An analysis of Role of underwriters in a Company

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Abstract: Underwriters possess expert knowledge of the dynamics of the industries in which they work. To evaluate or control hazards included in a payment or face financial problems, they access services. They either embrace or reject the risk on the basis of their interpretation, regardless with what works for the good of the company they serve, one of the most familiar and visible element of the IPO process is the underwriter. The underwriter can be referred as the organization that is actually responsible for selling, organizing and pricing the issue. They are one of the most vital player in the financial market and hence there is need to regulate them and keep a watch on their functioning. In this paper we are going to understand the concept of what underwriters are and the SEBI guidelines to regulate the functioning of them. Along with its limitations and benefits of underwriters to the company and their role in IPO's and financial market.

Keywords: Underwriters, SEBI, Company, Financial Market, Economy.

INTRODUCTION

The term 'underwriting' is a word used that those who are related to the business somehow or otherwise. Let this word understand us. It's a lane from which businesses enter the public. The inquiry emerges about the need to remain in the public domain. Each business requires the financial benefit for the payment of current debts, capital spending, company research and development, etc. This technique for raising capital was adopted by the company. Some major specialist financial institutions, such as banks, insurance companies or investment houses, offer underwriting services, guarantee reimbursement in the event of injury or financial loss and acknowledge the financial risk of liability resulting from that guarantee. About this subject, this description states.[1]

Underwriting is the principle of negotiations between the buyer and the bond issuer. This is focused on the newly issued bonds bought by investor bankers and sold to the public for the minimum sum of shares and debentures produced. This buying and sale process is a risk-taking mechanism in which capital is collected on behalf of the government and collaboration by investor banks for investors who issue both equity and debt securities. This applies to the selling of issues issued by the Public Limited Company. The one that is guaranteed is named 'Underwriter.' Via the difference in the amount of buying the problems and the sale of those problems, these underwriters gain profit. Basically, this principle occurs under the Companies Act when individuals are unable to subscribe to the issued share, and then these underwriters take responsibility for it as stated in the subscription agreement and receive the payment for it. He has to subscribe before he decides to do so, until the cap. There are several classifications of those performing contracts on various bases. But the large one has three forms, one is full subscription, the next is partial subscription, and finally firm subscription based on share and debenture issues.[2]

The principle of issuing shares is based on certain goals. Any public corporation needs to collect funds, and per the Companies Act, if they are not able to do so because the money has to be given to the public, but if there is a delay of more than 78 days then if the interest on it will be also payable. These funds can be collected by the sale to the public of the stock, which is possible by the process of subscribing. It ensures that the security is sold and promotes the cash during the company's financial crisis. A new business can be recognised because of this. For public corporations, this approach is beneficial. On the closing date, the businesses obtain the check. This is taken into account as a form of securities marketing. It is a kind of guarantee of the public's new protection

[1] https://economictimes.indiatimes.com/definition/underwriting,, Visited 30th December 2019
[2] https://shodhganga.inflibnet.ac.in/bitstream/10603/28023/1/chapter1.pdf, Visited 30th December 2019

and therefore raises the company's market value. It frees the company from the problems of marketing concerns and any business volatility and market uncertainty.[3]

DISCUSSION

Security and exchange board of India guidelines

According to SEBI, the number of underwriters should be determined by the promoter well in advance and prior authorisation must be obtained from SEBI. SEBI's permission would be given only after the net worth of the underwriters and their outstanding obligations have been calculated and, secondly, 25% of each class of shares must be sold to the public and the following form of firm allocation may be followed for the remaining 75%. In addition, the underwriter's obligations are that his responsibility cannot be raised by 20 times the net worth and that he does not derive advantages other than the underwriting commission, which is 5% of shares and 2.5% of debentures. In addition, if the investors do not sell the securities under certain conditions, the unsold securities are assigned to the underwriters in the proportion to which they are decided. This is the satisfaction of providing the company with the minimum subscription required. In addition, this scheme has many advantages as the supporter is the underwriters and the company's trust guarantees that the minimum shares for the company are sold out.

A notification must be obtained from the Securities and Exchange Board of India to serve as an underwriter (SEBI). Under the Securities and Exchanges Board of India (Underwriters) Rules, 1993, SEBI grants the certificate. These regulation deal mainly with concerns such as subscribers' registration, capital adequacy, responsibility and obligations. Under that agreement, the underwriter is expected to visit into a valid agreement with either the issuer entity and, among other things, the allocation of duties and obligations between the issuer entity and indeed the issuer entity should be specified by that agreement.

Limitations

Practically speaking, every person tries to make as much profit as they can. But in this profession, except for the commission they seek from the underwriting commission pursuant to section 76 of the Companies Act, 1956, the underwriter will not dig.

Another downside is the cost of using this form, which is high. Using this approach involves exchanging the data with the underwriters and they do valuable work for them. Yet revealing classified information contributes to the concern that it will be misused. One of the issues behind this strategy is that it might be possible for them to buy a majority of shares to protect the company's ownership. In addition, in the event of not selling these securities, dealers may be held liable by the underwriters.

In conclusion, the place to sell the securities through to the underwriters is the underwriting process. As investors accept ownership for just that amount of securities that they should sell at their own risk, it is a very reliable process. In its structure, this becomes protection for the organisation. The manager must render the final accounting for each underwriter at the termination of the underwriting. The fees and accounts for the cost incurred really should be remitted. With the expansion of the corporate sector, underwriting has become quite important in recent years.

Benefits to a company

- It relieves the company of the risk and uncertainty of marketing the securities.
- Underwriters have an intimate and specialized knowledge of the capital market. They offer valuable advice to the issuing company in the preparation of the prospectus, time of floatation and the price of securities, etc. They also provide publicity service to the companies which have entered underwriting agreements with them.
- It helps in financing of new enterprises and in the expansion of the existing projects.

[3] Li, Mingsheng, Zheng, Steven and Melancon, Melissa, Underpricing, share retention, and the IPO aftermarket liquidity, International Journal of Managerial Finance, Vol. 1(2) (2005)

- It builds up investors' confidence in the issue of securities.
- The issuing company is assured of the availability of funds. Important projects are not delayed for want of funds.
- It facilitates the geographical dispersal of securities because generally, the underwriters maintain contacts with investors throughout the country.

Role of underwriters

The entity responsible for pricing, distributing, and coordinating the problem is the underwriter, and it may or may not have additional services. With direct public offerings, an underwriter is not required. It is of utmost importance to choose a good subscriber, but it is important to note that many subscribers are equally selective of their clients. Since the credibility of an underwriter depends on good problems, few businesses would be willing to bet their reputation on risky companies. It is important to seek out an existing company with a strong reputation and quality research coverage in your field when choosing an underwriter. The decision also would depend on the form of arrangement that the underwriter is prepared to make with respect to the selling of securities. It should not be hard for successful and existing private companies to find an underwriter willing to make a firm commitment agreement. Under such an arrangement, the underwriter offers to buy all shares in the issue, irrespective of their right to offer them at a profit.

The underwriter assumes no liability for unsold shares under this agreement. Most underwriters are identical in their positions, apart from fees and distribution arrangements. In planning and making all relevant SEC filings, an underwriter will help potential investors make educated decisions about your offering. In checking the information they send, all underwriters are required to practise due diligence, so a certain amount of investigation can be expected from every other prudent underwriter.[4]

In addition to SEC registration filings, a preliminary prospectus will be produced by the underwriter that will become a significant part of the publicity strategy for the issue. After a small red passage mostly in document indicating that the company is not trying to sell shares before SEC approval, the document is often referred to as the straw man. The underwriter and the corporation will begin on a bus tour to gauge and draw interest from investors once SEC approval is obtained. Although the road show does not require obtaining binding investor commitments, it makes the underwriter evaluate the best positioning and issuance strategies.

The underwriter continues to provide services to all the new public company following the initial public offering. The underwriter can continue to market the stock for months or even years and after offering, to ensure liquidity for investors and to make the shares more attractive. The underwriter is also allowed twenty-five days after the subject to make claims or predictions about the company and its prospects. There is an SEC-mandated quiet period prior to that time, because investors are forced to rely solely on the documents submitted by the underwriter. At the end including its quiet period, most underwriters opt to have favourable treatment.

Services provided by underwriters

Underwriting services are provided by some large specialist financial institutions, such as banks, insurance or investment houses, whereby they guarantee payment in case of damage or financial loss and accept the financial risk for liability arising from such guarantee. An underwriting arrangement may be created in several situations including insurance, issue of securities in primary markets, and in bank lending, besides others. The name derives from the Lloyd's of London insurance market. Financial bankers, who would accept some of the risk on a given venture (historically a sea voyage with associated risks of shipwreck) in exchange for a premium, would literally write their names under the risk information that was written on a Lloyd's slip created for this purpose.

The underwriting practise in the insurance industry relates to the method of accepting or refusing risks. It's really the heart of insurance and is the first step taken to generate payments by an insurance provider. Insurance and underwriting were initially interchangeable. That is, the underwriting referred to the insurance undertaking's service. Underwriting took on a more technical sense as the insurance industry grew. Insurance in the early days is much intimate than it seems today. A contract was implemented between the owner of the property and the

[4] Marisetty, V. B., and Subrahmanyam, M. G. Group affiliation and the performance of IPOs in the Indian stock market, Journal of Financial Markets, Vol. 13, (2010)

second party who's also prepared to insure the property mentioned, such as between client and the service provider. The conditions on which the property would be insured were specified in the contract. The property owner wrote his name at the top of the contract, meaning that, if the property was eventually destroyed, he was the owner of the property and the beneficiary of the contract. At the bottom of the contract, the other party, who insured the contract and was the insurer, signed his name below. He "underwrote" the deal, literally.[5]

The person who determines whether one should protect risks for which applications are already submitted is an underwriter. The role of the underwriter is to assess a risk, estimate the possible liability, calculate the probability of loss, then decide whether to approve the insurance claim.

CONCLUSION

In the early days of marine insurance, the word "underwriter" originated. It was common practise to meet with those wanting to write such insurance in coffeehouses for people seeking insurance for a ship and its cargo. An individual seeking insurance for his or her ship and cargo must bring to the coffeehouse a paper detailing the ship, its contents, crew, and destination. The document would propagate, signing his name at the bottom and showing how much exposure he was willing to assume, for anyone who wanted to make the assumption any of the responsibility. The paper also contained an agreed-upon rate and conditions. Since these individuals signed their names under the risk definition, they became known as underwriters. Signatures on insurance contracts becomes those of company officers as insurers moved from individuals to businesses. In a more limited context, the term underwriter started to be using it; it referred only to the individual who carried out the risk selection process and decided the insurance conditions. The fundamental duties of underwriters today continue to be risk evaluation and evaluation of policy terms.

[5] Hanley, K. W., A. A. Kumar; and P. J. Seguin. Price Stabilization in the Market for New Issues, Journal of Financial Economics, Vol.34, (1993)