problem at hand, the researcher’s philosophical assumptions and personal experiences, as well as the intended audience (Creswell and Creswell 2018).

“Qualitative data is potentially rich, vivid and holistic which offers potential to uncover real-world complexities” (Martyn 2021, p.3). Given the subjective and interpretive nature of qualitative research (Denzin and Lincoln 2005), the key challenge resides in striking the right balance between the level of detail and richness of qualitative information, and the trustworthiness and validity of such data (Modell and Humphrey 2008). Qualitative research is characterised by smaller sample sizes thereby limiting the generalisability of the findings to the wider population (Rahman 2017). Quantitative research, on the other hand, involves the collection of numerical data that is subjected to statistical testing in order to “support or refute alternate knowledge claims” (Williams 2007, p.66). Quantitative data thus provides an objective measure of reality (Williams 2007), enabling the results to be extended to the whole population (Myers 2009).

\(^5\) These prospectuses are not included in the list of references of this study to preserve the anonymity of the two local PSIs.
However, quantitative studies fail to give insight into the deep and underlying meanings respondents attribute to the phenomenon being investigated (Yilmaz 2013).

By integrating both qualitative and quantitative research methods into a single study, the mixed-methods approach enables the researcher to provide a more nuanced understanding of the research phenomenon that could not possibly be achieved using quantitative or qualitative methods alone (Creswell and Creswell 2018).

In this study, a qualitatively-driven mixed methods approach is adopted, in which quantitative data plays a supplementary role to a predominantly qualitative design (Kajamaa et al. 2020). The quantitative component is “used to illustrate a particular aspect or dimension” that is otherwise inaccessible by the core qualitative component, thereby expanding and strengthening the research project as a whole (Morse and Cheek 2014, p.4).

### 3.4 Research tool

Given the largely exploratory nature of this research study, semi-structured interviews were deemed to be the most suitable research tool to fulfil the study’s research objectives. Additionally, the study also sought to investigate Donaldson’s (1962) hypothesis that firms issuing preference shares are more likely to be financially distressed, for which different quantitative techniques were employed.

#### 3.4.1 Semi-structured interviews

Semi-structured interviews are based on a pre-determined interview schedule to guide and direct the general flow of discourse between researcher and participant (Adeoye-Olatunde and Olenik 2021). The interview guide consists of a “blend of closed- and open-ended questions, often accompanied by follow-up why or how questions”, to allow for further probing (Adams 2015 p.493, McIntosh and Morse 2018).
Hence, through semi-structured interviews, the researcher can ensure that the relevant research material is covered, while simultaneously giving participants the space to freely “narrate their experiences”, thereby enabling the emergence of unforeseen themes from interview responses (Galletta and Cross 2013, p.47, Kallio et al. 2016).

Three interview schedules were formulated for this study, distinguishing between three main groups: PSIs; non-issuing listed companies; and other participants, consisting of two stockbrokers, an MSE representative, and a Big Four financial advisor (FA). The interview questions were tailored to each interviewee group accordingly and divided into three main sections, each addressing one of the three research objectives of this study, as depicted in Table 3.1 below. Question 3 was directed only at the non-issuing listed companies and an additional question relating to capital adequacy requirements was posed exclusively to the four interviewed listed banks.

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<tr>
<th>Section Heading</th>
<th>Interview Schedule of Issuers</th>
<th>Interview Schedule of Non-Issuers</th>
<th>Interview Schedule of Other Participants</th>
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<td>Section B: Barriers/Determinants of preference share issues</td>
<td>6-15</td>
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<td>6-17</td>
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<tr>
<td>Section C: Future use of preference shares</td>
<td>16</td>
<td>18</td>
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*Table 3.1: Structure of interview schedules*

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6 Vide Appendix 3.1
7 Hereafter referred to as Preference Share Issuer (PSI) A and Preference Share Issuer (PSI) B.
### 3.4.2 Financial distress analysis

To test the financial distress hypothesis, six ratios were carefully selected on the basis of the following three criteria (Bunyaminu and Issah 2012):

1. The degree of popularity in previous foreign and local studies relating to financial distress;
2. The ability to capture four key financial aspects: profitability, liquidity, solvency and gearing;
3. The extent of financial information available.

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<th>Ratio</th>
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<th>Description</th>
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<tr>
<td>Net Profit Margin</td>
<td>Profit for the Year [\text{Revenue}]</td>
<td>A profitability ratio that expresses the post-tax profit for a given financial year in terms of the total revenue generated in that same year. This is a good measure of a company’s overall financial health (Chatfield et al. 2020).</td>
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<tr>
<td>Return on Assets</td>
<td>Earnings before Interest and Tax [\text{Total Assets}]</td>
<td>A profitability ratio, derived from Altman’s (1968) Z-score, which gauges the entity’s ability to effectively use its assets to generate earnings. According to Balzan (2020), this measure is the greatest predictor for corporate failure amongst local companies.</td>
</tr>
<tr>
<td>Current Ratio</td>
<td>Current Assets [\text{Current Liabilities}]</td>
<td>A liquidity ratio that indicates the company’s ability to meet its immediate obligations. Zammit (2005) showed that this ratio has significant power to predict the bankruptcy potential of local companies.</td>
</tr>
<tr>
<td>Interest Coverage Ratio</td>
<td>Earnings before Interest and Tax [\text{Interest Expenses}]</td>
<td>This ratio reflects the entity’s capacity to cover its interest obligations from its earnings. The lower the ratio, the more likely it is for the company to default on its debt commitments (Chatfield et al. 2020).</td>
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<tr>
<td>Debt To Equity Ratio</td>
<td>Debt [\text{Equity}]</td>
<td>This ratio captures the company’s proportion of debt to equity, i.e., its level of gearing. It is commonly utilised to evaluate financial risk (Rolfsson and Åkerlind 2018).</td>
</tr>
<tr>
<td>Cash Debt Coverage Ratio</td>
<td>Cash Flow from Operations [\text{Debt}]</td>
<td>This is a solvency ratio which directly compares a company’s operating cash flows to its total debt. Beaver’s study (1966) reveals that this is the best predictor of corporate failure.</td>
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*Table 3.2: Breakdown of selected ratios*
In order “to avoid defining companies as financially distressed based on a single year of poor performance” (Platt and Platt 2006), three consecutive financial periods were analysed for each of the two issuers. The chosen three-year period for PSI B (2018-2020) represented the three years preceding the year in which the preference share issue was made (2021). However, in the case of PSI A, a different approach was adopted to capture the financial performance of the company more accurately before its preference share issues in 1995. In 1995, PSI A changed its year-end from 31st March to 31st January, thus its financial statements ending 31st January 1996 covered only a 10-month period, 9 months of which pertained to 1995, the year in which the preference share issues were made. Hence, this 10-month financial period, exactly preceding the preference share issues in December 1995, was incorporated within the sample accounting period.

An independent one-sample t-test was used to compare the sample mean ratios of the group of four non-issuing listed companies with the ratios calculated for PSI B. This was carried out for each of the six financial ratios in each of the three years 2018-2020.

To test the financial distress hypothesis, prior studies such as those of Moyer et al. (1987) and Chatfield et al. (2020), compare a sample of preference share issuing firms to a group of matching non-issuing firms. Whilst this could be done for PSI B, no suitable industry control group could be assembled for PSI A, given that there were no comparable listed companies at the time of its preference share issues. According to financial theory, it is inappropriate and misleading to compare the financial ratios of companies within different industries (Monti and Garcia 2010). Hence, since no statistical tests could be utilised for PSI A, trend analysis and a calculation of Altman’s (1968) Z-score was performed for the three-year period under review instead.

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8 Vide Appendix 3.2
9 PSI A made two simultaneous preference share issues in December 1995, each having a different fixed percentage dividend.
10 Vide Appendix 3.4
11 Vide Appendix 3.3
3.5 Research sample

3.5.1 Research participants

A list of all the Maltese companies having either a debt or equity listing or both on the MSE, as of 30th September 2022, was obtained from the MSE website.\textsuperscript{12}

The interview participants were contacted initially via email using the general email address found on the respective company website, attached to which was the letter of introduction and invitation to participate, duly signed by the Head of Department of Accountancy. When no reply was received to both the original email and the subsequent reminder email, companies were subsequently reached by telephone.

Upon acceptance to participate in the study, a further email was sent, in which a suitable interview date was arranged at a time, place, or online platform convenient for the participant. A copy of the interview schedule was also provided beforehand along with the consent form, which the interviewees were asked to read and sign prior to the agreed interview date, assuring them that their anonymity would be preserved throughout the study.

As shown in Tables 3.3 and 3.4, a total of 27 interviews were conducted, 22 of which were carried out with MLCs. The main target group of this study was Chief Financial Officers (CFOs) or finance managers of MLCs. However, if the CFOs were unable to answer the interview questions, the researcher’s participation request was forwarded to other individuals within the company who could provide better insight into the research topic. Hence, MLCreps also encompassed an accountant, a Chief Operating Officer, and a company director.

Furthermore, to obtain a broader picture of the Maltese preference share market, a further four interviews were carried out with a representative of the MSE, two local stockbrokers, and a FA of a local Big Four firm.

\textsuperscript{12} Vide Appendix 1.1
### Table 3.3: Breakdown of interviewed Maltese listed companies

<table>
<thead>
<tr>
<th>Preference Share Issuers/Non-Issuers</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>22 MLCs</td>
<td></td>
</tr>
<tr>
<td>2 Preference Share Issuers (PSI A and PSI B)</td>
<td></td>
</tr>
<tr>
<td>20 Non-Issuing MLCs</td>
<td></td>
</tr>
</tbody>
</table>

**Table 3.3: Breakdown of interviewed Maltese listed companies**

<table>
<thead>
<tr>
<th>Categories of Respondents</th>
<th>Research Participants</th>
</tr>
</thead>
<tbody>
<tr>
<td>23 MLC representatives</td>
<td>19 CFOs</td>
</tr>
<tr>
<td></td>
<td>The former CFO of PSI A</td>
</tr>
<tr>
<td></td>
<td>1 Chief Operating Officer</td>
</tr>
<tr>
<td></td>
<td>1 Accountant</td>
</tr>
<tr>
<td></td>
<td>1 Company Director</td>
</tr>
<tr>
<td>Malta Stock Exchange (MSE)</td>
<td>MSE representative</td>
</tr>
<tr>
<td>Investment Service Firms</td>
<td>2 Stockbrokers (Stockbroker 1 &amp; 2)</td>
</tr>
<tr>
<td>Big Four Accountancy Firm</td>
<td>1 Financial Advisor (FA)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>27 Participants</strong></td>
</tr>
</tbody>
</table>

**Table 3.4: Research participants**

### 3.5.2 Sample selection for financial distress analysis

The companies that were subjected to the financial distress analysis were the two companies that issued preference shares in Malta (PSI A and PSI B) in December 1995 and April 2021. The control group for PSI B consisted of the four other non-issuing MLCs that operated within the same industry.
3.6 Data collection

3.6.1 Qualitative data collection

The chosen method of collecting data must be adequate to address the research questions and objectives of the study (Cronin et al. 2015). This choice is important to obtain high-quality research that results in valid, accurate, and credible findings (Harrel and Bradley 2009).

Secondary data was gathered from various sources, which was analysed in Chapter 2 of this study. This served as an important theoretical foundation for this study, that informed the researcher on the preparation of the interview questions. The interview questions were piloted with the FA of one of the Big Four firms to ascertain their appropriateness prior to actual data collection (Priyadarshini 2020).

At the outset of the interview, participants were explicitly asked for their agreement to have the interview video or audio recorded, as applicable. All interviewees gave their consent, except for three research participants, due to this being against their company policy. In these three instances, handwritten notes were taken throughout the interview.

These interviews, lasting approximately one hour each, were conducted between October 2022 and January 2023. A total of 27 interviews were held, either online (12/27) via Zoom or Google Meet or at the organisation’s premises (15/27).

3.6.2 Quantitative data collection

The accounting ratios over the three-year period for each PSI were computed on the basis of the publicly available financial statements of the two listed companies. The relevant financial statements of PSI A were derived from the Malta Business Registry website, whilst the required accounts for PSI B and the four other non-issuing companies were retrieved from their website.
3.7 Data analysis

3.7.1 Qualitative data analysis

The audio and video recordings were listened to carefully many times and transcribed verbatim at the earliest opportunity after each interview, to preserve the researcher’s first impressions, as well as to keep the best possible record of the conversation. The transcripts and other notes taken by the researcher were subsequently analysed to identify commonalities and differences, “consolidate themes found in multiple answers and to supplement them with well-chosen illustrative quotations” (Adams 2015, p.604). Throughout the data analysis process, memos of the qualitative data were also electronically generated to document the researcher’s initial reflections and interpretations, encouraging the researcher to engage in critical and reflexive thinking (Kalpokaite and Radivojevic 2019, Lester et al. 2020).

3.7.2 Quantitative data analysis

The data extracted from the financial statements of the companies within the sample was inputted into Microsoft Excel and the selected ratios were calculated. The yearly changes in the ratios of PSI A and any emerging trends were analysed. In the case of PSI B and the four other non-issuing companies, the quantitative data was subsequently inputted and analysed using ISBM Statistical Package for the Social Sciences (SPSS) Statistics.

3.8 Research limitations

The first limitation is that although contact was made with all MLCs, 19 refused to participate in the research study given their limited level of knowledge and experience with preference shares, whilst other MLCs failed to respond.
Both the evaluation of responses from the semi-structured interviews and the computation and analysis of the chosen ratios were subject to the researcher’s personal judgment and hence prone to interpretation bias.

Additionally, there were only two PSIs in Malta. Therefore, the findings relating to the reasons for the public issuance of preference shares do not yield generalisable results. Likewise, with respect to the financial distress analysis undertaken in this study, due to the varying nature of MLCs and the significantly small sample size, the possibility for meaningful comparisons and the use of more sophisticated statistical tools, was significantly hampered. Moreover, in the independent one-sample t-test\textsuperscript{13}, the $p$-value depends heavily on the sample size and since the sample employed in this study is very small (less than 10), it is very unlikely to get statistical significance, even when mean differences vary considerably.

### 3.9 Conclusion

This chapter has provided an overview of the research methodology and tools, which in the researcher’s belief, were best suited to achieve the intended aims of this study. The following chapter presents the research findings gathered from the interviews and the financial distress analysis.

\textsuperscript{13} Vide Appendix 3.4
CHAPTER 4

RESEARCH FINDINGS
4.1 Introduction

This chapter gives an account of the findings acquired from the interviews. As demonstrated in Figure 4.1, Section 4.2 deals with preference shares and their features. Section 4.3 details the extent to which preference shares have been issued in Malta, addressing the first objective of this study. Sections 4.4 and 4.5 delve into the determinants and barriers to local preference share issues, respectively, thus relating to the second research objective. Section 4.6 explores the future use of preference shares, thereby covering the third research objective. Finally, Section 4.7 presents the concluding remarks.

Figure 4.1: Outline of Chapter 4
Chapter 4 Research Findings

4.2 Preference shares and their features

4.2.1 The hybrid nature of preference shares

The first two preliminary questions sought to elicit interviewees’ understanding of preference shares and their associated features.

All interviewees (23/23 MLCreps, 2/2 Stockbrokers, MSErep, FA) acknowledged the hybrid character of preference shares, “having its leg in two different places…being neither one nor the other”. When asked whether preference shares more closely resembled debt or equity, the majority of interviewees (17/23 MLCreps, 2/2 Stockbrokers, MSErep, FA) recognised that “there is no clear-cut answer to this question”, since the features attributable to preference shares will ultimately render them nearer to debt or equity.

More than half of the MLCreps (16/23 MLCreps) were unfamiliar with the accounting classification of preference shares as per IAS 32, due to having never explored preference shares as a means of financing. Other interviewees (7/23 MLCs, 2/2 Stockbrokers) recognised that the standard rightly permits the classification and subsequent accounting treatment of preference shares to be determined on a “case-by-case basis”.

4.2.2 The attractiveness of preference shares and their features

When asked about the most attractive features of preference shares from a corporate perspective, interviewees shared varying responses, with the most favoured characteristics being: the fixed dividend (19/23 MLCreps, 2/2 Stockbrokers, MSErep, FA), the redeemable feature (13/23 MLCreps, FA), the lack of voting rights granted to holders of such an instrument (11/23 MLCreps, 2/2 Stockbrokers, MSErep, FA), the non-cumulative feature (6/23 MLCreps), as well as no assets tied as security (4/23 MLCreps).
4.2.3 Flexibility of preference shares

Several interviewees(5/23MLCreps,1/2Stockbrokers,FA) sustained that one of the compelling advantages of preference shares is their flexibility, such that they can be customised to accommodate the financing needs of the entity. Stockbroker 2(1/2Stockbrokers) further stated that the high degree of flexibility that preference shares can provide is often underappreciated by MLCs, compromising their ability to exploit the full potential of preference shares.

4.3 The use of preference shares by MLCs

4.3.1 Preference share issues in Malta

In Malta, there have been only two PSIs. In 1995, Preference Share Issuer A (PSI A), made two simultaneous issues of preference shares, having debt-like characteristics: straight, a fixed coupon, redeemable, cumulative, and no voting rights. By contrast, the preference shares issued by PSI B in 2021 were perpetual, non-cumulative and offered the holder the right to participate in the distribution of dividends but not the right to vote.

When the remaining non-issuing MLCs(20/22MLCs), were asked whether they have ever considered publicly issuing preference shares, the absolute majority(17/20non-issuingMLCs) denied having ever done so, or felt the need to do so, due to having sufficiently satisfied their financing requirements through debt and/or common equity issues. One interviewee(1/23MLCreps) refrained from answering this question so as not to reveal confidential information.

One MLC(1/22MLCs) that had previously conducted an appraisal of a preference share issue, decided against such a decision because the company:

“[C]ould not clearly identify the advantages of having preference share capital both from a company and investor perspective [...] Unlike common equity and straight debt, preference shares do not have any significant pros and when [the company] analysed it, it said that it was not going to gain much out of these.”
Other interviewees (8/23MLCreps, 1/2Stockbroker) also seemed to struggle to identify “any particular or material advantage” of preference shares, that could sufficiently appeal to a listed entity to issue them.

4.3.2 The use of preference shares as a last resort

A common stance held by interviewees (9/23MLCreps, 1/2Stockbroker, MSErep) on preference shares, was that they are a financing of a last resort, such that preference shares are only issued by MLCs if no other alternative funding options are available.

Stockbroker 1 (1/2stockbroker) and the MSErep argued that they expect preference shares to be issued by those companies that “have their back against the wall”, in terms of access to financing sources, and that preference shares are:

“one of the last resources to raise capital, because why would a company consider issuing preference shares if not as a last resort?”

4.4 Reasons for local preference share issues

PSI A and PSI B were specifically requested to provide insight into the reasons for which they issued preference shares. The remaining interviewees (20/22MLCs, 2/2Stockbrokers, MSErep, FA) also shared their thoughts on the potential motivations for the issuance of preference shares.

4.4.1 Addressing financing needs and supporting corporate growth

According to both stockbrokers/MSErep/FA, the underlying raison d’être behind a public offering of any instrument is to raise capital in order to support the issuing company’s upcoming investment projects and its future growth prospects.

At the time of issue, both local PSIs were undergoing a growth spurt, and as detailed in their respective prospectuses, were pursuing aggressive investment
plans to further expand their operations. Therefore, preference shares were the preferred mode of financing to achieve their growth objectives.

The current CFO of PSI A claimed that the company’s 1995 redeemable preference share issues were “assigned a time limit” as they were intended to provide PSI A with the necessary funds for a specified timeframe, during which the company’s projects were expected to be completed. Contrarily, PSI B’s CFO divulged that their preference shares were issued as a perpetual instrument because of the long-term nature of their forthcoming projects.

### 4.4.2 Maintaining a balanced capital structure

Both interviewed stockbrokers (2/2Stockbrokers) argued that a preference share issue can help the company to maintain a balance in its capital structure and increase or decrease the cost of capital accordingly.

The CFO of PSI B confirmed that the listed entity wanted to achieve a target total equity ratio, by solidifying its equity base and providing the necessary debt capacity later on. Likewise, PSI A’s prospectus stipulated that one of the reasons for which the company was seeking new capital was: “to strike a prudent balance between shareholders’ funds and external borrowings”.

### 4.4.3 Retaining voting control

The CFO of PSI B divulged that the company’s main motivation for issuing preference shares was to retain voting control since preference shareholders were not granted any voting rights. The company wanted to prevent an external party from overthrowing the company’s present majority shareholder. Therefore, according to its CFO, PSI B issued preference shares “as a protective measure against the hostile takeover”. However, this was not the case for PSI A, as the CFO of the time remarked that their preference share issues were influenced by factors other than voting control.
In addition, eleven respondents (7/23MLCreps,2/2Stockbrokers,MSErep,FA) revealed that increasing the equity base without relinquishing control, is one of the few valid reasons for the public issuance of preference shares.

4.4.4 Taking advantage of market conditions

Unlike PSI B, the present and former CFOs of PSI A stated that the company’s decision to issue preference shares was mainly driven by the context and market dynamics in which the preference share issue took place.

As reported by the current CFO of PSI A, in 1995, the MSE had only just been incepted at the time of issue, and the Maltese debt market was not as developed as it is at present. The market expectation during those times was for listed bonds to be secured and hence, preference shares enabled the company to avoid having to pledge its assets as collateral. Moreover, the issuing company wanted to take advantage of its good reputation by approaching the market and obtaining a listing. The former CFO recounted how preference shares were deemed to be the ideal “first step to test the appetite of the market for public issues from the company”.

4.4.5 Enhancing debt capacity

In response to the question of whether the company’s preference share issues were fuelled by the need to enhance the company’s debt capacity, the present CFO of PSI A claimed that there was no such conscious strategy.

Contrariwise, the CFO of PSI B admitted to having issued preference shares to be able to take on additional debt financing for its prospective projects. The 2021 prospectus further described that a portion of the proceeds from the company’s public offer was meant to pay back its short-term bank facilities, which were taken to finance the company’s capital expenditure, as part of its growth strategy.
4.4.6 Achieving desired financial reporting outcomes

While accepting that current reporting requirements are onerous and merit due consideration in order to ensure the appropriate accounting classification of preference shares and avoid any tax issues, there was widespread agreement among interviewees (18/23 MLCreps, 1/2 Stockbrokers, MSErep, FA), including both PSIs, that, as declared by one MLCrep (1/3 MLCreps): "the financing decision will hinge on other factors, other than financial reporting implications".

Five interviewees (4/23 MLCreps, 1/2 Stockbrokers) stated that financial reporting implications of preference shares are a key consideration when the listed entity is over-g geared and wants to lower its debt-to-equity ratios. In such instances, MLCs would seek to structure the preference shares with equity-like features so as to ensure an equity classification in the balance sheet.

4.4.7 Financial Distress Theory

The use of preference shares in financial distress

The vast majority of interviewees (16/23 MLCreps, 2/2 Stockbrokers, MSErep, FA) acknowledged that the company’s ability to exercise its right not to distribute a dividend in a given year (whether temporarily or permanently) is a valued feature of preference shares, particularly during times of uncertainty. In spite of this, many MLCreps (14/23 MLCreps, 1/2 Stockbrokers, MSErep) admitted that failure to guarantee a dividend payment, even in times of financial distress, is unlikely to be well-received in the market, given the nature of the local investor base.

Six MELreps (6/23 MLCreps) also pointed out that this feature is not exclusive to preference shares since the distribution of ordinary dividends is likewise at management’s discretion. As commented by one interviewee (1/3 MLCreps):

“My question then is: what is the difference between an ordinary share and a preference share?”

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14 This depends on whether the preference shares are cumulative or non-cumulative.
A further six respondents expressed concern over the adverse impact a dividend omission may have on the reputation and market valuation of the company.

There was general disagreement among interviewees, including the CFOs of both PSIs, that preference shares would become more attractive in times of financial distress. Several stated that a financially troubled company would not be in a position to raise any capital from the market, via any kind of financial instrument.

However, other interviewees believed that preference shares may become a more popular source of financing in times of financial distress, arguing that financially troubled MLCs may be more disposed to explore all possible financing options.
Findings of financial distress analysis

This section presents the results from the financial distress analysis conducted as described in Chapter 3. The results are divided into two sub-sections, one concerning PSI A and the other relating to PSI B.

Preference Share Issuer A (PSI A)

<table>
<thead>
<tr>
<th>Accounting Ratio</th>
<th>Financial Period</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1993/4</td>
</tr>
<tr>
<td><strong>Profitability</strong></td>
<td></td>
</tr>
<tr>
<td>Net Profit Margin</td>
<td>5.28%</td>
</tr>
<tr>
<td>Return on Assets</td>
<td>8.69%</td>
</tr>
<tr>
<td><strong>Liquidity</strong></td>
<td></td>
</tr>
<tr>
<td>Current Ratio</td>
<td>1.58</td>
</tr>
<tr>
<td><strong>Gearing / Solvency</strong></td>
<td></td>
</tr>
<tr>
<td>Interest Cover</td>
<td>6.03</td>
</tr>
<tr>
<td>Debt to Equity Ratio</td>
<td>32.23%</td>
</tr>
<tr>
<td>Cash Debt Coverage Ratio</td>
<td>0.82</td>
</tr>
<tr>
<td><strong>Financial Distress</strong></td>
<td></td>
</tr>
<tr>
<td>Z-Score</td>
<td>3.09</td>
</tr>
</tbody>
</table>

*Table 4.1: Computed ratios of PSI A for a three-year financial period and yearly percentage changes*

As illustrated in Table 4.1 above and the below line graphs, PSI A experienced an overall worsening in its profitability, gearing, and solvency levels, in the 10-month period ending 31st January 1996, in comparison to the preceding two financial years. This is evident from the decline in the company’s net profit margin and return on asset ratio, as well as in its interest cover and cash debt coverage ratio.
Figure 4.2: Net profit margin of PSI A over a three-year financial period

Figure 4.3: Interest cover of PSI A over a three-year financial period

At face value, the debt-equity ratio and computed Z-score of PSI A appear to have slightly improved in the year 1995/6 compared to the previous year. However, the equity figure for the financial period 1995/6 incorporates the preference shares...
issued by the company in December 1995\textsuperscript{15}. Hence, in order to provide an accurate representation of the company’s position prior to its preference share issues, the following illustrations depict the Z-score and gearing of the company both with and without the preference share issues.

<table>
<thead>
<tr>
<th></th>
<th>Including Preference Share Issues</th>
<th>Excluding Preference Share Issues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt to Equity Ratio</td>
<td>32.65%</td>
<td>40.38%</td>
</tr>
<tr>
<td>Z-Score</td>
<td>2.91</td>
<td>2.66</td>
</tr>
</tbody>
</table>

\textbf{Table 4.2:} Debt to equity ratio and Z-score of PSI A before and after taking into account the preference share issues in the 1995/6 financial statements

\textbf{Figure 4.4:} Debt to equity ratio of PSI A over a three-year period with and without the preference share issues

\textsuperscript{15} Despite having debt-like features, the preference shares of PSI A were classified as equity in its 1995/6 financial statements. Under current accounting standards, these would be classified as debt.
Intriguingly, on closer inspection, the company’s debt-to-equity ratio stood at 40.38% and the Z-score at 2.66, once the preference share issues are omitted from the 1995/6 figures.

According to Altman’s Z-score model (1968), PSI A was financially sound in the year 1993/4 due to having a Z-score above 3 (as shown in table 4.1), whereas, in the subsequent two financial periods, even after taking into consideration the preference share issues, it classified within the ‘zone of ignorance’ or ‘grey area’, in which financial distress may or may not be impending\(^{16}\). The below diagram graphically illustrates this.

![Z-Score Graph](image)

**Figure 4.5:** Z-score of PSI A over a three-year period with and without the preference share issues

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\(^{16}\) Vide Appendix 4.1
Preference Share Issuer B (PSI B)

Table 4.3 below summarises the statistical results obtained for PSI B and the four other non-issuing firms forming the industry control group. Due to word constraints, only the two years prior to the preference share issues will be analysed and discussed, given that the results obtained in 2018 portray PSI B in an overall superior financial position than its industry rivals.\(^{17}\)

<table>
<thead>
<tr>
<th>Ratio</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mean Non-Issuing Group</td>
<td>Ratio of PSI B</td>
<td>(P) value</td>
</tr>
<tr>
<td>Net Profit Margin</td>
<td>10.89</td>
<td>12.96</td>
<td>0.688</td>
</tr>
<tr>
<td>Return on Assets</td>
<td>21.755</td>
<td>23.66</td>
<td>0.869</td>
</tr>
<tr>
<td>Current Ratio</td>
<td>0.595</td>
<td>1.42</td>
<td>0.024</td>
</tr>
<tr>
<td>Interest Cover</td>
<td>35.04</td>
<td>123.40</td>
<td>0.06</td>
</tr>
<tr>
<td>Debt to Equity Ratio</td>
<td>19.303</td>
<td>4.84</td>
<td>0.237</td>
</tr>
<tr>
<td>Cash Debt Coverage</td>
<td>0.09</td>
<td>0.03</td>
<td>0.893</td>
</tr>
</tbody>
</table>

Table 4.3: Statistical results of one-sample t-test with significant differences displayed in bold

All ratios indicate that PSI B was in a weaker financial position than its industry peers, during the years 2019 and 2020. Yet, out of the six chosen ratios, only the net profit margin, interest cover and debt to equity ratio yield significant results, at least one year prior to PSI B’s 2021 preference share issue.

<table>
<thead>
<tr>
<th>Year</th>
<th>Mean Net Profit Margin</th>
<th>Std. Dev. Net Profit Margin</th>
<th>Net Profit Margin of PSI B</th>
<th>T-value</th>
<th>Degrees of Freedom</th>
<th>(P)-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>10.89</td>
<td>9.350</td>
<td>12.96</td>
<td>0.443</td>
<td>3</td>
<td>0.688</td>
</tr>
<tr>
<td>2019</td>
<td>14.99</td>
<td>7.049</td>
<td>-14.50</td>
<td>8.367</td>
<td>3</td>
<td>0.004</td>
</tr>
<tr>
<td>2020</td>
<td>7.473</td>
<td>12.036</td>
<td>-22.21</td>
<td>4.932</td>
<td>3</td>
<td>0.016</td>
</tr>
</tbody>
</table>

Table 4.4: Net profit margin

\(^{17}\) Vide Appendix 4.2
Non-issuing firms had a significantly higher net profit margin than PSI B in both 2019 and 2020, with \( p \)-values of 0.004 and 0.016 respectively, as illustrated in Table 4.4 above. PSI B’s negative net profit margin in these two years is reflective of the significant losses the company suffered during this two-year period\(^\text{18} \).

<table>
<thead>
<tr>
<th>Year</th>
<th>Mean Interest Cover</th>
<th>Std. Dev. Interest Cover</th>
<th>Interest Cover of PSI B</th>
<th>T-value</th>
<th>Degrees of Freedom</th>
<th>( P )-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>35.04</td>
<td>39.456</td>
<td>123.40</td>
<td>3.879</td>
<td>2</td>
<td>0.06</td>
</tr>
<tr>
<td>2019</td>
<td>20.903</td>
<td>23.900</td>
<td>-18.67</td>
<td>3.311</td>
<td>3</td>
<td>0.045</td>
</tr>
<tr>
<td>2020</td>
<td>17.175</td>
<td>18.824</td>
<td>-13.05</td>
<td>3.211</td>
<td>3</td>
<td>0.049</td>
</tr>
</tbody>
</table>

**Table 4.5: Interest cover**

Table 4.5 displays that non-issuing firms also had a significantly higher interest cover than PSI B in the latter two years of the three year-period \( (p=0.045\) and \( p=0.049\)\), indicating that the company did not have sufficient earnings to cover its interest payments.

<table>
<thead>
<tr>
<th>Year</th>
<th>Mean Debt to Equity Ratio</th>
<th>Std. Dev. Debt to Equity Ratio</th>
<th>Debt to Equity Ratio of PSI B</th>
<th>T-value</th>
<th>Degrees of Freedom</th>
<th>( P )-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>19.303</td>
<td>19.649</td>
<td>4.84</td>
<td>1.472</td>
<td>3</td>
<td>0.237</td>
</tr>
<tr>
<td>2019</td>
<td>16.933</td>
<td>25.230</td>
<td>28.25</td>
<td>0.777</td>
<td>2</td>
<td>0.519</td>
</tr>
<tr>
<td>2020</td>
<td>29.02</td>
<td>24.582</td>
<td>166.38</td>
<td>9.678</td>
<td>2</td>
<td>0.011</td>
</tr>
</tbody>
</table>

**Table 4.6: Debt to equity ratio**

As shown in the table above, the mean debt to equity ratio for the non-issuing firms, for the year 2020, was significantly less \( (p=0.011)\) than the debt to equity ratio of PSI B, indicative of the dramatic change in the financing structure of the entity in 2020, with the level of borrowing increasing by more than triple that of the previous year and equity falling to half of its prior year-value\(^\text{19} \).

\(^\text{18}\) Vide Table A3.2.2 in Appendix 3.2

\(^\text{19}\) Vide Table A3.2.2 in Appendix 3.2
Chapter 4

Research Findings

4.5 Barriers to preference share issues

When interviewees were questioned on the main challenges and barriers to the use of preference shares, varying responses emerged.

4.5.1 Limitations of the local market

All interviewees (23/23MLCreps, 1/2Stockbrokers, MSErep, FA) referred to one or more aspects of the Maltese market as the main obstacles to the issue of preference shares.

**Low market appetite**

Twelve interviewees (8/23MLCreps, 2/2Stockbrokers, MSErep, FA) asserted that a significant barrier to the decision to issue preference shares is the fact that there is little to no market appetite for such an investment product in the local scenario.

As observed by many interviewees (14/23MLCreps, 2/2Stockbrokers, MSErep, FA), the local market is predominantly a bond market, evidenced by the fact that most public issues of corporate bonds are oversubscribed. Therefore, due to the relatively low cost and ease with which MLCs can raise the necessary finance through debt, MLCs have little incentive to choose preference shares over debt.

Several interviewees (4/23MLCreps, 1/2Stockbrokers, FA) also claimed that advisors and stockbrokers often do not recommend or encourage MLCs to issue preference shares, perceiving them to be “a very hard sell” in light of the bond-driven market. Two MLCreps (2/23MLCreps), shared the same sentiment stating that:

“[I]t is useless trying to issue an instrument to the market that you already know is going to be an uphill struggle…Trying to issue preference shares is a challenge unless there is a big change in the market.”

A frequently raised concern among respondents (13/23MLCreps, MSErep, FA) is the risk that preference shares are not sufficiently taken up by the public, causing the issuing company to “make a fool of itself”, possibly resulting in a reduction in the
MLC’s share price. As further expressed by one interviewee\(^1\) (MLCreps\), issuing preference shares and having a low turnout is:

“embarrassing first of all and, knowing that the company has carried out this risky venture and it was not able to raise the required capital would not bode well with the company’s commercial partners such as banks.”

Four interviewees\(^2\) (MLCreps\, Stockbrokers\, MSErep\) emphasised that when considering the significant amount of funds involved to issue shares on a regulated market, no MLC can afford to run the risk of the issue not being successful. Hence, as exclaimed by two interviewees\(^1\) (MLCreps\, MSErep\):

“Why would an issuer go through the hassle, cost, and risk of issuing preference shares if there isn’t appetite for them in the market?...[I]t is a gamble.”

**Market conditions and market rates of interest**

Numerous respondents\(^1\) (MLCreps\, Stockbrokers\, MSErep\, FA\) claimed that with increasingly rising prices and market interest rates, following the Russia-Ukraine war, as well as the recent government stock issue at a rate of 4\%, it is becoming an even greater challenge for MLCs to offer preference shares at attractive prices since the rate of return on preference shares is expected to be higher than that of bonds.

**The state of the Maltese market**

Multiple respondents\(^1\) (MLCreps\, Stockbrokers\, MSErep\, FA\) found either the size, maturity, and/or liquidity of the Maltese market, compared to more developed foreign markets, to be an added problem to the issuance of preference shares.

It was affirmed\(^2\) (MLCreps\, Stockbrokers\, MSErep\, FA\) that the local market is largely characterised by small-sized companies with “simple” capital structures. Others\(^2\) (Stockbrokers\, MSErep\, FA\) mentioned that the Maltese capital market needs more time to mature. Several interviewees\(^1\) (MLCreps\, Stockbrokers\, MSErep\, FA\) stated
that the illiquid local preference share market may also negatively impact the
demand for and in turn supply of such an instrument, because of the potential
difficulty for preference shareholders to find willing buyers to sell their
shareholding in the secondary market. The lack of liquidity in the local market for
preference shares was also listed as one of the main risks to the preference
shares issued by PSI B in its prospectus.

**Characteristics of local investors**

One CFO$^{(1/2MLcreps)}$ pointed out that: “the profile of the Maltese investor does not help”. As identified by some interviewees$^{(5/2MLcreps,2/2Stockbrokers,MSErep,FA)}$, whilst in international markets, numerous investors are risk-takers or have diversified investment portfolios and hence might be willing to take up preference shares, in Malta, the participation and existence of such investors are minimal. Instead, conservative retail investors, most of whom are retirees, make up most of the existing cohort of public investors.

**4.5.2 The attractiveness of preference shares to investors**

One of the dilemmas faced by MLCs when it comes to issuing preference shares, as voiced by one CFO$^{(1/2MLcreps)}$, is:

“[H]ow are you going to draw the line between making a preference share that is attractive to both the issuer and the investor?”

Upon placing themselves in the shoes of investors and contemplating the possible attractions of preference shares, MLcreps$^{(17/23MLcreps)}$ bluntly stated that they do not “think that there is anything or any particular feature that will coax [investors] to go for a preference share”. In their view, holders of preference shares assume a lot of risk, without receiving any real or significant benefit/s in return.
According to some interviewees (6/23MLCreps, FA), unless a listed entity is able to provide an exceedingly high return on preference shares, investors will not be enticed to invest, because as outlined by one CFO (1/23MLCreps):

“[W]hy would an investor subscribe to a preference share, when they can subscribe to a bond with less risk and a guaranteed return?”

4.5.3 Lack of knowledge of preference shares

All interviewees (23/23MLCreps, 2/2Stockbrokers, MSErep, FA) unanimously concurred that Maltese individual investors are not familiar with preference shares. A few MLCreps (5/23MLCreps) discerned this to be a substantial deterrent to the issue of preference shares, as it poses on the issuer the burden of having to inform the market on these types of securities prior to issuing them. Interviewees (8/23MLCreps, 1/2Stockbrokers) also repeatedly mentioned that certain shareholders and investors do not even understand the difference between bonds and common equity, let alone the inherent complexities of preference shares.

Yet, as stated by one MLCrep (1/23MLCreps), the question remains:

“Is the knowledge limited because there have been very few issues, or are there very few issues because preference shares are not much sought after by investors?”

Additionally, the two interviewed stockbrokers (2/2Stockbrokers) and the FA intimated that some brokers are not even fully aware of the features of preference shares. Moreover, twelve MLCreps (12/23MLCreps) also admitted to not having a thorough grasp of the subject, due to having last heard mention of preference shares during their former studies at the University of Malta. It is also worth noting that 19 MLCs refused to participate in this study specifically on account of their lack of experience with this hybrid instrument.
4.5.4 The perceived complexity of preference shares

One frequently mentioned barrier was the perceived complexity of preference shares, compared to other forms of financing. Indeed, a common sentiment among these interviewees (10/23 MLCreps, 1/2 Stockbrokers, MSErep, FA) was that due to their vast array of features, preference shares are:

“an unnecessary complication, which only adds to the existing worries of the issuing company”.

Numerous MLCreps (8/23 MLCreps) expressed their fear that a preference share issue would further complicate the capital structure of the entity. Five interviewees (4/23 MLCreps, FA) added that, given local investors’ fixation with bonds and the difficulty in explaining the technicalities of preference shares to investors, MLCs prefer to opt for more straightforward instruments, as otherwise, “they would be shooting themselves in the foot when it comes to selling”.

Multiple MLCreps (9/23 MLCreps) voiced their concern on the likelihood that preference shares are categorised as a complex financial instrument according to MiFID requirements. As discussed by these MLCreps, since such a classification would require investment firms to conduct an appropriateness test of the investor, they presumed that most retail investors would not pass such tests and hence be ineligible to invest. Thus, they were perturbed that this would further restrict the already lacking market for preference shares, dissuading MLCs from issuing such an instrument.

4.5.5 Taxation considerations

Seventeen interviewees (13/23 MLCreps, 2/2 Stockbrokers, MSErep, FA) agreed with the statement that preference shares are “debt with a tax disadvantage”, whilst others (10/23 MLCreps) perceived it to be an “overgeneralisation” because the tax deductibility or otherwise of preference dividends depends on their corresponding features.
Subsequently, interviewees were asked to indicate the extent to which the tax implications of preference shares are considered when deciding to issue them. Many interviewees (10/23 MLCreps, 2/2 Stockbrokers, MSE rep, FA) recognised the importance of the tax deduction, which inclines MLCs towards issuing a debt-like preference share rather than an equity-like preference share from a pure taxation perspective, due to its impact on the cost of financing.

However, several MLCreps (8/23 MLCreps) believed that taxation would not be a major consideration when deciding whether to issue preference shares. Three MLCreps (3/23 MLCreps) maintained that they would resort to preference shares only when in dire need of funds, and hence, the potential loss of the tax deduction would not deter them from issuing preference shares. Three interviewees (3/23 MLCreps) also highlighted that the tax position of the MLC may impact the importance of taxation to the decision to issue preference shares.

4.5.6 Actual and perceived conflicts of interest

An inquiry was made into whether preference shares give rise to any conflicts of interest between different stakeholders within the entity; the responses to which were equally divisive.

Most MLCs (15/23 MLCreps, 1/2 Stockbrokers, FA) did not envisage there to be any potential conflicts upon the introduction of preference shares, provided that the terms of the preference share issue are clear and the right company policies are in place stipulating management’s duty to act in the bests interests of all stakeholders.

The CFOs of both PSI A and PSI B stated that their respective preference share issues did not create any conflicts of interest because:

“There was nothing in the nature of the preference shares issued that could, in any way, cause a conflict with equity or debt holders.”

The remaining interviewees (8/23 MLCreps, 1/2 Stockbrokers, MSE) stated that there may be conflicts because ordinary equity holders would not be pleased with the entry of additional outsiders being given preference over them in the receipt of dividends
and residual assets, especially in the event of a liquidation. One CFO expressed his reservations about issuing preference shares because:

“You have a new cohort of shareholders, with more requirements, expectations and interactions and you have to manage those as well…and I would want to avoid that as much as possible.”

Several MLCreps mentioned that conflicts amongst different stakeholder interests may arise if voting rights or a convertibility option are granted to the holders of preference shares, as these would dilute the control and ownership of existing ordinary shareholders.

4.5.7 Market reaction to preference share issues

Actual reaction to the local preference share issues

There was a noticeable difference in the market reaction to the preference share issues made by the two local PSIs. Whilst the preference shares issued by PSI A were fully subscribed, only a third of those issued by PSI B were taken up by the public.

The present-day and former CFOs of PSI A attributed the public’s immediate positive response to their 1995 preference share issues, to the company’s strong brand name.

Conversely, the CFO of PSI B did not seem perturbed by the comparatively low market acceptance of their recent preference share issue. It was also noted that during the offer period, PSI B issued a supplement to its prospectus, amending a paragraph of the Securities Note, in which the company had originally stated that, in the event that the total subscriptions to the preference shares do not reach a certain amount of the offer, the issuer will not accept the subscriptions made. This paragraph was subsequently replaced with a statement that the company shall proceed with the allotment and listing of the preference shares, irrespective of the amount subscribed for. According to the FA, this signalled to the market that
PSI B was not confident in its ability to raise the necessary amount, possibly discouraging potential investors. Yet, in the FA’s view, the possible line of reasoning adopted by the company was that “it is better to raise some funds than nothing at all”.

**Expected reaction to the announcement of a preference share issue**

In response to the question on the likely market reaction to a listed entity’s announcement of a preference share issue, nine respondents\(^{8/23}\text{MLCreps, MSErep}\) presumed that the market would react positively, whereas seven interviewees\(^{6/23}\text{MLCreps, 1/2Stockbrokers}\) imagined that a preference share issue would not receive much concurrence on the part of investors, possibly resulting into a fall in company value.

The remaining interviewees\(^{7/23}\text{MLCreps, 1/2Stockbrokers, FA}\) qualified their answer by saying that the success of a preference share issue depends on various factors, including the extent of complexity\(^{3/23}\text{MLCreps}\) and type of features\(^{4/23}\text{MLCreps}\) of preference shares, the strength of the reputation and performance history of the issuer\(^{5/23}\text{MLCreps, FA}\) and the ability of financial intermediaries to successfully market the issue\(^{4/23}\text{MLCreps, 1/2Stockbrokers, FA}\).

Three interviewees\(^{2/23}\text{MLCreps, 1/2Stockbrokers}\) stated that a preference share issue would undoubtedly spark investors’ interest and might tempt them to invest simply “for the sake of trying something new”. Contrarily, some interviewees\(^{3/23}\text{MLCreps, 1/2Stockbrokers}\) mentioned that a preference share issue may cause investors to question the true motive behind the decision, consequently resulting in an adverse market reaction.

**4.5.8 Strengthening core capital – the case of banks**

There was a consensus among all four CFOs of the interviewed Maltese listed banks\(^{4/22}\text{MLCs}\), that they have little incentive to issue preference shares over ordinary shares, since the latter automatically qualify as a CET1 instrument, as
opposed to the former, whose eligibility largely depends on their features. Nevertheless, the listed banks’ representatives (4/23 MLCreps) clarified that convertible preference shares may be particularly attractive as they believed that these may be classified as core equity, and thus be used to improve the regulatory capital of the bank.

4.6 The future use of preference shares

4.6.1 The potential role of preference shares in the capital structure of MLCs

In the final question, respondents were asked to provide their thoughts on the prospect of future preference share issues. Most MLCs (13/22 MLCs) stated that they are open to considering preference shares as a potential future financing option. Some of these MLCs (9/22 MLCs) further added that this is contingent on the future circumstances and needs of the entity (6/22 MLCs); and on advancements in the local capital market, including enhanced maturity (5/22 MLCs), increased demand for preference shares (4/22 MLCs) and improved knowledge of the instrument (3/22 MLCs).

On the other hand, other MLCs (9/22 MLCs), including all four listed banks, claimed to be unwilling to issue such a financial instrument, being unable to envision any future scenario necessitating an injection of preference share capital. Only one interviewee (1/23 MLCs) declined to disclose whether the company would be inclined to issue preference shares in the future, due to confidentiality concerns.

When confronted with the question of whether they would consider re-issuing preference shares, the CFO of PSI B replied in the affirmative, whereas the current CFO of PSI A answered in the negative, stating that the company has no intention to issue such a financial instrument at this stage.

The former CFO of PSI A/stockbrokers/MSErep/FA were rather sceptical on the increased utilisation of preference shares by MLCs, stating that in their view, the market for preference shares will not grow any time soon, and hence preference
share issues are unlikely to become more commonplace. Stockbroker 2\(^{(1/2\text{Stockbrokers})}\) also proclaimed that this is a huge pity because:

“it would add a bit more of much-needed excitement to the work of the financial advisor and to our small market.”

The current CFO of PSI A went even so far as to say that preference shares are “a dying breed of shares”, not only in the local market but also on an international level.

### 4.6.2 Suggestions for increasing the use of preference shares

As a follow-up question, interviewees were requested to provide additional comments, or suggestions, with respect to increasing the use of preference shares by MLCs.

The absolute majority of interviewees\(^{(18/23\text{MLCreps,2/2Stockbrokers})}\) stressed the urgent need for increased education on the subject of preference shares. According to one CFO\(^{(1/23\text{MLCreps})}\), the responsibility for educating the market must be borne by three main parties: the issuer, the stockbroker, and the regulators.

Some respondents\(^{(3/23\text{MLCreps,2/2Stockbrokers,FA})}\) argued that every public listed entity must keep the market and investors continuously informed about their operations. However, one interviewee\(^{(1/23\text{MLCreps})}\) stated that this is still not common practice among MLCs. The FA contended that when it comes to preference share issues, the issuing company needs to embark on a more rigorous and sophisticated selling process in terms of advertisement and roadshow presentations.

Stockbroker 2\(^{(1/2\text{Stockbrokers})}\) claimed that issuing companies tend to be vocal about their performance solely during the offer period, after which the company “turns silent”. Therefore, Stockbroker 2\(^{(1/2\text{Stockbrokers})}\) suggested that, in the case of preference shares, the length of the offer period should be increased, to provide investors sufficient time to gain an understanding of the issuing entity and the instrument.
Many interviewees (11/23MLCreps, 1/2 Stockbrokers, FA) also emphasised that stockbrokers must play a more active role in such issues. Another recommendation (3/23MLCreps, 1/2 Stockbrokers) was for the provision of educational programmes and training on preference shares to investors. Two MLCreps (2/23MLCreps) also mentioned that the MSE and the MFSA should conduct general campaigns or provide specific courses on preference shares.

Having said this, some interviewees (2/23MLCreps, 1/2 Stockbrokers, MSErep) commented that education will only achieve so much, because “the market is what it is”, and:

“Unless there are very clear compelling advantages, both from a company side and an investor side, the choice will always be common equity versus debt”.

The solution to encouraging the use of preference shares, according to one CFO (1/23MLCreps), is the creation of an institution that would act as the market-maker for corporate bonds and equity in Malta, similar to how the Central Bank of Malta is the market-maker for Malta Government Securities.

4.8 Conclusion

This chapter presented the findings from the semi-structured interviews conducted, as well as from the financial distress analysis of the two local PSIs. The following chapter shall provide an in-depth discussion of these findings.
CHAPTER 5

DISCUSSION
OF FINDINGS
5.1 Introduction

This chapter discusses the findings presented in the preceding chapter, in relation to the relevant literature in Chapter 2. As shown in Figure 5.1, Sections 5.2 and 5.3 address the first research objective, describing the nature and features of preference shares and their extent of use by MLCs. Subsequently, Sections 5.4 and 5.5 deal with the second objective of this study, exploring the motivations and barriers to preference share issues in the local market. In achieving the third objective, Section 5.6 investigates the potential place preference shares may have in the capital structure of MLCs. Finally, Section 5.7 concludes the discussion.

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*Figure 5.1: Outline of Chapter 5*
5.2 The perceived nature and attractiveness of preference shares and their features

5.2.1 Are preference shares debt or equity?

It is clear from the findings\textsuperscript{20} that preference shares are widely recognised by interviewees as a hybrid instrument, which, as specified in the literature\textsuperscript{21}, neither entirely resembles debt nor ordinary equity. Accordingly, preference shares’ placement along the debt-equity continuum is dependent on the features that they are attributed with.

Intriguingly, knowledge of the accounting classification of preference shares as per IAS 32 is lacking\textsuperscript{22}. Those familiar with the provisions of the standard, however, considered the IFRS accounting treatment of preference shares and the ‘substance over form principle’, to adequately cater for the wide spectrum of preference shares.

5.2.2 Which features are the most attractive to MLCs?

Although most MLCreps are aware of the broad spectrum of features that Korsmo (2013) and Rizzo (2021a) referred to when it comes to preference shares, not all of these features were deemed to be attractive in equal measure\textsuperscript{23}.

Thanks to their “highly heterogeneous nature” (Korsmo 2013, p.1171), for a number of MLCreps\textsuperscript{24}, preference shares’ greatest advantage, as identified by Bessa (2017), is the ability of the issuing company to tailor the terms in such a manner as to accommodate its capital needs. Yet, as argued by one interviewed stockbroker, this flexibility is not sufficiently appreciated by MLCs, possibly because they perceive the wide-ranging features of preference shares to

\textsuperscript{20} Vide Section 4.2.1  
\textsuperscript{21} Vide Section 1.2.3  
\textsuperscript{22} Vide Section 4.2.1  
\textsuperscript{23} Vide Section 4.2.2  
\textsuperscript{24} Vide Section 4.2.3
increase the level of complexity rather than flexibility, as further discussed in Section 5.5.4.

5.3 The lack of preference share issues by MLCs

As established in the findings\textsuperscript{25}, out of a total of 80 companies listed on the MSE\textsuperscript{26}, only two have ever issued preference shares throughout Maltese history. The preference share issues made by these two MLCs were utterly dissimilar in terms of features, bearing testament to Yarko’s (2020, p.19) affirmation that “there is no common pattern” to preference share issues.

The use of preference shares as a financing vehicle by MLCs “does not seem to have become established practice” (Bonnevier and Børke 2014, p.436), and as with other European markets, debt and common equity remain the two most dominant sources of financing in the local domain\textsuperscript{27}. Furthermore, the majority of non-issuing listed companies claimed to have never even considered issuing preference shares, failing to discern any particular and/or significant advantages of having preference share capital. This shows that Graham and Dodd’s (1962) belief of their “fundamentally unsatisfactory” nature (as cited by Korsmo 2013, p.1164) was not unfounded.

The list of priorities ranking preference shares as the least desirable of the possible sources of capital available to a company, which Donaldson (1962) and Pinegar and Wilbricht (1989) believed to be commonly adopted by companies, also apparently prevails in Malta. Indeed, several MLCreps\textsuperscript{28} expressed their willingness to issue preference shares only in those cases where they have exhausted their ability to borrow from the bank or to issue debt, and/or common equity is not a feasible alternative. Therefore, the implication is that, given a choice, MLCs will always opt for debt first and for common equity subsequently, and only turn towards preference shares as a ‘last resort’.

\textsuperscript{25} Vide Section 4.3.1  
\textsuperscript{26} Vide Appendix 1.1  
\textsuperscript{27} Vide Section 4.3.1  
\textsuperscript{28} Vide Section 4.3.2
5.4 Venturing into unfamiliar territory: the main motives behind local preference share issues

5.4.1 Fulfilling financing needs and growth objectives

In line with Houston and Houston (1990), the underlying objective behind the two preference share issues listed on the MSE, was to support the issuing companies’ planned investment projects, in their pursuit of further growth. From the findings, it is also evident that these companies sought to purposely match the expected life of their investment projects to the exact nature and duration of the financial instrument.

5.4.2 Do preference shares help to maintain a balanced capital structure?

Consistent with the literature, one of the reasons for which the two local PSIs decided to issue preference shares is to obtain a balance in their capital structure. Indeed, as revealed in the findings, since the preference share issues of both PSI A and PSI B were accounted for as equity in their financial statements, these helped to balance out the high level of borrowings the companies had, which allowed them to attain the right debt-to-equity proportion that maximises company value whilst keeping the cost of capital to a minimum (Donaldson 1962, Fischer and Wilt 1968).

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29 Vide Section 4.4.1
30 Vide Section 2.4.2
31 Vide Section 4.4.5
32 Vide Tables A3.2.1 and A3.2.2 in Appendix 3.2
5.4.3 Are preference shares issued to retain voting control?

One of the distinctive features of preference shares, considerably emphasised by various literary sources\textsuperscript{33}, and likewise acknowledged by several interviewees\textsuperscript{34}, is the lack of voting rights typically granted to preference shareholders. In light of this, several writers acclaim that raising equity whilst retaining voting control of the company, is one of the primary reasons for which preference shares are issued.

This was proven to be the case for PSI B, which, having a single majority shareholder, sought to “avoid uninformed outside stockholder interference” (Bonnevier and Børke 2014, p.38). Moreover, as asserted by Houston and Houston (1990) and further substantiated by the CFO of PSI B\textsuperscript{35}, preference shares also reduce the threat of the company being an easy target of a hostile takeover. Additionally, in its 1995 preference share issues, PSI A’s choice to deprive its preference shareholders of the right to vote in the company’s general meetings might also signify the company’s preference for the avoidance of diluting existing shareholder control.

5.4.4 Are preference shares issued to take advantage of prevailing market conditions?

Only for one of the two local PSIs (PSI A) was the state of the market at the time of issue considered conducive to a public issue of preference shares\textsuperscript{36}, thus demonstrating some truth behind Elsaid’s (1969) assertion that preference shares are issued by listed corporations to seize favourable market conditions.

However, as opposed to Bonnevier and Børke’s (2014) and Brabenec et al.’s (2020) studies, the preference share issues by PSI A in 1995 were not motivated by a thriving bond market or low interest rates. Indeed, 1995 was a particularly unique period in Malta, where the MSE and the bond market were still in their...

\begin{footnotesize}
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\item \textsuperscript{33} Vide Section 2.4.3
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\end{itemize}
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infancy. Moreover, the company’s already well-established brand name presented it with the perfect opportunity to try out an unexplored means of financing and gauge the market appetite for such an instrument.

5.4.5 Are preference shares issued to enhance debt capacity?

A further motive behind PSI B’s public offering of preference shares was to build up its borrowing capacity, thereby establishing a strong foundation for the company’s next phase of debt financing, as argued by Fischer and Wilt (1968). However, it must be noted that this was only possible because the company’s preference shares were classified as equity in its financial statements. Indeed, debt-like preference shares accounted for as a liability will reduce, rather than enhance, the issuing company’s debt capacity. Furthermore, enhancing debt capacity was not amongst the reasons for which PSI A issued preference shares, hence providing only partial support to the arguments of Donaldson (1962) and Elsaid (1969).

4.4.6 Are preference shares used to achieve desired financial reporting outcomes?

The financial statement classification of preference shares is of considerable importance due to the ensuing implications on the tax deductibility of preference shares, their eligibility as a complex instrument under MiFID requirements, and as a CET1 instrument for capital adequacy purposes.

Nevertheless, the findings show that interviewees perceive the financial reporting of preference share issues to have little influence on the decision to issue preference shares. A possible reason for this is the poor level of familiarity that participants have with IAS 32 and their implications.

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37 Vide Section 4.4.5
38 Vide Section 2.3
39 Vide Section 4.4.6
In agreement with the written works of Levi and Segal (2015) and Chatfield et al. (2020), the findings show that some MLCs may be encouraged to issue preference shares when their gearing level is high because these can be structured to improve their debt to equity ratios (Shakespeare 2020).

5.4.7 The use of preference shares in times of financial distress

Would preference shares be attractive in times of financial distress?

The discretionary nature of a preference dividend payment and the flexibility that this provides to the company, particularly in times of financial distress, was generally appreciated by interviewees, in line with Wang (2006) and Chatfield et al. (2020).

However, a valid counterargument to this is the fact that ordinary shares also enable a financially troubled company to omit the dividend, a fact that the literature seems to overlook. Moreover, as emphasised by Santow (1962), if the preference shares are cumulative, the dividend can only be suspended temporarily, and hence, an ordinary share issue would give a company more flexibility in omitting the dividend than a cumulative preference share issue. Therefore, the dividend omission feature alone, may not provide sufficient grounds for the issue of preference shares by financially distressed companies.

Moreover, when considering the nature of local investors and their extent of reliance on dividend income, MLCs displayed their scepticism on the viability of issuing preference shares, even in times of financial distress. Echoing Donaldson (1962, p.125), interviewees emphasised that it is crucial, particularly locally, to treat preference dividends just as if they were “a fixed contractual commitment.” In addition, in line with the views of Suchard and Singh (2006) and Chatfield et

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40 Vide Section 4.4.6
41 Vide Section 4.4.7 The use of preference shares in financial distress
42 Vide Section 4.4.7 The use of preference shares in financial distress
al. (2020), suspending dividend payments may have a detrimental impact on the reputation and share price of the company.

In view of this, most interviewees repudiated the financial distress theory put forward in the literature, contending that a financially distressed company would not be able to issue any kind of financial instrument, including preference shares. Nonetheless, as other interviewees argued, companies having low profitability or experiencing cash shortages, with an urgent need to regain their financial strength, are likely to weigh all available courses of action, and thus may be more inclined to issue preference shares.

**Are preference shares issued by financially distressed companies?**

Whilst the majority of the interviewed MLCs disagreed with the validity of the financial distress theory in the local market, the results from the financial distress analysis undertaken in this study seem to paint a somewhat different picture. Indeed, the quantitative findings provide some empirical evidence in favour of the financial distress hypothesis, with respect to both PSIs.

The findings demonstrate that PSI A suffered a decline in its profitability, as evidenced by both its net profit margin and return on asset ratios in the financial period 1995/6. It is also evident that the preference share issues in December 1995 had a positive effect on the company’s degree of leverage, without which the company’s debt to equity ratio would have been relatively high compared to previous years.

The general deterioration of PSI A’s Z-score as the year of the preference share issues approached, particularly after adjusting for the preference share issues, may suggest that the company was facing some financial problems, although at no point did the score fall below the 1.81 cut-off point of the distress zone.

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43 Vide Section 4.4.7 *The use of preference shares in financial distress*
44 Vide Section 2.4.7
45 Vide Section 4.4.7 *Findings of financial distress analysis*
46 Vide Table 4.1 in Section 4.4.7
47 Vide Table 4.2 and Figure 4.4 in Section 4.4.7
48 Vide Figure 4.5 in Section 4.4.7 and Appendix 4.1
In turn, as shown in the statistical findings of PSI B\(^{49}\), all but one of the chosen ratios\(^{50}\) reveal PSI B to have a dramatically poorer financial condition than the four non-issuing listed companies, in terms of profitability, gearing and solvency, in each of the two years before the 2021 preference share issue. This implies that the company had a higher risk of financial distress than non-issuers during the aforementioned two-year period.

Consistent with earlier studies\(^{51}\), PSI B had a significantly lower net profit margin and interest cover than the four non-issuing firms for the years 2019 and 2020, and a significantly higher debt-to-equity ratio than non-issuing firms for the financial year 2020\(^{52}\). This substantiates the arguments of Ravid et al. (2007) and Lee and Figlewicz (1999) that companies having low earnings and weaker balance sheet positions are more likely to issue preference shares.

In summary, the above results seem to portray the two PSIs as showing some early signs of financial distress, at least in the financial period exactly prior to the preference share issues, thereby giving support to the financial distress hypothesis and its applicability to the Maltese market.

### 5.5 Facing the music: the main barriers to preference share issues by MLCs

#### 5.5.1 Limitations of the local market

The findings\(^{53}\) indicate that the characteristics of the local market and the nature and demographic of the local investor base, are the principal impediments to the issue of preference shares by MLCs.

\(^{49}\) Vide Table 4.3 in Section 4.4.7  
\(^{50}\) PSI B had a lower current ratio than the other non-issuing listed companies only in the year 2020. Vide Appendix 4.2  
\(^{51}\) Vide Section 2.4.7  
\(^{52}\) Vide Tables 4.4 to 4.6 in Section 4.4.7  
\(^{53}\) Vide Section 4.5.1
The lack of appetite for preference shares locally

The greatest worry for MLCs appears to be the lack of appetite for preference shares, given that Maltese investors are bond-fixated and bond issues largely dominate the local market landscape. Following the advice of their advisors and stockbrokers, MLCs continue to issue bonds, as opposed to preference shares, safe in the knowledge that they will obtain the necessary funding easily and inexpensively. Hence, interviewees believe that, like ordinary shares, this hybrid instrument will be no more than a second-best alternative to debt.

Given that the ultimate objective of any company seeking public funding is for the financial instrument issued in the market to be successful, MLCs perceive a preference share issue to be a great challenge in the local context, and as put by the MSE representative; a “gamble”. Consequently, an unsuccessful preference share issue would have a detrimental impact on the issuing company’s market capitalisation, as well as its reputation, potentially compromising its commercial ties with banks and other financiers.

Unfavourable market conditions

Contrary to the findings of Bonnevier and Børke (2014), the recent period of low interest rates discouraged MLCs from issuing preference shares, finding bonds, once again, to be a superior financing instrument due to the popularity of bonds among local investors. Moreover, with market prices on the rise, the likelihood of preference shares, being a fixed-income instrument, becoming an attractive and feasible source of capital for MLCs is questionable.

54 Vide Section 4.5.1 Low market appetite
55 Vide Section 2.4.4
56 Vide Section 4.5.1 Market conditions and market rates of interest
The current state of the Maltese market

According to some interviewees, another market-related obstacle to the issuance of preference shares is the limited size, maturity, and liquidity of the local capital market. As previously mentioned, the local equity market is still largely underdeveloped, which is demonstrated by the low number of common equity and preference share public issues and is further reflective of our small island state.

As outlined in PSI B’s prospectus, the liquidity risk attached to preference shares may further impair preference shareholders’ ability to sell their shareholding, as and when required. Hence, prospective investors may be hesitant in purchasing the preference shares of an MLC, limiting further both the demand and the supply of such an instrument in the market.

Characteristics of local investors

The findings further reveal the fact that local investors, mainly being individual retail investors and pensioners, are risk-averse and conservative, seeking a stable flow of income. Hence, local investors have an undeniable preference for bonds over preference shares. However, as argued by Brabenec et al. (2020), preference shares with a fixed and cumulative dividend may indeed suit local investors’ needs, and thus, there may be concurrence for the issue of such shares, although this has never again been attempted since PSI A’s 1995 preference share issues.

57 Vide Section 4.5.1 The state of the Maltese market
58 Vide Section 4.5.1 Characteristics of local investors
5.5.2 Are preference shares attractive from an investor perspective?

Coherent with Brabenec et al. (2020), when contemplating a preference share issue, it is clear from the findings that MLCs give due consideration to the investor perspective, so as to ensure the success of their security issues. After all, supply and demand are two sides of the same coin.

Various interviewees stated that the features of preference shares can act as a double-edged sword, in that, issuing preference shares that are attractive to the issuing company may mean having to attach features that are in turn unappealing to investors. However, to determine whether this is truly the case, one would need to investigate first-hand the perceptions of local investors, which hence is an area that may require further research.

It has also been established that the attractiveness of preference shares to local investors centres around the attached dividend payout. Unless preference shares provide an abnormally high return to the holder of such a security, Maltese individuals will have no desire to invest.

5.5.3 Is there a knowledge gap on preference shares?

There is also an apparent lack of knowledge of preference shares, not only among local investors, but also among stockbrokers and financial officials of MLCs. As hinted at by Vernimmen et al. (2018), preference shares are not easily understandable instruments.

The level of financial acumen of local investors is currently below par, which is to be expected, given that most Maltese retail investors are past retirement age and have limited or no financing background. It is not surprising therefore, as expressed by various MLCreps, that such investors struggle to comprehend the wide-ranging particulars of preference shares. This in turn places a heavy burden

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59 Vide Section 4.5.2  
60 Vide Section 4.5.3  
61 Vide Section 4.5.3
on issuers and financial intermediaries to educate the market and adequately inform investors on the features and risks of the instrument.

Furthermore, even those who supposedly have a strong level of financial knowledge appear not to be well-informed on the subject matter. This is particularly worrying on several fronts. If stockbrokers themselves are not wholly familiar with preference shares and their respective advantages and disadvantages, how are investors expected to rely on their advice and be willing to invest in such an instrument? This perhaps may explain why certain MLCs\textsuperscript{62} claimed that their stockbrokers often do not encourage the issuance of preference shares. Even more concerning is the fact that the financial managers of MLCs are unacquainted with preference shares, as it does not bode well for their future use as a source of financing.

Therefore, enhanced awareness and education on preference shares are imperative. By ensuring a proper understanding of preference shares, MLCs can explore new financing options, broaden their investor base and contribute to the development of the local capital market.

5.5.4 Are preference shares a complex instrument?

One of the major barriers faced by MLCs is the complexity of preference shares. In accordance with the literature\textsuperscript{63}, various respondents\textsuperscript{64} believed that a preference share issue would be “an added complication” (Laurent 2002, p.26), that would not be sufficiently understood and welcomed by investors. This perception stems from the vast and overwhelming number of features that preference shares can be endowed with.

\textsuperscript{62} Vide Section 4.5.1 Low market appetite
\textsuperscript{63} Vide Section 2.5.1
\textsuperscript{64} Vide Section 4.5.4
The findings\textsuperscript{65} further reveal that, as indicated by Donaldson (1962), MLCs prefer to avoid introducing a new class of shares, feeling that preference shares prevent the company and its directors from maintaining a “simple” capital structure.

Another area of concern is the potential classification of preference shares as a complex instrument as per MiFID II. Although unaware of the features preference shares would need to have to be qualified as complex, MLCreps expressed their belief that such a classification would burden both financial intermediaries and the investing public with the cost and tediousness of conducting or undergoing an appropriateness test (Rizzo 2021a)\textsuperscript{66}. As a result, MLCs may decide against publicly issuing preference shares, because such a classification would mean acquiring a smaller pool of investors and hence, less funds.

However, one can argue that the recent preference shares issued in the local market were deemed to be non-complex and hence, it is the issuers themselves and the terms they assign to their preference share issues which will ultimately determine their complexity.

5.5.5 Are preference shares a tax disadvantaged instrument?

Foreign literature\textsuperscript{67} strongly advances the notion that the lack of tax deductibility of preference shares is a key drawback to the issuance of such an instrument. However, according to local taxation laws\textsuperscript{68}, preference shares are tax deductible if they are classified as a liability in the financial statements of the issuing company under IFRS. Hence, as identified by many interviewees\textsuperscript{69}, the arguments of Elsaid (1969) and Chatfield et al. (2020), are only applicable in so far as the preference share is accounted for as equity. However, MLCs’ agreement with the statement that preference shares are “debt with a tax disadvantage” (Chatfield et al. 2020, p.402), suggests that many are unaware of

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{65} Vide Section 4.5.4
\item \textsuperscript{66} Vide Section 2.3.3
\item \textsuperscript{67} Vide Section 2.5.2
\item \textsuperscript{68} Vide Section 2.3.2
\item \textsuperscript{69} Vide Section 4.5.5
\end{enumerate}
\end{footnotesize}
the fact that an issuing company can in fact benefit from a tax deduction on such shares, depending on their features.

Even so, because of the significant impact of the tax shield on the cost of preference shares, as contended by Elsaid (1969) and Chatfield et al. (2020) and interview participants\(^\text{70}\) alike, preference shares having debt-like features are more likely to be attractive for the issuing company, from a taxation perspective.

Nonetheless, in agreement with Laurent (2002) and Ravid et al. (2007), taxation does not seem to be at the forefront of every interviewed MLC’s financing strategy, when contemplating an issue of preference shares, given that there may be other non-tax-related motives to issuing preference shares and the tax position of certain MLCs may render the tax deductibility of preference shares irrelevant.

### 5.5.6 Do preference shares give rise to conflicts of interest?

As mentioned in the findings\(^\text{71}\), the local preference share issues did not give rise to any conflicts, as the terms and features allocated to them were reasonable and comprehensible to all stakeholders involved. Several other interviewees were also of the same opinion as Donaldson (1962); that the introduction of preference shares within a company’s capital structure would not be the source of any discord between preference and ordinary shareholders, primarily because of management’s duty to always act in the best interests of the issuing company.

In line with Korsmo (2013) and Cai (2016), interviewees\(^\text{72}\) claimed that a preference share issue may trigger conflicts between preference shareholders and ordinary shareholders, because the latter would feel that they are second in line to the former, with respect to both dividend payments and asset distribution, particularly in the case of a company winding-up.

There may also be resistance on the part of ordinary shareholders for preference share issues that either grant equal voting rights or a convertibility option to the

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\(^{70}\) Vide Section 4.5.5  
\(^{71}\) Vide Section 4.5.6  
\(^{72}\) Vide Section 4.5.6
holders of such securities, as this would place preference shareholders at par with ordinary equity holders with respect to company decisions and company control. In this manner, as argued by Korchak (2019), ordinary shareholders may feel that they are being treated unjustly.

5.5.7 Does a preference share issue send negative market signals?

According to the literature\textsuperscript{73}, the announcement of a preference share issue is not typically perceived to be good news. The divergent market reactions to the two local preference share issues call this into question. The positive market reaction and immediate take-up of PSI A’s preference share issues in 1995, contrasts starkly with that of PSI B in 2021.

The findings\textsuperscript{74} of this study show that the market confidence in PSI A’s issue was principally thanks to the high market standing the company held at the time, thereby confirming Kallberg et al.’s (2013) conviction that the negative announcement effect of a preference share issue declines as the company’s credit rating increases. Conversely, in the case of PSI B, the supplement to its prospectus may have sent negative market signals on the likely success of the company’s preference share issue, consequently resulting in a low take-up. Perhaps, the complexity, volatility, and growth of the company’s business model, as well as the novelty of the financial instrument, may not have worked in its favour either.

Interviewees\textsuperscript{75} also had diverging opinions on the degree of market acceptance to preference shares issues, contending that this depends on their features, the name and financial performance of the issuing company, as well as the extent of marketing undertaken by stockbrokers, once again validating the findings of Kallberg et al. (2013). Furthermore, certain respondents agreed with Chatfield et al.’s (2020) consternation that a preference share issue may arouse the

\textsuperscript{73} Vide Section 2.5.4
\textsuperscript{74} Vide Section 4.5.7 Actual reaction to the local preference share issues
\textsuperscript{75} Vide Section 4.5.7 Expected reaction to the announcement of a preference share issue
suspicions of public investors on the financial soundness and future prospects of the issuing company, increasing their reluctance to invest.

5.5.8 Are preference shares attractive to banks for capital adequacy purposes?

According to the interviewed local listed banks\(^{76}\), current regulatory capital requirements provide minimal inducement for the public issuance of preference shares over ordinary shares, since the latter invariably qualify as CET1, whereas the eligibility of the former is contingent on their corresponding features. This opposes the arguments of Callahan et al. (2001) and Howe and Lee (2006), who claimed that such regulatory requirements are the chief reason why many financial firms favour preference shares.

5.6 Towards new horizons: the future use of preference shares

5.6.1 Are preference shares secured a future place in the capital structure of MLCs?

Intriguingly, while PSI B\(^{77}\) claimed to be disposed to re-issuing preference shares in the future, PSI A showed no such desire.

Although when looking at the Maltese market in its present state, Wang (1989, p.15) was arguably right in his observation that “preferred stock will hold only a minor place in the total corporate financing picture”, the findings\(^{78}\) reveal that the future of preference shares in Malta is not as bleak as it is often portrayed in the literature\(^{79}\). In fact, slightly more than half of the non-issuing MLCreps did not

\(^{76}\) Vide Section 4.5.8  
\(^{77}\) Vide Section 4.6.1  
\(^{78}\) Vide Section 4.6.1  
\(^{79}\) Vide Section 2.6
dismiss the possibility of using this unconventional financial instrument going forward.

However, this apparent willingness among certain MLCs is demonstrated only in the hope of there being further developments in the local market. Added market maturity; improved investor knowledge; and increased diversification of companies’ capital structure and investment portfolios, would further propel listed companies towards preference share issuance, all of which, however, are still yet to be achieved.

Nevertheless, a few MLCs\(^{80}\) are not as enthusiastic to use preference shares. The CFO of PSI A, interviewed stockbrokers, MSErep and the FA, conjecture that preference shares will not increase in popularity as a financing instrument and are slowly dying out, corroborating the past views of various writers\(^ {81}\).

The findings\(^ {82}\) of this study indicate that the prospect of preference shares being “assured of a continuing place in corporate capital structure” as exclaimed by Elsaid (1969, p.116) is still far from reality in the local context. As Walther (2014, p.162) and one stockbroker emphasised, preference shares “should be a staple of modern finance”, yet sadly, “the value that could be unlocked by companies” through preference share issues (Rizzo 2021a), is still rather underappreciated by MLCs.

5.6.2 What is to solution to increase the use of preference shares?

As proposed by many\(^ {83}\), the key to reversing this declining trend in preference share issues in the local market environment is increased education, the onus of which falls on every issuer, financial intermediary, and regulator, if preference shares are to be secured a place in the capital structure of MLCs.

\(^{80}\) Vide Section 4.6.1
\(^{81}\) Vide Section 2.6
\(^{82}\) Vide Section 4.6.1
\(^{83}\) Vide Section 4.6.2
Save for a select few, most MLCs adopt a passive approach to keeping the market informed. Hence, MLCs must be more vocal about their operations and financial performance, through regular company announcements and disclosures. This should be done not only during the offer period but all throughout the year, particularly when it comes to preference share issues. Moreover, issuers with the help of stockbrokers should engage in more rigorous marketing campaigns and roadshow presentations prior to the issue.

The stockbroker undoubtedly has an important role to play in preference share issues. Investment firms must gain a better grasp of this hybrid instrument in order to adequately present its attractions and weaknesses to both MLCs considering the use of such an instrument and investors.

In order to reduce this prevalent knowledge barrier with respect to preference shares in the local context, regulatory authorities, namely the MFSA and MSE, can also provide specific courses and/or other training programmes on preference shares.

However, whilst education serves to foster a greater level of understanding and awareness of preference shares, this may not necessarily translate into increased preference share usage, because the market and the instrument itself ‘is what it is’. To address the perceived illiquidity of the Maltese stock market, as contended by one interviewee\(^\text{84}\), it is high time for the establishment of market-makers for equity and corporate bonds in Malta. This would increase the diversity of the local capital market and widen the range of investment options available, thus attracting foreign investors and possibly stimulating the demand for preference shares.

These initiatives can help bring transformational changes in the current conservative mentality of the finance managers of MLCs and that of investors, and their persisting perception that preference shares do not have “any clear and compelling advantages”.

\(^{84}\) Vide Section 4.6.2
5.7 Conclusion

This chapter presented a discussion of the key findings. The next and concluding chapter will provide a summary of the study, along with some recommendations and areas for future research.
CHAPTER 6

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS
6.1 Introduction

This chapter concludes the dissertation. As illustrated in Figure 6.1, Section 6.2 summarises the findings of this study and Section 6.3 lays out the conclusions. Thereafter, Section 6.4 presents various recommendations and Section 6.5 proposes areas for further research. Finally, Section 6.6 provides the concluding remarks.

Figure 6.1: Outline of Chapter 6
6.2 Summary

The objectives of this study were threefold: to establish the extent to which preference shares have been issued by MLCs; to analyse the major determinants and barriers to such preference share issues; and to determine whether preference shares have a place in the capital structure of MLCs.

To achieve these objectives, a qualitatively driven mixed-methods research approach was adopted. Semi-structured interviews were carried out with 23 MLCreps (19 of which were CFOs), two stockbrokers, an MSE representative, and a financial advisor of a Big Four accounting firm, amounting to a total of 27 participants. A financial distress analysis was conducted on the two local PSIs through the selection of a set of ratios. The chosen ratios were analysed using different quantitative techniques for each respective issuer. For PSI A, the Z-score was calculated, and emerging trends were identified and analysed. For PSI B, an independent one-sample t-test was performed, involving comparisons with four other non-issuing MLCs within the same industry.

Findings show that preference shares are considered as being a hybrid instrument, and their attractiveness to MLCs as a source of finance largely depends on their associated features. It was also established that only two MLCs have issued preference shares in the local capital market. Most MLCs have never considered issuing preference shares, perceiving them to be void of any particular or significant advantage that may entice their issuance. Preference shares are also often viewed as being the last financing avenue for several MLCs.

In relation to the second objective, various motivations and barriers to local preference share issues were identified. The company’s strong brand name and the peculiar dynamics of the Maltese market in 1995, were deemed to be the main motivating factors for PSI A’s preference share issues; whereas PSI B issued preference shares primarily to retain voting control. Preference shares were also found to have been utilised by both PSI A and PSI B to support their growth and financing needs and maintain a balanced capital structure. Although, for most MLCs, preference share issues would not be viable in times of financial distress, the quantitative findings of this study provide some empirical evidence
in support of the financial distress theory, portraying the two PSIs as having experienced financial difficulties prior to their preference share issues.

It was found that barriers to the use of preference shares by MLCs are chiefly due to the existing limitations of the Maltese market, namely; the lack of market appetite; current rising market prices and interest rates; the limited size and lack of maturity and liquidity of the Maltese market; and the unsophisticated nature of the local investor base. Preference shares were also perceived to be inherently unattractive to investors and too complex in nature. It was also discovered that there is an apparent lack of knowledge of preference shares, further restricting their use by MLCs. For local listed banks, current regulatory requirements on capital adequacy are not seen to favour the issue of preference shares.

Finally, PSI B and many other MLCs were open to issuing preference shares in the future, expecting the local capital market to change for the better. Others, including PSI A, were not willing to introduce or re-introduce preference shares in their capital structure, seeing no future need for preference shares. Increased education on preference shares was deemed necessary to encourage further use of such an instrument by MLCs, although some claimed that this is fruitless if the local market remains as it is.

6.3 Conclusions

This study concludes that debt and common equity remain the preferred means of financing among MLCs, evidenced by the lack of preference share issues in the local capital market and the scarce consideration for using such a financing instrument. Despite their flexibility, preference shares are not sufficiently attractive to MLCs and are only resorted to when additional debt and/or ordinary share issues are not possible or feasible.

This study also concludes that the rationale for issuing preference shares may vary from one MLC to another. Preference shares issues may arise from the need to support corporate growth; meet capital needs; avoid dilution of control; exploit market conditions; maintain a balanced capital structure; and enhance debt
capacity. Financial distress may have also driven the issuance of preference shares by the two local PSIs. The greatest barriers to preference share issues by MLCs are those related to the nature and characteristics of the local market and investor; the perceived complexity of preference shares; and their lack of attractiveness to investors. This study also recognised the existence of a prevailing knowledge gap on preference shares.

The potential place of preference shares in the corporate capital structure of MLCs largely depends on the increased development of the local capital market and improved acceptance and understanding of preference shares. Without such changes, preference shares are unlikely to feature more in the local corporate scene. Greater education may be the best first step to increasing preference share issuance, whereby issuers, stockbrokers, and regulators all have an important role to play.

### 6.4 Recommendations

The study recommends that:

**A. proper market sounding should be conducted by MLCs prior to publicly issuing preference shares (Section 5.5.1 and 5.5.7)**

This would enable issuers to gauge the reaction of local investors to a public offering of preference shares and the likely take-up, as well as help determine the right price, size, and terms of the preference share issue. In this manner, the issuer can better ensure the success of their future preference share issues.

**B. issuers publish company announcements, details of their operations and planned projects, and other relevant company information, on a regular basis (Sections 5.5.7 and 5.6.2)**

Issuing companies must endeavour to keep the market informed not only during the offer period but even beyond, to increase investors’ familiarity with the issuing company, enhance the company’s brand name, and gain market confidence. As interviewees stated, no matter how complex preference shares may be, a
preference share issue made by a well-known and financially strong listed company is more likely to receive a positive market reaction.

C. **in cooperation with stockbrokers, the issuing entity engages in more rigorous roadshows and marketing efforts, when contemplating a preference share IPO (Sections 5.5.7 and 5.6.2)**

Roadshows, often taking the form of a series of presentations, are done to gauge the market appetite and communicate pertinent information about the company itself and the planned preference share issue to investors. Stockbrokers must also play a more active role in promoting the preference shares of an issuing company and help alleviate any possible concerns or questions that investors may have about the instrument and the attached terms.

D. **educational campaigns and training programmes be launched by the MFSA and MSE specifically on preference shares (Sections 5.5.3 and 5.6.2)**

It is recommended that local regulators should provide specific educational and training courses to not only investors but also to company officials and stockbrokers to:

1. foster greater awareness and understanding of preference shares;
2. highlight the advantages and disadvantages of the instrument both from an issuer and investor perspective; and
3. increase clarity on the accounting, taxation, and regulatory implications of preference share issues for MLCs.

E. **further technical and financial guidance is given on the subject of preference shares and other corporate finance areas, through increased financial journalism (Sections 5.5.3).**
The scarce financial literature on preference shares, on a national and global level, continues to contribute to the prevalent knowledge gap. Stockbrokers, financial advisors, Big Four accountancy firms, and other news and media outlets should seek to publish and disseminate more reliable and accurate financial information, through various mediums such as company websites, newsletters, etc., to improve the financial literacy of investors and enhance knowledge of preference shares.

F. market-makers for equity and corporate bonds are established to enhance the liquidity and maturity of the local capital market (Sections 5.5.1 and 5.6.2)

The introduction of market-making in Malta would help to stimulate the level of trading activity in the Maltese stock market and possibly attract a greater number of foreign investors, thereby resulting in a more diversified investor base and a potentially higher demand for preference shares.

6.5 Areas for further research

The study identified the following areas requiring further research:

A. The Attractiveness of Preference Shares: A Local Investor Perspective (Section 5.5.2)

This study would explore the perceptions of local investors on preference shares and their features. Its aim would be to determine the level of understanding of preference shares among the investing public and the possible attractions and downsides of preference shares as an investment instrument.
B. The Influence of Capital Adequacy Requirements on the Use of Preference Shares by Local Banks (Sections 2.3.4 and 5.5.8)

It has been established that regulatory requirements on capital adequacy determine the choice of financing for local banks. Hence, a further line of research could be to investigate the capital adequacy rules in relation to preference shares, to determine whether preference shares contribute towards strengthening the regulatory capital of local banks and investigate their perceived attractiveness.

C. The Use of Preference Shares in the Maltese Private Market: A Study

A similar study could be undertaken to analyse the use of preference shares by non-listed companies and private companies. It would be interesting to determine whether this hybrid instrument is more popular in the capital structure of private companies and whether the decision to issue preference shares is driven by the same reasons for which MLCs decide in favour or against such a financing option.

6.6 Concluding remarks

In an increasingly complex business environment, it is paramount for companies to choose the appropriate mix of financing to ensure their success and competitiveness in local and global markets. Unfortunately, MLCs are not, as yet, fully conscious and appreciative of the value that they could unlock by embracing more innovative sources of finance such as preference shares, and their potential contribution to the much-needed development of the local capital market. Although Maltese history has shown that preference shares are not a sought-after instrument by listed companies, as is commonly stated in corporate finance, ‘the past is not a guarantee of the future’. Moreover, as to the future use of preference shares by MLCs, four interviewees remarked: “never say never”.

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APPENDICES
Appendix 1.1: Maltese Listed Companies

Below is the list of the companies listed on the MSE as at 30th September 2022, which were considered when determining the appropriate research sample for the study. The MLCs have been categorised into three main groups: those having solely an equity or a debt listing, and those having both a debt and equity listing as at the above date.

<table>
<thead>
<tr>
<th>Equity-Listed Companies</th>
<th>Debt-Listed Companies</th>
<th>Companies with both a Debt and Equity Listing</th>
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<tbody>
<tr>
<td>Malta International Airport p.l.c.</td>
<td>Tumas Investments p.l.c.</td>
<td>MedservRegis p.l.c.</td>
</tr>
<tr>
<td>MaltaPost p.l.c.</td>
<td>6PM Holdings p.l.c.</td>
<td>Hili Properties p.l.c.</td>
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<tr>
<td>PG p.l.c.</td>
<td>MeDirect Bank (Malta) p.l.c.</td>
<td>APS Bank p.l.c.</td>
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<tr>
<td>Main Street Complex p.l.c.</td>
<td>Hal Mann Vella Group p.l.c.</td>
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<td><strong>Equity-Listed Companies</strong></td>
<td><strong>Debt-Listed Companies</strong></td>
<td><strong>Companies with both a Debt and Equity Listing</strong></td>
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<tr>
<td>BMIT Technologies p.l.c.</td>
<td>1923 Investments p.l.c.</td>
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<tr>
<td>Harvest Technology p.l.c.</td>
<td>Central Business Centres p.l.c.</td>
<td></td>
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<tr>
<td>VBL p.l.c.</td>
<td>Ferratum Bank p.l.c.</td>
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<tr>
<td>Loqus Holdings p.l.c.(^{85})</td>
<td>Gap Group p.l.c.</td>
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<tr>
<td></td>
<td>Mediterranean Maritime Hub Finance p.l.c.</td>
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<tr>
<td></td>
<td>Von der Heyden Group Finance p.l.c.</td>
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<tr>
<td></td>
<td>SD Finance p.l.c.</td>
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<td></td>
<td>Virtu Finance p.l.c.</td>
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<td></td>
<td>Stivala Group Finance p.l.c.</td>
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<tr>
<td></td>
<td>Bortex Group Finance p.l.c.</td>
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<td></td>
<td>Hudson Malta p.l.c.</td>
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<td></td>
<td>Hili Finance Company p.l.c.</td>
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<tr>
<td></td>
<td>Exalco Finance p.l.c.</td>
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<tr>
<td></td>
<td>Melite Finance p.l.c.</td>
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<tr>
<td></td>
<td>Phoenicia Finance Company p.l.c.</td>
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<td></td>
<td>Best Deal Properties Holding p.l.c.</td>
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<tr>
<td></td>
<td>Endo Finance p.l.c.</td>
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<tr>
<td></td>
<td>SP Finance p.l.c.</td>
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<tr>
<td></td>
<td>Mercury Projects Finance p.l.c.</td>
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<td></td>
<td>Smartcare Finance p.l.c.</td>
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</tbody>
</table>

\(^{85}\) This company is the only company listed on the Alternative Companies List but has been incorporated for the purposes of this study.
<table>
<thead>
<tr>
<th>Equity-Listed Companies</th>
<th>Debt-Listed Companies</th>
<th>Companies with both a Debt and Equity Listing</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>TUM Finance p.l.c.</td>
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<tr>
<td></td>
<td>Merkanti Holding p.l.c.</td>
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<td></td>
<td>Shoreline Mall p.l.c.</td>
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<td>AX Group p.l.c.</td>
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<td></td>
<td>Cablenet Communications Systems p.l.c.</td>
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<td></td>
<td>Browns Pharma Holdings p.l.c.</td>
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<td></td>
<td>Dino Fino Finance p.l.c.</td>
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<tr>
<td></td>
<td>BNF Bank p.l.c.</td>
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<tr>
<td></td>
<td>St Anthony Co plc</td>
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<tr>
<td></td>
<td>IZI Finance p.l.c.</td>
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<td></td>
<td>G3 Finance p.l.c.</td>
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<td></td>
<td>The ONA p.l.c.</td>
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<td></td>
<td>Together Gaming Solutions p.l.c.</td>
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</tr>
</tbody>
</table>

Table A1.1: List of Maltese Listed Companies as at 30th September 2022

Other debt-listed companies on the MSE in the period 1st October 2022 to 30th April 2023, which were not considered for the purposes of this study, include the following:

- Multitude Bank p.l.c.
- JD Capital p.l.c.
- Pharmacare Finance p.l.c.
- CF Estates Finance p.l.c.
- Qawra Palace p.l.c.
- Bonnici Bros Properties p.l.c.
- GPH Malta Finance p.l.c.
Appendix 3.1 Interview Schedules

This appendix presents the three interview schedules that were utilised during the semi-structured interviews conducted for the purposes of this study. Each schedule is tailored to three main respondent groups: PSIs, non-issuing listed companies and other participants consisting of two stockbrokers, a MSErep and a FA.
Interview Schedule – Preference Share Issuers

Introduction: The nature of preference shares and their features

1) In your view, do preference shares more closely resemble debt or equity? Why?

2) What are your views on the classification and accounting treatment of preference shares as per IAS 32 - *Financial Instruments: Presentation*?

3) In your opinion, what are the main features attributable to preference shares, and which of these features, if any, render preference shares attractive or unattractive as a financing instrument?

4) How do the dividend yield and financing cost of preference shares compare to those of bonds and ordinary shares?

5) What advantages and/or disadvantages do you perceive preference shares to have when compared to bonds and ordinary shares?

Section B: The determinants and barriers to preference share issues

6) Was your decision to issue preference shares motivated by any of the following reasons:

   a) To support corporate growth
   b) To retain ownership and control
   c) To take advantage of the prevailing market conditions and/or market rates of interest
   d) To enhance debt capacity or improve borrowing base
   e) To maintain a balanced capital structure
   f) Other?

7) How important is the dividend omission feature of preference shares in deciding whether to issue preference shares or not? Does this change during times of financial distress and if so, how?
8) Does financial distress alter the decision to issue preference shares and if so, in what manner?

9) To what extent did you consider the financial reporting implications of your preference share issue?

10) Do you perceive there to be any risk in issuing and investing in preference shares? Did this have any impact on your decision to issue preference shares?

11) In your view, does a preference share issue create any conflicts of interest between preference shareholders, ordinary shareholders, debtholders and managers of your company? Why or why not?

12) How did investors and other stakeholders react to your announcement of a preference share issue? In your opinion, why did they react in this manner?

13) Do you agree with the statement that preference shares are essentially ‘debt with a tax disadvantage’?

14) To what extent did you take into consideration the tax implications of preference share issues from a corporate and investor level, prior to issuing preference shares?

15) To what extent do you think that the individual investor is familiar with and understands preference shares and their associated privileges? What impact, if any, does this have on the decision to issue preference shares?

Section C: The future use of preference shares

16) Would you consider re-issuing preference shares in the future? Why or why not?
Interview Schedule - Non-Issuing Listed Companies

Introduction: The nature of preference shares and their features

1) In your view, do preference shares more closely resemble debt or equity? Why?

2) What are your views on the classification and accounting treatment of preference shares as per IAS 32 - Financial Instruments: Presentation?

3) In your opinion, what are the main features attributable to preference shares, and which of these features, if any, render preference shares attractive or unattractive as a financing instrument?

4) How do the dividend yield and financing cost of preference shares compare to those of bonds and ordinary shares?

5) What advantages and/or disadvantages do you perceive preference shares to have when compared to bonds and ordinary shares?

Section A: The extent of use of preference shares

6) Have you ever considered issuing preference shares?

Section B: The determinants and barriers to preference share issues

7) What are the main reasons why you do not issue preference shares?

8) How important is the dividend omission feature of preference shares in deciding whether to issue preference shares or not? Does this change during times of financial distress and if so, how?

9) Would being in financial distress alter your decision on issuing preference shares and if so, in what manner?

10) To what extent would you consider the financial reporting implications of preference share issues in your choice of financing?
11) Do you perceive there to be any risk in issuing and investing in preference shares? Would this have any impact on the decision to issue preference shares?

12) In your view, does a preference share issue create any conflicts of interest between preference shareholders, ordinary shareholders, debtholders and managers of your company? Why or why not?

13) In your view, how are investors and other stakeholders likely to react to the announcement of a preference share issue? Why?

14) Do you agree with the statement that preference shares are essentially ‘debt with a tax disadvantage’?

15) To what extent would you take into consideration the tax implications of preference share issues, from both a corporate and investor level, in your financing decision?

16) To what extent do you think that the individual investor is familiar with and understands preference shares and their associated privileges? What impact, if any, does this have on the decision to issue preference shares?

17) To what extent do regulatory requirements on capital adequacy influence your decision on whether or not to issue preference shares?

**Section C: The future use of preference shares**

18) Would you consider issuing preference shares in the future? Why or why not?
Interview Schedule - Other Participants

Introduction: The nature of preference shares and their features

1) In your view, do preference shares more closely resemble debt or equity? Why?

2) What are your views on the classification and accounting treatment of preference shares as per IAS 32 - Financial Instruments: Presentation?

3) In your opinion, what are the main features attributable to preference shares, and which of these features, if any, render preference shares attractive or unattractive as a financing instrument?

4) How do the dividend yield and financing cost of preference shares compare to those of bonds and ordinary shares?

5) What advantages and/or disadvantages do you perceive preference shares to have when compared to bonds and ordinary shares?

Section B: The determinants and barriers to preference share issues

6) In your opinion, to what extent, if any, is Maltese listed companies’ decision to issue preference shares motivated by the following reasons:
   a) To support corporate growth
   b) To retain ownership and control
   c) To take advantage of the prevailing market conditions and/or market rates of interest
   d) To enhance debt capacity or improve borrowing base
   e) To maintain a balanced capital structure
   f) Other?

7) In your opinion, what are the main reasons why the majority of Maltese listed companies do not issue preference shares?
8) How important is the dividend omission feature of preference shares in deciding whether to issue preference shares or not? Does this change during times of financial distress and if so, how?

9) Do you think that being in financial distress would alter a listed company’s decision on issuing preference shares and if so, in what manner?

10) To what extent do you think financial reporting implications of preference share issues are considered in a listed company’s choice of financing?

11) Do you perceive there to be any risk in issuing and investing in preference shares and what impact, if any, would this have on the decision to issue preference shares?

12) In your view, would a preference share issue create any conflicts of interest between preference shareholders, ordinary shareholders, debtholders and managers of your company? Why or why not?

13) To what extent do you think that the individual investor is familiar with and understands preference shares and their associated privileges? What impact, if any, does this have on the demand for preference shares?

14) In your view, how are investors and other stakeholders likely to react to the announcement of a preference share issue? Why?

15) Do you agree with the statement that preference shares are essentially ‘debt with a tax disadvantage’?

16) To what extent do you think the tax implications of preference share issues, from a corporate and investor level, are taken into consideration in the financing decision?

17) To what extent do regulatory requirements on capital adequacy influence listed banks’ decision on whether or not to issue preference shares?
Section C: The future use of preference shares

18) Do you think that preference shares will be used more by Maltese listed Companies in the future? Why or why not?
Appendix 3.2 Computation of Ratios for Financial Distress Analysis

Enclosed in this appendix is the secondary data extracted from the publicly available financial statements of both PSI A and PSI B in the sample, and the results of the ratios computed on the basis of such financial statements, over a three-year financial period. In the case of PSI B, the ratios for the other four non-issuing listed companies within the same industry, forming the control group, were also calculated. The computed ratios were required to perform trend analysis (for PSI A) and an independent one-sample t-test (for PSI B)\textsuperscript{86}, to determine the financial distress of both preference share issuers.

\textsuperscript{86} Vide Appendices 3.4 and 4.2
### Preference Share Issuer A

<table>
<thead>
<tr>
<th>Accounting Ratios</th>
<th>1993/4</th>
<th>1994/5</th>
<th>1995/6</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit for the Year</td>
<td>€</td>
<td>€</td>
<td>€</td>
</tr>
<tr>
<td>Revenue</td>
<td>938,000</td>
<td>1,356,000</td>
<td>697,000</td>
</tr>
<tr>
<td>Net Profit Margin</td>
<td>5.28%</td>
<td>7.42%</td>
<td>4.57%</td>
</tr>
<tr>
<td>Earnings Before Interest and Tax</td>
<td>€</td>
<td>€</td>
<td>€</td>
</tr>
<tr>
<td>Total Assets</td>
<td>18,232,000</td>
<td>20,347,000</td>
<td>23,586,000</td>
</tr>
<tr>
<td>Return on Assets Ratio</td>
<td>8.69%</td>
<td>8.71%</td>
<td>4.78%</td>
</tr>
<tr>
<td>Current Assets</td>
<td>€</td>
<td>€</td>
<td>€</td>
</tr>
<tr>
<td>Current Liabilities</td>
<td>4,467,000</td>
<td>5,148,000</td>
<td>4,468,000</td>
</tr>
<tr>
<td>Current Ratio</td>
<td>1.58</td>
<td>1.50</td>
<td>1.85</td>
</tr>
<tr>
<td>Earnings Before Interest and Tax</td>
<td>€</td>
<td>€</td>
<td>€</td>
</tr>
<tr>
<td>Net Interest Expenses</td>
<td>263,000</td>
<td>249,000</td>
<td>312,000</td>
</tr>
<tr>
<td>Interest Cover</td>
<td>6.03</td>
<td>7.12</td>
<td>3.61</td>
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<tr>
<td>Total Borrowings</td>
<td>€</td>
<td>€</td>
<td>€</td>
</tr>
<tr>
<td>Total Equity</td>
<td>10,886,000</td>
<td>11,763,000</td>
<td>15,001,000</td>
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<tr>
<td>Debt to Equity Ratio</td>
<td>32.23%</td>
<td>37.31%</td>
<td>32.65%</td>
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<tr>
<td>Cash Flow from Operations</td>
<td>€</td>
<td>€</td>
<td>€</td>
</tr>
<tr>
<td>Debt</td>
<td>3,509,000</td>
<td>4,389,000</td>
<td>4,898,000</td>
</tr>
<tr>
<td>Cash Debt Coverage Ratio</td>
<td>0.82</td>
<td>0.55</td>
<td>0.27</td>
</tr>
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</table>

**Table A3.2.1**: Computed ratios for PSI A over a three-year financial period
Appendix 3.2 Computation of Ratios for Financial Distress Analysis

Preference Share Issuer B

<table>
<thead>
<tr>
<th>Accounting Ratios</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit for the Year</td>
<td>€3,241,300</td>
<td>€-3,204,080</td>
<td>€-5,955,418</td>
</tr>
<tr>
<td>Revenue</td>
<td>€25,008,395</td>
<td>€22,099,721</td>
<td>€26,813,722</td>
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<tr>
<td>Net Profit Margin</td>
<td>12.96%</td>
<td>-14.50%</td>
<td>-22.21%</td>
</tr>
<tr>
<td>Earnings Before Interest and Tax</td>
<td>€6,629,791</td>
<td>-€1,995,448</td>
<td>-€3,582,658</td>
</tr>
<tr>
<td>Total Assets</td>
<td>€28,017,219</td>
<td>€31,812,055</td>
<td>€38,085,192</td>
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<tr>
<td>Return on Assets Ratio</td>
<td>23.66%</td>
<td>-6.27%</td>
<td>-9.41%</td>
</tr>
<tr>
<td>Current Assets</td>
<td>€10,163,423</td>
<td>€10,073,654</td>
<td>€13,113,749</td>
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<tr>
<td>Current Liabilities</td>
<td>€7,134,106</td>
<td>€11,053,133</td>
<td>€22,212,874</td>
</tr>
<tr>
<td>Current Ratio</td>
<td>1.42</td>
<td>0.91</td>
<td>0.59</td>
</tr>
<tr>
<td>Earnings Before Interest and Tax</td>
<td>€6,629,791</td>
<td>-€1,995,448</td>
<td>-€3,582,658</td>
</tr>
<tr>
<td>Net Interest Expenses</td>
<td>€53,727</td>
<td>€106,864</td>
<td>€274,433</td>
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<tr>
<td>Interest Cover</td>
<td>123.40</td>
<td>-18.67</td>
<td>-13.05</td>
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<tr>
<td>Total Borrowings</td>
<td>€834,017</td>
<td>€3,979,458</td>
<td>€11,763,018</td>
</tr>
<tr>
<td>Total Equity</td>
<td>€17,232,185</td>
<td>€14,085,178</td>
<td>€7,070,110</td>
</tr>
<tr>
<td>Debt to Equity Ratio</td>
<td>4.84%</td>
<td>28.25%</td>
<td>166.38%</td>
</tr>
<tr>
<td>Debt</td>
<td>€834,017</td>
<td>€3,979,458</td>
<td>€11,763,018</td>
</tr>
<tr>
<td>Cash Debt Coverage Ratio</td>
<td>0.03</td>
<td>-0.28</td>
<td>0.23</td>
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</tbody>
</table>

*Table A3.2.2: Computed ratios for PSI B over a three-year financial period*
## Non-Issuing Control Group

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<tbody>
<tr>
<td>Profit for the Year</td>
<td>€ 4,496,000</td>
<td>€ 4,449,000</td>
<td>€ 4,742,000</td>
<td>€ 642,042</td>
<td>€ 257,689</td>
<td>€ -143,140</td>
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<tr>
<td>Revenue</td>
<td>€ 21,274,000</td>
<td>€ 22,430,000</td>
<td>€ 23,977,000</td>
<td>€ 3,897,951</td>
<td>€ 4,376,375</td>
<td>€ 5,442,783</td>
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<tr>
<td>Net Profit Margin</td>
<td>21.13%</td>
<td>19.84%</td>
<td>19.78%</td>
<td>16.47%</td>
<td>5.89%</td>
<td>-2.63%</td>
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</tr>
<tr>
<td>Earnings Before Interest and Tax</td>
<td>€ 6,973,000</td>
<td>€ 7,312,000</td>
<td>€ 7,859,000</td>
<td>€ 650,331</td>
<td>€ 466,512</td>
<td>€ 164,980</td>
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<tr>
<td>Total Assets</td>
<td>€ 13,604,000</td>
<td>€ 23,110,000</td>
<td>€ 25,604,000</td>
<td>€ 8,322,761</td>
<td>€ 9,147,662</td>
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<tr>
<td>Return on Assets Ratio</td>
<td>51.26%</td>
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<td>30.69%</td>
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<td>Current Assets</td>
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<td>€ 8,459,000</td>
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<td>€ 2,088,649</td>
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<tr>
<td>Current Liabilities</td>
<td>€ 6,029,000</td>
<td>€ 7,106,000</td>
<td>€ 6,732,000</td>
<td>€ 5,018,099</td>
<td>€ 5,502,204</td>
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<tr>
<td>Current Ratio</td>
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<td>1.19</td>
<td>1.10</td>
<td>0.38</td>
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<tr>
<td>Earnings Before Interest and Tax</td>
<td>€ 6,973,000</td>
<td>€ 7,312,000</td>
<td>€ 7,859,000</td>
<td>€ 650,331</td>
<td>€ 466,512</td>
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<tr>
<td>Net Interest Expenses</td>
<td>€ 0</td>
<td>€ 137,000</td>
<td>€ 227,000</td>
<td>€ 8,289</td>
<td>€ 208,823</td>
<td>€ 273,669</td>
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<tr>
<td>Interest Cover</td>
<td>N/A</td>
<td>€ 53.37</td>
<td>€ 34.62</td>
<td>€ 78.46</td>
<td>€ 2.23</td>
<td>€ 0.60</td>
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<tr>
<td>Total Borrowings</td>
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<td>€ 0</td>
<td>€ 3,528,000</td>
<td>€ 1,145,488</td>
<td>€ 1,258,547</td>
<td>€ 1,352,759</td>
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<td>Total Equity</td>
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<td>€ 2,482,368</td>
<td>€ 2,740,057</td>
<td>€ 2,553,160</td>
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</tr>
<tr>
<td>Debt to Equity Ratio</td>
<td>0%</td>
<td>0%</td>
<td>30.22%</td>
<td>46.14%</td>
<td>45.93%</td>
<td>52.98%</td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash Flow from Operations</td>
<td>€ 5,823,000</td>
<td>€ 7,714,000</td>
<td>€ 6,616,000</td>
<td>€ 870,943</td>
<td>€ 1,257,387</td>
<td>€ 3,132,972</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt</td>
<td>€ 0</td>
<td>€ 0</td>
<td>€ 3,528,000</td>
<td>€ 1,145,488</td>
<td>€ 1,258,547</td>
<td>€ 1,352,759</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash Debt Coverage Ratio</td>
<td>N/A</td>
<td>N/A</td>
<td>1.88</td>
<td>0.76</td>
<td>1.00</td>
<td>2.32</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Table A3.2.3:* Computed ratios for non-issuing listed Companies 1 and 2, over a three-year financial period.
## Non-Issuing Control Group

<table>
<thead>
<tr>
<th>Accounting Ratios</th>
<th>Non-Issuing Company 3</th>
<th>Non-Issuing Company 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit for the Year</td>
<td>€758,676</td>
<td>€2,088,772</td>
</tr>
<tr>
<td>Revenue</td>
<td>€15,568,699</td>
<td>€16,049,372</td>
</tr>
<tr>
<td>Net Profit Margin</td>
<td>3.73%</td>
<td>13.01%</td>
</tr>
<tr>
<td>Earnings Before Interest and Tax</td>
<td>€980,188</td>
<td>€3,187,238</td>
</tr>
<tr>
<td>Total Assets</td>
<td>€19,670,223</td>
<td>€20,981,479</td>
</tr>
<tr>
<td>Return on Assets Ratio</td>
<td>4.98%</td>
<td>15.19%</td>
</tr>
<tr>
<td>Current Assets</td>
<td>€9,196,559</td>
<td>€9,675,644</td>
</tr>
<tr>
<td>Current Liabilities</td>
<td>€7,949,265</td>
<td>€7,745,171</td>
</tr>
<tr>
<td>Current Ratio</td>
<td>1.16</td>
<td>1.25</td>
</tr>
<tr>
<td>Earnings Before Interest and Tax</td>
<td>€980,188</td>
<td>€3,187,238</td>
</tr>
<tr>
<td>Net Interest Expenses</td>
<td>€38,767</td>
<td>€130,660</td>
</tr>
<tr>
<td>Interest Cover</td>
<td>25.28</td>
<td>24.39</td>
</tr>
<tr>
<td>Total Borrowings</td>
<td>€1,034,679</td>
<td>€503,998</td>
</tr>
<tr>
<td>Total Equity</td>
<td>€9,214,912</td>
<td>€10,353,416</td>
</tr>
<tr>
<td>Debt to Equity Ratio</td>
<td>11.23%</td>
<td>4.87%</td>
</tr>
<tr>
<td>Cash Flow from Operations</td>
<td>-€629,842</td>
<td>€3,455,403</td>
</tr>
<tr>
<td>Debt</td>
<td>€1,034,679</td>
<td>€503,998</td>
</tr>
<tr>
<td>Cash Debt Coverage Ratio</td>
<td>-0.61</td>
<td>6.86</td>
</tr>
</tbody>
</table>

*Table A3.2.4: Computed ratios for non-issuing listed Companies 3 and 4, over a three-year financial period*
Appendix 3.3 Financial Distress Analysis using Altman’s Z-Score

The Altman Z-score remains one of the most widely accepted and utilised bankruptcy forecasting model in both research and practice (Altman et al. 2017). In his original study on 66 publicly trading manufacturing firms, Altman (1968) compiled a set of financial ratios, which best discriminated between distressed and non-distressed companies. Combined, these ratios, which were grouped into five categories: profitability; liquidity; leverage; solvency; and activity, formed the following discriminant analysis function:

\[ Z = 0.012X_1 + 0.014X_2 + 0.033X_3 + 0.006X_4 + 0.999X_5 \]

Where:
- \( X_1 = \) Working Capital/Total Assets
- \( X_2 = \) Retained Earnings/Total Assets
- \( X_3 = \) Earnings Before Interest and Tax/Total Assets
- \( X_4 = \) Market Value of Equity/Book Value of Total Liabilities
- \( X_5 = \) Sales/Total Assets
- \( Z = \) Overall Index

Altman (1968) concluded that firms having a Z-score of greater than 2.99 are deemed to be financially sound, whilst those having a Z-score below 1.81 are presumed to be in the ‘distress zone’ and thus at risk of corporate failure. Companies having a Z-score ranging between the two aforementioned cut-off scores, fall within the ‘zone of ignorance’ or the ‘grey zone’, meaning that there is a possibility that the company goes bankrupt within the next two years.

The prediction accuracy of Altman’s (1968) model was reported to be 95% in the first year and 72% in the second year prior to corporate failure.
Appendix 3.4 Statistical Data Analysis using the Independent One-Sample T-Test

The independent one-sample t-test is a parametric test that was used to compare the sample mean ratios of four non-issuing listed companies to the ratio of PSI B. This was performed for each of the six selected financial ratios in each respective year of the period 2018 to 2020.

The Null Hypothesis (H₀) specifies that the mean ratio of the four non-issuing listed companies is comparable to the ratio provided by PSI B, and is accepted if the p-value exceeds the 0.05 level of significance.

The Alternative Hypothesis (H₁) specifies that the mean ratio of the four non-issuing listed companies is significantly different from the ratio provided by PSI B, and is accepted if the p-value is smaller than the 0.05 criterion.
Appendix 4.1 Z-Score Computation Results

The below table depicts the computation of the Altman Z-Score for PSI A over the three-year financial period under review, as well as after the exclusion of the preference share issues from the 1995/6 financial statements of the company.

<table>
<thead>
<tr>
<th>Z-Score</th>
<th>PSI A</th>
<th>With preference share issues</th>
<th>Without preference share issues</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1993/4</td>
<td>1994/5</td>
<td>1995/6</td>
</tr>
<tr>
<td>Working Capital</td>
<td>€</td>
<td>€</td>
<td>€</td>
</tr>
<tr>
<td>Total Assets</td>
<td>€</td>
<td>€</td>
<td>€</td>
</tr>
<tr>
<td>Retained Earnings</td>
<td>€</td>
<td>€</td>
<td>€</td>
</tr>
<tr>
<td>Total Assets</td>
<td>€</td>
<td>€</td>
<td>€</td>
</tr>
<tr>
<td>Earnings Before Interest and Tax</td>
<td>€</td>
<td>€</td>
<td>€</td>
</tr>
<tr>
<td>Total Assets</td>
<td>€</td>
<td>€</td>
<td>€</td>
</tr>
<tr>
<td>Market Value of Equity</td>
<td>€</td>
<td>€</td>
<td>€</td>
</tr>
<tr>
<td>Book Value of Total Liabilities</td>
<td>€</td>
<td>€</td>
<td>€</td>
</tr>
<tr>
<td>Sales</td>
<td>€</td>
<td>€</td>
<td>€</td>
</tr>
<tr>
<td>Total Assets</td>
<td>€</td>
<td>€</td>
<td>€</td>
</tr>
<tr>
<td>Z-Score</td>
<td>3.09</td>
<td>2.81</td>
<td>2.91</td>
</tr>
</tbody>
</table>

*Table A4.1: Z-Score Computation of PSI A for 1993/4 and 1994/5, and including and excluding the preference share issues for the year 1995/6*
Appendix 4.2: Independent One-Sample T-test Results

The tables provided in this appendix supplement those provided in Chapter 4, but which could not be illustrated and discussed due to space limitations. These give a depiction of the differences, significant or otherwise, between the mean sample ratios of the industry control group and the ratio of PSI B, for the sample three-year financial period.

<table>
<thead>
<tr>
<th>Year</th>
<th>Mean Return on Assets</th>
<th>Std. Dev. Return on Assets</th>
<th>Return on Asset Ratio of PSI B</th>
<th>T-value</th>
<th>Degrees of Freedom</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>10.89</td>
<td>9.350</td>
<td>12.96</td>
<td>0.443</td>
<td>3</td>
<td>0.688</td>
</tr>
<tr>
<td>2019</td>
<td>14.99</td>
<td>7.049</td>
<td>-14.50</td>
<td>8.367</td>
<td>3</td>
<td>0.004</td>
</tr>
<tr>
<td>2020</td>
<td>7.473</td>
<td>12.036</td>
<td>-22.21</td>
<td>4.932</td>
<td>3</td>
<td>0.016</td>
</tr>
</tbody>
</table>

*Table A4.2.1: Return on assets ratio*

<table>
<thead>
<tr>
<th>Year</th>
<th>Mean Current Ratio</th>
<th>Std. Dev. Current Ratio</th>
<th>Current Ratio of PSI B</th>
<th>T-value</th>
<th>Degrees of Freedom</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>0.595</td>
<td>0.388</td>
<td>1.42</td>
<td>4.256</td>
<td>3</td>
<td>0.024</td>
</tr>
<tr>
<td>2019</td>
<td>0.773</td>
<td>0.519</td>
<td>0.91</td>
<td>0.53</td>
<td>3</td>
<td>0.633</td>
</tr>
<tr>
<td>2020</td>
<td>0.755</td>
<td>0.619</td>
<td>0.59</td>
<td>0.533</td>
<td>3</td>
<td>0.631</td>
</tr>
</tbody>
</table>

*Table A4.2.2: Current ratio*

<table>
<thead>
<tr>
<th>Year</th>
<th>Mean Cash Debt Coverage Ratio</th>
<th>Std. Dev. Cash Debt Coverage Ratio</th>
<th>Cash Debt Coverage Ratio of PSI B</th>
<th>T-value</th>
<th>Degrees of Freedom</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>0.09</td>
<td>0.685</td>
<td>0.03</td>
<td>0.152</td>
<td>2</td>
<td>0.893</td>
</tr>
<tr>
<td>2019</td>
<td>2.657</td>
<td>3.667</td>
<td>-0.28</td>
<td>1.387</td>
<td>2</td>
<td>0.30</td>
</tr>
<tr>
<td>2020</td>
<td>3.103</td>
<td>3.659</td>
<td>0.23</td>
<td>1.57</td>
<td>3</td>
<td>0.214</td>
</tr>
</tbody>
</table>

*Table A4.2.3: Cash debt coverage ratio*