

# MERCHANT BANKING IN INDIAN ECONOMY

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## **ABSTRACT**

The services of merchant bank cover project counselling, pre-investment activities, feasibility studies, project reports, design of capital structure, issue management, underwriting, loan syndication mobilization of funds, foreign currency finance, mergers, amalgamation, takeover, venture capital and public deposits. Merchant banking is a skill-based activity and involves serving financial needs of every client. Merchant bankers can turn to any of the activities depending upon resources, such as capital, foreign tie ups for overseas activities and skills. The basic function of merchant bankers is marketing corporate and other securities, that is guaranteeing sales and distribution of securities. All aspects organization, underwriting and distribution of the sale of industrial securities are handled by them. They are experts and good judges of the type, timing, and terms of issues and make them acceptable to investors under prevailing preferences and market conditions, and at the same time afford the borrowing company the freedom and flexibility it needs to meet possible future contingencies.

## **KEYWORDS**

Merchant banking, financial institution, portfolio management, counselling.

## **INTRODUCTION**

The term 'merchant banker does not have a fixed and uniform definition as it is used differently in different countries. In the US, merchant banks are called investment banks and, in the UK, they are called accepting and issuing houses. Although the terminology is different in various countries, their functions are more or less the same. The merchant banker is a financial intermediary mainly involved with the activity of issue management for starting ventures as well as existing companies. Basically, they provide advisory services in different roles to corporate entities in respect of subscribing, selling and buying securities.

SEBI 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 securities as manager, Consultant, advisor or rendering corporate advisory services in relation to such issue management. So, the main business of a merchant banker is issue management. A merchant banker is an organization. Individuals are not called merchant bankers; they are called brokers. This is the subtle difference between the two terms.

The role and activities of a merchant bank are different from those of the traditional bank. The primary difference is that a merchant bank does not accept a deposit of money while a commercial bank does. Merchant banks provide advisory services to the corporate world and the general public. Merchant banks are more specialized organizations, which provide services to high-net-worth individuals as well as companies. They manage investors' money, after analyzing the possible risks, and give them advice to convert money into more money. The services provided to the corporate world take many forms, such as underwriting securities, facilitating mergers and acquisitions, arranging and funding syndicated loans and providing financial advice on pricing of securities. They offer a package of financial services, such as portfolio management, marketing corporate and other securities, credit syndication and mergers and acquisitions.

According to the Securities and Exchange Board of India (Merchant Bankers) Rules,1992, "A merchant banker is 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 services in relation to such issue management".

Merchant banking is a skill-based activity and involves serving financial needs of every client. Merchant bankers can turn to any of the activities depending upon resources, such as capital, foreign tie-ups for overseas activities and skills. A merchant bank differs from a commercial bank. While a commercial bank is primarily concerned with accepting public deposits for lending purpose, providing working capital finance, allowing its customers to withdraw of money by cheques, providing cash credit, overdraft, bill discounting facilities, issuing credit cards and providing facilities relating to transfer of funds, a merchant bank renders a number of services incidental to the promotion and development of projects such as corporate counselling, project consultancy, corporate restructuring, issue management, loan syndication, portfolio management, leasing services, providing assistance for technical and financial collaborations, etc.

## **LITERATURE REVIEW**

S. Lalitha (1993) observed that a consortium of brokers and merchants, should take the role of market makers. This is because, share brokers, generally being partnership firms do not have the financial clout which is necessary for market activity. Mr. Anand Desai (1994) has made an attempt to analyse that with the abolition of the office of the controller of capital issues it has become imperative that the issue of securities be priced optimally one that gives the maximum benefit of the premium to the issuer and at the same time is attractive and offers reasonable scope for capital appreciation to the assessor. K.C. Gupta and Joginder (2008) 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. SEBI was also made all powerful to regulate the activities of merchant banking was the necessity of banks themselves which were in need of non-fund based income so as to improve their profitability margins by all means in the changed economic scenario. Shreyas B.S (2014) have tried to summarize the evolution and the growth of merchant bankers from the year 1967. Merchant banking rapidly growing in Indian economy. Merchant banking is oldest in the primary market and it has bright future in coming years. Animesh (2016) investigated that Globalization of Indian Economy has made the whole economy open, which has move multinational player in era of the financial services. Government has now open up the doors of investments especially in the area of banks and insurance which leads to competitive environment for the present players. The study also revealed that in India, at present, a substantial number of Merchant Bankers are operating under the direct supervision of Securities and Exchange Board of India (SEBI) and also evaluated the performance of selected Merchant Bank of India. Dr Jyoti Lahoti (2016) in their research paper have tried to explain organization and nature of merchant unit also the role of merchant bankers in the development of Indian economy. In their research paper have also tried to review the objectives and the services rendered by the merchant bankers. Merchant banking is a service provided by financial institution which helps in the economic development of the country. Merchant banking provides various services like portfolio management, loan syndication and issue management. Dr Singh and Dr Saxena (2017) in their research paper have tried to analyse that merchant banking is a service provided by many financial institutions to increase the growth of corporate sector which reflect into Indian economy. Merchant banking consists of wide range of financial activities and financial institutions. Merchant banking is a combination of consultancy services and banking.

## **OBJECTIVES & RESEARCH METHODOLOGY**

The purposes of carrying this study are as under:

1. To analyse historical growth of merchant banking.
2. To enumerate the services provided by merchant banking.
3. To appreciate the role of merchant banking in Indian economy.

This study is based on the information collected from various secondary sources such as books, magazines, newspaper articles, research journals available online and various websites in order to achieve its objectives.

## **HISTORICAL GROWTH OF MERCHANT BANKING IN INDIA**

The history of merchant banking can be traced to Italy and France where it developed during the seventeenth and eighteenth centuries. Originally, the Italian grain merchants used to assist in financing other merchants in their businesses, while carrying on their own. Historically, their role was confined to facilitating production and trading commodities, as well as financing those operations. However, this is not the current picture now. The gamut of merchant banking services has grown significantly and substantially over the years. The fund-based activity with which they commenced their operations has now become a non-fund based activity.

The modern era in merchant banking began in London, where merchant bankers commenced their activities by financing foreign trade through the acceptance of bills of exchange. With the passage of time, they extended their services to the governments of underdeveloped countries in raising finances through floating bonds for them in the London money market. The post-war period witnessed a manifold increase in merchant banking activities. Over the years, their services have increased substantially to loan syndication, underwriting issues, portfolio management etc.,

The merchant banking business got more importance in the year 1983 when there was a tremendous boom in the primary market where companies were floating huge a new issues. To squeeze this opportunity, merchant banking activities were organized and undertaken in several forms. Commercial banks and foreign development finance institutions organized their merchant banking business through formation of divisions. National banks formed subsidiaries. Sharebrokers and consultants constituted themselves into public limited companies. Some merchant banking companies entered into collaboration with merchant bankers of foreign countries abroad with several branches. As of now there are numerous merchant bankers who are registered with the SEBL. It includes public sector, private sector and foreign players. Prominent among them are SBI Capital Markets Ltd., Axis Bank Ltd., Bajaj Capital Ltd., Tata Capital Markets Ltd., Morgan Stanley India Company Pvt. Ltd., Barclays Securities (India) Pvt. Ltd. etc

## **SERVICES PROVIDED BY MERCHANT BANKING**

In recent years they have extended their business to cover a wide variety of services. At present, merchant banks across the globe are engaged in providing the following services.

**Project Counselling** - As a project counsellor, a merchant banker carries out project feasibility study, prepares project report in consultation with technical, financial and marketing experts, decides upon the financing pattern to fund the cost of the project, appraise the project report with banks and financial institutions, fills up of application forms for obtaining funds from financial institutions and securing government approval.

**Issue Management** - Another major service that is provided by a merchant banker is the issue management. This service comprises preparation of prospectus, registration of prospectus, obtaining approval, for the issue from SEBI, arranging underwriting for the proposed issue, preparing documents for the stock exchange, selection of the registrar to the issue, etc.,

**Credit Syndication** - Merchant banks undertake the preparation of the project profile, loan application for financial assistance on behalf of promoters from various financial institutions for term loans, working capital finance for new projects, etc. They also arrange finance for projects from foreign countries.

**Servicing of issues** - Many merchant bankers act as paying agents for servicing the long-term loans taken in the past, for keeping a register of shareholders and debenture-holders for companies, acting as paying agents for their dividends and debenture issues, arranging investment of funds and for the sale custody of securities on account of clients in the country and abroad.

**Investment Management** - Merchant bank render expert advice on matters pertaining to investment decisions, for example, they assess the effects of taxation and inflation on gilt-edged and other securities. They also tender advice on investment in government securities, trusts, charitable institutions and companies. They buy and sell securities on behalf of their client companies.

Placement and distribution - Merchant bankers help their client companies in distributing different securities like equity shares, debt instalments, mutual fund products, insurance products, commercial paper, etc.

Services to non-resident investors - Merchant bankers do provide services to non-resident investors in terms of identification of investment opportunities, choice of securities, investment management and operational services like purchase and sale of securities.

### **ROLE OF MERCHANT BANKING IN INDIAN ECONOMY**

The merchant bankers play crucial role in fostering growth in an economy. As a promoter, they translate the project ideas into productive and profitable ventures. Once the enterprise starts functioning, they provide myriad of services to the entrepreneur in its successful functioning. They guide entrepreneurs not only in choosing suitable pattern of financing the project but also help them in procuring the required funds at reasonable cost both from domestic and foreign markets. They also help the entrepreneurs in entering overseas markets, forging alliances with domestic and foreign plays for expanding and diversifying the business. At times, entrepreneurs intending to recapitalize and restructure their firms resort to expert guidance of merchant bankers. It can rightly be said that merchant bankers have gained prominent place in financial markets across the world. The role of merchant bankers is becoming more pronounced in emerging economies like India. Despite rapid progress made in almost all sectors of the economy during the post reform period and India emerging as the second fastest growing economy in the world, the growth has not been balanced in as much as it is influenced by services and manufacturing sectors that have mainly contributed to growth. Agriculture is still lagging behind. Even the growth rate has not been sustainable as is evidenced from the declining performance of the manufacturing sector in recent years.

As the growth has not been equitable and size of population below poverty line has not declined significantly during the post liberalization period. Geographically also, the country has lacked balanced growth. This is why the Government of India pursued inclusive growth approach in eleventh plan to ensure rapid and balanced development on sustainable basis and reduce the degree of inequality and poverty and decided to continue the same during the 12<sup>th</sup> five-year plan. This requires huge investment especially in agriculture, manufacturing and infrastructure sectors. Infrastructure sector alone is expected to require \$1000 billion during the next five years. The 12<sup>th</sup> Five-year Plan (2012-17) envisages investments worth \$1000 billion 50 per cent of which would come from the private sector. So, about \$100 billion would be required in the private sector in both equity and debt, every year from April 2012 onwards. Arranging such a burgeoning amount of funds for infrastructure and other sectors needs services of merchant bankers. The growing emphasis on development of fertilizers, petrochemicals and electronic industries, which are highly specialized and complex in character, requires specialized services which merchant banker can afford to provide. With changing emphasis in the lending policies of banks and other financial institutions from security orientation to project orientation, corporate enterprises would require the expert services of merchant bankers for project appraisal, financial management etc.

In the wake of globalization of financial markets of India and consequent inflow of FIIs in Indian stock markets, increased complexity in investment activities and volatility of the markets, corporate demand of expertise of merchant bankers has increased tremendously. These merchant bankers' services are required to help the entrepreneurs in project and issue management and managing resources from overseas markets. Further, companies aspiring to enter off-shore markets to expand their operations need expert advice of merchant bankers in locating the market, choosing product line, selecting suitable partner and taking all statutory and other steps to set up the enterprise in the foreign country.

### **CONCLUSION**

To conclude, the term 'merchant banking' has no precise definition because it is widely and loosely used, being sometimes applied to banks which are not merchants and sometimes to merchants who are not banks, and sometimes to houses that are neither merchants nor banks. Furthermore, the term merchant banking has been used differently in different parts of the world. While in the UK, a merchant banking refers to the 'accepting and issuing houses which provide a variety of services such as issue management, portfolio

management, underwriting of issues, rendering advice on project development, on mergers and amalgamation, etc. In the USA, it is known as 'Investment banking' which is concerned with garnering savings and channelling them into profitable outlets. Investment bankers act as the intermediaries to provide specialised service in securities for long-term. They simply buy the securities in bulk with a view to selling them to investors at large. They also provide other services involved in marketing of securities. However, a merchant bank may be regarded as an institution which embraces a wide range of activities such as project counselling, pre-investment activities, feasibility studies, project reports, foreign currency finance, portfolio management, credit syndication, acceptance credit and other services.

A merchant bank is any person who is engaged in the business of project counselling, issue management, portfolio management, credit syndication, acceptance credit and corporate consultancy. A merchant banker renders wide variety of services right from conception of business ideas to floatation of the enterprise and its management. Thus, he acts as project counsellor, manager of issue, credit syndicator, and manager of portfolio. Besides, he helps the client companies in distributing their securities and arranges fixed deposits and foreign currency financing for them. The history of merchant banking can be dated back to the late 17th and early 18th centuries when it first started in Italy and by the Italian grain merchants. With the passage of time, merchant banking in modern era started from London where the merchants began to finance the foreign trade through acceptance of bills. Subsequently, they extended their services issue management, credit syndication and portfolio management. The post war period witnessed tremendous expansion of merchant banking business. In India, merchant banking started in 1967 when the RBI allowed the Grindlays' Bank to do merchant banking activity. Later on, Citibank and the SBI embraced merchant banking activity in 1970 followed by other banks and institutions. In view of variety of services provided by merchant bankers, they have come to be recognised as an important institution to foster growth of a country. This is why they have gained prominence in financial markets across the world. The role of merchant bankers is becoming more pronounced in emerging economies like India in view of surging industrial growth, growing new issue activity, globalisation of financial markets and increasing inflows of FIIs. Merchant banking business in India is regulated by SEBI (Merchant Bankers) Regulation Act, 1992. As such, no person can undertake merchant banking activity without being registered with the SEBI.

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