

UNIT-IV

Merchant Banking

Defining

MERCHANT

Banking

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Introduction

- Merchant Banking is a combination of Banking and consultancy services.
- It provides consultancy, to its clients, for financial, marketing, managerial and legal matters.
- Consultancy means to provide advice, guidance and service for a fee.
- It helps a businessman to start a business.
- It helps to raise (collect) finance.
- It helps to expand and modernise the business.
- It helps in restructuring of a business.
- It helps to revive sick business units.
- It also helps companies to register, buy and sell shares at the stock exchange.
- In short, merchant banking provides a wide range of services for starting until running a business.
- It acts as Financial Engineer for a business.

- According to SEBI, ***“a merchant banker is one who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to the securities as manager, advisor or rendering corporate advisory services in relation to such issue management”.***
- Investment Banking Vs Merchant Banking The term ‘merchant banking’ and ‘investment banking’ are often used interchangeable in the financial literature.
- The term ‘Investment Banking’ has the US origin whereas the term ‘merchant banking’ is in vogue in countries such as the UK and India.

History and Evolution of MB

- The first merchant banking activity in India started in **1969 by the Grindlays Bank** by opening a merchant banking division.
- Initially they were issue managers looking after the issue of shares and raising capital for the company.
- But subsequently they expanded their activities such as working capital management; syndication of project finance, global loans, mergers, capital restructuring, etc., initially the merchant banker in India was in the form of management of public issue and providing financial consultancy for foreign banks.
- In 1973, SBI started the merchant banking and it was followed by ICICI.
- Between 1974 and 1985, the merchant banker has promoted lot of companies.
- However, they were brought under the **control of SEBI in 1992**.
- Merchant banks were brought under the ambit of SEBI regulations and this led to a disciplined growth of the industry.
- New checks and balances have been introduced in the functioning of merchant banks in India.
- Collaborative arrangements with the foreign merchant banks were also common.

INSTITUTIONAL STRUCTURE

In tracing the history of the merchant banking in India, the structure of merchant bankers appeared as follows at one point of time:

1. Merchant banking divisions of **commercial banks**, both Indian and Foreign.
2. Merchant banking divisions of **financial institutions** (e.g. IDBI, IFCI, etc.)
3. Merchant banking companies promoted **by stock broking firms**. (e.g. JM Financial, DSP)
4. Merchant banking services of **NBFCs**.

However, the above structure has undergone a transformation now.

The merchant banking divisions of the commercial banks exist now as independent subsidiary companies of the parent firms.

For example, the ***SBI Capital Markets Ltd is the subsidiary of SBI.***

The merchant banking activities of the NBFCs almost cease to exist.

FUNCTIONS OF MERCHANT BANKER

- A merchant banker is not merely an issue manager.
- The scope of his activities extends beyond issue management.
- He undertakes new responsibilities such as syndication of project financing, global fund raising, designing new financial instruments and deal making in corporate takeovers.
- From dealing in shares for major industrial houses to takeovers, the merchant bankers have come a long way in the spectrum of services that are offered.
- Their operations have considerably widened and have become more specialized. The following are the functions of merchant bankers in India:

FUNCTIONS of MB:

1. **Managing Public Issue of Companies:** Merchant bank advise and manage the public issue of companies. They provide following services:
 - a. Advise on the timing of the public issue.
 - b. Advise on the size and price of the issue.
 - c. Acting as manager to the issue, and helping in accepting applications and allotment of securities.
 - d. Help in appointing **underwriters** and brokers to the issue.
 - e. Listing of shares on the stock exchange, etc.

2. **M**anagement of Interest and Dividend:

- Merchant bankers help their clients in the management of interest on debentures / loans, and dividend on shares.
- They also advise their client about the timing (interim / yearly) and rate of dividend.

3. **P**roject Management:

- Merchant bankers help their clients in the many ways.
- For e.g. advising about location of a project,
- preparing a project report,
- conducting feasibility studies,
- making a plan **for financing** the project,
- finding out **sources of finance**,
- advising about concessions and incentives from the government

4. **Portfolio Management:**

- A merchant bank *manages* the portfolios (investments) of its clients.
- This makes investments *safe, liquid and profitable* for the client.
- It offers *expert guidance* to its clients for taking investment decisions.

5. **Raising Finance for Clients:**

- Merchant Banking helps its clients to raise finance through *issue* of shares, debentures, bank loans, etc.
- It helps its clients to raise finance from the **domestic and international** market.
- This finance is used for starting a new business or project or for modernization or expansion of the business.

6. **Revival of Sick Industrial Units:**

- Merchant banks help to revive (cure) sick industrial units.
- It negotiates with different agencies like banks, term lending institutions, and **BIFR** (Board for Industrial and Financial Reconstruction).
- It also plans and executes the full revival package.

7. **Special Assistance to Small Companies and Entrepreneurs:**

- Merchant banks advise small companies about business opportunities, government policies, incentives and concessions available.
- It also helps them to take advantage of these opportunities, concessions, etc.

8. **S**ervices to Public Sector Units:

- Merchant banks offer many services to public sector units and public utilities.
- They help in raising **long-term capital**, marketing of securities, foreign collaborations and arranging long term finance from term lending institutions.

9. **C**orporate Restructuring:

- It includes mergers or acquisitions of existing business units, sale of existing unit or disinvestment.
- This requires proper negotiations, preparation of documents and completion of legal formalities.
- Merchant bankers offer all these services to their clients.

10. **Handling Government Consent for Industrial Projects:**

- A businessman has to get government permission for starting of the project.
- Similarly, a company requires permission for **expansion** or **modernization** activities. For this, many formalities have to be completed.
- Merchant banks do all this work for their clients.

11. **Advice on Expansion and Modernization:**

- Merchant bankers give advice for expansion and modernization of the business units.
- They give expert advice on mergers and amalgamations, acquisition and takeovers, diversification of business, foreign collaborations and joint-ventures, technology up gradation, etc.

12. **Broker in Stock Exchange:**

- Merchant bankers act as brokers in the stock exchange.
- They buy and sell shares on behalf of their clients. They conduct research on equity shares.
- They also advise their clients about which shares to buy, when to buy, how much to buy and when to sell.
- Large brokers, Mutual Funds, Venture capital companies and Investment Banks offer merchant banking services.

13. **Underwriter/Money Market Operation:**

- Merchant bankers deal with and underwrite short-term money market instruments, such as:
 - a. Government Bonds. b. Certificate of deposit issued by banks and financial institutions. c. Commercial paper issued by large corporate firms. d. Treasury bills issued by the Government (Here in India by RBI).

14. **Leasing Services:**

- Merchant bankers also help in leasing services.
- Lease is a contract between the lessor and lessee, whereby the lessor allows the use of his specific asset such as equipment by the lessee for a certain period.
- The lessor charges a fee called rentals.

Remember functions as this short form:

[MP RS]2 in CHABUL

MMPRRSSCHABUL

Managing Public Issue of Companies

Management of Interest and Dividend:

Project Management

Portfolio Management

Raising Finance for the Clients

Revival of Sick Industrial Units:

Special Assistance to Small Companies and Entrepreneurs:

Services to Public Sector Units:

Corporate Restructuring:

Broker in Stock Exchange:

Underwriter/Money Market Operation:

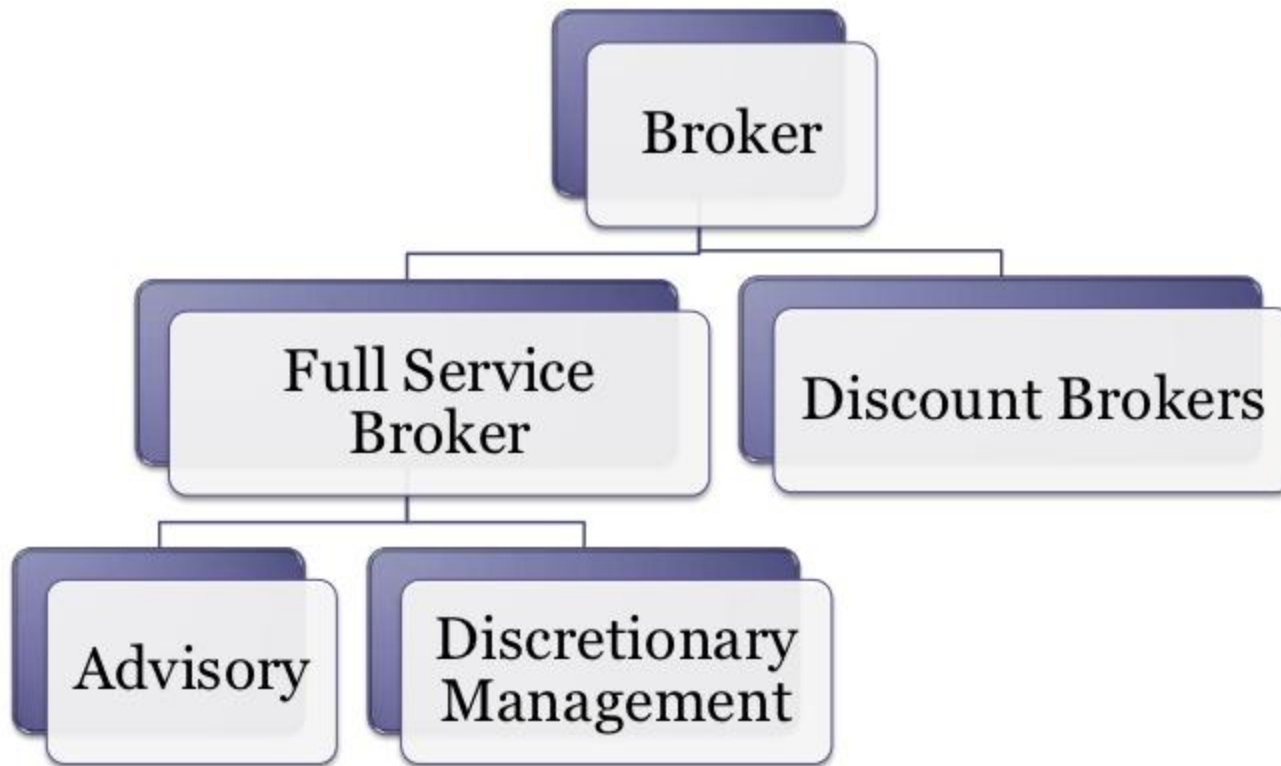
Leasing

Securities Brokerage

Meaning

- A securities brokerage is a firm trading stocks and bonds on behalf of its clients.
- It employs brokers authorized to buy and sell securities based on clients' orders.
- Firms providing financial advice to clients charge more, while those which only execute clients' orders offer a discount service.

Types of brokers



❖ Full Service Broker

- Advisory

- Expensive
- Have to maintain good relationship and contact
- Provide financial consultant and financial advisory services
- Range of products to buy E.g. bonds, MF, ETF, CD, etc.



- Discretionary Management

- Expensive

- Have to maintain good relationship

- Take complete control over the investment

- Takes investment decision on behalf of customers and provide only periodical statement to the customers



❖ Discount Brokers

- Low cost
- Only buying and selling of securities
- No range of services
- No assistance

