

# THE INTERNATIONAL JOURNAL OF BUSINESS & MANAGEMENT

## Merchant Banking Past and Present: Indian Scenario

Shreyas B. S.

Master of International Business, Bangalore University, Karnataka, India

### Abstract

Merchant banking covers wide range of financial activities and in process include a number of different financial institutions. Merchant banks are popularly called "Accepting and issuing houses". The merchant banking services were first ushered by foreign banks, namely "the National Grindlays Bank" in 1967 and the "City bank" in 1970. During such stage the need for specialized merchant banking services was felt in India with the rapid growth and size of the issues made in the primary market. It was only in 1992 after the formation of Securities and Exchange Board of India, which defined a set of rules and regulations for merchant banking activity in spite of the fact that it was introduced two decades ago. The research paper has given an overall view of merchant banking in past as well as present with respect to India. Merchant banking is one of the oldest and specialized financial intermediaries in the primary market. Currently merchant banking activity has developed rapidly in the Indian capital market with more than 1450 merchant bankers and more than 930 has registered with SEBI. Merchant banking in India has a very bright future in the coming years and has all potential in competing with International countries.

**Keywords:** Merchant banking, SEBI, Capital market, Regulations, Growth

### 1. Introduction

The financial system of a country is a complicated and integrated set of sub systems of financial institutions, markets, instruments and financial services which facilitate the transfer and allocation of funds efficiently and effectively. Indian financial system consists of both organized and unorganized segments. The formal financial system comes under the purview of Ministry of Finance, Reserve Bank of India, Securities and Exchange Board of India and other regulatory bodies. Merchant Banking has its origin in the trading methods of countries in the late eighteenth and early nineteenth century when trade-taking place was financed by bill of exchange drawn by merchanting houses, as merchants were merely financing their own activities. The role of merchant banking is wide ranging and they can now provide most of the financial services required by a company, touching almost all aspects of establishing and running of industrial units on sound financial footing. Merchant banks are popularly called "Accepting and issuing houses". Merchant banking is one of the oldest and specialized financial intermediaries in the primary market.

### 2. Concept and Evolution of Merchant Banking

#### 2.1. Meaning and Definition of Merchant banking

In the Indian context, merchant bank has been defined by V. Gangadhar and M. Sunder as a service activity. In other words, banking departments rendering non-fund based services of arranging funds rather than providing them to the needing industrial concerns is called merchant banking.

The first authoritative definition for the term 'Merchant Banker' has been given in the Rule 2 (e) of SEBI (Merchant Bankers) Rules, 1992. Accordingly, "A Merchant Banker means any person who is engaged in the business of Issue Management either by making arrangements regarding selling, buying or subscribing to Securities as Manager, Consultant, Adviser of rendering Corporate Advisory Service in relation to such Issue Management".

#### 2.2. Evolution of Merchant Banking

The merchant banking services were first ushered by foreign banks, namely "the National Grindlays" Bank in 1967 and the "City bank" in 1970. During such stage the need for specialized merchant banking services was felt in India with the rapid growth and size of the issues made in the primary market. It was only in 1992 after the formation of Securities and Exchange Board of India, which defined a set of rules and regulations for merchant banking activity in spite of the fact that it was introduced two decades ago. Commercial Banking and Investment Banking are often confused with Merchant Banking. In many ways, there may be similarities in their functions. However, in certain ways, Merchant Banking is distinctly different from commercial Banking and Investment Banking. Nationalized banks have created new subsidiaries to carry out merchant banking activities, other domestic financial institutions have created separate divisions and share brokers and consultancies have registered themselves as public limited companies or partnerships or proprietary firms.

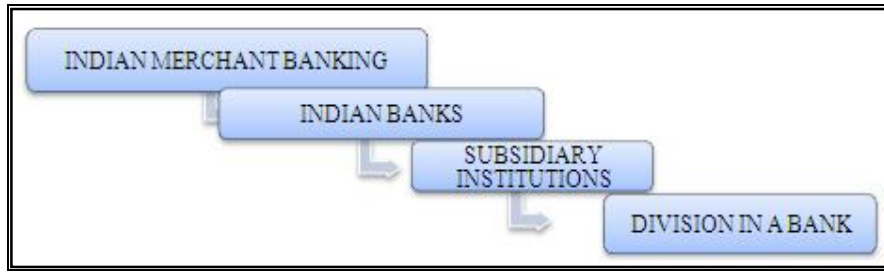


Figure 1: Operation of Indian Merchant banking  
Source: Authors Compilation

**3. Merchant banking in India: Past and Present**

In India Merchant banking activities started from the year 1967. Prior to the enactment of Indian Companies Act 1956, managing agents acted as issue houses for securities, evaluated project reports, planned capital structure and to some extent provided venture capital for new firms and few share broking firms also functioned as merchant bankers. The need for specialized merchant banking services was felt in India with the rapid growth in the number and size of the issues made in the primary market. Initially, merchant banking services were offered along with other traditional banking services. The Banking Regulation Act permitted commercial banks to offer a wide range of financial services through the subsidy rule through its amendments. The State Bank of India was the first Indian Bank to set up merchant Banking division in 1972. At later stages ICICI set up its Merchant Banking division followed by Bank of India, Bank of Baroda, Canada Bank, Punjab National Bank and UCO Bank. The merchant banking gained prominence during 1983-84 due to boom in the new issue.

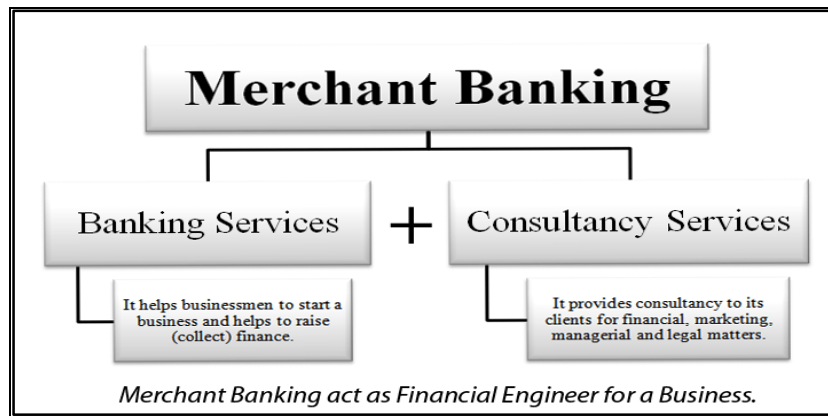


Figure 2: Merchant banking Services in India  
Source: Internet

In addition to the above, the scope of Merchant Banking services has extended to providing advisory services to companies to increase or divest their stakes, public sector undertaking disinvestments, international issues, etc. With the OTCEI being operating now, merchant bankers will have a key role to play in terms of appraising the projects and offering two-way quotes for market making in case of entrepreneur going for listing in the above exchange. Presently the growth of Indian industry has given rise to further opportunities in mergers and acquisitions and takeovers. The Finance Ministry has excluded services provided by merchant banks and other agencies in a merger and acquisition (M&A) transaction from the scope of taxable services provided by a 'management consultant.' The rationale accorded is that the role of such agencies is limited to compliance of any statute or regulation -- such as takeover regulations of the Securities and Exchange Board of India (SEBI) -- and not governed by any contractual relationship with the advisee company. Merchant banks are also working on asset valuation, investment management and promotion of investment trusts. Merchant banks do not provide any consultancy on an M&A transaction, but merely verify and submit a report to the authorities concerned, according to the Central Board for Excise and Customs (CBEC). Currently merchant banking activity has developed rapidly in the Indian capital market with more than 1450 merchant bankers and more than 930 has registered with SEBI. Merchant banking in India has a very bright future in the coming years and has all potential in competing with International countries.

**4. Merchant banking: Recent Developments and Challenges ahead**

The Merchant Banking was at its best during 1985-1992 being when there were many new issues. It is expected that 2015 is going to be party time for merchant banks, as many new issue are coming up. The foreign investors, both in the form of portfolio investment and through foreign direct investments are venturing into Indian Economy. It is increasing the scope of merchant bankers in many ways. Disinvestment in the government sector gives a big scope to the merchant banks to function as consultants in the country. New financial instruments are introduced in the market time and again that basically provides more opportunity to

the merchant banks. The mergers and corporate restructuring along with MOU and MOA are giving immense opportunity to the merchant bankers for consultancy jobs.

Time and again the Merchant banking Industry in India witnessed experienced and underwent significant changes. The very purpose for which these firms commence their services should be taken care of and they should mold their policy decision and activities to move in tune with the main objectives of Investor's protection and to create healthy environment in capital markets. No doubt, Merchant Banking firms are subject to a host of control measures, regulations and rules framed and guided by SEBI. To some extent, frequent changes and /or amendments to policies and control measures, though needed for smooth working of the securities Industry, proves to be detrimental to the very existence of the Merchant Banking system in the country. Currently merchant banking activity has developed rapidly in the Indian capital market with more than 1450 merchant bankers and more than 930 has registered with SEBI. In the coming year's merchant bankers have reason to believe, they will be promoted with government and market support to compete internationally.

## 5. Conclusion

In spite of distinct problems, merchant banking in India has vast scope to develop because of lot of domestic as well as foreign businesses booming here. Indian economy provides an amicable environment for these firms to set up, flourish and expand here. Merchant banking is one of the oldest and specialized financial intermediaries in the primary market. Merchant banking in India has emerged as an indispensable financial advisory activity. Merchant banking in India has a great demand over the globe, attracting many companies to try their hands in this field. Companies need to build a strong image and some are still at initial stages to leave a mark in the international market. Merchant banking in India has a very bright future in the coming years and has all potential in competing with International countries. In the coming year's merchant banking have reason to believe, they will be promoted with government and market support to compete internationally.

## 6. References

1. Narasimhah, M.S. and Ramana, L.V. (1995), Pricing of Initial Public Offerings: Indian Experience with Equity Issues, The ICFAI Journal of Applied Finance, Vol. 1, pp.26-39.
2. Ritter, J.R. (1991), The Long Run Performance of Initial Public Offerings, Journal of Finance, Vol.46, pp.3-28
3. Agarwal, Pramod Kumar (1997), Merchant Banking in India Delta Publishing House, New Delhi.
4. Gordon, J.E., and Nararajan K. (2004), Financial Markets & Institutions, Himalaya Publishing House, New Delhi.
5. Bhole, L.M. (2004), Financial Institutions and Markets, Tata McGraw Hills, New Delhi.
6. Varshney, N.P. & Mittal, K.D. (2009). Indian financial system (10<sup>th</sup> ed.). New Delhi: Sultan Chand & Sons Educational Publishers.
7. [www.capitalmarket.com](http://www.capitalmarket.com)
8. [www.financeindia.com](http://www.financeindia.com)
9. [www.iseindia.com](http://www.iseindia.com)
10. [www.sebi.gov.in](http://www.sebi.gov.in)
11. [www.merchantbanking.fortis.com](http://www.merchantbanking.fortis.com)
12. [www.nseindia.com](http://www.nseindia.com)
13. [www.smcindiaonline.com](http://www.smcindiaonline.com)