Merchant Banking

What is a 'Merchant Bank'?

As Investopedia defines it, a Merchant Bank is a company that deals mostly in international finance, business loans for companies and underwriting. These banks are experts in international trade, which makes them specialists in dealing with multinational corporations.
However, it does not provide regular banking services to the general public.

- Perform underwriting, loan services, financial advising and fund raising services
- Serve large corporations (operating in more than one country) and high net worth individuals
- These do not provide regular banking services, such as offering checking accounts to the general public. In fact, merchant banks don't take deposits.
- A vast majority of activity involves international transactions

Merchant Banks

* Merchant Banks are financial institutions that provide specialised services in corporate finance, portfolio management, issue management and banking services.

* A merchant bank typically works with companies that may not be large enough to raise funds through an IPO; help corporations issue securities through private placements, which require less regulatory disclosure and are sold to sophisticated investors.

Investment Banks

* Investment Banks are specialised intermediaries which provide services in marketing of securities for companies, and channelize savings into profitable investments for individuals.

* Investment banks, on the other hand, underwrite and sell securities to the general public through IPOs. The bank's clients are large corporations

Merchant Banks

*Merchant banks are in the business of helping corporations to get the required funds. It offers a range of services from corporate financing to loan arranging.

Perform security-related activities

*Governed by Merchant Bankers Rules and Regulations issued by Ministry of Finance and SEBI

Commercial Banks

*Commercial banks take deposits from customers, which may be individuals or corporate, and provide payment transmission services, savings and loan facilities.

Perform deposit and lending activities

*Governed by the Banking Regulation Act, 1949 and RBI directives.

Development Banks and Merchant Banking

Development banks are the specialized financial institutions because they provide not only finances but also help in promotion of new enterprises.

Role of Development Banks

- Promote the development of industry or agriculture.
- Provide medium and long term loans.
- Offering concessional loans for setting up industrial units in backward areas.
- Evaluating investment proposals.
- Identifying possibilities for economies of scale in production.

Evolution of Merchant Banking

- It was in 1813, when merchants came from European countries to trade with India.

- Agency houses were set up by merchant bankers based at London.
  - ✓ Raise deposits at cheaper rate
  - ✓ Made advances at higher rate

- During 19th century, foreign merchant bankers operated in India "East India House".

- Managing Agency House- 600 industrial establishments managed by managing agency system in 1951.

  E.g.: Tata's, Birla's, etc.

- Functions performed by managing agency houses are;-
  - ✓ Investing Funds
  - ✓Assist the enterprise in procuring finance
  - ✓Raising Public Deposits

- In 1948, Industrial Finance Corporation of India (IFCI) was set up to provide long and medium term finance to industrial enterprise.

- In 1955, The Industrial Credit and Investment Corporation of India (ICICI) was set up provide developmental finance to industrial concerns.

Functions of Merchant Banking

- **1. Corporate Counseling**
  - ❖Free of charge service to a corporate units
  - ❖Render advise
  - ❖Help to improve performance and build better image among investors.
  - ❖Counseling is provided in the form of opinions, suggestions.

- Areas of counseling includes-
  - ❖ It guides the corporate units as to area of diversification.
  - ❖ Detailed market analysis.
  - ❖ Help in reviving the old line projects.
  - ➢ It offers help to the sick units in the following ways-

i. Conducts detailed studies.

ii. Make an assessment of the revival prospects.

iii. Providing help in raising loans.

iv. Help in getting approval of financial institutions or banks for schemes of rehabilitation.

v. Monitors rehabilitation schemes

vi. Finds out possibility of takeover of sick units

2.PROJECT COUNSELLING

Project Counselling broadly covers the study of the project and providing advisory services on the project viability and procedural steps to be followed for its implementation.

Project Counselling covers the following aspects-

- Development and or review of an project idea/project profile
- Preparation of project report
- Estimation of cost of project
- Deciding means of financing the project
- Studying the procedural aspects of project implementation
- Provide assistance in obtaining Government consent.

Other Services In The Field Of Project Counselling

- Capital structuring
- Amalgamations , mergers and takeovers
- Profitability study of the project
- Guiding young entrepreneurs as to investment opportunities in India.
- Shaping the pattern of financing,etc.

3.CAPITAL RESTRUCTURING SERVICES

Merchant banks render different Capital Restructuring Services to the corporate units depending upon the circumstances a particular unit is facing.

Capital Restructuring Services may include the following services-

- Examination of the corporate's capital structure to decide the extent of capitalization
- Render advise on mergers, takeovers and amalgamations
- Identify areas of diversification of existing production systems .

CASE	SERVICE RENDERED BY MERCHANT BANK
• Bonus Issue	• Help client in preparing Memorandum for Controller of Capital Issue (CCI) .
▪ Companies governed by FERA	▪ Suggest an alternative capital structure which is in conformity with legal requirements ▪ Also advises company on disinvestment issues to their maximum advantage • Suggest appropriate capital structure helpful in revival • Also advise on means of bringing fresh capital into business.
▪ Sick Units	

4.PORTFOLIO MANAGEMENT

Merchant banks provide services to the investor of advising on the optimum investment mix taking into consideration the following factors-

I. Objectives of investment
II. Tax bracket applicable to the investor
III. Need for maximising return
IV. Capital appreciation,etc.

Portfolio Management Services

A. **To Indian Nationals-**

- Sale and purchase of securities
- investing and purchase of securities
- Investing and managing fixed deposits
- Safe custody of securities in India and overseas , etc.

B. To Non-Resident Indians-

- Advice on selection of investment
- Critical evaluation of investment portfolio
- Hold securities in safe custody
- Providing tax counseling and filing tax returns , etc.

5.Issue Management

Besides being a sponsor of issues , merchant banks now provide the following services to ensure success in marketing of securities-

- Preparation of prospectus
- Preparation of a budget
- Preparation of (Controller of Capital Issues)CCI application
- Selection of issue house
- Appointment of registrar, broker and bankers to issue
- Advertising and arranging publicity agency for post and pre-issue.
- Selection of institutional and broker underwriters .
- Compliance of listing requirements of stock exchange etc.

6.Loan/Credit Syndication

Credit Syndication involve following services-

- Estimation of total cost on project
- Preparation of financial plan to meet total cost of project
- Assistance of clients in preparation of loan application
- Making selection of institutions
- Follow up of the term loan application with financial institutions.
- Helping in expediting legal documentation formalities
- Help in estimating working capital requirements
- Arrange bridge finance.

7. Arranging Working Capital Finance

- Earlier working capital finance – not merchant bank activity rather commercial bank's activity.
- Merchant Banks which started this activity : - Canara Bank

  - Grindlays Bank - Central Bank of India
- Finance for working capital is provided usually through issue of debentures.

Canara Bank-advisory services-related to working capital finance.

- Estimation of working capital requirements
- Assistance in preparing the application for credit facilities for submission to the bankers and RBI.

- Assistance in negotiations for sanction of appropriate credit facilities.

- Helps in expediting documentation and other formalities for disbursements.

- Advises the client for issue of debentures for meeting the increased long term working capital requirements of the client company.

8.Lease Finance

- Leasing is the arrangement that provides a firm with the use and control over assets without buying and owning the same.

- Parties - Lessor (owner of the asset)
  - Lessee (user of the asset)
- Assist their clients by providing finance for the acquisition of the asset taken on lease.

9. Venture Capital

- Maintain - Venture Capital fund to assist the entrepreneurs who lack capital to be risked.

- Capital funds may be provided for: -
  unproven ideas
  -start-up funds

10. Specialised Services

- In addition to the basic activities involving marketing of securities , merchant banks also provide corporate advisory services on issues like merges and amalgamation ,takeover etc.

Specialised services provided by:

- Grind lays Bank:
- -advise & assistance in negotiating terms and conditions of mergers &acquisitions
- advise on valuation of amount of purchase consideration
- Expediting legal documentation process & obtaining official approval
- Carry out management audit to identify areas of strength & weakness of a corporate unit.

Canara Bank: Services related to amalgamation & merger

- Determining the strength and weakness
- Deciding suitable form of organisation
- Helps in preparing legal documentation
- Helps in obtaining approval from various authorities
- Co-ordinating the activities of professionals involved in merger & amalgamation

11. Public Deposits

- Merchant bankers also help companies in raising finance by way of public deposit.

Role of Merchant Banker

- Promoter – identification of projects ,obtaining govt. approval , raising funds etc
- Coporate advisor – financial planning , tax planning etc
- Managerial economist – organisational goals , locational factor , size & operational scale etc

- Financial & investment expert – working capital requirement , financial requirement etc

- Rehabilitator – at the time of merger , acquisition etc

Recent developments in merchant banking

1.Setting up of bank subsidiaries
2.Reorganisation of private firms
3.Establishment of sua
4.Securities and exchange board of india
5.Discount and finance housr of india
6.CRISIL
7.SHCIL

Merchant banking in india

1. At present merchant banking services in india are provided by commercial banks,ICICI,IFCI etc.
2. Merchant banking can be categorised into four broad sections
3. A.providing long term sources of funds
4. B.project counselling
5. C.Capital structuring
6. D.Portfolio management

ROLE OF MERCHANT BANKERS IN ISSUE MANAGEMENT

The management of public issue of securities is core of merchant banking

i. Pre-issue activities
ii. Post-issue activities
iii. Issue marketing

PRE-ISSUE ACTIVITIES

1. **Documents to be submitted**:
   - MOU
   - Due diligence certificate
   - List of promoters
   - Draft prospectus in computer floppy
   - Ten copies of draft offer

2. **Appointment of Intermediaries**:

   Intermediaries such as advisor, bankers to the issue, registrar, underwriters are appointed in consultation with lead merchant banker.

3. **Underwriting**:

   Lead merchant banker shall undertake minimum of 5% or 25lacs whichever is low.

4. **Offer documents to be made public:**

   Draft offer document shall be made public for a period of 21 days from date of filling the offer document with the Board.

5. **Appointment of compliance officer:**

   Compliance officer have liaison with Board with regard to various laws, rules, regulations and other directions issued by Board.

6. **Mandatory collection centres:**

   Minimum number of collection centres for issue of capital shall be

   - 4 metropolitan cities
   - All centres of stock exchange where registered office of company is situated.

7. **Final offer document:**

   Furnish a new due diligence certificate, final prospectus copy, offer document.

8. **Application forms:**

   Application form must be accompanied by abridged prospectus. Disclaimer clause of SEBI should be printed in bold. Application form for new issue is made

9. **Minimum application amount:**

   It shall not be less than 25% of issue price and total amount payable is not less than Rs.2000

10. **Listing of securities:**

11. **Period of subscription:**

    Subscription shall be kept open for atleast 3 working days and not more than 10 working days.

12. **Oversubscription:**

POST - ISSUE ACTIVITIES

1. **Redressal of investor grievances:**

2. **Co-ordination with intermediaries:**

   Maintaining close co-ordination with registrars to the issue and to depute its officers to various intermediaries.

3. **Stock Invest:**

   Ensure compliance with instructions issued by the RBI.

4. **Underwriters**

a. Issue is closed at earliest date then issue shall b fully subscribed before closure.

b. No definite figure of subscription, the issue should be kept open.

c. In devolvement of underwriters, underwriters shall honour commitment within 60 days.

d. In undersubscribed issues, lead merchant banker furnish information who failed to meet their underwriting de-volvements.

5. **Bankers to an issue**

   Maintain a separate bank (Bankers to an issue) as per provisions of section73(3) of the Companies Act 1956

6. **Post issue advertisements**

   All issues and details are released within 10 days from completion of activities.

7. **Basis of allotment**

   In oversubscription allotments are to be made in the prescribed manner.

8. **Compliance with guidelines on advertisement:**

   The lead merchant banker shall ensure compliance with guidelines on advertisemnet by issuer company.

ISSUE MARKETING

The merchant banker has to undertake the marketing of issues.

The ultimate aim of issue marketing is to persuade the investors to subscribe the issue made by the company.

Merchant banker advises client to go for:

a) fresh issue
b) bonus issue
c) additional issue
d) right issue

MERCHANT BANKING SCENARIO

In 1996-97 the number of merchant bankers went down to 65 from 234.

In 1997-98 structural changes have been brought in merchant banking activities.

Segregation has been brought up in the activities and merchant bankers have been prohibited from carrying fund based activity.

THANK YOU