Transforming the Valuation Ecosystem

DR. M. S. SAHOO

Dr. M. S. Sahoo, an acclaimed thought leader in the area of securities markets and a distinguished public servant, served as Chairperson of the Insolvency and Bankruptcy Board of India. He has also served as a Member of the Competition Commission of India, Secretary of the Institute of Company Secretaries of India, Whole Time Member of the Securities and Exchange Board of India, Economic Adviser with the National Stock Exchange of India and held senior positions in Government of India as a Member of Indian Economic Service.

As I understand, market usually discovers price of an asset reflecting its worth. However, it is often neither feasible nor desirable for an asset to pass through the market to discover its worth. In such cases, worth of an asset needs to be estimated. The person who estimates the worth is a 'valuer', the process of estimation is 'valuation' and the worth so estimated is 'value'. If value of an asset is what the price ought to be in the given context, the valuation is perfect. Similarly, if price of an asset converges with the valuation, the market is efficient.

Value and price thus compete to reflect true worth of an asset. In a sense, a valuer competes with the market, the most powerful creation of men, to arrive at more authentic worth of an asset. A market economy requires valuations of assets to facilitate a variety of transactions and or to meet legal requirements.

A corporate insolvency proceeding, for example envisages estimation of fair value and liquidation value of the assets of the corporate debtor. These values serve as reference for evaluation of choices, including liquidation, and selection of the choice that decides the fate of the corporate and its stakeholders. A wrong valuation may liquidate a viable company and rescue an unviable one, which may be dangerous to an economy. Further, certain stakeholders in an insolvency proceeding have entitlements in terms of liquidation value. An incorrect valuation may deprive a stakeholder of its legitimate dues and or decision of the Committee of Creditors.

Similarly, a banker determines the amount of loan that can be sanctioned against security or guarantee. It may not have adequate protection, where it sanctions a loan against the security of an asset /guarantee of a guarantor whose worth is overestimated. A company issues shares on preferential basis based on valuations. An erroneous valuation may result in one set of shareholders getting shares either too cheap or too expensive. The Government divests its stake in PSUs based on valuation of the enterprise. An inaccurate valuation may either fail the divestment or rip off the exchequer. The decisions arising from use of inappropriate values, in addition to causing unfair gain or loss to parties, has the potential to distort market and misallocate resources which may impinge upon economic growth. Given such importance of valuation, the valuation profession constitutes a key institution of market economy.

The profession has a long history in India, probably dating back to late 19th century. It acquired remarkable recognition and credibility in the late 20th century in sync with its gradual institutionalisation after independence. Different statutes - banking, securities, tax, company, insolvency - require valuation for a variety of purposes. Each statute focusses on what needs to be valued, who can render valuation services and the manner of such valuation, keeping in view the purpose of such valuation. There are, however, certain transactions which require valuations under multiple statutes. For example, issue of compulsorily convertible preference shares to a non-resident Indian requires valuation under the Companies Act, 2013, the Income-tax Act, 1961 and the Foreign Exchange Management Act, 1999. Though the users often demanded quality, they did not focus on building ecosystem for valuation services. Several self-regulating organisations came up to build the expertise of their members to meet the immediate needs of specific classes of users and to promote members' interests. Different statutes thus formed separate islands to serve the users but did not engender a holistic development of an ecosystem befitting valuation profession.

An estimated fifty thousand individuals practise this profession today. Many of them, however, do not enjoy the same respect of the society as members of other professions like medical science or chartered accountancy. For want of valuation standards (akin to accounting standards for accounting profession), a valuer finds difficult to defend his valuation. The users of valuation services do not always have the assurance of minimum quality valuation services. Nor do they have any effective remedy against misconduct of a valuer. Most often remedy is de-empanelling the mischievous valuer. Further, there is no agency to address market failures in the market either for valuers or valuation services, or to balance the rights of professionals to practise the profession vis-à-vis those of users to receive quality services. This is so because the profession does not have an institutional arrangement that ensures that the practitioner is qualified, authorised, and accountable for his services, as available for other professions in the country.

The traditional arrangement for any profession is a statutory body like the Institute of Chartered Accountants of India and the National Medical Commission, with twin responsibility of development and regulation of the profession. There have been several attempts in the past to provide such an institutional arrangement for valuation profession. Based on recommendations of expert groups, Bills were introduced in Parliament to provide for the profession as part of the company law. The Government even drafted an exclusive legislation (Valuation Professionals Bill, 2008) to provide for a two-tier statutory self-regulation with the *Council of Valuation Professionals* as the principal regulator and *Recognised Institutes* as the frontline regulators. These attempts, however, fizzled out as not all stakeholders could be on the same page. The Companies Act, 2013, for the first time, in section 247, provided that valuations required under the company law shall be conducted by a registered valuer (RV). This provision, however, could not be operationalised for want of an institutional arrangement to register and regulate valuers.

Insolvency proceedings, as mentioned earlier, required valuations. With the operationalisation of the Insolvency and Bankruptcy Code in late 2016, an acute need was felt for an institutional arrangement for valuation. The Government amended section 247 by a *Removal of Difficulties Order* in October 2017 to provide an interim institutional framework comprising the Authority and RegisteredValuers Organisations (RVOs). To operationalise this provision, it notified the Companies (Registered Valuers and Valuation) Rules, 2017 (Rules) and designated the IBBI as the Authority. The Rules, for the first time, provide a unified institutional framework for development and regulation of valuation profession. An individual, who has (a) prescribed qualification and experience; (b) is enrolled as a valuer member with an RVO; (c) completed the specified educational course, and (d) passed the examination of the relevant asset class, conducted by IBBI, is eligible for registration as an RV. Presently, there were 16 RVOs with about 4500 RVs across three asset classes.

The remit of the Rules is, however, limited to valuations required under the Code and the Companies Act, 2013. However, considering the inherent benefits, The Government, regulators, and banks alike are preferring to use the services of RVs. The Department of Investment and Public Asset Management uses the services of RVs to carry out valuations of PSUs for disinvestment. The Department of Defence Production is using RVs for corporatisation of Ordinance Factory Board to seven defence PSUs. The authorities are mandating and contemplating to mandate valuations by RVs for additional purposes. The RBI, in its draft Rules relating to overseas investments, has recently proposed that unlisted foreign equities should be issued or transferred at a price which is within ±5% of the fair value arrived at by an RV.

To complete the process of institutionalisation, a Committee of Experts has recently recommended an exclusive statute to provide for the establishment of the *National Institute of Valuers*(NIV) to protect the interests of users of valuation services and to promote the development of, and to regulate the profession of valuers and market for valuation services, with a view to ensuring that valuers enjoy an enviable reputation of the stakeholders, while being accountable for their services. The ecosystem envisaged by the Expert Committee has four elements, namely, (i) NIV, which would be a statutory body primarily responsible for the development and the regulation of the valuation profession in India; (ii) Valuer Institutes, who would provide educational courses; (iii) Valuer Professional Organisation (VPOs), who would be front-line regulators primarily responsible for development of the valuation profession; and (iv) Valuers, who would render valuation services. The last three would be registered with the NIV. They would compete for excellence among themselves.

The details of the ecosystem are available in the report of the committee at MCA website. Let me briefly touch four important aspects in the ecosystem:

(i) **Asset Classes:** The market needs valuation of every asset. However, it may not be viable to develop ecosystem for valuation of each asset. For learning and professional practice, assets displaying similar characteristics need to be grouped into classes. The framework accordingly suggests, to start with, the courses as well as registration of Valuers in three asset classes, namely, L&B, P&M, and Financial Assets. It enables the NIV to add / subtract an asset class to valuation profession as well as add / subtract an asset to an asset class, with changing needs. This would enable valuation of niche assets like art or pisci culture and new assets that may emerge in future.

(ii) **Talent:** An enduring and enviable profession requires induction of young and bright talent. It is extremely important in view of ageing membership of valuation profession, which is a concern in some jurisdictions. The framework endeavours to attract such talent to join the profession. Students should consider valuation profession as an option, while making a career choice after 10+2 level. The framework envisages talented, professionally qualified individuals with relevant experience, to join the profession, after undergoing a condensed valuation course.

(iii) **Educational courses**: The framework defines broad entry norms for the profession in terms of educational qualifications and enables the NIV to prescribe the details and to modify the same with changing needs. An individual may join the profession on completing any of the courses:

(i) National valuation programme, a four-year integrated full-time professional course, which includes an internship of one year, if he has passed higher secondary examination;

(ii) graduate valuation programme, a two-year full-time professional course on valuation, which includes an internship of one year, if he has a degree or equivalent qualification in any of the identified disciplines relevant for an asset class; or

(iii) Limited valuation programme, a four-hundred-hour professional course, if he does not have relevant qualification, but has been rendering valuation services as a Valuer for at least five years. This would enable the existing practitioners to join the profession even if they do not have specified qualification.

The entry and exit examinations for these courses will be conducted by the NIV to ensure standardisation and quality.

(iv) **Credits:** The educational curses would be designed and delivered in modules. An individual enrolled in the national valuation programme and graduate valuation programme may be required to earn three types of credits being: (i) generic subject credits which is common to every asset class, (ii) specific subject credits for a particular asset class, and (iii) practice credits for a particular asset class. An individual shall be considered to have completed national valuation programme in the asset class L&B, if he has acquired X subject credits common to every asset class, Y subject credits specific to L&B, and Z practice credits specific to L&B. An individual, who has completed national valuation programme in the asset class L&B, shall be considered to have completed national valuation programme in the asset class P&M, if he has acquired Y subject credits specific to P&M, and Z practice credits specific to P&M. The same is true for the graduate valuation programme.

Four Pillars: These four elements need to be complemented by four pillars:

Academic backing: The valuation profession needs a strong academic backing. As a field or discipline of study, it must be backed by a combination of advances in theory and systematic empirical research. Beyond national / graduate valuation programmes, it should offer specialised courses in valuation at the master's level and promote doctoral and post-doctoral studies. One of the conditions of registration as a valuer institute should be that it shall produce certain minimum research every year so that the discipline of valuation is continuously enriched, and Indian valuers have a global presence. The NIV should review the performance of valuer institutes, most probably, every year in terms of success in exit examination, and quantity and quality of research and publications.

Valuation Standards: The valuation of an asset is an estimate of its worth, arrived at after factoring in multiple parameters, externalities, and assumptions. Different valuers may arrive at different estimates of value for the same asset. This may be because of lack of uniform approach to valuation. If every valuer gives a markedly different value for the same asset in the same circumstance, by using a different approach, a customer may be worse off with the valuation and the valuer who has arrived at the right valuation, may find it difficult to defend his position. The market may question the ability of the valuers and the integrity of the valuation process. Accountability and liability of the valuers may be severely restricted. Such a situation is not in the interest of the market where various crucial economic and commercial decisions are taken based on the valuation reports. It is, therefore, necessary to have uniformity in approach to valuation to reduce the scope of deviations between the valuation reports of different valuers. This is ensured through specification of standards, which the valuers must apply while conducting valuations. A Government Committee has recommended the asset class specific Valuation Standards to be adopted by valuers in conduct of valuations.

Technology: I understand, many valuers make extensive use of technology, such as drones and Automated Valuation Models (AVMs), to assist them in valuations. We must facilitate and encourage the use of technology to assist the valuers in conducting valuations. I am sure that the efficacy of AVMs will improve in times to come, and most probably, they would be replaced by newer tools using Artificial Intelligence. Therefore, we must build capacity of valuers on a continuous basis to use technology and their upgrades that assist in valuation. However, we need to be careful on two aspects. First, we should ensure that there is no attempt to replace valuers by technology and technological protocols must not limit the application of mind. Otherwise, the market may stop distinguishing high quality service from low quality service, leading to casualty of professional excellence and that may be the end of the profession. Second, we should ensure that the technology provider is not dominant, or, if it is dominant, it does not abuse its dominance. It must not control price; it should be fair to everyone, charge a fair and reasonable price, and supply the technology on impartial terms to whosoever is willing to pay for it. It must not control the quantity either. Technology must not be used to create closed user groups (CUGs) with a limited number of users. It should not create a two-sided market, with a set of valuers on one side and a set of clients on the other side. This will limit the choice of clients to a set of valuers and vice versa. This contrasts with an all-India competitive market for valuation services where there are thousands of suppliers of valuation services as well as thousands of users of valuation services, where no one has control either over price or quantity. The client and the valuer must meet in an open market - no one should have the ability to channel either demand for or supply of valuation services to a particular source. If a technology provider attempts to control either quantity or price, that is, supply or demand, it will not only invite competition scrutiny but also a regulatory framework. I am drawing your attention to this, as there are instances of technology providers abusing their dominant position at marketplace in some other markets and inviting competition scrutiny.

Reputation: There will be huge scrutiny of the valuation profession, and the proposed institutional framework should be ready for the same. This would require adequate transparency, accountability, and governance norms for the NIV and VPOs. More importantly, the reputation and credibility of the profession rest on the members of the profession. A profession enjoys respectability of the stakeholders if its members are respected by the society. Members of a profession are respected if the profession itself is respected. There is a virtuous circle of respectability and vice versa. A virtuous circle has, however, potential to turn vicious rather quickly, while vicious circle takes a very long time to turn virtuous. If the profession has both good and bad professionals, the reputation of the profession takes a hit. Bad professionals may drive out good professionals from the profession and discourage entry of good professionals into the profession. Reputation of a profession is impacted even when a member of the profession is acting in his personal capacity and not discharging his duties as a professional.

Recently, the Apex Court has held that any action which brings disrepute to a profession is a misconduct whether related to professional work or not. That is why a profession must allow entry of only those individuals who are fit and proper persons. It must require him to remain fit and proper as a condition of continued registration. It must let only those individuals in, who the profession would feel proud of, and prevents entry of those individuals, who may bring disgrace to the profession. It must keep an individual, whose antecedents are doubtful or questionable, away from a profession. This is necessary to maintain and enhance the confidence of users in professionals. Since a profession usually acquires a reputation in its infancy, and once acquired, it is difficult to mend it, it is necessary to guard the reputation of the profession from day one.

To sum up, seeing the progress in last few years, I genuinely believe that there is a sincere attempt by all concerned - valuers, RVOs, IBBI and Government - to transform the valuation ecosystem. The four elements (NIV, Valuer Institutes, VPOs and RVs) and four pillars (academic backing, valuation standards, technology, and reputation) would make the valuation ecosystem robust, put the valuation profession on par with other professions, promote valuation as a discipline of study, boost the growth of market for valuation services, and minimise concerns in valuations which at times wrongly attributed to the profession. The ecosystem would transform the valuation profession into the most valuable profession, which respects values, and, in turn, is respected by the society. It would facilitate estimation of value which price must emulate, and which stakeholders must prefer over price. It is our collective responsibility to see that such an ecosystem is in place at the earliest. We must extend all possible help and support to IBBI, and the Government to provide statutory backing to the ecosystem.