CHAPTER VI

MERCHANT BANKERS:
PRE-ISSUE MANAGEMENT
6.1 Introduction

It is perceived that the growth of capital market is very much depended on the growth of an economy, which, in turn, has a glaring impact on the overall activity of merchant bankers. Merchant bankers as lead managers render corporate advisory services to the entities and make corporate financing through issue of securities. Security markets in India bring together the buyers and sellers of securities, meaning that they are the machineries to facilitate the exchange of financial assets. The security market can be distinguished between money market and capital market. Where money market typically involves financial assets that expire in one year or less, the capital market, on the other, deals in financial assets with life span of more than one year. The capital market also includes equity and long-term debt market, which are structured by the primary market and the secondary market. Long-term debt market comprises of corporate debt and government debt market. The market where the new corporate securities (i.e. public issues/initial public offering) are dealt with is referred to as the primary market. Once the shares are allotted to the shareholders these shares are then transacted in the secondary market or stock exchanges. Secondary market is, thus, referred to those transactions where one investor buys shares from another investor through a broker at the prevailing market price or at whatever price both the buyer and seller agree upon. In India both the primary and secondary market are governed as per the rules and regulations framed by the SEBI (Figure-6.1).

In the previous chapter a brief discussion on economic growth in India and its impact on the corporate sectors are made. This chapter makes an effort to deal with the capital issue management and more importantly on the pre-issue management. A study on the role of merchant bankers as lead managers and its role as underwriters are also discussed here. Finally, a humble attempt has been made to enquire a relation among the economic growth in terms of GDP, growth of
6.2 Corporate financing through primary market

Every company requires short term as well as long-term finance for continuing its operations effectively. Short-term finance is raised by the organisation through approaching various banks and financial institutions, lenders and also accepting fixed deposits from public and shareholders. Long-term finance is met through loans from various entities and also by issue of corporate securities. The initial and subsequent capital issue of securities like equity shares, preference shares, debentures or bonds can be made in the primary market through

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public issues as well as rights issues. Initial issue of securities are offered to the public through issue of prospectus and subsequently the public subscribe to them in the primary market directly. Usually, internal resource generation is made through issue of bonus shares. In case of rights issue, existing shareholders are given pre-emptive rights to purchase additional securities of the company. In both the cases of right and bonus issues the company has to offer at the first instance to the existing holders of the securities on a pro-rata basis as required under the provision of Sec 81 of the Companies Act, 1956. Bonus shares, basically, are issued by capitalisation of reserve balances and undistributed profits of the company. So, there is no scope of resource mobilisation from primary market to the issuer company by issuing bonus shares.

The merchant bankers have a greater role on the capital issue management comprising primary issues (i.e. new issues) and rights issues, whereas, there is no scope of any such activity in case of bonus issues by such entities. Thus, issue of bonus shares has not been considered in our study. In a private placement, funds are raised in the primary market by issuing securities privately to some investors without resorting to underwriting. The investors in this case may be financial institutions, commercial banks, other companies, friends and associates of the promoters, etc. Corporate financing through private placement is also excluded from our study. Though the study gives more stress on the activities as are accomplished in the primary market but there is no denying the fact that there is momentous impact of the performance of secondary market on the new issue market as an active secondary market promotes the growth of the primary market and aids capital formations. This chapter, as such, makes an attempt to cover all the areas in brief here.

6.3 Secondary market and its operations

Stock Exchange is, basically, a market place for dealing in shares and securities. It is here that buyers and sellers transact business through
their agents called 'stock brokers', in the purchase and sale of corporate
and government securities. This is why, Stock Exchange is often referred
to as 'Stock Market' or 'Share Market' or 'Secondary Market'. It refers to
an institution of paramount importance in the economic life of the
country. It would be impossible for private corporate enterprises to
thrive and grow in the absence of Stock Exchange. The institution
provides liquidity to private investments in corporate enterprises\(^2\).

The origin of the stock market in India goes back to the end of the
eighteenth century when long-term negotiable securities were first
issued. However, for practical purposes, the sincere beginning occurred
in the middle of the nineteenth century after the enactment of the
Companies Act in 1850. A stock exchange is an organised market for
purchase and sale of second-hand, listed and permitted corporate and
government securities. Securities traded here are called 'second hand
securities', because they are 'brand new' when issued through the
primary market, and only thereafter, are listed and traded on the stock
exchanges by the original allottees. At present, there are 21 stock
exchanges in India recognised under the Securities Contracts
(Regulations) Act, 1956. They are located at Mumbai, Kolkata, Madras,
Delhi, Ahmedabad, Hyderabad, Indore, Bhubaneshwar, Rajkot,
Mangalore, Patna, Jaipur, Bangalore, Cochin, Kanpur, Pune, Ludhiana,
Gauhati, and Baroda. The recently recognised stock exchanges are at
Coimbatore and Meerut\(^3\). The Bombay Stock Exchange (BSE), the
National Stock Exchange (NSE), the Over The Counter Exchange of India
(OTCEI) and the Interconnected Stock Exchange of India (ISE) are
headquartered at Mumbai. The legislative jurisdiction over stock
exchanges is vested in the Union Government by the Constitution of
India. The Union Government enacted the Securities Contracts
Regulations Act (SCR Act) in 1956, to regulate the functioning and
trading of the stock exchanges. The SCR Act and the Securities


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Contracts Regulation Rules (1957) together constitute the legal framework which not only regulates the stock exchanges but also protects the interests of the investors. The Securities Contracts Regulations Act, 1956 provides inter alia

(a) recognition of stock exchanges and regulation of their functioning,
(b) licensing dealers,
(c) recognition of contracts,
(d) controlling speculation,
(e) restricting rights of equitable holders of shares, and
(f) empowering government to compel any public limited company to get its shares listed.

In this regard it is important to note that there exists a relation between the primary and secondary market operations. Securities, which are issued in the primary market, are subsequently listed in the stock exchanges to enable buyers and sellers to effect their transactions. For the economy as a whole, an increase in savings in the form of securities ownership is measured by the volume of new issues. Transactions in existing securities represent shifts among owners, which always cancel out in the aggregate. Similarly, transactions in existing securities do not provide additional funds to finance capital formation; it is the volume of new issues which provide additional financing to business enterprises. Merchant bankers make some valuable contribution in managing new issues of corporate sector. The following section makes an attempt to know the trends in stock market in India.

6.4 Trends in stock market in India

The stock markets showed a tremendous improvement in the 1980s and the steady uptrend continued till 1984. The primary market too, was healthy during this period. In February 1985, Mr. V P Singh as finance minister announced a path breaking budget reducing taxes and making a firm statement in support of economic reforms,

fully backed by the then prime minister, Mr. Rajiv Gandhi. This budget heralded a boom, which lasted until Mr. Singh's second budget in February 1986. The country, however, was facing severe drought, which probably constrained the economic pragmatism during that period. Between March 1986 and June 1988, the markets remained largely depressed.

Markets picked up once again between 1988 and 1992, despite a few hiccups like the Gulf War along the way. This time the boom was fuelled by a member of the Bombay Stock Exchange named Mr. Harshad Mehta who was involved with the 'securities scam' that came to light in April 1992. Although the scam was the result of machinations in the gilt-edged securities market, the huge funds to which Mr. Mehta had wrongful access, were used to fuel an artificial boom in the stock exchanges.

Wounded badly by the scam, the markets nevertheless staged a remarkable recovery in late 1993 and 1994. However, the country's economy went into prolonged recession in late 1994. The years 1995, 1996 and 1997 had experienced some of the worst situations ever seen in the stock markets. Software, e-commerce, information technology, internet, entertainment and communication shares, however, helped the stock markets to revive in 1998, culminating in a runaway boom until February 2000, when an insipid and short sighted budget announced by the then finance minister, Mr. Yashwanth Sinha.

Indian stock market had shown extreme volatility during the last decade, with prices swinging wildly, often without any change in fundamentals. The BSE Sensex, which was more than 5000 points in the year 2000, dipped to less than 3500 points by the second half of the year 2001. The market capitalization also felt sharply...
during this period. Several reasons could be taken as the reason for the then slump in the Indian stock market. One of the major reasons for that phase was the stock market scams occurring at regular intervals. The particular scam was related to the Unit Trust of India (UTI) had affected the market and the investors confidence as well. In addition to that, the tumbling of information technology shares, which reached to the highest levels, also brought down the Sensex drastically during that year. The terrorist attack in the US and the subsequent war atmosphere further dampened the gloomy atmosphere in the Indian stock market. The global stock market crash had also affected the Indian market adversely7.

Mr. Ketan Parekh, the prime accused in another exemplary stock scam (March, 2001), operated through a large number of entities which facilitated hiding of nexus between corporate sources of fund flow and the ultimate use in the stock market. The Joint Parliamentary Committee (JPC) probing the stock scam observed that some of the corporate groups, which had given funds to Mr. Parekh entities during January 2000-April 2001 were Adani, HFCL, DSQ, Cadila, Essel, Kopran and Nirma and the amount outstanding from him to these entities, was over Rs 1,273 crore (Rs 12.73 billion). The JPC said the amount outstanding to Global Trust Bank from Parekh entities as on March 23, 2001 was Rs 266.87 crore (Rs 2.67 billion) and Parekh had also received funds from Centurion Bank, ICICI Bank and Bank of Punjab against which a total amount of Rs 65.47 crore (Rs 654.7 million) was outstanding8.

6.5 New era in the primary capital market

The abolition of the Capital Issue Control Act, 1947 has brought a new era in the primary capital markets in India. Controls over the pricing of

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7 Capital market, http://www.directories-today.com/i_capital_mkt.htm

the issues, designing and tenure of the capital issues are abolished. The issuers, at present, are free to make the price of the issues. The main drawback of free pricing was the process of pricing of issues. The issue price is determined around 60-70 days before the opening of the issue and the issuer company itself does not have any clear idea about the market perception and also the price so determined. Book building mechanism, a new process of price discovery, has been introduced to overcome this limitation and also to determine the issue price effectively. Before establishment of SEBI the quality of disclosures in the offer documents was very poor. The board has also formulated and prescribed stringent disclosure norms in conformity to global standards and has taken initiatives for registration of intermediaries associated with the process of capital issue management. This is done to ensure professionalism of the intermediaries and to prevent malpractices indulged by some of the intermediaries. The primary market intermediaries are (a) merchant bankers, (b) registrars and share transfer agents, (c) brokers to the issue, (d) bankers to the issue and (e) debenture trustees who are required to be registered with the SEBI.

6.6 Pricing of capital issues

Pricing of capital issues is part of pre-issue management, which is the most important task in the primary capital market. The SEBI, after its inception, has taken a robust step on the removal of the restriction on pricing of capital issues. The companies are now permitted to fix a price of the equity either at par or at a premium subject to certain conditions. Under CCI regime, all the issuer companies coming with a public issue had to price their issue based on the CCI formula. This process was a case of anti-market practice as all companies, either sound or not, were required to price their issues very conservatively. The merchant bankers' role during this period was very limited. However, under free pricing era, pricing of capital issues is made by companies either by themselves or in consultation with the merchant bankers. If the premium is too low the issue, as a general rule, gets oversubscribed and if the premium is too
high it is bound to be undersubscribed. The merchant bankers are responsible in considering the future prospects of the company and also in assessing whether the market can absorb the premium on issue. According to SEBI guidelines, the merchant bankers are also responsible for vetting prospectus to ensure that the investors are adequately informed about the justification of price and stating the net asset value. The premium of capital issues is to be determined after taking into account net asset value, profit earning capacity and market price. Justification of price of capital issues has to be stated and included in the prospectus.

After considering the recommendation of Malegam Committee, SEBI has prescribed the guidelines (issued on 01.03.1996) and recommended that the basis for issue price of capital issues should disclose the following information:

(i) Earnings per share (EPS) for the last three years (adjusted for changes in capital);
(ii) Pre-issue P/E ratio and comparison thereof with industry P/E, where available;
(iii) Average return on net worth for the last three years;
(iv) Minimum return on increased net worth required to maintain pre-issue EPS;
(v) Net asset value per share based on last balance sheet;
(vi) Net asset value per share after issue and comparison thereof with the issue price; provided that the project earnings shall not be used as a justification for the issue price in the offer document;
(vii) The accounting ratios disclosed in the offer document in support of issue price shall be calculated after giving effect to the consequent increase in capital on account of compulsory conversion outstanding, as well as, on the assumption that the options outstanding, if any, will be exercised to subscribe for additional capital.
6.7 Method of pricing of Initial Public Offering (IPO)

Pricing of an IPO in the Indian primary market starts with the concept of understanding the nature of the project where the promoter of the issuing company requires to invest. There are certain stages through which pricing of an IPO is made. These stages can be discussed in the following paragraphs:

(i) Planning to go public for estimating the preliminary price during the early phase

During this stage, the issuing company who is planning to go for the issue is to select a merchant bank. Then the merchant banker is being asked to suggest an offer price for the public issue of the issuing company. Merchant banker is required to evaluate all the factors like special risk factors, financial leverage, operating leverage, reasons for changes in the company's financial position, principal products and services, patent rights, market strategy, production schedule, management profile, composition of the Board of Directors and the prevalent rules and regulations for determining the pricing of an IPO. The lacuna of this method is that companies normally tend to select that merchant banker who used to offer them the highest price for the issue. Merchant bankers, on the other, in order to get the mandate, price the IPO as aggressively as possible. This process, very often, is reduced to a competitive bidding and at the end the merchant banker and the issuing company realise that the issue was priced much higher than its intrinsic value.

(ii) Deciding upon the price band

In this stage the issuing company appoints the merchant banker as lead manager who exercises his due diligence by checking all the important aspects of the company. The merchant banker determines the price band in consultation with the issuing company after considering the following information about its client:

(a) track record of past performance;
(b) comparison of issuing company with other similar companies in respect to future earnings, cash flow from operations and fundamental asset values;
(c) information on the overall trend in the IPO market and success rate of similar issues during the period;
(d) feasibility of perceptions about the company's management from the brokers and prospective investors.
(e) the company's accounting methods and whether there had been any changes in methods in recent years and reasons behind such changes.

(iii) Determining the final offer price

During this stage, merchant banker, after acquiring all relevant information, consults with the issuing company for determining the final price. The free pricing of IPO, however, is suffered from certain limitations. They are (a) inadequate disclosure in the prospectus, (b) decorating the prospectus with attractive projections which are often misleading, (c) price rigging by the promoters by colluding with the brokers to justify higher prices to the investors.

6.8 Book Building: the latest price discovery mechanism of IPOs in India

To keep pace with the globalisation and liberalization process the government of India was very keen to bring the capital market in line with international practices through gradual deregulation of the economy. It led to liberalisation of capital market in the country with more expectations from primary market to meet the growing needs of funds for investment in trade and industry. Therefore, there was a vital need to strengthen the capital market which, it was felt, could only be achieved through structural modifications, introducing new mechanism and instruments, and by taking steps for safeguarding the interest of the investors through more disclosures and transparency. As such, an important mechanism named as 'book building' in the system of initial public offerings (IPOs) was recognised by SEBI in India after having the
recommendations of the committee under the chairmanships of Y. H. Malegam in October, 1995. The SEBI recognised book building as an alternative mechanism of pricing. Under this approach a portion of the issue is reserved for institutional and corporate investors.

According to SEBI, book building is "a process undertaken by which a demand for the securities proposed to be issued by a body corporate is elicited and built up and the price for such securities is assessed for the determination of the quantum of such securities to be issued by means of a notice, circular, advertisement, document or information memoranda or offer document." Book building process is a common practice used in most developed countries for marketing a public offer of equity shares of a company. As such, book building is regarded as a method of transparent and flexible price discovery of initial public offerings (IPOs) where the price of securities is determined by the issuer company along with the Book Running Lead Manager (BRLM) on the basis of feedback received by the syndicate members from investors as well as market intermediaries during a certain period.

6.8.1 Why book building?

In India, the traditional fixed price method of tapping individual investors is suffered from two defects: (a) delays in IPO process and (b) pricing of issue. In fixed price method, public offers do not have any flexibility in terms of price as well as number of issues. From experience it is realised that a majority of the public issue on fixed price method is either under-priced or over-priced. Individual investors (i.e. retail investors), as such, are unable to distinguish good issues from bad one based on such pricing methodology. This is because the issuer company and the merchant banker as lead manager do not have the exact idea on the fixed pricing of public issues. Thus, it is required to find out a new mechanism for fair price discovery and to help the least informed investors by imparting better information on issue price. That is why, book building acts as a scientific method through which a consensus
price of IPOs may be determined on the basis of feedback received from most informed investors like, Unit Trust of India (UTI), Life Insurance Corporation of India (LIC), General Insurance Corporation of India (GICI), Foreign Institutional Investors (FIIs), State Financial Corporation of India (SFCI), etc. The method helps in making a correct evaluation of a company's potentiality and to determine the price of its shares. Public offers in fixed price method involve a pre-issue cost of 2-3% and carry the risk of failure if it does not receive 90% of the total subscription. In book building such costs and risks can be avoided because the issuer company can withdraw from the market if there is no demand for the security at all. In fixed price option, on the other, the price of issues is fixed first and then the securities are offered to the investors. In case of book building process the book is built by Book Runner Lead Manager (BRLM) based on every day demand whereas under fixed price method the demand is known after the close of the issue.

6.8.2 How is book built in India?

The individuals who are directly associated with book building process are the issuer company, the Book Runner Lead Manager (BRLM) and the syndicate members (Figure-6.2). Both the BRLM (the category-I merchant banker) and the syndicate members are eligible to act as underwriters. The method and process which are followed in the book building mechanism as per SEBI guidelines can be summarized below:

1. The issuer company, proposing an IPO, appoints a category-I merchant banker as a BRLM.

2. Initially, the issuer company consults with the BRLM in drawing up a draft prospectus (i.e. offer document) which does not mention the price of the issues, but includes other details about the size of the issue, past history of the company, and a price band. The securities available to the public are separately identified as “net offer to the public”.

3. The draft prospectus is filed with SEBI which gives it a legal standing.

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(4) A definite period is fixed as the bid period and BRLM conducts awareness campaigns like advertisement, road shows etc.

Figure- 6.2
Book building process

(5) The BRLM appoints syndicate members and the SEBI registered intermediaries to underwrite the issues to the extent of “net offer to the public”.

(6) The BRLM is entitled to remuneration for conducting the book building process.

(7) The copy of the draft prospectus may be circulated by the BRLM to the institutional investors as well as to the syndicate members.

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(8) The syndicate members create demand and ask each investor for the number of shares and the offer price.

(9) The BRLM receives the feedback about the investor's bids through syndicate members.

(10) The prospective investors may revise their bids at any time during the bid period.

(11) The BRLM on receipts of the feedback from the syndicate members about the bid price and the quantity of shares applied has to build up an order book showing the demand for the shares of the company at various prices. The syndicate members must also maintain a record book for orders received from institutional investors for subscribing to the issue out of the placement portion.

(12) On receipts of the above information, the BRLM and the issuer company determine the issue price. This is known as the market-clearing price.

(13) The BRLM then closes the book in consultation with the issuer company and determine the issue size comprising of (a) placement portion and (b) public offer portion.

(14) Once the final price is determined, the allocation of securities should be made by the BRLM based on prior commitment, investor's quality, price aggression, earliness of bids etc. The bid of an institutional bidder, even if he has paid full amount may be rejected without being assigned any reason as the book building portion of institutional investors is left entirely at the discretion of the issuer company and the BRLM.

(15) The Final prospectus is filed with the registrar of companies within 2 days of determination of issue price and receipts of acknowledgement card from SEBI.

(16) Two different accounts for collection of application moneys, one for the private placement portion and the other for the public subscription should be opened by the issuer company.
(17) The placement portion is closed a day before the opening of the public issue through fixed price method. The BRLM is required to have the application forms along with the application moneys from the institutional buyers and the underwriters to the private placement portion.

(18) The Allotment for the private placement portion shall be made on the 2nd day from the closure of the issue and the private placement portion is ready to be listed.

(19) The Allotment and listing of issues under the public portion (i.e. fixed price portion) must be as per the existing statutory requirements.

(20) Finally, the SEBI has every right to inspect such records and books which are maintained by the BRLM and other intermediaries involved in the book building process.

6.8.3 Equity issues through book building process in India during 1999-2002

The practice of book building is new to the Indian capital market and the procedure is still evolving. The ICICI first used the book building route for its Rs. 1000 crore issue in April 1996, followed by Rs. 4323 crore Larsen & Toubro issue and Rs. 5878 crore TISCO issue for the placement portion. The issue of Hughes Software made history in more ways than one. It was the first Indian IPO in IT industries to adopt the "book-building" process. In November 1999, investors gave an enthusiastic response to the issue of HCL technologies. The issue got oversubscribed by 27 times. This was despite the fact that the company revised its original price band of Rs.450-540 to Rs. 500-580. The final price offered was Rs. 580 for the shares. Other companies accepted the book building mechanism were Shree Rama Multi Tech Ltd., Zydus Cadila Healthcare Ltd. Mascot Systems Ltd., Creative Eye Ltd., MosChip Semiconductor Technology Ltd., SIP Technologies and Exports Ltd., Hughes Tele. Com India Ltd., MRO TEK Ltd., Pritish Nandy

10 Ibid, p.575.
Communications Ltd., Balaji Telefilms Ltd., AZTEC Software & Technology Services Ltd, Mid-Day Multimedia Ltd and D-Link (India) Ltd. A detail of issue through book building process of different companies in India during 1999-2002 through National Stock Exchange (NSE) is presented below (Table-6.1).

### Table- 6.1

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Name of the issue</th>
<th>Book Runner (as category-I merchant bankers)</th>
<th>Date of issue</th>
<th>Number of members</th>
<th>Number of Bidding Centres</th>
<th>Issue Size (Book Building)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>HCL Technologies Ltd.</td>
<td>Kotak Mahindra Capital Company</td>
<td>16.11.1999 to 24.11.1999</td>
<td>173</td>
<td>12</td>
<td>127.80 lacs shares</td>
</tr>
<tr>
<td>3</td>
<td>Shree Rama Multi Tech Ltd.</td>
<td>DSP Merrill Lynch</td>
<td>15.01.2000 to 21.01.2000</td>
<td>9</td>
<td>10</td>
<td>99.36 lacs shares</td>
</tr>
<tr>
<td>4</td>
<td>Zydus Cadila Healthcare Ltd.</td>
<td>JM Morgan Stanley Ltd.</td>
<td>09.02.2000 to 16.02.2000</td>
<td>17</td>
<td>11</td>
<td>133.97 lacs shares</td>
</tr>
<tr>
<td>6</td>
<td>Creative Eye Ltd.</td>
<td>HSBC Securities and Capital Market (India) Ltd.</td>
<td>30.06.2000 to 06.07.2000</td>
<td>2</td>
<td>1</td>
<td>18.76 lacs shares</td>
</tr>
<tr>
<td>8</td>
<td>Hughes Telecom India Ltd.</td>
<td>Kotak Mahindra Capital Company</td>
<td>29.08.2000 to 05.09.2000</td>
<td>44</td>
<td>16</td>
<td>Rs.674.10 crores</td>
</tr>
<tr>
<td>9</td>
<td>MROTEK Ltd.</td>
<td>DSP Merrill Lynch</td>
<td>04.09.2000 to 09.09.2000</td>
<td>10</td>
<td>10</td>
<td>45.98 lacs shares</td>
</tr>
<tr>
<td>10</td>
<td>Pritish Nandy Communications Ltd.</td>
<td>JM Morgan Stanley Ltd.</td>
<td>04.09.2000 to 11.09.2000</td>
<td>8</td>
<td>9</td>
<td>23.56 lacs shares</td>
</tr>
<tr>
<td>11</td>
<td>Balaji Telefilms Ltd.</td>
<td>JM Morgan Stanley Ltd.</td>
<td>06.10.2000 to 12.10.2000</td>
<td>12</td>
<td>12</td>
<td>25.20 lacs shares</td>
</tr>
<tr>
<td>12</td>
<td>AZTEC Software &amp; Technology Services Ltd.</td>
<td>JM Morgan Stanley Ltd.</td>
<td>12.10.2000 to 18.10.2000</td>
<td>15</td>
<td>13</td>
<td>46.80 lacs shares</td>
</tr>
<tr>
<td>13</td>
<td>Creative Eye Ltd.</td>
<td>HSBC Securities and Capital Market (India) Ltd.</td>
<td>03.11.2000 to 09.11.2000</td>
<td>4</td>
<td>8</td>
<td>45.04 lacs shares</td>
</tr>
<tr>
<td>15</td>
<td>Mid-Day Multimedia Ltd.</td>
<td>IL&amp;FS Merchant Banking Services Ltd.</td>
<td>12.02.2001 to 18.02.2001</td>
<td>3</td>
<td>13</td>
<td>Rs.45 crores</td>
</tr>
<tr>
<td>16</td>
<td>D-Link (India) Ltd.</td>
<td>Tata Finance Merchant Bankers Ltd.</td>
<td>20.02.2001 to 27.02.2001</td>
<td>9</td>
<td>16</td>
<td>13.71 lacs shares</td>
</tr>
<tr>
<td>17</td>
<td>Bharat Tele Ventures Limited</td>
<td>JM Morgan Stanley Private Ltd., DSP Merrill Lynch Ltd.</td>
<td>28.01.2002 to 2.02.2002</td>
<td>28</td>
<td>59</td>
<td>1853.367 lacs shares</td>
</tr>
<tr>
<td>18</td>
<td>i-flex solutions ltd.</td>
<td>JM Morgan Stanley Private Ltd., DSP Merrill Lynch Ltd., Kotak Mahindra Capital Co Ltd., Solomon Smith Barney India Pvt. Ltd.</td>
<td>05.06.2002 to 11.06.2002</td>
<td>97</td>
<td>30</td>
<td>39.617 lacs shares</td>
</tr>
</tbody>
</table>

Source: National Stock Exchange

When the concept of book building was introduced to this country towards the end of 1999, the main objective was that it would help to ‘discover’ the right price for a public issue which in turn would evade unreasonable issue pricing by greedy promoters. Let us look at the post performance of the scrips issued through book building route (Table-6.2).

**Table-6.2**

Present position of some book-building issues through IPOs in India

<table>
<thead>
<tr>
<th>SR No.</th>
<th>IPO name</th>
<th>Issue date</th>
<th>IPOs</th>
<th>Face value</th>
<th>Offer Price</th>
<th>Book-Built (Rs.cr)</th>
<th>No. of times over-subscribed</th>
<th>Listing price</th>
<th>High</th>
<th>Low</th>
<th>Current Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Hughes Software</td>
<td>7.10.99</td>
<td>10</td>
<td>630</td>
<td>243.06</td>
<td>25.00</td>
<td>1589.00</td>
<td>4848.25</td>
<td>433.70*</td>
<td>638.35*</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>HCL Technologies</td>
<td>10.12.99</td>
<td>4</td>
<td>580</td>
<td>741.24</td>
<td>27</td>
<td>1150.00</td>
<td>3021.00</td>
<td>335.25#</td>
<td>425.30#</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Shri Rama Multi</td>
<td>4.2.00</td>
<td>5</td>
<td>120</td>
<td>119.25</td>
<td>46.00</td>
<td>110.25</td>
<td>121.90</td>
<td>36.00</td>
<td>36.00</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Cinevista Comm.</td>
<td>24.2.00</td>
<td>10</td>
<td>300</td>
<td>87.00</td>
<td>NA</td>
<td>202.00</td>
<td>427.00</td>
<td>42.00</td>
<td>42.10</td>
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<tr>
<td>5</td>
<td>Cadila Healthcare</td>
<td>28.2.00</td>
<td>5</td>
<td>250</td>
<td>334.94</td>
<td>7.00</td>
<td>196.90</td>
<td>238.00</td>
<td>101.30</td>
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<tr>
<td>6</td>
<td>Mascot Systems</td>
<td>2.5.00</td>
<td>4</td>
<td>460</td>
<td>108.00</td>
<td>8.00</td>
<td>575.00</td>
<td>599.00</td>
<td>93.65</td>
<td>94.00</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Aksh Optifibre</td>
<td>18.7.00</td>
<td>5</td>
<td>60</td>
<td>26.82</td>
<td>8.00</td>
<td>65.00</td>
<td>173.20</td>
<td>62.70</td>
<td>91.70</td>
<td></td>
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<tr>
<td>8</td>
<td>Mukta Arts</td>
<td>28.7.00</td>
<td>5</td>
<td>165</td>
<td>75.00</td>
<td>4.85</td>
<td>220.00</td>
<td>295.00</td>
<td>135.00</td>
<td>155.10</td>
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</tr>
<tr>
<td>9</td>
<td>Hughes Tele. Com</td>
<td>20.9.00</td>
<td>10</td>
<td>12</td>
<td>674.29</td>
<td>0.87</td>
<td>11.50</td>
<td>12.20</td>
<td>7.50</td>
<td>9.00</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Mro-Tek</td>
<td>25.9.00</td>
<td>5</td>
<td>95</td>
<td>43.66</td>
<td>1.40</td>
<td>96.00</td>
<td>116.90</td>
<td>23.80</td>
<td>24.30</td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Pritish Nandy Com.</td>
<td>35.9.00</td>
<td>10</td>
<td>165</td>
<td>36.61</td>
<td>1.50</td>
<td>150.00</td>
<td>180.20</td>
<td>22.90</td>
<td>23.65</td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>Tips Industries</td>
<td>26.9.00</td>
<td>10</td>
<td>325</td>
<td>87.75</td>
<td>3.10</td>
<td>342.00</td>
<td>425.95</td>
<td>71.40</td>
<td>72.65</td>
<td></td>
</tr>
<tr>
<td>13</td>
<td>Balaji Telefilms</td>
<td>27.10.00</td>
<td>10</td>
<td>130</td>
<td>32.76</td>
<td>1.78</td>
<td>171.00</td>
<td>363.80</td>
<td>147.10</td>
<td>168.90</td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>Aztec Software</td>
<td>02.11.00</td>
<td>3</td>
<td>80</td>
<td>46.80</td>
<td>1.43</td>
<td>99.00</td>
<td>141.25</td>
<td>52.45</td>
<td>52.45</td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>Creative Eye</td>
<td>23.11.00</td>
<td>5</td>
<td>50</td>
<td>22.52</td>
<td>3.71</td>
<td>59.40</td>
<td>70.00</td>
<td>17.65</td>
<td>18.00</td>
<td></td>
</tr>
</tbody>
</table>

NA: Not available, * On Rs 5 paid-up, # On Rs 2 paid-up
Source: The Financial Express

Of the fifteen IPOs that fixed their offer price through the ‘price-discovery mechanism’ between October 1999 and November 2000, only three (Hughes Software, Aksh Optifibre, and Balaji Telefilms) are currently quoting above their offer prices. The largest ever public offer made in this country through the book-building route was by HCL Technologies. This IPO created history of sorts by leaping into the list of top 10 shares by market capitalisation on its very first day of trading. The recent trend

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in market price of shares of those companies does not portray a bright performance of this mechanism. Let us hope for a prospective future.

6.9 Management of capital issues

Managing issue of corporate securities is the core of category-I merchant banking functions. Companies need finance for (i) implementation of a new project, (ii) capital restructuring of existing project, (iii) modernisation or diversification of an existing unit and (iv) long-term working capital requirements. In all the cases services of merchant bankers are seriously felt. Management of capital issues in India, today, is a specialised professional service and is performed by category-I merchant bankers as lead managers prescribed by SEBI. Merchant bankers in respect to pre-issue management perform various activities which include: (a) drafting of prospectus, (b) appointment of underwriters, (c) ensuring proper channel for issue of instrument, (d) appointment of brokers and intermediaries, (e) coordination for vetting of prospectus by SEBI etc.

The procedure for managing capital issues can be broadly categorised into:

a) Pre-issue management,
b) Post-issue management.

The issue management is generally comprised of marketing equity shares, preference shares, and debentures/bond through public issues and rights issues. In both stages of capital issues, the new companies are to comply with the legal requirements prescribed by SEBI. In this chapter attempts are made to discuss the procedures to be adopted by the merchant bankers on pre-issue management. In addition to this, this chapter also tries to portray the performance of merchant bankers as lead managers and as underwriters of such capital issues.

Pre-issue obligations of merchant bankers according to SEBI guidelines are discussed below:

1. **Exercising due diligence**
   After getting an appointment as lead manager to an issue, the merchant banker is required to maintain a standard of due diligence. It is the responsibility of merchant banker to satisfy all the aspects of offering, veracity and adequacy of disclosure in the offer documents. The lead manager is also responsible even after the completion of the issue process.

2. **Payment of requisite fees**
   The requisite amount of fees should be paid by the lead merchant banker as per regulation 24A of SEBI (Merchant Bankers) Rules and Regulations, 1992, along with draft offer document to SEBI.

3. **Submission of documents along with offer documents**
   The lead merchant banker should submit the following documents with offer documents:
   
   (i) **Memorandum of Understanding (MOU)**
   The lead merchant banker is required to enter into a MOU with the issuer company specifying their mutual rights, liabilities and obligations relating to the issue. The lead manager is also responsible to submit a copy of MOU to SEBI.

   (ii) **Due diligence certificate**
   The lead merchant banker should submit due diligence assuring that all suggestions and observations made by the SEBI have been duly incorporated in the offer document. It should also furnish a due diligence certificate along with the prospectus to the registrar of companies.

   (iii) **Certificates signed by the Company Secretary or Chartered Accountant**
   In case of listed companies making further issue of capital, the lead merchant banker should submit the following certificates duly signed by

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the company secretary or the chartered accountant along with the draft offer documents notifying that:

(a) all refund orders of the previous issues were despatched within the prescribed time and in the prescribed manner;

(b) all the certificates were despatched to the allottees within the prescribed time and in the prescribed manner; and

(c) the shares were listed on the scheduled stock exchanges as specified in the offer documents.

(iv) Undertaking

An undertaking should be submitted by the issuer company to the SEBI to the effect that transactions in securities by the 'promoter', the 'promoter group' and the immediate relatives of the promoters during the period between the date of filing the offer documents to the registrar of companies or stock exchange as the case may be and the date of closure of the issue shall be reported to the concerned stock exchanges within 24 hours of the transactions.

(v) List of promoters group

The issuer company should also submit to the SEBI a list of persons who constitute the promoters group and their individual shareholdings.

(4) Appointment of intermediaries

The lead merchant bankers are to appoint co-managers and advisors for various issues. It is to be ensured that the number of co-managers to the issue does not exceed the number of lead merchant bankers to the said issue as is specified in the SEBI (Merchant Bankers) Act and there should only be an advisor to the issue.

(5) Appointment of other intermediaries

The merchant bankers must also ensure that the other intermediaries appointed are duly registered with the SEBI and before advising the issuer company on their appointment, the capability and capacity of those entities must be assessed independently in order to carry out the assignments. The lead manager should also ensure that bankers to the issue are appointed in all mandatory collection centres and make sure that the other intermediaries like registrar to the issue appointed are
registered with the SEBI. The promoter and director of the issuer company are restricted to act only as a registrar to the issue. Where, however, the number of applications in a public issue is large, the issuer company in consultation with the lead merchant banker may associate one or more registrars registered with the SEBI.

(6) **Underwriting**

The lead merchant banker should also satisfy themselves about the ability of the underwriters to discharge their underwriting obligations before appointing them. A written consent must also be obtained from underwriters before including their names in the final offer document. Moreover, a statement must be incorporated in the offer document to the effect that in the opinion of the lead merchant banker, the underwriter's assets are adequate enough to meet their underwriting obligations.

(7) **Despatch of issue material**

The merchant bankers should ensure that offer documents and other issue materials for public issues are despatched to the various stock exchanges, brokers, underwriters, bankers to the issue, investors association, etc. well in advance. In case of rights issues, the letters of offer must be despatched to all shareholders at least one week before the date of opening of the issue.

(8) **Mandatory collection centres**

The minimum number of collection centres for an issue must be in

   a) the four metropolitan centres situated at Mumbai, Delhi, Calcutta and Chennai;

   b) all such centres where the stock exchanges are located in the region in which the registered office of the company is situated.

(9) **Authorised collection agents**

Authorised collection agents are appointed by the issuer company in consultation with the lead merchant banker subject to necessary disclosures including the names and addresses of such agents made in the offer document. The modalities of selection and appointment of collection agents can be made at the discretion of the merchant banker and they should ensure that the collection agents so selected are
properly equipped in terms of infrastructure and manpower requirements. The collection agents are designated to collect such applications accompanied by money paid by cheques, draft and stock invests.

(10) Advertisement for rights post-issues

The lead merchant bankers should ensure that in case of rights issue, an advertisement giving the date of completion of despatch of letters of offer, shall be released at least in an English national daily with wide circulation, one Hindi national paper and a regional language daily circulated at the places where registered offices of the issuer company are situated at least 7 days before the date of opening of the issue.

(11) Abridged Prospectus

The salient features required to be included in the abridged prospectus have to be in Form 2A with information like: general information on name and address of the registered office of the company, capital structure, terms of present issue, particulars of the issue, financial performance of the company for last five years, payment/refunds, management perception of risk factors, etc. The lead merchant bankers should also ensure responsibility on the following:

a) every application form distributed by the issuer company or anyone else is accompanied by a copy of the abridged prospectus;
b) the form may be stapled to be part of the abridged prospectus;
c) the abridged prospectus shall not contain matters, which are extraneous to the contents of the prospectus;
d) the abridged prospectus must be printed at least in point 7 size with proper spacing;
e) enough space shall be provided in the application form to enable the investors to fill in various details like name, address, etc.
6.10 Public and rights issues of corporate securities: A study on merchant bankers managing as lead managers

As stated in Chapter-I, information regarding performance of merchant bankers as lead managers on capital issue management are not very much available because these institutions do not publish any printed report on capital issue management activities. Moreover, it is not possible to have either any primary or secondary information from individual merchant bankers as they are disinterested to meet and provide such information to the researcher. However, sincere efforts are made to collect information only from a secondary source particularly from the “Prime Directory”\(^{15}\) (an exclusive publication highlighting the detail of merchant banking activities in India). As mentioned earlier, a number of websites have also been used through internet to get requisite information. For the study, merchant bankers (category-I) officiating as lead managers in public and rights issues of corporate securities from 1990 to 2000 are considered (Table- 6.3). Chart-6.1 also depicts the participation of merchant bankers as lead managers in public and rights issues of corporate securities at a glance during 1990-91 to 1999-2000.

Table-6.3
Details of merchant bankers (category-I) officiating public and rights issue as lead managers during 1990 -2000

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of lead Managers participated in public issues</th>
<th>Number of lead managers participated in rights issues</th>
<th>Total Number of lead managers</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990-91</td>
<td>50</td>
<td>45</td>
<td>95</td>
</tr>
<tr>
<td>1991-92</td>
<td>35</td>
<td>47</td>
<td>82</td>
</tr>
<tr>
<td>1992-93</td>
<td>66</td>
<td>63</td>
<td>129</td>
</tr>
<tr>
<td>1993-94</td>
<td>108</td>
<td>88</td>
<td>196</td>
</tr>
<tr>
<td>1994-95</td>
<td>187</td>
<td>108</td>
<td>295</td>
</tr>
<tr>
<td>1995-96</td>
<td>260</td>
<td>133</td>
<td>393</td>
</tr>
<tr>
<td>1996-97</td>
<td>234</td>
<td>85</td>
<td>319</td>
</tr>
<tr>
<td>1997-98</td>
<td>65</td>
<td>40</td>
<td>105</td>
</tr>
<tr>
<td>1998-99</td>
<td>28</td>
<td>22</td>
<td>50</td>
</tr>
<tr>
<td>1999-2000</td>
<td>40</td>
<td>21</td>
<td>61</td>
</tr>
</tbody>
</table>

Source: *Prime Directory*\(^{16}\)

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It is observed that during 1990-91, total number of merchant bankers participated in mobilising money through public issues was 50, which increased to 260 during 1995-96. Likewise, during the same period, total number of merchant bankers participated in managing rights issues were 45, which subsequently increased to 133 in 1995-96 (Table-6.3). Thus, merchant banking, which remained almost stagnant and stereotyped for over two decades17, witnessed an astonishing growth after a series of policies on economic reforms undertaken by the Government. This resulted in proliferation of participation of merchant bankers in Indian capital market corresponding with the unprecedented growth in new issue market. Both the number and the amount of capital issues through public as well as rights issues had risen sharply during that period. Moreover, there were increased interests of the household sector who were desirous of investing in primary issues, participating in the various schemes of mutual funds and putting their hard earned income in the secondary market as well. The secondary market, as it was perceived, had the ability to give a quick return in comparison to other mode of investments. The corporate sectors were also in a changed mood with the impetus received from government. The number of new companies registered with the Registrar of Companies (ROC) was also increased during the period. The number of government and non-government companies in India during 1990-91 was 25899 which multiplied to 55850 in 1995-96. However, the quantum of growth started to decline since 1996-97 and it continued till 1998-99. It was also observed that the growth rate (in terms of number of companies at work) during 1990-91 was 13% increased to 15.6% during 1994-95. The rate, however, started to come down since 1996-97 and prolonged till 1998-99 when it was 5.67 % (Chapter-V, Table-5.5). The initiatives taken by the merchant bankers to promote corporate entities during those periods were very much encouraging. Comparing the corporate growth during 1990-96, in a span of 6 years, the total number of public

as well as rights issues had also increased from 350 to 1719 and the total amount involved in the issue also showed a major rise from Rs. 395501.01 lacs to Rs. 1834187.49 lacs during 1995-96 (Chapter-VII, Table-7.1).

Chart-6.1

Participation of merchant bankers as lead managers

Based on Table-6.3

It is, however, found that the participation of merchant bankers into public and rights issues as lead managers has been in a declining mood since 1996-97 (Chart-6.1). During 1999 and later in 2000, for instance, there were only 40 and 21 merchant bankers participated in public issues and rights issues respectively as compared to 234 and 85 during 1996-97 (Table-6.3). Moreover, the total amount involved in capital issues of corporate securities had also reduced sharply from Rs. 1437262.84 lacs in 1996-97 to Rs. 923338 lacs in 1999-2000 (Table-7.1, Chapter -VII). Some of the most important reasons for recession in regards to participation of merchant banker in the Indian capital market were (a) the stricter restrictions imposed by SEBI on merchant banking activities, (b) formal amendment to the SEBI regulations on merchant banking activities since 9th December, 1997 (as discussed in details in

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Chapter- IV, Section 4.8.1), (c) a depressive mood in the global economic environment, (d) political instability of the government, (e) influx of unscrupulous and fly-by-night companies which were very active in availing the loopholes of the merchant banking regulations, (f) tremendous depression in the Indian stock market as some scams came out open to lose of investors' faith (Chapter- VI, Section 6.4) and (g) mixed trends in almost every indicator of corporate performance (Chapter- V, Section 5.6).

6.11 Role of merchant bankers as underwriters

One of the most important functions of new issue market is to facilitate the 'transfer of resources' from savers to users. The other functions can be divided, from the operational standpoint, into a triple-service function: (a) origination, (b) underwriting and (c) distribution\(^{18}\). Origination refers to the work of investigation and analysis and processing of new proposals. The idea of underwriting is originated on account of uncertainties prevailing in the capital market as a result of which the success of the issue becomes unpredictable. The sale of securities to the ultimate investors is referred to as distribution which can be performed by brokers and dealers in securities who maintain regular and direct contact with the ultimate investors. This task is ultimately done under the proper guidance of lead merchant bankers performing issue management function.

The ability of the new issue market to cope with the growing requirements of the expanding corporate sector depends on the triple-service function. The merchant bankers used to take up the cudgels for the triple-service function through capital issue management activities.

6.11.1 Basic idea behind underwriting

An underwriter refers to an organisation that underwrites shares or bonds. In the context of public issue of corporate securities, underwriting

agreement represents an insurance against possibility of inadequate subscription of share or debentures (i.e. under subscription). This underwriting agreement is entered into between the company and certain other parties called underwriters. Generally the agreement is undertaken before the shares, or debentures are offered to the public for subscription. SEBI (underwriters) Rule, 1993 defines “underwriting as an agreement with or without conditions to subscribe to the securities of a body corporate when the existing shareholders of such body corporate or the public do not subscribe to the securities offered to them in consideration of a commission”. In substance, it is a contract of guarantee whereby a person called underwriter agrees himself to take up for unsubscribed shares or debentures or he procures public to apply for them if the whole or an agreed portion of the shares or debentures are not applied for. The underwriters in India may broadly be classified into (i) institutional underwriter and (ii) non institutional underwriter.

6.11.2 Need for underwriting of public issues

Part-I of schedule-II to the Companies Act, 1956 stipulates that if a company fails to receive 90% of the issued amount from public subscription plus accepted development amount from underwriters within 120 days from date of opening of the issue, the company shall refund the amount of subscription received from the public. In this connection, section 69(1) of the Companies Act, 1956 pronounces that if the amount stated in the prospectus as the minimum amount has not been subscribed and the sum payable on application for such amount has not been received by the company, any allotment shall not be made of any share capital of a company offered to the public for subscription. Therefore, it is very clear that a company is required to make an agreement or a contract against under-subscription so as to raise its minimum subscription and also to make the entire issue activity successful. Even if, the company is sure that all the shares or debentures offered to the public will be taken up by the public, offered shares or debentures would be underwritten by the underwriters as SEBI
has restricted that underwriting is mandatory to the extent of net offer to the public. The following individuals can serve as an underwriter to an issue:

a) public financial institutions,

b) brokers or members of recognised stock exchanges registered with SEBI,

c) investment institutions including mutual funds and

d) SEBI registered merchant bankers.

Merchant bankers managing the public issues as lead managers have to take decision upon the pattern and the issue amount to be underwritten in consultation with the issuing company. The merchant banker as lead manager is also required to accept a minimum underwriting obligation of 5% of the total underwriting commitment or Rs.25 lacs whichever is less and the underwriting commitment, as aforesaid, shall not exceed 5 times of his net worth at any point of time\(^\text{19}\). Apart from that, the lead manager (Category-I merchant banker) appoints the underwriters in managing the entire public issues. So, merchant bankers as lead managers may appoint other merchant bankers as underwriters. Although authorised merchant bankers of all the three categories (i.e. Category-I, II and III merchant bankers) were initially permitted by SEBI to underwrite the public issues, only the performance of Category-I merchant bankers has been taken into consideration for this study because Category-II and III merchant bankers have been abolished after formal amendment to the SEBI regulations since 9\(^{th}\) December, 1997. In fact, it is intended to enquire the role of Category-I merchant bankers on capital issue management activities as lead managers and also as underwriters for the present study. Since underwriting activity is linked with the management of public issues, the pattern of underwriting

\(^{19}\) Underwriting: "In respect of every issue under his management, the lead manager shall accept a minimum underwriting obligation of 5% of the total underwriting commitment or Rs. 25 lacs whichever is less. The outstanding underwriting commitment of a merchant banker shall not exceed 5 times his networth at any point of time". [Vide SEBI (Merchant Bankers) Rules, 1992,, Chapter-IV, p.83]
emerging in the process of capital issue has significance in the context of the present study.

6.11.3 Underwriting commission

Section 76(1) of the Companies Act, 1956, provides that underwriting commission can be paid by a company to any person in consideration of (a) his subscribing or agreeing to subscribe, whether absolutely or conditionally, for any shares in, or debentures of, the company, or (b) his procuring or agreeing to procure subscriptions, whether absolute or conditional, for any shares in, or debentures of, the company, subject to the fulfilment of the following conditions:

(i) the payment of the commission is authorised by the articles;
(ii) the names and address of the underwriters and the number of shares or debentures underwritten by each of them should be disclosed in the prospectus;
(iii) the amount of commission should not exceed, in case of shares, 5% of the price at which the shares have been issued or rate authorised by the articles which ever is less and in the case of debentures it should not exceed 2.5% of the price at which the debentures are issued;
(iv) the rate of commission should be disclosed in the prospectus or in the statement in lieu of prospectus and should be filled with the registrar along with a copy of the underwriting contract before the payment of the commission;
(v) a copy of the contract for the payment of the commission should be delivered to the registrar along with prospectus or the statement in lieu of prospectus for registration.\(^{20}\)

The Central Government has permitted the following rates (Table-6.4) for payment of underwriting commission to the underwriters of public issues.

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Table-6.4
Rates showing underwriting commission

<table>
<thead>
<tr>
<th>Nature of the issue</th>
<th>On amounts devolving on underwriters</th>
<th>On amounts subscribed by the public</th>
</tr>
</thead>
<tbody>
<tr>
<td>(I) Equity Shares</td>
<td>2.5%</td>
<td>2.5%</td>
</tr>
<tr>
<td>(II) Preference Shares / Convertible and non-convertible debentures:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) For amount upto Rs. 5 lakhs</td>
<td>2.5%</td>
<td>1.5%</td>
</tr>
<tr>
<td>(ii) For amount in excess of Rs. 5 lakhs</td>
<td>2%</td>
<td>1%</td>
</tr>
</tbody>
</table>

Source: Machiraju,H,R 21

6.11.4 Function of merchant bankers as underwriters: A Survey

For the purpose of the study, data relating to year wise function of the top 25 Category-I merchant bankers as underwriters (considered as representative of the whole for our study) of public issues in terms of number of issues as well as amount of issues during 1990-2000 has been considered (Table-6.5 and Table-6.6). The top 25 merchant bankers operating in India are selected for the study. This is because out of 286 merchant bankers these 25 merchant bankers handled almost 33.35% of the total number of public issues and rest 261 institutions managed the other 66.65% during the period 1990-2000. Moreover, another top 25 merchant bankers (selected separately) handled about 61.73% of the total amount of public issues and the remaining merchant bankers administered the rest 38.27% during the same period. As such, the study is restricted to act of those 25 merchant bankers (under separate assignment) as representative of the whole community in India.

Table-6.5 portrays the underwriting details of top 25 merchant bankers (selected exclusively on the basis of number of issues) comprising of commercial banks, financial institutions, foreign banks, private and public companies during 1990-2000. It is revealed that in terms of number of issues, Prudential Capital Markets Ltd. with 962 issues during this entire period is ranked first and Bank of Borada (BOB) with 897 issues comes second out of the total 286 merchant bankers who have participated in underwriting services during 1990-2000. During 1997-2000, out of 25 merchant bankers about 15 merchant bankers fail to perform like the previous years, however, during the same period the SBI Capital market Ltd, ICICI Securities & Finance Co. Ltd, ENAM Financial Consultants Pvt. Ltd., Industrial Development Bank of India, BOB Capital Markets Ltd. and Canara Bank have been able to maintain the same spirit (Table-6.5) throughout these years.

It is also observed that Prudential Capital Markets Ltd. has participated in maximum of 962 public issues during 1999-2000. The institution, however, neither during 1990-93 nor during 1997-2000 has any active participation. BOB Capital Markets Ltd. also provides the same picture of intermittent performance during the period under study. Another remarkable observation is that since 1997-98 most of the merchant bankers have lost their interest to participate in the underwriting of public issues because of the sluggish performance of the primary market. (Table-6.5). In other words, there are lesser participations from the financial institutions in this specialised segment of financial services. The reason behind such lesser interest was also due to recession of primary capital market as capital mobilisation by the corporate entities came down drastically during this period.
### Table 6.5

**Underwriting Details: 1990-2000**

**Top 25 Merchant Bankers on the Basis of Number of Issues Managed**

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Prudential Capital Markets Ltd.</td>
<td>-</td>
<td>-</td>
<td>269</td>
<td>499</td>
<td>177</td>
<td>17</td>
<td>-</td>
<td>-</td>
<td>-</td>
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161
Thus, it can be mentioned that the activity of some of the leading merchant bankers is not so consistent and encouraging during the later part of the decade, though during one or two specific years they have done exclusively well. SBI Capital Market Ltd. as a leading merchant banker who is ranked 7th of the 25 best performed merchant bankers, fails to reach the peak during all these years but the entity has achieved the rare distinction of participating in underwriting of public issues in each and every year of 1990-2000. ENAM Financial Consultants Pvt. Ltd., Canara Bank, ICICI Securities & Finance Co. Ltd. and Industrial Development Bank of India have also participated in the same way during 1990-2000 (Table-6.5).

It is also found (Table-6.6) that out of another 25 merchant bankers (selected exclusively on the basis of amount of issues handled) the year wise activity of some merchant bankers like Industrial Development Bank of India (IDBI), ICICI Securities & Finance Co. Ltd., SBI Capital market Ltd., Kotak Mahindra Capital Co., JM Morgan Stanley Ltd., DSP Merrill Lynch Ltd., ENAM Financial Consultants Pvt. Ltd., BOB Capital Markets Ltd. and Canara Bank are much more consistent than the others during 1990-2000 although the later group holds the key. It is also evidenced that merchant bankers like Hongkong Bank, Standard Chartered Bank, IND Bank Merchant Banking Services Ltd., ANZ Grindlays Bank Ltd., and Prudential Capital Markets Ltd. did not participate in underwriting business since 1997-98 (Table-6.6). In regard to activity of merchant bankers in this specified category, IDBI has played a major role during the period under review. Though IDBI has secured 20th position in terms of number of public issues (Table-6.5) but it has occupied the 1st position in terms of amount of issues handled during 1990-2000 (Table-6.6).
### TABLE 6.6
UNDERWRITING DETAILS: 1990-2000

TOP 25 MERCHANT BANKERS ON THE BASIS OF AMOUNT OF ISSUES MANAGED

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<td>19870.73</td>
<td>23495.01</td>
<td>5272.97</td>
<td>3730.50</td>
<td>975.00</td>
<td>25.00</td>
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<td>626.00</td>
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It is also observed (Table-6.6) that ICICI Securities & Finance Co. Ltd. with an amount of public issue of Rs. 164637.78 lacs has occupied the second position, the SBI Capital market Ltd. with Rs. 94231.61 lacs is in the third position, followed by Kotak Mahindra Capital Co., JM Morgan Stanley Ltd., DSP Merrill Lynch Ltd. and others. Though the overall position of IDBI in terms of issue management is satisfactory but its position has suffered a severe set back since 1997-98. Likewise some other merchant bankers, though they are very active in the early part of 1990s, lose their heart in this service during the later part. This phenomenon is widely felt throughout the decade and the reasons of which are already discussed in this chapter earlier.

6.11.5 Overall function of merchant bankers as underwriters: A study

Table-6.8 presents the overall function of the top 25 merchant bankers (selected for our study) as underwriters during 1990-2000.

<table>
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<th>Year</th>
<th>Total number of public issues underwritten</th>
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<tr>
<td>1991-92</td>
<td>1023</td>
<td>66374.44</td>
</tr>
<tr>
<td>1992-93</td>
<td>2769</td>
<td>227766.88</td>
</tr>
<tr>
<td>1993-94</td>
<td>3427</td>
<td>319870.74</td>
</tr>
<tr>
<td>1994-95</td>
<td>4726</td>
<td>260102.01</td>
</tr>
<tr>
<td>1995-96</td>
<td>1322</td>
<td>64751.23</td>
</tr>
<tr>
<td>1996-97</td>
<td>125</td>
<td>27924.10</td>
</tr>
<tr>
<td>1997-98</td>
<td>20</td>
<td>10303.88</td>
</tr>
<tr>
<td>1998-99</td>
<td>11</td>
<td>5842.81</td>
</tr>
<tr>
<td>1999-2000</td>
<td>40</td>
<td>181579.14</td>
</tr>
</tbody>
</table>

Based on Table-6.5 and 6.6

It is found from the above table that during 1990-91, the total number of public Issues underwritten by merchant bankers was 570 which subsequently rose to 4726 during 1994-95. However, there was a total reversal trend during the following years and the numbers of issues underwritten reached to a mere 11 in 1998-99. From 1999-2000 onwards a slight encouraging picture is viewed both in numbers of public issues as well as the total amount involved. The total amount of public
issues underwritten during the same period was Rs. 48369.24 lacs, which later increased to Rs. 319570.74 lacs in 1993-94 (Table-6.7). Therefore, it is perceived that merchant banking industry, which remained almost sluggish and stagnant in earlier years, witnessed an astonishing spurt in their activities after a series of policies on economic reforms undertaken by the government.

Chart-6.2 and 6.3 also present at a glance the position of merchant bankers as underwriters in terms of number of public issues handled and amount involved in the public issues respectively for the period under study.

**Chart-6.2**

*Position of top 25 merchant bankers as underwriters (number of public issues) during 1990-2000*

![](chart.png)

Based on Table-6.7

It is experienced from the above two charts that the role of merchant bankers in respect to number of public issues managed by them has been in a declining mood since 1995-96 (Chart-6.2). Moreover, in respect to the amount involved in such issues since 1994-95 (Chart-6.3) there is more or less the same picture. However, during 1999-2000 in comparison to 1995-96 there is a different observation.
Based on Table 6.7

Where during 1999-2000 the number of issues administered is a mere 40, the amount associated with is Rs. 181579.14 lacs, which is much in contrast during 1995-96 when the number involved is a huge 1322 including an amount of Rs. 64751.23 lacs (Table 6.7). Thus, it is perceived that some companies are showing favour in accumulating more finance from the public through primary market operation.

6.12 Relation among economic growth, growth of corporate sectors and function of merchant bankers

In this section an attempt has been made to relate the function of these selected merchant bankers with the related economic growth in GDP along with the development of corporate sectors. As we have already discussed that there is a positive influence of economic growth on corporate performance. As such capital mobilisation is required only when the corporate sectors make some sincere attempt towards achieving better corporate performance. Merchant bankers perform a vital role, through their expertise, in capital mobilisation of the corporate entities that ultimately enhances the growth of corporate sectors, which in turn promotes the economic growth of a country. Thus, merchant
bankers may influence the economic growth, on one hand, and vis-a-vis is encouraged by the economic growth of a country.

Different charts portray at a glance the trend of economic growth [Chapter-V, Chart-5.4], growth of corporate sectors [Chapter-V, Chart-5.5], and also the overall position of merchant bankers on the basis of participation as lead managers [Chapter-VI, Chart-6.1], and as underwriters [Chapter-VI, Chart-6.2 and 6.3] so as to derive any relation among these factors.

The pattern in the Chart-5.4, Chapter-V reveals that there is an overall improvement in GDP growth promoting gross domestic saving and gross domestic capital formation during the phase-I of reform period (1992-93 to 1996-97). On the contrary, a declining trend in GDP growth, gross domestic saving and gross domestic capital formation are seen during the second phase of reform period (1997-98 to 2001-02). In fact, favourable trend during the phase-I of reform period is due to some of the important structural changes enabled by financial sector reforms, which include introduction of free pricing of financial assets in almost all segments, relaxation of quantitative restrictions, removal of barriers to entry, new methods of flotation of securities, increase in the number of instruments, transparency and disclosure practices. The slowing down of the structural reforms along with declining on rate of saving in the domestic front and cyclical influences transmitted through global business cycles have weakened the investment demand during the second phase of reforms. The reasons for the two different trends in two different phases of reform have already been discussed elaborately in Chapter-V. The Chart-5.5, of the same chapter reflects the growth of corporate sectors along with sales and related profitability during the ten-year period. It is found that the period 1993-94 to 1995-96 shows a similar pattern of growth and a reversal trend in the subsequent years. When considering the participation of merchant bankers into public and rights issues as lead managers there is a rising mood during 1990-96, whereas a declining mood has been found since 1996-97. However,
there seems to be a little improvement from 1999-2000 onwards (Chapter-VI, Chart-6.1). This particular trend is more or less similar to the economic growth and growth in corporate sectors during first and second phase of economic reforms in India as reflected in Chapter-V, Chart-5.4 and Chart-5.5.

A similar pattern is also witnessed while considering the services of merchant bankers as underwriters in terms of number of issues and amount involved in those issues [Chapter-VI, Chart-6.2 and 6.3]. While a rising trend gives a positive outlook during the initial years up to 1994-95, the trend reverses since 1995-96 onwards in both the situations. However, the most significant trend is observed during 1998-99. While the number involved is not so encouraging, but the amount of issues is worth mentioning. The sudden spurt during the period is observed in Chart-6.3.

Based on these charts it can be realised that there is a significant relationship among economic growth, the growth of corporate sectors as well as the role of these financial entities in the form of merchant bankers. The period 1992-93 to 1994-95 has a strong relevance in the overall economic development in India and the impact of which is tremendously felt in all the sectors of the economy. Thus, the same behavioural pattern can be identified in the different charts considered for the study.

6.13 Conclusion

In reviewing the function of merchant bankers as lead manager and its role as underwriter in pre-issue management of corporate securities during 1990-2000 it may be concluded that these institutions have made a significant contribution to the corporate scenario. Ever since, the SEBI has proved their presence to regulate the Indian capital market, the merchant bankers are given enough space to utilise the opportunity. And it is observed that some of these entities have risen to the occasion and have made the best possible utilisation where the others have failed
to capitalise. Moreover, these entities have also experienced the other side of the coin as there is a mixed trend in the economy as well. Thus, it is evidenced that merchant bankers have played an important role in preparing prospectus, monitoring underwriting of public issues and also other activities relating to pre-issue management of corporate securities. In the next chapter, we will make an endeavour to study the role of other 25 merchant bankers (selected exclusively on different parameters considered for evaluating their performance) on the post-issue management and also to find whether they are good enough to prove their worth.