

ANALYSIS OF MERCHANT BANKING IN INDIA

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INTRODUCTION

Original Definition: A Merchant Bank is a British term for a bank providing various financial services such as accepting bills arising out of trade, providing advice on acquisitions, mergers, foreign exchange, underwriting new issues, and portfolio management.

The Focus Definition: 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.

Modern Definition: 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 onward. 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.

TRADITIONAL MERCHANT BANKING

Merchant Banking, as the term has evolved in Europe from the 18th century to today, pertained to an individual or a banking house whose primary function was to facilitate the business process between a product and the financial requirements for its development. Merchant banking services span from the earliest negotiations from a transaction to its actual consummation between buyer and seller.

In particular, the merchant banker acted as a capital source whose primary activity was directed towards a commodity trader/cargo owner who was involved in the buying, selling, and shipping of goods. The role of the merchant banker, who had the expertise to understand a particular transaction, was to arrange the necessary capital and ensure that the transaction would ultimately produce "collectable" profits. Often, the merchant banker also became involved in the actual negotiations between a buyer and seller in a transaction.



MODERN MERCHANT BANKING

During the 20th century, however, European merchant banks expanded their services. They became increasingly involved in the actual running of the business for which the transaction was conducted. Today, merchant banks actually own and run businesses for their own account, and that of others.

Since the 18th century, the term merchant banker has, therefore, been considerably broadened to include a composite of modern-day skills. These skills include those inherent in an entrepreneur, a management advisor, a commercial and/or investment banker plus that of a transaction broker. Today a merchant banker is who has the ability to merchandise -- that is, create or expands a need -- and fulfill capital requirements. The modern European merchant bank, in many ways, reflects the early activities and breadth of services of the colonial trading companies.

Most companies that come to a U.S. merchant bank are looking to increase their financial stability or satisfy a particular, immediate capital need.

Professional merchant bankers must have: 1) an understanding of the product, its industry and operational management; 2) an ability to raise capital which might or might not be one's own (originally merchant bankers supplied their own capital and thereby took an equity interest in the transaction); 3) and most importantly, effective skills in concluding a transaction - the actual sale of the product and the collection of profit. Some people might question whether or not there are many individuals or organizations that have the abilities to fulfill all three areas of expertise.

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.

- **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).

- **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

- **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.

Who are merchant bankers?

-Merchant banks are private financial institution.

-Their primary sources of income are PIPE (Private Investment In Public Entities) financings and international trade.

-Their secondary income sources are consulting, Mergers & Acquisitions help and financial market speculation.

-Because they do not invest against collateral, they take far greater risks than traditional banks.

-Because they are private, do not take money from the public and are international in scope, they are not regulated.

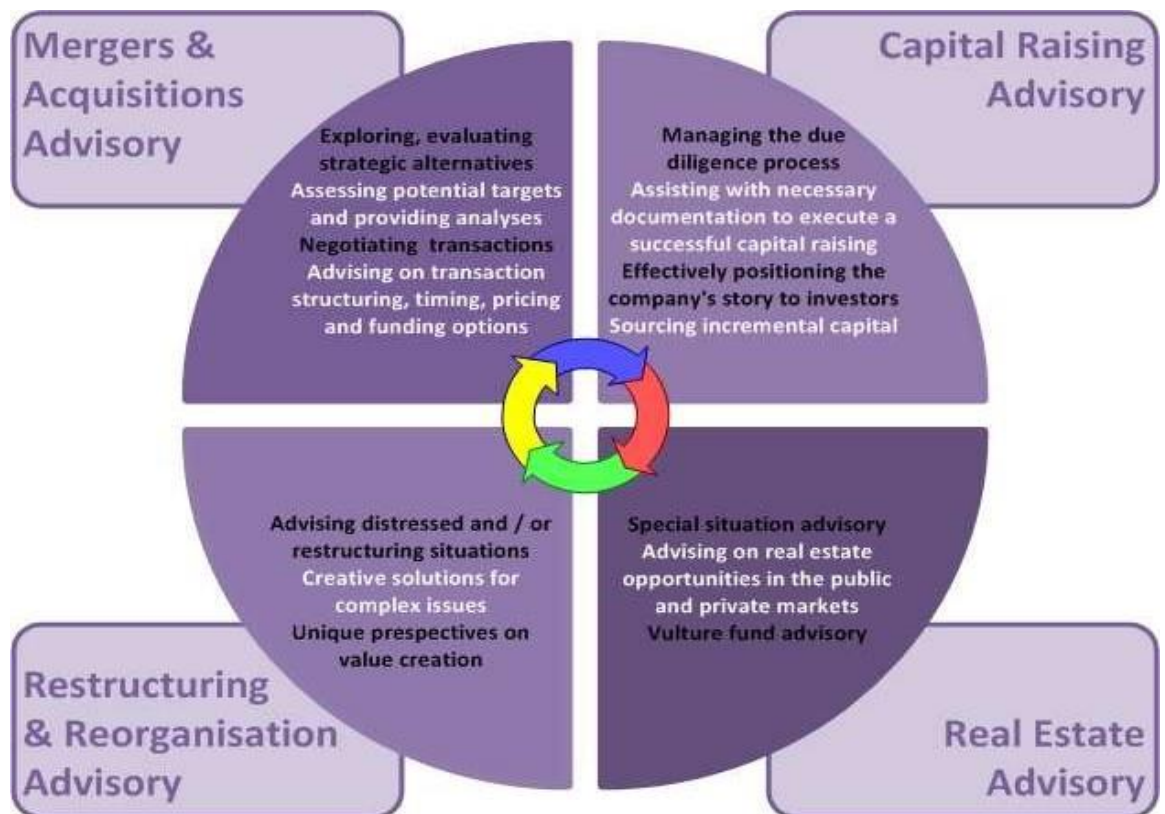
-Anyone considering dealing with any merchant bank should investigate the bank and its managers before seeking their help.

-The reason that businesses should develop a working relationship with a merchant bank is that they have more money than venture capitalists. Their advice tends to be more pragmatic than venture capitalists.



Functions of Merchant Bankers:

1. Consulting advice on going public and international business.
2. Advice and help in taking your company public. If they are unwilling to supply Investment Banking bridge loans, they have a low cost strategy for taking your company public.
3. They do PIPE (Private Investment in Public Equities) financings.
4. They can advise or help with a company's M&A strategy.
5. They are essential advisors for companies seeking to become multinational corporations



MERCHANT BANKING IN INDIA

In India Merchant Banking activities started from the year 1967, following the footsteps of similar activities in UK & USA. Currently Merchant Banking activity has mushroomed in the Indian capital market with both public & private sector settings up their respective merchant Banking divisions. Currently, the total no. of merchant bankers in India are approx. 1450 with more than 930 registered with SEBI. The SEBI authorized Merchant Bankers Include merchant Banking divisions of All India Financial Institutions, nationalized & foreign banks, subsidies of the commercial banks, private merchant banks engaged in stock broking, underwriting activities & financial consultancy & investment advisory service firms.

Merchant banking in India - an overview

Companies raise capital by issuing securities in the market. Merchant bankers act as intermediaries between the issuers of capital and the ultimate investors who purchase these securities.

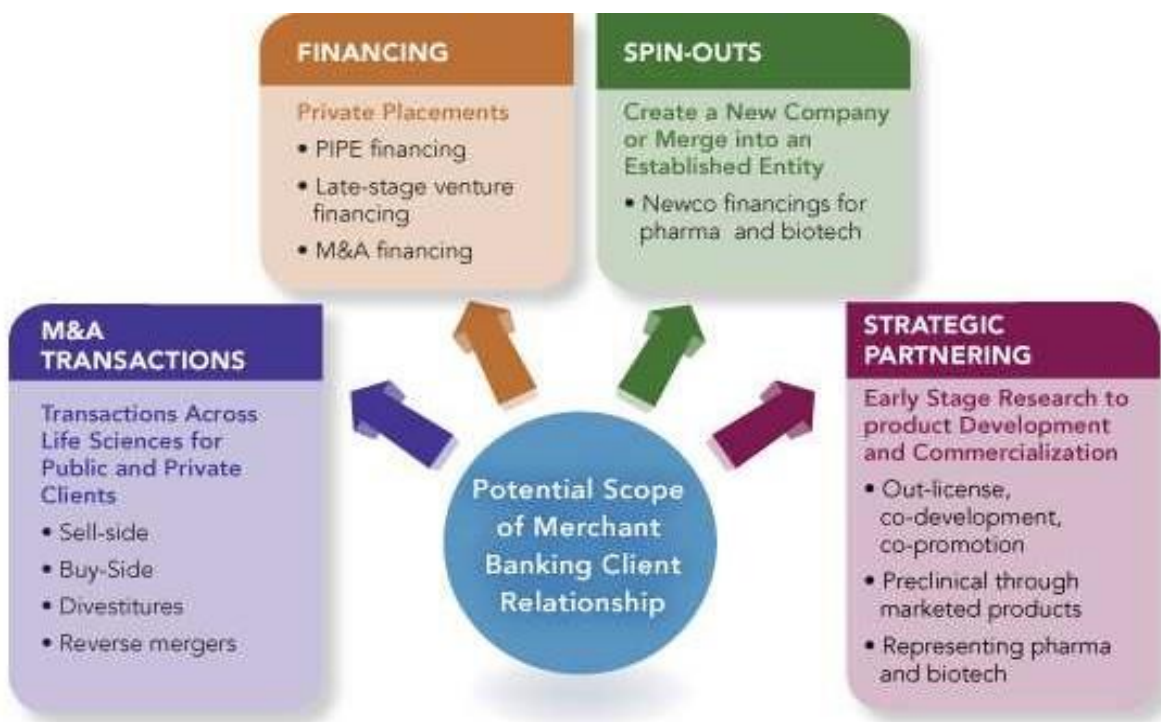
Merchant banking... is the financial intermediation that matches the entities that need capital and those that have capital. It is a function that facilitates the flow of capital in the market.

Merchant banker registered with SEBI:

Public Sector: - Commercial banks (12), Financial Institutions (6), State Institutions (4)

Private sector: - International bankers (10), Banks (10), finance & investment (231)

Role in India



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 authorized 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. (SHCI)

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.

BRIEF ANALYSIS OF SOME MERCHANT BANKS OF INDIA

>**State Bank of India**

>**Canara Bank**

>**Punjab National Bank**

>**ICICI Bank Ltd.**

>**Kotak Mahindra**



SBI Merchant Banking Group is strongly positioned to offer perfect financial solutions to your business. We specialize in the arrangement of various forms of Foreign Currency Credits for Corporate.

State Bank of India is the nation's largest bank. Tracing its roots back some 200 years to the British East India Company (and initially established as the Bank of Calcutta in 1806), the bank operates more than 22405 branches and over 65627 ATMs within India. State Bank of India has more than 50 offices in nearly 35 other countries, including multiple locations in the US (California), Canada, and Nigeria. The bank has other units devoted to capital markets, fund management, factoring and commercial services, and brokerage services. The Reserve Bank of India owns about 60% of State Bank of India.

We provide the resources, convenience and services to meet your needs by arranging Foreign Currency credits through:

- Commercial loans
- Syndicated loans
- Lines of Credit from Foreign Banks and Financial Institutions
- FCNR loans
- Loans from Export Credit Agencies
- Financing of Imports.



Canara Bank is one of the leading " Merchant Bankers / Investment Bankers" in India, offering specialized services related to Capital Market to Banks, PSUs, State owned Corporations, Local Statutory bodies, corporate sector including MSMEs.

- Bank is SEBI registered Category I Merchant Banker (holding permanent certificate of registration) rendering Issue Management (Public / Rights / Private Placement Issues), Underwriting, Consultancy and Corporate Advisory Services etc, as a Capital Market Intermediary.
- Bank also hold SEBI Certificate of Permanent Registration to handle “Bankers to an Issue” assignments with network of exclusive Capital Market Service Branches for handling Collecting (Escrow)/Refund/Paying Banker assignments. We are also a Self-Certified Syndicate Bank for extending Application Supported by Blocked Amount (ASBA) facility through our Branches.
- Bank do undertake "project appraisals" with linkage to resource raising plans from Capital Market/ Debt Markets and facilitate tie-ups with Banks / Financial Institutions and Potential Investors.
- Bank has uniqueness is in extending services through single window / “In house” concept in the following areas:
 - Merchant Banking
 - Commercial Banking
 - Investments
 - Bankers to Issue - Escrow Bankers / ASBA
 - Underwriting
 - Loan Syndication
- As leading Merchant Bankers in India, Canara Bank have been associating with issues involving various types of industries, banks, statutory Bodies etc. and have an edge in handling Private Placement issues – both retail & HNIs/QIBs.

SPECTRUM OF SERVICES:

- Equity Issue Management (Public/Rights)
- Debt Issue Management
- Project Appraisals
- Monitoring Agency Assignments
- Security Trustee Services
- Buy Back Assignments
- Share Valuations
- Employees Stock Option Scheme - Certification
- Debenture Trusteeship
- Issuing & Paying Agent (IPA) for Commercial Paper Issues

ISSUE MANAGEMENT SERVICES:

- Project Appraisal
- Capital structuring
- DRHP/RHP- Compilation of Offer Document.
- Tie-ups (placement)
- Formalities with SEBI / Stock Exchange / ROC etc.,
- Underwriting
- Promotion /Marketing of Issues
- Collecting Banker / Banker to an issue
- Post Issue Management
- Refund Bankers
- Debenture Trusteeship
- Registrar & Transfer Agency (our Subsidiary)
- ASBA-Self Certified Syndicate Bank

ONGOING ASSIGNMENTS:

- On tap Retail Private Placement Bond Issues- Arrangers/ Collecting Bankers.
- Fair Market Valuation of Shares (Involving Indian and Foreign Accounting Standards).



1,30,542 **Employees:**

You see, ICICI Bank is with more than 5900 branches and 16650 ATMs nationwide. ICICI's retail banking group offers lending and deposit services to small businesses and individuals. Larger businesses are served by the corporate banking group, which offers finance services and treasury products. ICICI's rural and government banking unit offers micro-loans and agricultural banking. Foreign operations, as well as services related to international trade finance and expatriate Indians, fall under the international banking group. Other ICICI offerings include online banking, asset management, and insurance.

ICICI Security is a SEBI Registered CAT-1 Merchant banker.

ICICI Advice on Wide Variety of Product: 1: Private Equity Financing
2: Secondary sale transactions 3: pre-IPO deals



Punjab National Bank (PNB) is one of India's largest nationalized banks with some 4,500 branches or service counters. The financial institution offers services in personal and corporate banking, including industrial, agricultural, and export finance, as well as international banking. Its personal lending services include loans for housing, autos, and education. PNB's diverse client list includes Indian conglomerates, small and mid-sized businesses, non-resident Indians, and multinational companies. The bank was established in Lahore in 1895 -- before the country was partitioned into India and Pakistan in 1947.

At present, the Bank is holding following Licenses from SEBI:

Merchant Banker

Banker to the Issue

Debenture Trustee

- In terms of SEBI guidelines, all debenture issues (public/rights) of the companies with the maturity period exceeding 18 months are required to have "Debenture Trustee" and its name must be stated in the prospectus of the issue.
- We are registered with SEBI for handling of the debenture trustee assignments – Registration No. IND000000023.
- Dissemination of info



India premier Investment bank. A subsidiary of Kotak Mahindra bank. Reconstruction from a private company to a public limited company effective from June 13, 2003. Act as a lead manager to several (IPO's) & help in Client in accessing the public & private equity market.

KIB provide high Quality Advisory services encompassing the following business area of operations.

Merger & Acquisition advisory

Raising capital from debt & Equity capital market

Raising Capital from financial sponsor. Infrastructure financing advisory.

Objective: Offer a wide suite of capital market & advisory solution to client covering leading domestic & multinational cooperation, banks, financial institutions, & govt. companies across major industry sector.

Present scenario of Indian Merchant Banking

U.S Stock Market Listings of Fast- Growing Indian Companies: An innovative financing Option

New York, Oct. 10 /PR Newswire/ Emissary Capital, LLC A merchant bank based in New York City and specializing in Indian Companies, is a pioneer firm leading the charge for Indian Companies to obtain stock market listings in the U.S and European investors in conjunction with a U.S public company with market listing. This turns a fast growing Indian company into U.S public company with the prestige and capability to raise money from U.S and European institutional investors. Focus on small and medium enterprises (SMEs). SMEs are dynamic force in India fall under this category.

India's strength in Information Technology sector is well known, but it is India's fast growing manufacturing sector, driven by approximately three million SME`s in sectors ranging from auto components to industrial goods, that is rapidly India a leading global manufacturing hub. Debt Financing is not the answer for SME`s. There seems to an across the board consensus that Indian SME`s have not been able to fully tap their potential and keep pace with India's growth because of their inability to access greater sources of financing. For vast majority of Indian SME`s, the high domestic interest rate regime (prime rate of 12.75% to 13.25%) continues to be a substantial hindrance. Furthermore, the ability to raise debt financing outside India (typically referred to as External Commercial Borrowings (ECBs) is strictly regulated by RBI. No IPO boom for Indian SMEs in Indian stock markets. The Indian stock markets including the BSE & NSE have essentially ignored robust Indian SMEs. The avg. size of Indian IPO rose to approximately \$140. million in 2010. Meanwhile smaller Indian companies seeking to raise funds of less than that amount have found it increasingly difficult to raise funds through Indian Stock Markets listings.

According to SEBI only 104 companies raised capital in the range of \$2.5 million to \$125 million in march.2010 fiscal year. No companies have raised money in the \$1.25 million to \$2.5 million range since April 2010. Finally, only 52 companies have been able to raise funds in the range of \$2.5 million to \$125 million in March 2010 fiscal year. There are few smaller Indian IPOs because Indian merchant bankers prefer to work on bigger IPOs that earn them bigger, as the work required for a small IPO compared to a large IPO is relatively the same. Also the regional stock exchanges, where the majority of SMEs would list themselves if possible, face stiff competition from India's two major stock exchanges BSE & NSE.

Emissary Capital Ltd. Is a full service merchant banking firm which specializes in assisting fast growing Indian companies in obtaining financing and U.S stock market listings as well as identifying and advising on mergers & acquisitions transactions for such companies.

Conclusion

- Longstanding client relationships
- Strong positions in high-growth client and product niches
- Multiple revenue growth initiatives are in place with detailed and concrete action plans, and with rigorous follow-up mechanisms
- Growth is controlled by a sound Risk Management System and disciplined cost management
- Small & Medium scale enterprises SMEs need immediate attention from merchant bankers to get access to finance.
- SMEs are facing stiff competition from large scale companies.

LIMITATIONS OF THE STUDY

- > Due to paucity of time only limited information can be collected.
- > There can be a possibility of “individual biasness” on the part of respondents.
- > Study would be confined to only 10 public & private sector merchant banking companies.
- > Sample size to be taken may not be the true representative of the population.