

## MERCHANT BANKING INDIA: RECENT DEVELOPMENT IN MERCHANT BANKING

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### ABSTRACT

A merchant bank is a financial institution providing capital to companies in the form of share ownership instead of loans. A merchant bank also provides advisory on corporate matters to the firms in which they invest. In the United Kingdom, the historical term "merchant bank" refers to a bank. A Merchant Bank can be generally described as a financial services company with a private equity investment arm offering investment banking and ancillary services as well. Because a merchant bank acts not only as an advisor and broker but also as a principal, a merchant bank has a longer term approach than a typical investment bank and is highly concerned with the viability of each investment opportunity and providing the right advice for a strong partnership with each client company.

In banking, a merchant bank is a traditional term for an Investment Bank. It can also be used to describe the private equity activities of banking. This article is about the history of banking as developed by merchants, from the Middle Ages onwards. Merchant banking is an important service provided by a number of financial institutions that helps in the growth of the corporate sector which ultimately reflects into the overall economic development of the country. Merchant banks were expected to perform several functions like issue management, underwriting, portfolio management, loan syndication, consultant, advisor and host of other activities. Merchant banking is a combination of banking and consultancy services.

**Keywords:** Merchant Bank, Financial Institution, Management, Underwriting, Portfolio Management

### Merchant Banking:

The term 'merchant banking' has been used differently in different parts of the world. While in U.K. merchant banking refers to the 'accepting and issuing houses', in U.S.A. it is known as 'investment banking'. The word merchant banking has been so widely used that sometimes it is applied to banks who are not merchants, sometimes to merchants who are not banks and sometimes to those intermediaries who are neither merchants nor banks.



### ROLE OF MERCHANT BANKERS

Fundamentally, merchant banks are financial institutions. They engage in business loans as well as underwriting. They mostly cater to large enterprises and individuals of high net worth. They perform a combination of consultancy and banking services. It was in 1967 that National Grindlays Bank introduced the concept of merchant banks in India. In 1972, the

State Bank of India became the first Indian Commercial Bank to set up a separate Merchant Banking Division. Till date, however, merchant banks in India have been operating mostly as issue houses and not full-fledged merchant banks like in other countries.

### **Regulations governing merchant bankers**

The Securities Board of India, under the SEBI Regulations, exercising its powers under Section 30, SEBI Act, 1992, has made regulations for various components of the capital market. The merchant bankers are regulated by SEBI (Merchant Bankers) Regulations, 1992. H. R. Machiraju has described the objectives of these regulations in the following terms:

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### **SEBI (Merchant Bankers) Regulations, 1992**

This regulation has five chapters pertaining to definitions, compulsory registration with SEBI, renewal of certificate and fee payable to SEBI, capital adequacy requirements, obligations and responsibilities, code of conduct, procedure for inspection by SEBI, of documents, records and books of accounts, procedure in case of default, i.e. the action to be taken against concerned merchant banker (cancellation or suspension of registration by SEBI).

### **Authorization by SEBI**



- The criteria established for obtaining the SEBI authorization are:
- Professional qualifications in law, finance or business management
- Available infrastructure including office space, power, equipment, etc.
- Compliance with capital adequacy norms
- A record including experience, reputation, etc.

### **Classification of merchant bankers**

The Securities Exchange Board of India segregated merchant bankers into the following four categories:

#### **Category-I**

Advisor, issue manager, consultant, portfolio manager and underwriter.

#### **Category-II**

Consultant, advisor, portfolio manager, and underwriter.

#### **Category-III**

Advisor, underwriter, and consultant only.

#### **Category-IV**

Advisor or consultant to issue of capital.

Given the above provisions, the role of lead managers of an issue could be fulfilled only by merchant bankers registered under Category-I alone. From 9 December 1997, however, all other categories were abolished, and merchant bankers can now only be registered under Category-I by SEBI.

### **Capital Adequacy Norms**

The Securities Exchange Board of India (SEBI) has prescribed capital adequacy norms for merchant bankers to register under the various categories.[12] The minimum 'net worth' set by SEBI for Category-I of merchant bankers was initially fixed at the value of Rs. 1 crore and later raised to the value of Rs. 5 crores through an amendment of the regulations in the year 1995.

### **Other guidelines in the SEBI (Merchant Bankers) Regulations, 1992**

SEBI has laid down several other guidelines in that are a must to be complied with.

These are as follows:

- Submission of the half-yearly unaudited result of financial documents to SEBI
- Compulsory Appointment of Compliance Officer.
- SEBI may send in an officer for inspection of records, books, etc.
- SEBI may collect an authorization fee followed by annual or renewal fees.
- There exists a minimum underwriting obligation upon lead managers to the extent of 5% of the size of the issue or of Rs. 25 lakh, whichever is lesser.

### **Code of conduct for merchant bankers**

Since merchant banking is a profession, like all other professionals, merchant bankers must abide by a specific and strict code of conduct. The code of conduct for merchant bankers states that a merchant banker must:

- Protect the interest of the investors to the best of his capabilities.
- Conduct business with a high level of dignity, integrity, and fairness.



## **ROLE OF MERCHANT BANKERS**

### **Raising finance**

Merchant Bankers help their clients in raising finance by way of issue of a debenture, shares, bank loans, etc. They tap both the domestic as well as the international markets. Finance



raised by this method may be used for commencing a new project or business or it may even be used for expansion and modernization of an existing business.

### **Promotional activities**

In India, merchant bankers play the role of promoter of industrial enterprises. They help entrepreneurs in conceiving ideas, identifying projects, preparation of feasibility reports, getting Government approvals as well as incentives, etc. Merchant bankers may, at times, also provide assistance in financial and technical collaborations and i joint ventures.

### **Brokers in stock exchanges**

Merchant bankers buy and sell shares in the stock exchange on behalf of the clients. They additionally conduct researches on equity shares; advise the clients on the share to be purchased, the time of purchase, quantity of such purchase and the time for selling these shares. Mutual funds offer merchant banking services, large brokers, investment banks, and venture capitals.

### **Handling government consent for industrial projects**

A merchant banker completes all formalities for his or her client, about government permission to expand and modernize business (necessary for companies) and commencing new businesses (necessary for business people).

### **Special assistance to entrepreneurs and small companies**

Merchant banker advises entrepreneurs and small companies on availability and existence of business opportunities, concessions, incentives and government policies and helps them to take advantage of this option available to them, to the best of their capabilities.

### **Services to PSU's**

Merchant banker offers numerous services to public sector undertakings and units and their public utilities. They assist in raising capital (long-term), in the marketing of securities, in foreign collaborations as well as in arranging for long-term finances from lending institutions.

### **Revival of sick units**

A merchant bank helps in reviving sick industrial units. They negotiate with various agencies such as banks, long-term lending institutions, and the Board for Industrial and Financial Reconstruction (BIFR). They also plan and execute full revival packages.

### **Portfolio management of sick units**

Merchant bankers offer revival services to companies that issue the securities as well as investors. These bankers advise clients, which are usually institutional investors, on investment decisions. They undertake purchase and sale of securities to provide them with portfolio management services. Some of these bankers are operating mutual funds as well as offshore funds.

### **Corporate restructuring**



These services of merchant bankers include mergers, acquisitions (about existing units), the sale of units and disinvestment. These procedures demand proper negotiations, thorough preparation of numerous documents and completion of lengthy legal formalities. Merchant bankers fulfill all these formalities on behalf of the clients.

### **Money market operations**

A merchant bank deals with as well as underwrites short-term instruments like:

- government bonds
- certificate of deposit issued by banks and financial institutions
- commercial paper issued by large corporate firms
- treasury bills issued by the government (in India by the Reserve Bank of India)

### **EASING AND FINANCE SERVICES**

Merchant banks also assist leasing and financing services. A lease refers to a contract that exists between a lessor and a lessee, by which the lessor permits the use of a specific asset that belongs to him or her (like equipment, land) by the lessee for a specified period. There is a fee charged by the lessor charges which is referred to as the rentals. Several merchant bankers offer leasing and financing facilities to the customers. Some banks also keep venture capital funds to assist entrepreneurs. These banks also help the companies to raise finance through public deposits.

### **Management of dividend and interest**

Merchant banks help the clients in the management of the interest on the debentures or loans, as well as the dividend on the shares. In addition to this, they advise the client with respect to the timings (whether interim or annual) of the dividend as well as the rate of the dividend.

### **Other services**

Along with all the services mentioned above, the merchant bankers also offer certain other specialized services such as advisory services on matters such as mergers, amalgamations, tax related matters, on the matter of recruitment of executives, the cost of audit as well as its management among several others. The scope of functions, activities and the services provided by the merchant bankers are ever increasing and growing with the constant development in the money market

### **Developments in Merchant Banking Establishment:**

1. Setting up of Banks Subsidiaries
2. Re-organization of Private Firms
3. Establishment of SUA
4. Securities and Exchange Board of India (SEBI)
5. Discount and Finance House of India (DFHI)
6. Credit Rating Information Services of India Ltd. (CRISIL)
7. Stock-Holding Corporation of India Ltd. (SHC)

### **1. Setting up of Banks Subsidiaries:**



In order to meet the growing demand for broad-based financial services from the corporate sector more effectively, the merchant banking divisions of the nationalized Banks have started forming independent subsidiaries. These subsidiaries offer more specialized services with professional expertise and skills.

SBI Capital Markets Ltd., was incorporated as the first such subsidiary of SBI on 2nd July, 1986. Then Canara bank Financial Services Ltd. was set up as wholly owned subsidiary of Canara Bank in 1987. PNB Capital Services Ltd. was promoted by PNB during mid-1988. Many more subsidiaries are being set up by other nationalized banks.

## **2. Re-organization of Private Firms:**

Expecting tough competition from growing number of merchant banking subsidiary companies of nationalized banks, private merchant bankers have also started reorganizing their activities e.g., J.M. Financial & Investment Consultancy Ltd., 20th Century Finance Corporation Ltd., LKP Merchant Financing Ltd. etc. are some of the private sector firms of merchant bankers who have taken steps to reorganize their activities.

## **3. Establishment of SUA:**

In order to educate and protect the interest of investors, to provide information about new issues of capital market, to evolve a code of conduct for underwriters and to render legal and other services to members and public, the Stockbroker Underwriters Association (SUA) was established in 1984. SUA works in co-ordination with merchant bankers and takes steps for promoting the activities of capital market.

## **4. Securities and Exchange Board of India (SEBI):**

To develop and regulate securities market, investor protection and to formulate rules and guidelines for regulation of securities market, the Central Government constituted Securities and Exchange Board of India on April 4, 1988.

The Board carries out all functions as may be delegated to the Board/Chairman by Central Government for the development and regulation of securities market. Persons dealing in security market, merchant bankers, underwriters, sub-brokers, portfolio managers, mutual funds etc. have to seek authorization from the Board.

## **5. Discount and Finance House of India (DFHI):**

DFHI was incorporated as a company under the Companies Act, 1956 with an authorised and paid up capital of Rs. 100 crores. Out of this, Rs. 51 crores has been contributed by RBI, Rs. 16 crores by financial institutions and 33 crores by public sector banks.

It would also have lines of credit from public sector banks; refinance facility from the Reserve Bank of India in order to meet the working capital requirements. DFHI aims at providing liquidity in money market as it deals mainly in commercial bills.

## **6. Credit Rating Information Services of India Ltd. (CRISIL):**



CRISIL has been set up in 1987 to provide help to investors, merchant bankers, underwriters, brokers, banks and financial institutions etc. CRISIL rates various types of instruments such as debt, equity and fixed return securities offered to the public. It helps the investors in taking investment decisions.

#### **7. Stock-Holding Corporation of India Ltd. (SHC):**

SHC was set up in 1986 by the All India Financial Institutions to take care of safe custody, delivery of shares and collection of sale proceeds of the securities. The setting up of SHC is bound to affect the capital market in future.

#### **CONCLUSION:**

Based on this paper Merchant banking in India has vast scope to develop because of lot of domestic as well as foreign business booming here and also recent developments helpful to booming of Indian economy. Indian economy provides an amicable environment for these firms to setup flourish and expand here

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