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UNDERWRITING AT CROSSROADS: PRIME

The concept of underwriting, which is a safety net for the promoters on one hand and a major source of income for merchant bankers and brokers on the other, is now at crossroads.

For one, SEBI's guidelines issued in October 1994 which allowed the companies to tap the capital market without underwriting, led to fewer issues going for underwriting. For another, the declining market conditions have made the underwriters do the disappearing act.

In 1993-94, 98 per cent of the issues had gone for underwriting. Since the guidelines were issued mid-year, the impact in 1994-95 was not phenomenal and this figure fell marginally to 81 per cent. However, the decline was significant in 1995-96 with only 31 per cent of the issues going for underwriting and in the first four months of the current financial year, the percentage has bottomed out to only 12. (Table I)

In terms of underwritten amount as percentage of total issue amount, the fall has been even more significant with many mega and good issues opting out. While 1992-93 was a great year with 88 per cent of the total public amount being underwritten, it declined to 68 per cent each in 1993-94 and 1994-95, then nosedived to 28 per cent in 1995-96 and is now down to 9 per cent in the first four months of the current financial year. (Table II).

The underwriting concept is truly facing a dilemma today. While excellent issues do not go for underwriting to save on costs, the underwriting safety net is not available to almost all other issues with the spectre of devolvement looming large.

In the CCI days, almost all issues got oversubscribed and, therefore, devolvement was almost unheard of. The introduction of free pricing guidelines by SEBI in June 1992 led to an increasing flood of new issues, many of poor quality, and undersubscriptions became a fact of life, specially during poor market conditions.

The first major jolt came in April 1993 when the mega issue of Chambal Fertiliser failed. In April 1994 again, scores of public issues devolved. As if April always brings bad news, the devolvement season started again in April 1995, this time with a bang. The mega issues of Bhushan Steel and Malvika Steel bombed leaving huge devolvments in the laps of the underwriters. As if that was not enough, the mega issues of Niwas Spinning Mills, Pal- Peugeot and Pittie Cement also devolved later in the year. As a result, a massive devolvement of Rs.730 crore took place in 1995-96 which amounted to nearly 24 per cent of the total underwritten amount.

In the first quarter of the current financial year (1996-97), bad news has already started coming in the form of devolvement of the issues of Elque Polyester, Parasrampurua Synthetics, Pasupati Fabrics and BSM Knitfab, aggregating Rs.136 crore or 50 per cent of the total underwritten amount.

Despite devolvments, the business of underwriting had remained attractive. Underwriting not only earned easy commission but also opened the door to marketing of issues which then helped earn brokerage and incentives as application forms for most issues are made available only to the underwriters.

In terms of business income opportunity, SEBI's decision in October 1994 making underwriting optional gave a big setback to the merchant bankers and brokers. It became clear that most corporates with a sound track record would bypass the underwriters and so would many others whenever the market conditions were right.

Little wonder, the size of the cake became increasingly smaller. 1993-94 and 1994-95 were bonanza years with the underwriting cake size being Rs.8469 crore and Rs.9086 crore respectively, meaning thereby an underwriting commission income of over Rs.200 crore per year. The underwritten amount, however, fell to only Rs.3060 crore in 1995-96 and now to a meagre Rs.314 crore in the first four months of the current financial year.

While financial institutions and banks dominated the underwriting scene until 1992-93, the emergence of private merchant bankers in 1993-94 changed the rules of the game. In 1995-96, for example, 67 per cent of the total underwriting was cornered by the private merchant bankers and brokers, up from 22 per cent in 1989-90. (Table IV).

The underwriting field expanded to many players. From a handful of 576 underwriters in 1989-90, the number rose to a phenomenal 2128 in 1994-95 of whom 1712 were brokers and 333 were private merchant bankers. With fewer issues being underwritten coupled with the scare of devolvement, the number of broker-underwriters fell down to 1207 in 1995-96. (Table III)

In the present scenario, the underwriting business has become so risky that promoters are finding it difficult to obtain the services of financially strong underwriters. This is an ironical situation as it is in depressed market conditions, that the promoters really need underwriting services.

When some support does come by, several underwriters seek undated discharge letters from the company absolving themselves from devolvments. In many other cases, the underwriters have looked at all possible means to make it difficult for the promoters to force devolvement commitments on them. However, SEBI has been taking a tough stand on enforcing devolvments.

The promoters are caught in another bind. Should they somehow manage to get their issues underwritten in order to attract the confidence of the investors or does an underwritten issue, infact, indicates weakness. On the other hand, many corporates have started feeling that underwriting is a wasteful expense as in good times the underwriters do not really help in procuring subscriptions with issues rolling on their own and when the markets are bad, they are the first to disappear.

In this complex scenario, most companies have either deferred their issues or cut down the premium or even reduced the issue size. In many issues now, underwriting commitments either given have been withdrawn.

A matter of heartburn for the underwriters has been that good mega issues do not go for underwriting. However, a recent cheering news is that the forthcoming TISCO issue is offering underwriting and no wonder the queues are already building up.

The endpoint is that devolvments do sometimes turn out to be blessings in disguise. Getting large chunks of shares, which through the public issue route, are not possible, the underwriters have made a killing when share prices of some of these companies yielded excellent returns like in the case of Chambal Fertilizer.

TABLE I

**NUMBER OF PUBLIC ISSUES UNDERWRITTEN
(1989-90 TO 1995-96)**

	NO. OF ISSUES	NO. OF ISSUES UNDERWRITTEN	PER CENT
1989-90	187	138	74
1990-91	141	116	82
1991-92	196	185	94
1992-93	528	518	98
1993-94	770	754	98
1994-95	1343	1094	81
1995-96	1428	440	31

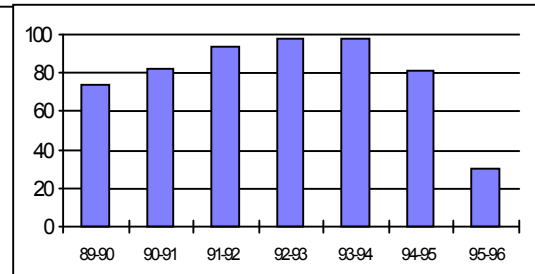


TABLE II

**PUBLIC ISSUE AMOUNT UNDERWRITTEN
(1989-90 TO 1995-96)**

(Rs.crore)

	NO. OF ISSUES	NO. OF ISSUES UNDERWRITTEN	PER CENT
1989-90	2793	490	18
1990-91	1704	957	56
1991-92	1711	1383	81
1992-93	6061	5361	88
1993-94	12544	8470	68
1994-95	13312	9086	68
1995-96	10982	3060	28

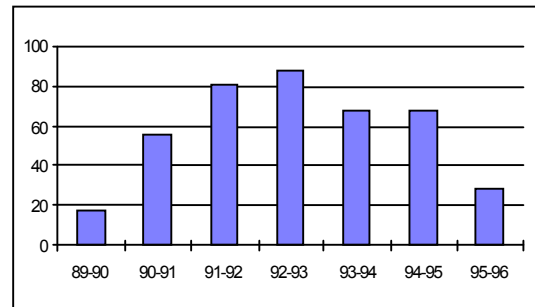


TABLE III

NUMBER OF UNDERWRITERS

	Inst.	Banks	Pvt. Merchant Bankers	Brokers	Total
1989-90	10	49	-	517	576
1990-91	13	50	14	573	650
1991-92	12	55	30	851	948
1992-93	20	56	58	1296	1430
1993-94	15	57	186	1478	1736
1994-95	20	63	333	1712	2128
1995-96	28	59	411	1207	1705

TABLE IV

PER CENT SHARE OF UNDERWRITERS OF UNDERWRITTEN AMOUNT

	Inst.	Banks	Pvt. Merchant Bankers	Brokers
1989-90	31	47	-	22
1990-91	42	38	-	20
1991-92	18	44	8	30
1992-93	28	35	11	26
1993-94	23	20	29	28
1994-95	17	18	35	30
1995-96	19	14	40	27