CHAPTER VII

SUMMARY OF FINDINGS AND SUGGESTIONS

INTRODUCTION

In this chapter the findings of the study are summarised and pertinent suggestions are made to improve the working of the merchant banker under study.

The cost of capital issues consists mainly of underwriting commission, brokerage and other expenses. It includes both mandatory and non-mandatory costs.

The correlation coefficients between commission and other expenses, commission and total expenses, other expenses and total expenses are nearly 1. They are 0.943, 0.977 and 0.992 in the case of New companies and 0.978, 0.993 and 0.996 in the case of existing companies. There is very high correlation in the case of both new and existing companies.

It is found that during each of the years under study "other costs" accounted for a large share in the total costs. During the period under study i.e. from 1989-90 to 1994-95, the ratio worked out to be 8.73% for new companies
and 8.43% for the existing companies. The larger cost in respect of new companies could be due to higher expenses on advertisements and brokerage/underwriting commission associated with new ventures.

**Relationship between expenses and amount offered**

The average cost of issue (for both new and existing companies) as a percentage of the amount offered to public varied between 6.37 percent (1989-90) and 9.93 percent (1991-92). For the six years as a whole, the cost averaged to 8.55 percent. The following hypotheses have been formulated and tested in the study.

- There is no significant relation between commission and other expenses.
- There is no significant relation between commission and total expenses.
- There is no significant relation between other expenses and total expenses.

There is high correlation between the variables in the above hypotheses and hence the hypotheses have been rejected.

From the linear Regression it was found that when commission is Re 1, the other expenses will be Rs.1.697 in the case of New companies. Similarly in the case of existing companies, when the commission is Re.1, the other expenses will be Rs.1.669.
Distribution of Equity Issues by Amount Offered for Public Subscription and Cost of Issue

The relation between different percentages of cost of issue and the different size of issue has been studied with the help of chi-square test and it was found that there is no significant association between the two at 5% level.

Amount Raised through Equity Issue by Select Merchant Banks

To study the performance of merchant bankers with respect to amount raised the following hypothesis has been formulated and tested in the study.

There is no significant difference among the merchant bankers with respect to amount raised.

The efficiency of the merchant bankers had been studied by assigning rank under Duncan's Multiple Range Test (DMRT).

It has been found that SBI capital markets Limited is in the first rank by raising Rs.392.008 crores over the study period of 1989-90 to 1994-95.

Purpose for which issues are made

It has been found that New Project accounted for the single largest share in the number of issues during each of the years under study. Its share varies
between 30.00 percent and 47.83 percent. In terms of value the share of New projects ranges between 27.00 percent and 54.64 percent after some variation in the intermittent years. This is due to the various measures of liberalisation announced by the government of India to set up new ventures.

**Progress of Underwriting Business**

It has been found that the quantum of underwriting function of select merchant bankers under study exhibited an Increasing trend during the period of study except in 1994.

The minimum proportion of increase was 29.89% where as the maximum stood at 342.75% in 1993 which constituted a range of 312.86%

**Underwriting of Public issues by Different categories of Underwriters**

It has been found that the amount underwritten as a percentage of amount offered to the public increased from 65.82 percent in 1989-90 to 94.97 percent in 1993-94. This is due to the following reasons.

- Buoyant conditions prevailed in the capital market.
- The population of minimum 90% subscription norms in respect of public/rights in May 1990.
Security-wise analysis is made in respect of equity issue, non-convertible debentures and convertible debentures. In order to study the significance of the difference among the underwriters with regard to amount underwritten the following hypotheses have been formulated and tested in the study.

- There is no significant difference among the underwriters with regard to the percentage of amount underwritten value in the equity shares.
- There is no significant difference among the underwriters with regard to the percentage of underwritten value in the amount of issues of Non-convertible debentures.
- There is no significant difference among the underwriters with regard to percentage of underwritten value in the issue of convertible debentures.

It is found that all the above hypotheses have been rejected, i.e. there are significant difference among the underwriters with regard to underwritten percentage on equity shares, Non-convertible debentures and convertible debentures.

In order to ascertain which underwriter underwrites a major portion of the issue, they are ranked by the Least Significant Differential Test (LSD) and it is found that:

- Financial Institutions ranked first in the equity issue.
• With regard to Non-convertible debenture issue banks ranked first.
• In the case of convertible debentures issue brokers ranked first

**Project Appraisal by Select Banks**

It is found that the issues handled by BOI finance and projections given in their issues are miserable failures. There is a consistent negative deviation in all the four parameters. i.e. sales, gross profit, net profit and earnings per share. Some of the good merchant banks who could bring more reliable issues to the market include Bank of Baroda, SBI Capital Markets Ltd and Ind Bank. Bank of Baroda appears to be the most reliable merchant banker. The amount of appraised issues has been higher than that of non-appraised issues.

It is ascertained that either the merchant bankers do not have the requisite skill or they do not have the necessary commitment to give accurate and useful forecast in the prospectus.

**Merchant Banking Income Earned**

The total merchant banking Income earned by select merchant bankers under study for 1989-90 to 1994-95 shows increasing trend. Statistical tool, the curve of best fit has been employed wherever data relating to income for minimum 5 year period is available. This is available with regard to SBI
CAPS, Canara Bank, Indian Overseas Bank, Bank of Baroda and IND Bank Merchant Banking Services Ltd

It is found that the original and Trend values for different merchant bankers showed marginal variation. The projected income for the period 1995-96 has also been calculated for the following merchant bankers understudy.

Table 7.1

<table>
<thead>
<tr>
<th>S.No</th>
<th>Name of the merchant banker</th>
<th>Amount Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>SBI CAPS</td>
<td>589.64</td>
</tr>
<tr>
<td>2</td>
<td>IND Bank</td>
<td>340.91</td>
</tr>
<tr>
<td>3</td>
<td>Canara Bank</td>
<td>150.20</td>
</tr>
<tr>
<td>4</td>
<td>IOB</td>
<td>72.46</td>
</tr>
<tr>
<td>5</td>
<td>Bank of Baroda</td>
<td>514.02</td>
</tr>
</tbody>
</table>

Issue Management Fees and Underwriting Commission earned

In order to study which merchant banker is consistent with regard to Income earned by way of Issue Management fees and underwriting Commission earned, coefficient of variation for each merchant banker under study is calculated during the study period of 1989-90 to 1994-95.
SUGGESTIONS TO IMPROVE MERCHANT BANKING

The merchant banking industry in India has been akin to mushrooms sprouting almost everywhere and in a very short span of time, the number has swelled from 312 in April 1992 to 816 in April 1996. But more than the number, what is important is their competence, quality of service and responsibility towards the investing public. It is here that merchant bankers are found lacking. With 800 plus merchant bankers today and with net worth being the only criterion for being one. One finds top merchant banks and the run of the mill ones, all vying for the same mandates. Almost every industrial house, big or small, has a financial company today. And merchant banking seems to be the first activity that they would love to do.

A very large number of merchant bankers make it difficult for SEBI to monitor them. It need some tough criteria for people to qualify as merchant bankers, just net worth is not enough irrespective of whether it is Re.1 crore or Rs.5 crores. Financial muscle should not determine a company's capability to take up this line of activity, considering the direct bearing it has on the average investor.

Regarding disclosure norms, an Independent agency to ensure that the disclosures made in the offer documents are true, fair and adequate; secondly, disclosures must conform to the letter and spirit of the statutory requirements. The independent agency can be an independent professional, who is well
versed with the legal, procedural, financial and accounting requirements of a public issue. In addition, he should be bound by a strict code of conduct and in case of default, the punishment should be a deterrent, like suspension/cancellation of membership depending on the gravity of the offence.

Primary market plays an important role in raising resources. Many fly-by-night operators entered the market to raise resources and then disappeared without completing the project. The tendency to raise capital even before the plant and machinery have been purchased is peculiar to Indian Scenario. The global scene is different as companies can raise resources only after they have commenced the production. It is, therefore, essential that the regulatory body has some regulations for primary market.

The minimum requirement for listing shares on stock exchange has been raised to Rs.5 crore. This requirement makes it difficult for small companies to raise resources through public offering. The positive effect of this will be that only sound companies can raise money and investors will be protected from dubious promoters. Thus over all market scenario will improve.

Manufacturing companies which do not have a track record of paying dividend for three years out of the preceding five years can access the public issue market, provided their projects have been appraised by a financial institution or a scheduled commercial bank and if such appraising entity is
participating in the project finance either by way of subscribing to the equity or by providing loans.

The ability to market the issue will determine the survival of merchant bankers. To market the papers whether bearish or bullish market the banker needs to have faith and thrust of the investors. This has to emerge from the brand equity of the merchant banker. They have to develop their own corporate image based on their superior or consistent service values they offer their investors, merchant bankers, should come back to their investors, with the post-issue performances and build equity around the performance of the instruments lead managed or arranged by them.

Today, every issue needs rigorous marketing efforts to push it through the market successfully. And this is the reason why the concept of issue pre-writing is fast catching on with merchant bankers. Under Issue pre-writing, the lead manager sells the entire issue to leading finance companies, brokers and persons with a high net worth. Pre-writing ensures one time subscription to the issue.

The pre-writers bring in their subscription amount one day prior to the opening up of the issue or on the first day of the issue and receive their front-end commission.
In a pre-written issue the amount spent on advertisement and printing is substantially lower and is confined to the extent of statutory requirements. Therefore, over subscription is limited, thereby giving the investors a better change of allotment. Apart from the reduction in expenses, the company can get rid of the anxiety as the issue will fare.

In order to reduce the burden on SEBI officials as well as placing more responsibility on the merchant bankers, SEBI has decided to stop vetting of rights issues altogether. This responsibility now rests with the lead managers.

As many companies coming out with public issues are not known to the investors and the pricing is not done in the right manner, SEBI has now decided to intensify its scanning of the public issue documents. A committee comprising chiefs of senior executive directors of the five divisions of SEBI has been formed to clear all public issues which are more than Rs.100 crores. Formerly all the issues were cleared by the primary markets division. Clearances to public issues would be accorded by SEBI depending on the size of the issue. Issues less than Rs.20 crores would be cleared by the division chiefs, those between Rs.20 crores and Rs.50 crores by the executive directors and those between Rs.50 crores and Rs.100 crores by the senior executive director.

What the merchant banking profession needs is infusion of more quality competition. Merchant banking is no longer an advisory service. Increasingly
investors would expect merchant bankers to put their foot where the mouth is. Most of the merchant banking firms are poorly capitalised. Market sophistication is also expected to increase as is risk of investment. Indian capital markets are poised, unless things go terribly wrong, to raise huge amounts for productive capital formation by way of equity and debt. How to bring the best out of them should be their own concern as well as that of the system.

**ACTIONS TO BE TAKEN BY SEBI AND GOVERNMENT OF INDIA**

It is desirable to bifurcate the job of drafting an equity offer document and certifying the truth, correctness and fairness of information from the merchant banker.

The maximum number of issues that can be handled by each merchant banker per annum should be fixed.

Mere Net worth is not enough for people to qualify as merchant bankers. there should be upgradation of the other criteria to qualify as merchant banker.

Corporates should not be allowed to fix premium freely. There should be a separate body to fix the premium price.
Small investors should be protected by guaranteeing minimum assured return.

SEBI's present staff strength should be increased. Adequate number of staff should be appointed in SEBI.

Merchant bankers should be made accountable in case of listing of shares by companies. Even after the listing of shares they must be made accountable.

Submission of due diligence certificate by the Merchant Bankers should not be of a routine job. Special effort must be made to verify the document, including those relating to litigation like commercial disputes, patent disputes, disputes with filing of the draft prospectus. In case of negligence they should be punished.

Generally SEBI relies heavily on the certification made by the lead manager, while vetting the offer document.

The number of merchant bankers are not in proportion to the number of issues.

A very large number of the two crore odd investors in the country were small investors and they need to be protected. SEBI should take strong steps to
bring in more transparency in the India in capital market to protect the small investors so that investors are not taken for a ride.

Professionally Qualified, Component and experienced manpower must be employed in SEBI to assess and verify the correctness, fairness and adequacy of disclosure in the offer document. At present it is lacking.

Generally underwriters are seeking shelter behind technical points in case of devolvement of issues. It is very difficult for the promoters to force development on them. Strict norms to be introduced to solve the problem.

The SEBI is more of an administrative body devoid of any original powers, acting under the direction of the government. Where as the Securities and Exchange Commission (SEC) in USA is an independent agency created under statute. Neither the US congress nor the executive branch directs or controls its operation. In India, SEBI should also be given autonomy and wide ranging powers to discharge its duties and to give the investor a better deal.

In case the securities of the issue are once listed and in subsequent years the trading is suspended or listing is with drawn for reasons like listing fees not paid, listing not renewed, etc. the merchant banker should pursue their issue companies to keep alive the listing or else ask the companies to refund the money to the investors.
Merchant bankers should be included for liability under section 62 and 63 of the companies Act, 1956, for mis-statements in the prospectus as applicable to the directors of the company.

Regarding underwriting, 90 percent subscription rule may be continued but make it stronger and have the listing corporations refund the subscriptions, in case of under subscription, with a penalty. The amount of penalty in each case being proportional to the extent of the short fall from 90 percent.

The companies whose scrips are listed must be insisted to obtain credit rating from the concerned agencies.

CONCLUSION

All the above suggestions or a few of them, implementation of which will improve the services rendered by merchant bankers.