Slash dividends, cease buybacks: prioritize shoring up balance sheet

Given that many companies are going to scramble to find money just to survive, dividends and buy-backs should be the last thing on a board's agenda. Only after business has stabilized and there is visibility ahead, should companies look at paying their shareholders.

The Finance Minister while presenting FY20-21 Union Budget proposed to remove dividend distribution tax on companies: henceforth the tax is to be collected from recipients, at the applicable rate, which could be as high as 43%. Since then companies have scrambled to declare an interim dividend to make it more tax-efficient for the (controlling) shareholders.

Market data shows that 424 companies have announced interim dividends between 1 February and 20 March 2020. 181 of these companies have declared an interim dividend in March. And of these 64 companies have done so after 10 March. There have been no announcements since 20 March. In contrast just 181 companies declared an interim dividend between January and March last year. A newspaper report, with a somewhat higher number of dividend paying companies, puts the amount distributed at Rs 360 billion. And many are already looking ahead, seeking regulatory waiver to payout ahead of their AGM.

There has also been a steady stream of buy-back announcements. Three in February, and 12 in March, of which nine have been in the last fortnight, including an NBFC. Clearly boards failed to the foresee the full import of COVID-19.

There is significant uncertainty in the present environment, including on companies that have declared (but not yet paid) dividends prior to the current pandemic crisis. While the full impact of COVID-19 on company cash flows in the fourth quarter and end of the financial year in the Indian context remains uncertain, it will be prudent for India Inc. to "defer" all dividend payments and cease buy-backs.

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These dividend cut-backs will no doubt have an impact for investors who are looking for some income at a time when interest rates on deposits and fixed interest instruments are at all-time lows and taxation rules have moved against them, particularly the small investors. But at a market dividend yield of around 1.5%, this will not be a significant number. And in any case, it is more important for companies to conserve cash, to face the current crisis and future uncertainties. Suffice to say, payment of dividend is no longer judicious.

While the signs of an impending crunch were there from the beginning of March itself, the last two weeks have been calamitous. There has been a halt in most company's operations following the 21-day shutdown mandated by the Government of India. A sharp and dramatic downward impact on the stock markets has added to this sense of gloom.

There are media reports that Tata Sons, Bajaj Group, and Godrej are among the 277 promoters that have increased their stake in group concerns through market purchases in March. While signalling confidence in the operating companies is welcome, the controlling shareholders clearly missed a beat on this. They should have asked whether money may be needed in the operating companies, and injected money directly through fresh issuances. True, the price difference between what is available from the market and that at which additional capital can be injected, makes market purchases far more compelling.

SEBI, therefore, needs review its pricing guidelines, given the market sell-off. It will be a while before companies touch the SEBI determined price, calling for its pricing rules for both preferential allotment and QIP's to be relaxed. This will enable companies to raise capital to meet their survival and other funding needs. Given the unprecedented situations, SEBI must also allow companies to rescind buy-backs.

As the situation has unfolded, the European Banking Authority, has shifted its stance from urging banks to be prudent with regard to dividends and buybacks, to refraining from doing so as it that will result in capital flowing out of the banking system. Reserve Bank needs to take a leaf from this.

In terms of scale, we are nowhere close to where the US industry is of having spent its dry powder on buy backs, it is looking to Washington for a bail-out of gargantuan portions. But still, given the economic cost this lockdown is expected to extract, Indian industry will need government to step in. This is why owners cannot risk appearing self-serving by basing decisions only on how much personal tax they expect to save or by using this crisis to use their money to ratchet-up their shareholding.

After years of advocating companies return more to their shareholders, we are suggesting a pause. Companies must consider the impact of the COVID 19 related risks on their financial position. They must review their financials to ensure that enough cash is available for meeting the business needs to restart business and a sufficiently far-sighted pool of capital is available to meet the company's needs till the economy stabilizes. And they need to take hard calls. Those that still can, must review their pay-out decision. And all need to safeguard their cash reserves, to help pull through these unexpected times.

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The attached article is a commentary on general trends in the securities market.

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