Challenges for Indian Investment Banking

Indrajit Gupta
Managing Director & CEO
SBI Capital Markets Ltd.

Investment Banking - Recent Developments

The fast pace of integration of the Indian economy with the rest of the world and its dynamic status call for a number of challenges for the new age investment bankers. Investment banks have to keep pace with the continuously changing environment and cater to the needs of their clients with international standa-rds. Added to this, accelerating changes in the capital market space for equities, fixed-income securities, derivatives, fund raising through debt/syndication and international offerings are altering the dynamics and strategies of investment banks. Investment banks today are faced with evolving competition and stringent regulatory, fiscal, and legal requirements engendering tougher operating environments. Last decade has witnessed a tremendous boom in the investment banking activities in India with more and more global players and new domestic players setting shops here. While investment banking today has matured as an industry in India and also reflects the increasing influence of global markets on India, it has also thrown up several challenges. The figures given below reveals the spurt in activities in the year 2004-2005, to quote a few examples.

Capital Markets: Total funds mobilised through public and rights offering of debt and equity during the year was Rs.29122.05 crores from 60 issues as compared to Rs.21988 crores from 56 issues in FY04. The public issue of debt and equity witnessed a lot of activity during the current year, raising a total sum of Rs.25506.34 crores as compared to Rs.20990 crores in the previous year. The number of public offerings have remained almost the same from 35 in FY04 to 34 in FY05. The market for public issue of equity was vibrant, with 29 offerings in FY05 mobilising Rs.21392.93 crores as compared to Rs.17752 crores from 29 offerings in FY04. The amount mobilised through rights offering increased sharply from Rs.998 crores in FY04 to Rs.3615.71 crores in FY05.

M&A Activities: M&As have now become an important driver in the evolution of the Indian multinational companies, who not too long ago shied away from global competition. New benchmarks are getting set and action in M&As is just beginning to hot up from the Indian perspective. The mergers and acquisitions activity in the country more than doubled during 2004, showing that the India Inc is finally consolidating for better economies of scale. The total size of mergers and acquisitions (M&A) during 2004 was to the tune of $ 12.3 billion (Rs 54,120 crore) as compared to $5.11 billion (Rs 22,484 crore) for 2003.[1]

International Offerings: Another noticeable aspect in 2004 was the overseas fund raising spree by Indian companies. India Inc raised $ 3.9 billion abroad as compared to only $450 million raised abroad in the previous year. With the appetite of fund managers for Indian companies progressively on the rise, the private sectors is likely to witness greater action both domestically and for cross border M&As.

Private Equity: Private Equity deals accounted for nearly 13 per cent by value in India in 2004.[2] Even as valuations soared and the Indian stock market reached record highs, private equity investors invested Rs. 76.83 bn (US$ 1.7 bn) in Indian companies, the highest amount in the last three years. As the number of Private equity firms considering India opportunities increase, investment banks need to tap this huge resource for channeling much needed funds in to the emerging sectors in India.

Derivative Markets: Derivatives are an innovation that has redefined the financial services industry and it has assumed a very significant place in the capital markets. The derivatives market in India has grown exponentially, especially at NSE. It is worth mentioning here that NSE has around 99.5% of the market share of exchange traded financial derivatives market in India. Stock futures and Index futures are two of the most popular contracts traded on NSE, having a market share of 59% and 29% (by turnover) respectively of the total derivatives market segment.

FIIs: Positive tidings about the Indian economy combined with a fast-growing market have made India an attractive destination for foreign institutional investors (FIIs). In 2004, FII investments crossed $9 billion, the highest in the history of Indian capital markets. A Smith Barney (a Citigroup division) study says the estimated market value of FII investment in the top 200 companies (including ADRs and GDRs) at current market prices is a whopping $43bn. This is 18 per cent of the market capitalisation of the BSE 200.

So the challenges confronting investment bankers are multiplying by the day. As margins get whittled down, many in the industry are fighting to survive by hiking business volumes, acquiring a global reach and reducing costs. Investment banks need to gear up to address some of the critical areas to continue to offer a differentiated service to its clients.

One Stop Service Provider

Similar to the development in the retail-banking field, investment banking companies need to adapt to the growing requirement of providing all of the products and services that their customers need and want. To be able to meet these new requirements, investment banks need to be able to rapidly create new financial products, targeted marketing campaigns to sell those products as well as cross-sell existing products to their customers. The market today necessitates shorter innovation cycles for rolling out newer and customised products tailored to meet the risk and investment profile of its clients.

Size is definitely relevant for investment banks to edge out its competitors and offer the entire range of services to its clients. The challenge for the existing investment banks is to be able to create new opportunities through a combination of various services and reaching out to newer profile of clients. Investment banks need to be able to nurture and grow marketing and product development efforts to remain relevant to its clients.

An Intensely Competitive Industry

India has found a new visibility in the global arena and private corporations and state owned companies alike are taking the opportunity to tap the capital market for financing their growth. The list of companies wanting to tap the capital market is increasing and the investor appetite for such issues is also gathering depth. In such a scenario the role of investment banks is more relevant in the capital market.

This has been reflected in the emergence of new players with the global boundaries shrinking. The Indian market has seen the participation of accounting firms as well as local outfits of global investment banks compete tooth and nail for mandates. This is only going to increase with many mid size advisory firms also joining the fray.

In this period of financial euphoria, retail investors need to be cautious of subscribing to new issues. Hence, investment banks need to make sure their due diligence and valuation processes are up to the mark. Even after maintaining strict standards during the valuation, special effort has to be spent in marketing to fetch the best price for its clients. Hence, the investment banker has to the balancing act of adhering to the best standards in due diligence, providing correct valuation to the retail investors and fetch the best prices for its clients. There are no short cuts in this area as the trust and confidence of the investors are important for the healthy growth of capital markets and investment banking as well.

Customer Service as the Key Differentiation

Relationship management has been the cornerstone of investment banking and in the times ahead will continue to remain a critical aspect. Investment banks today have to manage the client's expectations and advise them on the appropriate structured products and the timing of their usage to suit their needs. The investment banker, is hence, not just an underwriter or a selling agent, but has to take up an added role of an advisor, who guides the client through the entire process of transaction. Rather than just executing a deal, he has to look at the long term and enforce strong relationships with his clients.

The growing geographic presence, to be close to the investor has necessitated the emergence of a Front Office and Back Office relationship. Investment banks need to hone this link to seamlessly offer the best services to its clients around the world and strengthen the potential to capitalise on business opportunities.

With the general outlook for India as a whole improving, the interest of Foreign Institutional Investors has increased and is set to grow in the future. Investment banks need to work with FIIs having a long-term focus to facilitate the investments needed for the economic growth in India. This would require them to strengthen their placement capabilities on the platform of robust research capabilities to offer better services for its clients.

In this era of intense competition, the quality of service being offered, both in terms of customization to the client requirement as well as the ease of access to the service for the client can be the difference between the winners and the 'also-ran'.

Maintaining the Trust Factor

Successful investment banks must provide trusted, strategic advice to their clients. For trust and confidence to be maintained, every deal, transaction, and service must be efficient and compliant with market and government regulations.

Those investment banks that also run investment management businesses and stock broking businesses have to be careful to maintain strict "firewalls" with their corporate finance arms to ensure that price sensitive information does not reach these parts of the business before it is announced to the market as a whole. In practice, this requires investment banking managements to require keen compliance to ethical and regulatory codes of conduct to avoid conflicts of interest, a source of constant challenge to the industry.

Compliance with Regulations

The regulatory environment is on the move to keep pace with the changes in the investment scenario globally and now demands prompt, accurate and greater disclosures. The Regulators in India have already begun to take steps to follow the already prevalent global practice of imposing civil as well as monetary penalties on erring companies as well as their advisors. With the increase in cross border transactions, more tougher laws are anticipated to inculcate the financial discipline. This will only help in boosting the confidence of Indian investors and also the global players in the Indian financial system. This is where Indian investment banks have to step in with impeccable integrity and standards. With companies focusing on their operations, they should be able to rely on their investment bankers to take them through the entire transactions and take care of all the legal requirements.

Money laundering is becoming a significant threat to the integrity of the Indian financial system. It is imperative that the investment banks exercise due diligence in all its client assessment and contribute the financial intelligence to strengthening the entire financial system. In the emerging scenario, investment banks need to be aware of the reputational risks associated in such events and accordingly improve their systems in anticipation of such sweeping regulatory changes.

Apart from the stated compliance requirements, investment banks can differentiate themselves by offering a more transparent and risk compliant procedures to provide comfort to its clients and set new benchmarks.

Integration with Global Financial Markets

Indian investment banks need to increase their exposure outside India to help clients bag the best opportunity available. Two-way fungibility between domestic shares converted from ADRs and GDRs, special concessions to domestic companies listed abroad and concessions to encourage foreign investments in India have seen an upswing in overseas offerings and increased participation by foreign investors in India. India also makes an attractive investment option because of its acknowledged high growth potential. To cash in on this emerging trend, investment bankers have to be well integrated with the global financial world. Major areas of focus will be investment in intellectual capital, placement and marketing capabilities, size and scope of services and relationship management.

Corporate Governance and International Standards

Besides using their strengths and strategic initiatives for creating shareholder value, banks have to be conscious of their responsibilities towards corporate governance. Standards overall have improved, aided undoubtedly by significant regulatory changes over the last few years. Securities Exchange Board of India (sebi) initiatives have set the industry in the right direction, but the final destination is still some distance away.

Introducing internationally followed best practices and observing universally acceptable standards and codes are necessary for strengthening the domestic financial architecture. This includes best practices in the area of corporate governance along with full transparency in disclosures. In today's globalized world, focusing on the observance of standards will help smooth integration with world financial markets.

Nurturing Human Assets

Like any other knowledge driven industries, investment banking is driven by human capital and it is a continuous endeavour of all investment banks to constantly enrich their gene pool of talent. With India being increasingly important to global players and the emergence of attractive career options, investment banks would need to continue to position themselves as a rewarding career opportunity to prospective employees.

Attracting and retaining the best talent and providing the right training and development to stay relevant is going to be crucial for investment banks. Work environment and effective performance management systems to identify and reward performers is increasingly becoming relevant for investment banks to keep attrition at bay.

More and more Indian companies have started to fix values to their employees and use various methods to value human capital. In this context, the following words of Sri N.R.Narayana Murthy assumes greater importance and relevance.

"Our assets walk out of the door each evening. We have to make sure that they come back next day morning"

Use of Technology to Drive Cost Competitiveness

Technology has traditionally been the backbone of investment banking. But the cutting-edge IT, is no longer an option, it's a necessity. And, for the next few years, it's crucial. As average commissions fall, as transaction volumes rise, and as new regulations emerge, firms must improve efficiency in new ways. Creative products, innovative offerings, fail-safe execution, always-on support, and adaptable and scalable technology are essential to avoid being gobbled up by the competition. Systematic, automated record-keeping and increased financial visibility and control both help companies comply with requirements and improve operations.

As markets move towards T+1 settlement systems, cash and liquidity management will play an important role. Technology underpins the straight through processing initiative and will be the route to automation efficiency and a reduced cost per transaction for investment banks.

Reporting is one area in which a brokerage can stand out. With the complexity of trading and the array of technology systems in place, delivering even basic information is a significant challenge. While the data does exist somewhere, the need to access and integrate that data, then deliver it to reporting applications in near-real time, is an incredibly complex and difficult challenge. This is where innovative and technology based solutions can make a vast difference.

Developing knowledge management systems to effectively capture the knowledge with in the organization, retain and leverage it to its advantage in better servicing its clients would be beneficial.

As Agents of Change

The capital market is one of the most vibrant sectors in the financial system, marking an important contribution to economic development. For a country of India's size, the retail participation of investors in equity market seems disproportionately low. An increasing trend of retail investors also throws up another challenge to the investment banks to reach out to the investors and offer them an efficient platform for participating in the equity markets.

In addition to acting as agents of the clients and being responsible for the transactions they handle, investment banks do have a broader role with the responsibility for development of the markets as a whole. There is a need to sensitize market regulators from time to time on important issues to bring about suitable policy changes and capital market reforms. It is the synergy between these operations that contribute to the key role investment banks play in capital markets and their consequent role in generating economic growth.

The increase in the volumes traded in the derivatives markets is another indication of the need to continuously relevant to new ideas and investment strategies to customers. Phenomenal growth in derivatives in India in recent times has seen daily trading in interest-rate derivatives match that in government securities. Nevertheless, the market is still embryonic, both in terms of depth and sophistication. Any disruption in the market could have far-reaching ramifications. It is therefore important for policy makers to ensure that legal, accounting, valuation and risk reporting policies are continuously monitored and improved to ensure market stability.

Conclusion

In such a fast changing environment, investment bankers have a very important role, a challenging one too, for they have to play the balancing act between achieving optimum benefit to the client, maintaining their credibility taking care of the investor's interests and be relevant to its stakeholders. The ability of the investment banks to consistently understand and map its client present and future needs and meet them is one of the biggest challenges. Unless an investment bank has charted its own strategy, it may very well find itself a part of someone else's.

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1 Source: The Indian Express Online Media Ltd, 05/01/2005 quoting a survey by Bloomberg
2 Source: KPMG News release December 2004