Role and Accountability of Investment Bankers in the Primary Market

Dr.Ambrish Gupta
Sr.Professor of Finance
FORE School of Management

INTRODUCTION

Investment Bankers, officially termed as Merchant Bankers in Hindustan, by the SEBI (Merchant Bankers) Regulations, 1992 are basically known for offering a specialized branch of banking- tailor made to the requirements of the corporate clients and the investors- primarily concerned with assisting the capital market in its primary function of capital flow intermediation, i.e. movement of capital from investors to corporates. Thus the responsibility cast upon them is double edged. While they have to arrange the best deal for their clients, they have also to be investor friendly. Establishing this balance is a daunting and delicate task. They need to win the faith and trust of both the investors (*who do not pay them for their services*) and the investee (*who pays them for their services*). Obviously they play a crucial role in the growth and development of industry and the capital market.

TERMS USED

This paper uses the terms investment banker(s)/merchant banker(s) and investment banking/merchant banking interchangeably to mean and convey the same thing.

SEBI ACT, RULES AND REGULATIONS

The profession of investment bankers, like anywhere else in the developed markets in the world, is a regulated profession in Hindustan as well. SEBI (Merchant Bankers) Regulations, 1992 define the expression 'merchant banker', lay down conditions for registration of merchant bankers such as corporate structure, capital adequacy, infrastructure, relevant experience and knowledge, clean track record etc., set out their general obligations and responsibilities, such as code of conduct, redressal of investor grievances, underwriting obligations, restriction on activities not related to the securities market, not to act as merchant banker for an associate, prohibition on insider trading etc., procedure for inspection and action in case of default such as suspension and cancellation of registration.

Code of conduct casts heavy responsibilities on merchant bankers and specifies that they shall:

1. Make **all efforts to protect the interests of investors and shall render the best possible advice to its clients** having regard to the client's needs and the environments and his own professional skills,
2. Ensure high standards of service,
3. Exercise due diligence, and
4. Not collude with other market intermediaries to the detriment of the interest of the investors.

ROLE OF INVESTMENT BANKERS

Primarily investment bankers' main identity over the long decades has been the activity of public issue management. SEBI (Merchant Bankers) Regulations' clause 2 (cb) has itself defined a Merchant Banker to mean any person who is engaged in the business of issue management (IPOs, FPOs, Offers for Sale, Rights Issues, IDRs etc.) either by making arrangements regarding selling, buying or subscribing to securities or acting as manager, consultant, advisor or rendering corporate advisory services *in relation to such issue management.*

However with the growth and development of the economy, its privatization and globalization coupled with ever growing needs of the capital market, and realization of this by SEBI, their role and functions have undergone a sea change over the last decade. SEBI (Merchant Bankers) Regulations' clause 3 (2) no more restricts their advisory services to issue management alone. Merchant bankers today offer a plethora of advisory and consulting services such as Investment advisory to investors, Project identification, Pre-investment survey and Marketing studies, Project finance: Feasibility studies, capital structure, loan syndication, Working capital finance advisory/ syndication, Lease/loan syndication, PSU disinvestment, ESOP structuring and Corporate governance compliance etc. The clause 3 (2) also adds underwriting and portfolio management as their other activities.

Management of Corporate restructuring: Mergers & Takeovers, **Capital restructuring:** share buyback and delisting**, Private placement** of debt, preferential issues and qualified institutions placement (QIP), under various SEBI regulations, have emerged as significant part of their core business areas. They are now allowed by the RBI to act as **Primary dealers** as well in the money market. Clearly their role and responsibilities have become far more diverse and challenging.

A recent trend has been the emergence of **single window** full service provider investment banking **groups** offering not only merchant banking activities as mentioned above, but also, direct fund mobilization through distribution of IPOs and mutual funds, wealth management, investment advisory, equity research, share broking, etc. Key industry players, such as, **Kotak Mahindra, JM, ENAM, Morgan Stanly, ICICI, SBI** and **IDBI,** to name a few, are thus consolidating all activities related to primary market, secondary market and money market through a close knit network of subsidiary companies. It is working well for all-the merchant bankers, the corporates and the investing public.

PARADIGM SHIFT IN THE ROLE, ACTIVITIES AND GROWTH OF INVESTMENT BANKERS

The increased role and responsibilities of merchant bankers have led to their enormous and diverse growth. Data and information provided hereunder amply demonstrate the paradigm shift that has taken place in their profession since the advent of SEBI towards the last leg of the year 1991-1992.

A. Growth in Numbers

The table below provides the details of growth in number of SEBI registered investment bankers since the inception of SEBI:

Sl.No.	Numbers as on 31-03….		Average Numbers During…	
	Year	Number	Year	Number
1	1992	74	1991-92	74
2	**1993**	**74**	**1992-93**	**74**
3	1994	422	1993-94	248
4	1995	790	1994-95	606
5	1996	1012	1995-96	901
6	1997	**1163**	1996-97	1088
7	1998	802	1997-98	983
8	1999	415	1998-99	609
9	2000	186	1999-00	301
10	2001	233	2000-01	210
11	2002	145	2001-02	189
12	2003	124	2002-03	135
13	2004	123	2003-04	124
14	2005	128	2004-05	126
15	2006	130	2005-06	129
16	2007	152	2006-07	141
17	2008	155	2007-08	154
18	2009	134	2008-09	145
19	2010	164	2009-10	149
20	2011	192	2010-11	178

Notes

1. 1991-92: Last year of CCI.
2. 1992-93: First full year of SEBI.

3. Data source

3.1.For the years ended 31-03-1993 to 2009: Handbook of Statistics on the Indian Securities Market 2009: SEBI.

3.2.For the year ended

- 31-03-1992: Figure not available. 31-03-1993 figure used as proxy.
- 31-03-2010: SEBI Annual Report 2010.
- 31-03-2011: SEBI Bulletin, April 2011, No. 4, Volume 9.

4. Average numbers during ………..

- Average of the 'preceding year end' and 'current year end'. Rounded off to nearest integer. The figures have been arrived at to work out 'activities per merchant banker' in the tables that follow.

- Since 31-03-1991 figure is not available, yearend figure on 31-03-1992 is taken as average figure for 1991-92.

B. Growth in Activities in the Primary Market

A vivid chronicle picture of their activities is presented here under both in terms of numbers of issues/offers handled and amount mobilized to (public to corporates) and fro (back from corporates to public).

B.1. Issue management:

It comprises management of public issues, rights issues and overseas offerings.

Year		Total Issues						Issues per Merchant Banker					
													Amount in Rs. crore
		Public issues		Rights issues		Overseas Offerings		Public issues		Rights issues		Overseas Offerings	
		No.	Amt.	No.	Amt.	No.	Amt.	No.	Amt.	No.	Amt.	No.	Amt.
1	**1991-92**	196	1,898	316	3,851	...	...	2.65	25.65	4.27	52.04	...	...
2	**1992-93**	**528**	**6,252**	**488**	**12,630**	**2**	**690**	**7.14**	**84.49**	**6.60**	**170.68**	**0.03**	**9.32**
3	**1995-96**	1,407	11,663	291	6,520	...	...	1.56	12.94	0.32	7.24	...	...
4	**2000-01**	119	6,519	27	729	...	...	0.57	31.04	0.13	3.47	...	...
5	**2001-02**	...	...	...	...	5	2,384	...	...	...	...	0.03	12.61
6	**2005-06**	...	...	...	...	133	48,292	...	...	...	...	1.03	374.36
7	**2007-08**	91	53,219	30	32,519	98	74,122	0.59	345.58	0.19	211.16	0.64	481.31
8	**2010-11**	67	55,613	24	9,594	59	48,723	0.38	312.43	0.13	53.90	0.33	273.72

Notes:

- **Selection of years:**
  1991-92: The last year of CCI. **1992-93:** The 1st full year of SEBI/information on overseas offerings. **1995-96:** The year of maximum number of public issues during SEBI regime. **2000-01**: The mid year of public/rights issues. **2005-06:** The year of maximum number of overseas issues during SEBI regime. **2007-08**: The year of maximum amount mobilized in public/rights/overseas issues during SEBI regime before the latest year. **2010-11:** The latest year.
- Data source for Total Issues-PRIME.
- Issues per Merchant Banker-Figures derived.

B.2. Management of corporate restructuring:

It comprises management of takeover open offers.

Year		Total offers		Offers per Merchant Banker	
					Amount in Rs. crore
		Numbers	**Amount**	**Numbers**	**Amount**
1	**1997-98**	41	591	0.04	0.60
2	**2004-05**	57	4,663	0.45	37.01
3	**2006-07**	90	15,127	0.64	107.28
4	**2007-08**	119	14,875	0.77	96.59
5	**2010-11**	112	18,898	0.63	106.17

Notes:

- **Selection of years:**
  1997-98: The 1st year of data availability. **2004-05**: Midyear. **2006-07:** The year of maximum amount of open offers during SEBI regime before the latest year.**2007-08**: The year of maximum number of offers during SEBI regime.**2010-11**: The latest year.
- Data source for Total Offers-PRIME.
- Offers per Merchant Banker-Figures derived.

B.3. Management of capital restructuring

It comprises management of share buyback and delisting.

Year		Amount in Rs. crore							
		Total Issues				Issues per Merchant Banker			
		Share buyback		Delisting		Share buyback		Delisting	
		Numbers	Amount	Numbers	Amount	Numbers	Amount	Numbers	Amount
1	**1998-99**	1	1	...	...	0.001	0.001	...	...
2	**2003-04**	...	...	3	1,430	...	...	0.02	11.53
3	**2004-05**	11	3,600	...	...	0.09	28.57	...	...
4	**2006-07**	...	...	25	1,082	...	...	0.18	7.67
5	**2007-08**	...	...	23	2,159	...	...	0.15	14.02
6	**2008-09**	46	4,221	...	...	0.32	29.11	...	...
7	**2010-11**	20	4,295	12	3,559	0.11	24.13	0.07	19.99

Notes:

- **Selection of years:**
  1998-99/2003-04: 1st years of applicability of buy back/delisting respectively. **2004-05:** Midyear of buyback. **2006-07:** The year of maximum number of delisting issues and their midyear. **2007-08:** The year of maximum amount of delisting before the latest year. **2008-09:** The year of maximum number and amount of buyback issues before the latest year. **2010-11:** The latest year.
- Data source for Total Issues-PRIME.
- Issues per Merchant Banker-Figures derived.

B.4. Private placement

It comprises arrangement of debt and management of QIPs.

Year		Amount in Rs. crore							
		Total Issues				Issues per Merchant Banker			
		Debt		QIPs		Debt		QIPs	
		Numbers	Amount	Numbers	Amount	Numbers	Amount	Numbers	Amount
1	**1995-96**	72	10,035	...	...	0.08	11.14	...	...
2	**2002-03**	485	48,424	...	...	3.60	358.70	...	...
3	**2006-07**	...	...	25	4,963	...	...	0.18	35.20
4	**2008-09**	799	1,74,327	2	189	5.51	1202.26	0.01	1.30
5	**2009-10**	...	...	67	43,968	...	...	0.45	295.09
6	**2010-11**	824	1,91,127	47	24,676	4.63	1073.75	0.26	138.63

Notes:

- Debt: Tenors above 365 days.
- **Selection of years:**
  1995-96/2006-07: 1st years of data availability of debt/ applicability of QIPs respectively. **2002-03:** Midyear of debt. **2008-09:** The year of maximum number and amount of debt before the latest year and midyear of QIPs. **2009-10:** The year of maximum number and amount of QIPs before the latest year. **2010-11:** The latest year.
- Data source for Total Issues-PRIME.
- Issues per Merchant Banker-Figures derived.

C. Observations, Comments and Analysis

Now follow brief observations and comments on the growth of the investment bankers in Hindustan and analysis of their growth.

C.1. Growth in numbers:

Mushrooming growth in the numbers of merchant bankers registered with SEBI up to 31-03-1997: Courtesy its policy of 'no permission required for floating an issue' and 'free pricing'. Resultant flood of issues (as evident from table B.1.), floatation of issues excessively overpriced, bad issues and fake issues during the early years of SEBI, *with full support of the merchant bankers*, left the investor confidence shaken to its bottom and led to debacle in the capital market (as evident again from table B.1.). Result: the numbers of merchant bankers themselves started declining. Thereafter, swings in the capital market led to swings (down-up-down-up) in their numbers. Up to March 2009 the numbers had stabilized within a narrow range of 130 to 150. Last two years again saw a spurt. Finally in between March 1993 and 2011 numbers moved up from 74 to 192.

C.2. Growth in Activities in the Primary Market
Activity wise observations and comments follow.

- **C.2.1. Issue management**
  - General trend towards lesser number of issues managed and higher amount of mobilization.

- **C.2.2. Management of corporate restructuring**
  - Trend towards both the higher number of issues as well as amount mobilized. Only numbers decreased a bit during 2010-11.

- **C.2.3. Management of capital restructuring**
  - **Share buyback:** Trend towards increase in numbers as well as amount mobilized back from the corporates to investors. Only numbers decreased during 2010-11.

  - **Delisting:** General trend towards lesser number of issues and higher amount of mobilization back from the corporates to investors.

- **C.2.4. Private placement**
  Debt: Spectacular rise in both numbers and amount mobilized. Left behind other activities.

  - **QIPs:** Swings. Still numbers during 2010-11 almost double the numbers of initial year 2006-07 and amount mobilized being almost 5 times.

C.3. Growth Analysis
Ultimately what has this growth meant for the investment bankers? Let us analyze.

Average Numbers of Merchant Bankers/Activities		Amount in Rs. crore						
		1st year of SEBI/ Beginning of activity/Data availability	Issues per Merchant Banker				Absolute growth in numbers of Merchant Bankers/ Amount mobilized per MB	
			1st year of SEBI/ Beginning of........		2010-11		%age	Times
			No.	Amt.	No.	Amt.		
1	Average Numbers of Merchant Bankers	1992-93	74	...	178	...	140.54	2.41
2	Activities-							
2.1	Issue Management:							
	➢ Public issues	1992-93	7.14	84.49	0.38	312.43	269.78	3.70
	➢ Rights issues	1992-93	6.60	170.68	0.13	53.90	(68.42)	(o.32)
	➢ Overseas offerings	1992-93	0.03	9.32	0.33	273.72	2,836.91	29.37
2.2	Management of Corporate Restructuring	1997-98	0.04	0.60	0.63	106.17	17,595.00	176.95
2.3	Management of Capital Restructuring:							
	➢ Share buyback	1998-99	0.001	0.001	0.11	24.13	2,41,29,000	2,413
	➢ Delisting	2003-04	0.02	11.53	0.07	19.99	73.37	1.73
2.4	Private Placement:							
	➢ Debt	1995-96	0.08	11.14	4.63	1073.75	9,538.69	96.39
	➢ QIPs	2006-07	0.18	35.20	0.26	138.63	293.84	3.94
	Average of activities..........		**1.76**	**40.37**	**0.82**	**254.09**	**529.40%**	**6.29**

Conclusions are obvious. The profile of the investment banker has undergone a sea change. The investment banker of today mobilizes huge capital and earns a huge amount from the primary market activities. Over the years of comparison, his business, and therefore the income, has increased by a staggering **529.40%** or to **6.29 times. And, this is when number of assignments per merchant banker have gone down to 46.59%. This shows a paradigm shift in the extent of the role played by the investment bankers today in the primary market.**

ACCOUNTABILITY OF INVESTMENT BANKERS IN THE PRIMARY MARKET
Has this increased role, thanks to SEBI, and revenue made them more accountable towards the primary market? Have they become more investor friendly? Are they discharging due diligence in spirit? There are such and many more issues to be examined in the light of the code of conduct specified for them. The subject is vast, varied and

complex and cannot be justified within one paper of this size. **I will therefore restrict to certain issues identified by me for this paper.**

A. Investor Protection:

In this respect the most hated as well as most loved, yet never concluding, debate centres on **free pricing**. Merchant bankers are regularly accused of advising their clients and fixing unjustifiable issue prices for fetching more assignments due to tough competition among themselves which goes against the interest of the investors. Let me provide some data here to support this allegation.

A.1. Losses on the listing day itself:

Details of IPOs floated during 2010-11.

Number of IPOs Floated	Closed at a Loss on the Listing Day			Loss			No. of IPOs With More Than Average Loss
	No.	%age	Offer Price Range (Rs.)	Minimum	Maximum	Average	
52	18	**34.62%**	26-450	3.65%	52.86%	15.99%	7
Company Name				SJVN Ltd.	Omkar Specialty Chemicals Ltd.		
Offer Price				Rs. 26.00	Rs. 98.00		

Notes:
- Data source-PRIME for number of IPOs floated, company names, offer prices and closing listed prices.
- Other figures derived from the data.

A.2. Losses in the long term

The Economic Times of 29-09-2010 reported in the article 'Reality Check: Greed May Be Fuelling Your IPO Chase', among others, the following findings on the basis of its study of 277 IPOs that got listed since January 2006 till the time of study in September 2010:

1. Nearly two thirds (*only*) of the IPOs posted listing gains (*that is, one thirds of them posted listing losses.* 2010-11 findings above confirm the findings of ET study of 2006-2010. The trend thus continues.)
2. Three years since the listing, only 31% of the scrips could maintain their prices above their respective IPO prices.
3. Watch out, only 3 out of 10 IPOs earn above average returns in the long run.

A.3. IPO index of BSE (BSE IPO)

The movements in the index since its launch vis-à-vis Sensex:

Close	BSE IPO		SENSEX	
	Index	Rise/(Fall)	Index	Rise/(Fall)
August 2009	2009	...	15,667	...
March 2010	2014	0.25%	17,528	11.88%
March 2011	1748	**(13.21%)**	19,445	**10.94%**

Notes:
- Data source:www.bseindia.com
- August 2009: Month of launch of BSE IPO.

BSE IPO is also telling the same story.

Overpricing has caught the attention of all the SEBI chairmen, past as well as present, while being in the office. The ET article mentioned above quoted the then SEBI chairman, C.B. Bhave:

'In a bid to maximize returns for promoters they (investment bankers) are not looking at the interests of the investors'. Mr. Bhave lamented last week. 'You need to introspect whether it is a healthy practice. If you keep investors disappointed, day in and day out, the cause of investors will only be a lip service'.

It is another story that all the SEBI chairmen themselves have done just lip service to the investors on this issue instead of trying to come out with concrete measures to fight the menace of overpricing.

The litmus test that investment bankers should undertake while deciding issue pricing is whether they would themselves be investing in the issue at the decided price.

B. Due Diligence

I wish to touch upon two issues here.

B.1. Excessive disclosures in the offer document

In the name of due diligence, the offer documents have become very bulky today. It is *unusual now* to find offer documents of less than 300 pages. It is *usual now* to prepare offer documents of 500/700 pages. Merchant bankers need to explore the possibilities of reducing the flab in the offer documents, making them thinner and leaner without compromising on the information needed, making them readily readable and understandable and investor friendly so that they could arrive at meaningful conclusions about the quality of the issue and take a better investment decision. To begin with, guidance in this regard can be had from my paper '**Excessive Disclosures in The Offer Document: Making The Document More Meaningful and Investor Friendly'** published in **PRIME Directory 2010.**

B.2. Due diligence in spirit:

Consider the following extracts from the **Atlas Copco (India) Ltd.'s** delisting offer which opened in March 2011:

B.2. 1. The offer

Offer to acquire 36, 62,204 Equity Shares approved by the shareholders on 24-12-2010.

B.2. 2. Floor price

The floor price for the Equity Shares was determined by the Promoter in consultation with Manager to the Offer to be Rs. 1426/- per equity share. .

B.2. 3. Determination of the exit price

1. The minimum price per Equity Share payable by the Promoter will be the price at which the maximum number of Offer Shares are tendered ("**Discovered Price**") pursuant to a RBP (reverse book-building process) as per SEBI regulations.
2. The Promoter has informed the Company vide its letter dated January 26, 2011 that, after considering prevailing market conditions and with a view to reward shareholders, **they are willing to accept Equity Shares tendered in the delisting offer at a price of Rs. 2,250/- per equity share** ("**Indicative Offer Price**"). **However this should in no way be construed as:**
   - **A ceiling or maximum price** for the purpose of the RBP and the Public Shareholders are free to tender their Equity Shares at any price higher than the Indicative Offer Price. or
   - **A commitment by the Promoter** to accept up to 36, 62,204 Equity Shares tendered in the Offer if the Discovered Price is Rs. 2,250 or less.

How the promoter is trying to put a limit on the price to be discovered while still saving his skin through the disclaimers? Is this proper due diligence by the merchant banker? Is it not a coercive and restrictive practice? *Merchant bankers need to introspect and discharge due diligence in spirit. They need to set high standards of service. Their decision needs to tilt in favour of the investors in case of conflict of interest between the client and the investors.*

C. Unfair and Restrictive Trade Practices

When the merchant bankers crawl for PSU public issue assignments for a *princely fee* of, for instance, 0.00000000001% to get the mandate for **Steel Authority of India Ltd's** Rs. 8,000 crore FPO and 0.000001%o for **MOIL's** IPO, just for the lust of league tables, can they be expected to genuinely account for the investors' interest in spirit? And are they not adopting unfair and restrictive trade practices to keep the competition at bay? Obviously in such a scenario they can serve the purpose of the client (government) only. Losses suffered by the investors in the recent PSU offerings, such as, **SJVN, MOIL, PSB** and **PFC** etc., bear ample testimony to this. **It is high time they shunned working free for the government and started acting as professional players.**

D. Lax IPO Procedures

Lax IPO procedure in the case of **Coal India Ltd**.'s IPO, that is, incorrect uploading of bid forms by the top 10 brokers (not named) marketing the issue led to depriving 12,000 investors of the shares of the company. As reported by the Economic Times of 08-03-2011, SEBI directed the merchant bankers associated with the issue, **Citigroup,**

Kotak Mahindra, Morgan Stanley, Bank of America, Merrill Lynch, deutsche Bank and **Enam Securities** to compensate these investors before those 10 brokers were hired for any further issues. Such irregularities have a far reaching adverse impact on the success of floats since these brokers command most of the distribution network in the primary market. **Merchant bankers need to be careful about continuous quality check of software/ hardware systems associated with book building and ensure the technical competency of their associated market intermediaries.**

E. SME Promotion

Specific SME public issue guidelines were issued by SEBI on 13-04-2010 to promote capital raising for them from the capital market. The required infrastructure for the purpose at NSE is yet to be approved by the SEBI. It is the responsibility of the merchant bankers to promote SME's which require a different ball game, a venture capitalists approach towards the SMEs and their IPOs and identification of private equity funds for resource mobilization with suitable risk management mechanism for them. The assignments may not be very rewarding initially. But the merchant bankers need to create a market for them in the long term interest of entrepreneurs/entrepreneurship and the primary market. It is a great opportunity and they need to identify and nurture promising ventures in their own interest also in the long term. Let us not forget that a flower blossoms out of a bud only. **Infosys** was also a very small company when it entered the primary market in 1993 with an IPO, which interestingly was **undersubscribed** and eventually bailed out by investment bank **Morgan Stanley** which picked up 13% of equity at the offer price of Rs. 95 per share. **Today it is one of the internationally best known software companies of Hindustan having rewarded the investors stupendously.**

F. Policy Reforms

The accountability of the investment bankers does not end with mere compliance of regulatory norms. They need to contribute to the formation of more and more investor friendly norms as well. Here are a few suggestions, which by no means are exhaustive:

1. Factoring issue pricing into IPO grading. It is well proven that there is no correlation between highly graded issue and its performance.
2. Larger reservation for retail and other individual investors in the bidding process.
3. Drastic reduction in the unnecessary bulk in the offer documents.
4. Simplification of the application form and abridged prospectus.
5. Inclusion of projections, with suitable safeguards, in the offer document to facilitate better investment decision. This will also put a check on the pricing itself

The merchant bankers and their association AMBI need to take up these and such other issues with SEBI and vigorously push for them.

CONCLUSION

Ultimately the merchant bankers need to look upon themselves as the guardians of the primary market so as to promote its healthy and orderly development, ensure adequate investor protection and promote markets which ensure fairness, efficiency and confidence - in both issuers and investors. Let them not forget that primary market is the mother of the secondary market. Only a healthy primary market will lead to a high industrial growth and ultimately to the sustainable growth of the secondary market.

Comments invited at **ambrish@fsm.ac.in.**