

MERCHANT BANK: Meaning, Functions and Regulations

Historical Background

Merchant banking services, in India, were started only in 1967 by National Grindlays. Bank followed by Citi Bank in 1970. The State Bank of India was the first Indian commercial bank to set up a separate merchant banking division in 1972.

Later, the ICICI set up its merchant banking division in 1973 followed by a number of other commercial banks like Canara Bank, Bank of Broada, Bank of India, Syndicate Bank, Punjab National Bank, Central Bank of India, UCO Bank, etc.

What is a Merchant Bank?

In modern terms, a merchant bank is a firm or financial institution that invests equity capital directly in businesses and often provides those businesses with advisory services. A merchant bank offers the same services as an investment bank; however, it typically services smaller clients and makes direct equity investments in them. Merchant banks mainly work with small-scale enterprises that are unable to raise funds through an initial public offering.

Merchant banking means the activity of rendering a number of services including Management of securities, Portfolio management, Underwriting and Insurance, Financial advice and project counseling etc. Large brokers, Mutual Funds, Venture capital companies and Investment Banks offer Merchant-Banking services. The main difference between merchant banking and commercial banking is that commercial banking involves accepting deposits and granting loans and advances whereas merchant banking involves rendering of the services for a fee.

Functions of Merchant banks:

- (1) Underwriting of shares and debentures
- (2) Management of Public issues
- (3) Portfolio management
- (4) Credit syndication which involves all the steps of applying for a loan.
- (5) Corporate Advisory services.
- (6) Management of off shore funds.
- (7) Leasing and financing
- (8) Foreign collaborations and foreign currency management.
- (9) Investment services for non resident Indians.
- (10) Counseling small scale business organizations
- (11) Project finance and project promotion services.

(12) Treasury management services

(13) Disbursement of dividends.

Merchant Banking Regulations:

SEBI (Merchant Bankers') Regulation Act, 1992 defines a 'merchant banker' as "any person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities or acting as manager, consultant, adviser or rendering corporate advisory service in relation to such issue management".

At present no organisation can act as a 'merchant banker' without obtaining a certificate of registration from the SEBI.

However, It must be noted that a person/ organisation has to get himself registered under these regulations if he wants to carry on or undertake any of the authorised activities, i.e., issue management assignment as manager, consultant, advisor, underwriter or portfolio manager.

To obtain the certificate of registration, one had to apply in the prescribed form and fulfill two sets of norms (i) operational capabilities and (ii) capital adequacy norms.

Classification of Merchant Bankers:

The SEBI has classified 'merchant bankers' under four categories for the purpose of registration:

1. Category I Merchant Bankers:

These merchant bankers can act as issue manager, advisor, consultant, underwriter and portfolio manager.

2. Category II Merchant Bankers:

Such merchant bankers can act as advisor, consultant, underwriter and portfolio manager. They cannot act as issue manager of their own but can act co-manager.

3. Category III Merchant Bankers:

They are allowed to act as underwriter, advisor and consultant only. They can neither undertake issue management of their own nor they act as co-manager. They cannot undertake the activities of portfolio management also.

4. Category IV Merchant Bankers:

A category IV merchant banker can merely act as consultant or advisor to an issue of capital.

Capital Adequacy Norms:

SEBI has prescribed capital adequacy norms for registration of the various categories of merchant bankers. The capital adequacy is expressed in terms of minimum net worth, i.e., capital contributed to the business plus free reserves.

The following are the capital adequacy norms as laid down by SEBI:

Capital Adequacy Norms	
<i>Category of Merchant Bankers</i>	<i>Minimum Net Worth</i>
Category I	₹ 5 crore
Category II	₹ 50 lakhs
Category III	₹ 20 lakhs
Category IV	Nil

Fees:

According to the SEBI (Merchant Bankers) Amendment Regulations, 1999, w.e.f. 30.9.1999, every merchant banker shall pay a sum of Rs. 5 lakhs as registration fees at the time of grant of certificate by the Board. The fee shall be paid by the merchant banker within 15 days of receipt of intimation from the Board.

Further, a merchant banker to keep registration in force shall pay renewal fee of Rs. 2.5 lakhs every three years from the fourth year from the date of initial registration.

Government Policy for Merchant Banking:

The Government issued policy guidelines for merchant bankers to ensure sufficient physical infrastructure, necessary expertise, good financial standing, professional integrity and fairness in their transactions. The merchant bankers have to be competent to serve the investors also.

On 1st March, 1993 new policy guidelines have been issued by SEBI for the merchant bankers to ensure greater transparency in their operations and to make them accountable so as to protect the investor's interest. The guidelines relate to pre-issue obligations, underwriting, advertisements and post-issue obligations of the merchant bankers.

Merchant bankers in india:

There are 135 merchant bankers in india who are registerd with SEB. In india it include private sectors, public sector and foreign players, some of them are:

1. Private Sector merchant banking

Bajaj Capita Ltd

Icici Securities

Tata Capital Market Ltd

Icici Bank Ltd

Reliance Securities Ltd

Kotak Mahindra Capital Ltd

Yes Bank Ltd

Axix Bank (Formerly Uti Bank Ltd)

2. Public sector merchant banking

(PNB) Punjab National Bank

Bank Of Maharashtra

State Bank Of Bikaner and Jaipur

State Bank Of India Capital Market Ltd

IFCI Financial Service Ltd

Karur Vysya Bank Ltd

3. Foreign players in merchant banking

Morgan Stanley India company Pvt. Ltd

Goldman Sachs (India) Securities

Bank Of America

Duetshe Bank

Fedex Securities

Barclays Bank Plc

Citigroup Global Market India

Functions of Merchant Bankers/Services Offered

1. Corporate Counseling- Corporate counseling is the beginning of **merchant banking services**. Every industrial unit either new or existing needs it. The scope of corporate counseling is very vast. It covers a wide range of merchant banking activities and includes services such as project counseling, project management, loan syndications, working capital management, capital restructuring, public issue management, fixed deposit, lease financing.

2. Project Counseling

This has originated from corporate counseling. It relates to project finance and includes preparation of project reports, cost of the project and also arranging the financing pattern. The projects are appraised on the basis of the location, marketing, and technical and financial viability of the project.

3. Loan Syndication

It refers to a loan arranged by a bank for a borrower who is likely to be a large company, a local authority, or a government department. **So**, the merchant banker first finalizes the cost of the project before approaching a financial institution for term loans. After that, the merchant banker designs the capital structure, determine the promoter's contribution, and decides the approximates amount to be raised. It also ensures that the project adheres to the guidelines for financing industrial projects. Merchant bankers render comprehensive services of loan syndication to cover all types of arrangements.

4. Management of Capital Issues

Management of capital issues involves selling of securities, namely, equity shares, preference shares, and debentures and bonds to the investors. The merchant bankers prepare the action plan and budget for the total expenses for the issues, drafting the prospects getting the consent letter publicity, coordinating with underwriters, selecting the advertising agency for pre-issue and post-issue merchant banker renders the advice to the issuer company regarding the types of security to be issued.

For the success of the issue, the merchant banker should keep close liaison and coordination with various agencies involved in public issues. It is the responsibility of the merchant banker to groom the issue to ensure full subscription.

5. Corporate Advisory Services

Merchant bankers set up corporate advisory service branches to render exclusive services to their corporate customers. **In India**, SEBI guidelines insist that all the issues should be managed by at least one authorized merchant banker. The success of the issue is dependent on the selection of the **right types of security**. So, expert advice for merchant bankers is on immense importance to ensure success and security.

6. Portfolio Management

Portfolio management refers to minimizing the risk and maximizing the returns. Hence, the term portfolio management can be applied only to share and debentures. Merchant bankers render portfolio management services to their customers and help the investors to choose the right type of securities that is safe and

ensures liquidity and profitability. So merchant bankers need to keep regular market information and economic surveys.

7. Advisory Services to Mergers and Takeovers

The term merger means a combination of two companies in a manner such that only one company survives and another goes out of existence.

On the other hand, takeover refers to the purchase of a company by another company and in the process of acquiring and controlling interest in the shares capital of another existing company. Merchant banker act as a middleman between two companies by safeguarding the interest of both. He gets the approval from the financial institutions of the government or from the RBI.

8. Consultancy to Sick Industrial Units

A merchant banker guides the existing units for growth and diversification. He/she appraises their technology and process, assessing their requirements and restructuring their capital base and also chalks out the rehabilitation program which can be accepted by the banks and other financial institutions.

9. Leasing

In a lease transaction, the merchant banker renders the services that include an arrangement for lease finance facilities for leasing companies, advice on the optimal structuring of the transaction, legal documentation, and tax counseling.

10. Foreign Currency Financing

Foreign currency finance is the fund provided for foreign trade transactions.

It may take the form of export-import trade finance, euro currency loan. Indian joint venture abroad or foreign collaborations.

The main areas that are covered in this type of merchant activity are as follows:

1. Providing assistance for carrying out the study of turnkey and construction contract projects.
2. Providing assistance in applications to working groups, liaison with RBI, ECGD, and other institutions.
3. Providing assistance in opening and operating bank accounts abroad.
4. Providing assistance in obtaining export credit facilities from the EXIM bank for export of capital goods, and arranging for the necessary government approvals and clearance.
5. Providing guidance on the forward cover for exchange risk.
6. Assisting in arranging foreign currency guarantees and performance bonds for exporters.

11. Providing Venture Capital Financing

Merchant bankers help companies in obtaining venture capital financing for financing their new and innovative strategies.

12. Broking

Brokers are persons mainly concerned with the procurement of subscription to the issue from the prospective investors. The appointment of brokers is not compulsory and the companies are free to appoint any number of brokers.

13. Act as Debenture Trustee

Trustees who are appointed to safeguard the interest of debenture holders are called debenture trustees. They are to be appointed before the issue of debentures by a company. No person can act as a debenture trustee a certificate of registration has been obtained from SEBI for the purpose.