MERCHANT BANKING

O.P. Agarwal

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[As per the Revised Syllabus 2017-18 of Mumbai University for B.Com. (Financial Markets) Semester IV]

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PREFACE TO FIRST EDITION

Merchant bankers are the important aspect in mobilisation of debt for the companies. For such capitalisation, debt planning is required to be done, by various intermediaries. Merchant bankers is one of such intermediary. Merchant banker is one to maintain balance between SEBI guidelines, need of companies for funds and the investors' protection. The merchant bankers carry out all the activities relating to the issue of shares/debentures. They draft prospectus, appoint registrars to the issue, provide arrangements for underwriting, select brokers, bankers to the issue and handling problems after issue of securities. Their role is so important that SEBI has made it mandatory to appoint merchant bankers.

All such activities have been incorporated in this book for the students to enable them to understand things better.

The entire book has been covered under four chapters in a very simple language for better understanding the subject.

Since this being the first edition, I will be obliged to get suggestions from students, professors and other readers for better knowledge.

In the completion of this book, I need to express thanks to my wife Mrs. Veena Agarwal, M.A. (Eco.) for her supportive activities.

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Date: 7th November, 2017

SYLLABUS

B.COM. (FINANCIAL MARKETS)
SEMESTER IV

MODULES AT A GLANCE

Sr. No.	Modules	No. of Lectures
1.	Introduction to Merchant Banking	15
2.	Initial Public Offering (IPO)	15
3.	Issue of DRs, ADRs and CPs	15
4.	Issue of Bonds and Debentures	15
	Total	60

Sr. No.	Modules/Units
1.	**INTRODUCTION TO MERCHANT BANKING**
	Introduction to Merchant banking, Importance, need, functions, Merchant banking services — Project counselling, Loan syndication and Corporate counselling; Pre-issue merchant banking activities — Obtaining stock exchange approvals, action as per SEBI guidelines, Finalizing the appointments with — Manager/Advisers, Underwriters, Brokers, Bankers, Advertising agency, Drafting and approval of prospectus; Post-issue merchant banking activities — Issue subscription, Allotment of shares, Refunds, Periodical reports to SEBI.
2.	**INITIAL PUBLIC OFFERING (IPO)**
	Initial Public Offering — Issuance Process, Role of registrar, SEBI guidelines for IPO eligibility, IPO grading, Draft Red Herring Prospectus (DRHP), Listing agreement, Pricing the issue, Book building process, Allotment; SEBI Guidelines in Drafting the Offer Document; Pre- and Post-launch activities in IPO, SEBI Guidelines on QIP, Rights and Bond Issues.

3.	**ISSUE OF DRs, ADRs AND CPs**
	Types and Process of Issuing of Depository Receipts (DRs) — American Depository Receipts (ADRs), Global Depository Receipts (GDRs), European Depository Receipts (EDRs), Indian Depository Receipts (IDRs), ADR structure and norms, Indian Depository Receipts (IDRs) and Guidelines; Procedure for issue of Commercial Paper — Credit Rating, Redemption process.
4.	**ISSUE OF BONDS AND DEBENTURES**
	Procedure for Issue of Bonds and Debentures, Foreign currency convertible bonds.

QUESTION PAPER PATTERN

Maximum Marks: 75
Questions to be Set: 05
Duration: 2½ Hours
All questions are compulsory carrying 15 Marks each.

Question No.	Particulars	Marks
Q.1	Objective Questions (A) Sub-questions to be asked (10) and to be answered (any 08) (B) Sub-questions to be asked (10) and to be answered (any 07) (*Multiple Choice/True or False/Match the Columns/Fill in the Blanks)	15 Marks 15 Marks
Q.2 Q.2	Full Length Question ***OR*** Full Length Question	15 Marks 15 Marks
Q.3 Q.3	Full Length Question ***OR*** Full Length Question	15 Marks 15 Marks
Q.4 Q.4	Full Length Question ***OR*** Full Length Question	15 Marks 15 Marks
Q.5 Q.5	(A) Theory Questions (B) Theory Questions ***OR*** Short Notes To be asked (05) To be answered (03)	08 Marks 07 Marks 15 Marks

Note: **Theory question of 15 Marks may be divided into two sub-questions of 7/8 and 10/5 Marks.**

CONTENTS

Chapter 1

INTRODUCTION TO MERCHANT BANKING

1.1 INTRODUCTION (MEANING)

The term merchant banking is used differently in different countries and so there is no precise definition for it. In India, Ministry of Finance has defined Merchant Banker as "any person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to the securities as manager, consultant, advisor or rendering corporate advisory service in relation to such issue management."

1.2 IMPORTANCE

To promote the new issue (of shares) market, there is need for a qualitative improvement in the offer of new issues, both in terms of time taken and the cost of floatation. At present, the time taken for organising a new issue is about 12 months and the cost of raising new capital varies in-between 3% to 8%. This higher level is brought down relatively by specialised merchant banking institutions by catering to the requirements of both large and small units.

Cost of floatation of equity and preference capital is higher for new companies than for existing companies indicating thereby the difficulties experienced by new companies in making a new issue. Merchant banks can help saving in the cost of new companies.

The new issue market has not succeeded fully in mobilising savings partly due to the preference of the public to company deposits and partly due to low yield of equities as compared to those on fixed interest securities. There has been steep rise in the cost of new issues. There are certain minimum costs to be incurred in respect of fees to brokers (0.5%), promoters' expenses, 1.5%. Lead Manager's Commission 0.20% to 0.25%, underwriting commission @ 2.5% etc.

While bigger companies are able to manages this while small industries find it difficult to meet this minimum cost with uncertain prospects of public response.

1.3 NEED FOR MERCHANT BANKING

For small size projects, a promoter can raise the required funds by recourse to the traditional source of finance, *viz.,* bank finance. However, for medium and large size projects, the promoters cannot exclusively depend on commercial banks who normally do not give long-term and large amount of loans. In such cases the promoters have to find **alternative sources** of finance with all-India and State-level financial institutions or development banks such as IFCI, IDBI, State Industrial Development Corporation IRCI (for sick units) ICICI Bank Ltd., international markets and the capital market.

There is a wide range of activities which may be grouped under Merchant banking. These activities or needs may be divided under two heads, *viz.,* counselling and procuring finance.

The main activities are:

1. **Project counselling or reinvestment studies for investors**—
   (*a*) identify promising projects.
   (*b*) preparing feasibility report.
   (*c*) preparing project reports
   (*d*) assist investors in obtaining licences.
   (*e*) doing precise capital structuring.
   (*f*) arranging foreign collaborations
   (*g*) giving guidance on amalgamations, mergers and takeovers.
2. **Syndication of loans and project finance:** After identification of the project and obtaining licences from government departments, the need arises for undermentioned steps:
   (*a*) Assisting in approaching financial institutions and banks for sources of finance.
   (*b*) Expert advice on government policies, demand-supply gap, availability of raw materials, plant capacity utilisation, etc.
   (*c*) Consultation about alternative sources of finance, debt equity ratio, over run finance.
   (*d*) Liaison with government departments, banks and financial institutions.
   (*e*) Advice for modernisation, expansion and diversification.
3. **Issue Management:** Management of the public issue of shares/debentures (and even an offer for sale) has been the traditional services rendered by merchant bankers. Following are the services rendered under this category:
   (*a*) decide on size and timing of public issue.
   (*b*) preparing for marketing.

(*c*) optimum underwriting support.

(*d*) appointments of bankers and brokers.

(*e*) issue management.

(*f*) preparation of draft prospects and other documents.

(*g*) preparation of advertising and promotional material.

4. Provision of working capital.
5. Foreign currency loans' arrangements for export credit.
6. Portfolio management for NRIs such as guidance on purchase and sale of securities, advice on market conditions, safe custody of documents, collection of dividends, interest, etc., service link between NRIs and RBI for obtaining necessary permissions.

1.4 FUNCTIONS OF MERCHANT BANKING

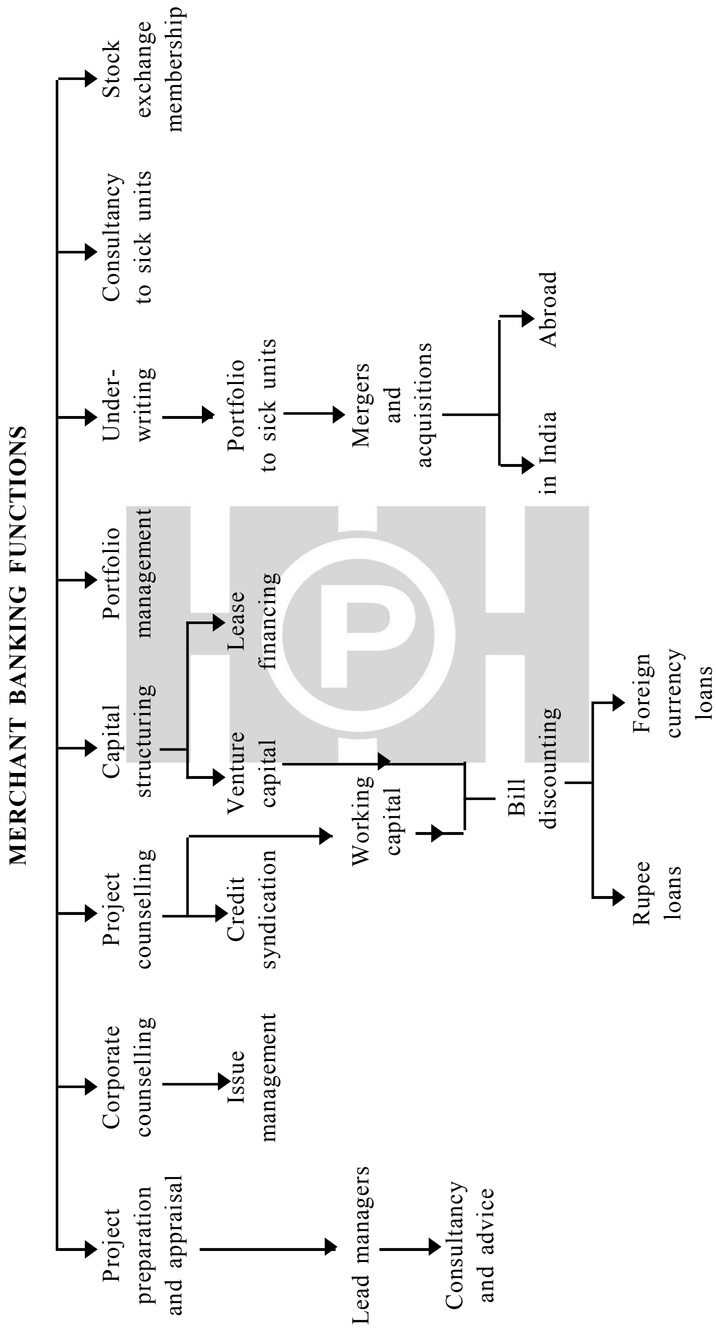
There are various functions for Merchant bankers in new public issues of a company, which are depicted by a chart on the next page:

Merchant Banking services are activities, *i.e.,* counselling corporate clients, on capital structure, form of capital, terms and conditions of issue, underwriting of issue, timing of issue and preparation of prospectus. They may also relate to private placement of capital and the raising of long-term loans, either in foreign exchange or in Indian rupees.

Thus, the activities are mainly stock exchange oriented, a few proposals of mergers and acquisition are also to be handled.

There is no doubt that one of the important functions of merchant banking relates to issue house activities, there are others, which are equally important. Now, we deal in detail all such functions:

(a) Project finance: When it is decided to set up a project the merchant bankers provide a comprehensive package of services for financial structuring and funding. A project finance assignment fully tests, the creativity of the merchant banker and the entire


MERCHANT BANKING FUNCTIONS
Project preparation and appraisal
Lead managers
Consultancy and advice
Corporate counselling
Issue management
Project counselling
Credit syndication
Working capital
Capital structuring
Venture capital
Lease financing
Bill discounting
Rupee loans
Foreign currency loans
Portfolio management
Under-writing
Portfolio to sick units
Mergers and acquisitions
in India
Abroad
Consultancy to sick units
Stock exchange membership

gamut of merchant banking services including loan syndication, issue management, euro (dollar) currency financing and suppliers or buyers' credits.

(b) Corporate finance: It covers capital restructuring, project management, issue management, working capital arrangements, acceptance credit, etc.

(c) Loan syndication: Assistance in getting term loans for project. Such loans are taken either from a single finance provider or a syndicate or consortium.

Definition and Nature of Syndicated Loans

Syndicated loans are syndicated to banks or sold off in parts to other banks or financial institutions as attractive forms of investment. Syndicated loans are credits granted by a group of banks to a borrower. They are a hybrid between relationship lending and disintermediated debt. Syndication can be a means of avoiding excessive single name exposure, in compliance with regulatory limits on risk concentration, while maintaining a relationship with the borrower. Syndicated loans help to meet the borrowers demand for loan commitments without bearing alone the credit and market risks. Syndicated credits are a very significant source of international financing, accounting for a third of all international financing, including bond, commercial paper and equity issues.

Syndicated loans acquired new characteristics in the beginning of 1990s when the banks which suffered losses in the debt crisis of 1980s exchanged their syndicated loans for Brady bonds, started applying more sophisticated risk pricing techniques, developed in the corporate bond market; covenant triggers which linked pricing explicitly to corporate events such as changes in ratings and debt servicing, guarantees and unfunded risk transfer (*e.g.,* credit default risk) techniques such as synthetic securitisation enabled banks to buy protection against credit risk while keeping the loans on the balance sheet. The adoption of the new risk management techniques enabled a wider circle of financial institutions, pension funds and insurance firms to lend on the market. Lenders saw syndicated loans as a loss-leader for selling more lucrative investment banking and other services. The availability of data on the performance of loans contributed to the development of a secondary market which attracted non-bank financial firms in addition to borrowers from emerging markets, corporations in industrial countries.

The emergence of high yield bond market in 1980 acted as a catalyst for change in corporate finance and for the emergence of the bank loan asset class. Application of credit risk portfolio management has helped the bank loan asset class to emerge.

Companies that borrow money are called issuers. The primary types of issuers in the syndicated loan market are investment grade, leveraged and middle market. The investment grade market, relates to project finance. Leveraged firms have capital structures, in which debt dwarfs equity by three times or more. The middle market, refers to small loans market which are referred to as club loans.

Loan market has structured vehicles known as collateralised loan obligation (CLOs) and loan participation mutual funds known as prime funds. CLOs are set up to hold and manage pools of leveraged loans. It is financed by several tranches of debt that have rights to collateral and payment streams in descending order. CLOs are usually rated by two of the seven major rating agencies. Loans are fully secured by the assets of the company in addition to carrying covenant protection. In case of bankruptcy the buyer of leveraged loan will generally get most of the money back.

Assessment of Syndicated Loans

In the assessment of the potential risks and returns of syndicated bank loans three features are emphasized. They are:

- Seniority
- Security/Collateral
- Floating rate nature of returns

The first two components mitigated credit risk and the third, the interest rate risk. Bank loans were less risky than high yield bonds which were subordinated, unsecured and fixed interest bearing. Leveraged loans are a floating rate asset class whose base rate is LIBOR reset every quarter to keep pace with changing interest rate. The leveraged loans are loans to companies that do not have an investment grade rating and/or that have a high level of contracted and/or outstanding debt. The loans are made to companies to make acquisitions, expansion, refinance recap and make one time high dividend payment.

Structure of Syndicated Loan

The different titles used by significant participants in the syndications process are administrative agent, syndication agent, documentation agent, agent, co-agent or managing agent, and lead arranger or book runner.

The administrative agent is the bank that handles all interest and principal payments and monitors the loan.

The syndication agent is the bank that handles, in purest form, the syndication of the loan. Often, however, the syndication agent has a less specific role.

The documentation agent is the bank that handles the documents and chooses the law firm.

The agent title is used to indicate the lead bank when there is no other conclusive title available, as is often the case for smaller loans.

Co-agent or *book runner* is a league table designation used to indicate the 'top dog' in a syndication.

Structure of Syndicated Loan

1. Mandated Arranger to originate, structure and syndicate the transaction.
2. Book runner issues invitation to participate in the syndicate and disseminates information to banks and informs the borrower about the progress of the syndication.

3. Participants are banks providing funds.
4. Administrative agent is the arranger of a syndicated transaction in the US market and merchant bankers in the Indian Market (London Inter-Bank Offered Rate)

Pricing structure spreads and fees: Banks in the syndicate receive a spread over a floating rate benchmark such as LIBOR on the portion of the loan that is drawn and fees.

Arrangement fees is paid upfront to the arranger and other members of the lead team for putting the deal together.

Defaults and Recoveries

Credit losses equal the incidence of default multiplied by one minus recovery rate. Seniority and security are important in default recovery but their knowledge was not widespread. Enterprise value which is not in the form of hard assets formed the basis of structuring the deals on non-investment grade companies. Bank loan asset class has modest yet solid returns and very low volatility when compared to high yield bonds and many other fixed income asset classes. Further, bank loans have correlations with most other major investment classes dampening volatility in broader portfolios.

The advantages of seniority and security are significant but data on recoveries of bank credit vary between 60 and 80 per cent. Strong Sharpe ratios and attractive low or negative correlations have made bank loans into strong risk reduction asset class available in the capital markets.

The fees payable in a Syndicated Loan

Arrangement fee Received	Front-end	Also called arrangement fees. and retained by lead arranger.
Legal fees	Front-end	Legal Adviser.
Underwriting	Front-end	Price of the commitment to obtain finance.
Participation fees	Front-end	Received by senior participant

Facility fee	Per annum	Paid to bank for the facility whether used or not
Commitment fee	Per annum charged on undrawn amount	Paid as long as facility is not used.
Utilization fee	Per annum charged on drawn part	Boosts the lenders yield; enable the borrower to announce a lower spread to the market than actually being paid.
Agency fee	Per annum	Paid to agent bank.
Conduit fee	Front-end	Paid for channeling payment to avoid withholding tax.
Prepayment fee	One-off prepayment	Penalty for prepayment.

Relative size of spreads and fees differs in conjunction with a number of factors. Fees are more significant for Euribor based loans than LIBOR loans. For industrialized market borrowers fees is higher than for emerging market ones.

Lenders demand additional compensation for the higher and more variable credit risk in emerging markets.

Secondary Market

The leveraged loan market matured dramatically in the past 30 years in USA and Europe with emergence of a growing investor base and the establishment of market standards for practices. A trade association to set guidelines for the market and oversee the standards and practices for trading loans as well as mark to market pricing. The Loan Syndications and the Trading Association (LSTA) was established in 1995. These developments helped the growth of a secondary market which is efficient.

Corporate loan market has come to dominate the markets for other asset classes. The primary issuances for the corporate loan market increased 4.2 times from $389 billion in 1994 to $1648 billion in 2005. Corporate borrowers have availed of the advantages of this asset class.

But the impetus to the maturation of the asset class was provided by the development of the secondary market in terms of the growth of the investor base, leading to the innovation of vehicles, including access to the retail investor. The secondary market has provided the needed liquidity to manage the credit risk profiles of their portfolios. The secondary trading activity grew from $8 billion in 1991 to $77.6 billion in 1998 and $170 billion in 2005 in U.S.A. The distressed loan market was a major contributor for this growth. The market adopted to changing credit climate. The secondary market has more than tripled since 1998.

The investor base for corporate loans has grown and diversified over the last decade. Banks used to be dominant buyers and holders of corporate loans. But institutional investors have come to represent the loan's share of investment activity. Banks role however changed from pure loan originators to arrangers and traders/dealers of loan. The growth in the secondary market is remarkable because loans are not securities but rather private placement instruments. The institutional investors restructure their loan portfolios into prime funds or structured vehicles such as CLOs/CDOs. Insurance companies (5%) and hedge funds (12%) participate in the market.

(d) Issue management: It is marketing of corporate securities, *viz.,* equity shares, preference shares and debentures offering them to public. Merchant bankers act as intermediary to transfer capital from those who own it to those who need it. The pre-issue management includes —

— preparation of prospectus, offer for sale and/or private placement.

— marketing and underwriting

— pricing of issue

(e) Corporate advisory services relating to issue: In India, company now freely decides the pricing of issues with valuable inputs from the merchant bankers, who have to sell the issue at the decided price. The pricing of issue especially in the public issue, is very important. The pricing has to be such that the investors will be attracted to invest, in the issue at the price, at the same, the premium can play a very big role, in deciding the company's capital structure, as larger the premium lesser will be the requirement for borrowed funds.

The promotor also needs to decide whether to go for a fresh issues or go for a rights issue (first option to buy shares). However, this will depend mainly on the quantum of funds that the company needs to raise. The success of the issue is dependent on the selection of the right type of security. In this matter, the expert advice of the merchant bankers is of immense importance.

In the issue management the merchant bankers have to coordinate the various agencies to the issue. The success of the issue depends on the cooperation of the agencies involved.

(f) The merchant bankers offer following services during the public issue:

(*a*) preparing an action plan and budget for the total expenditure for the issue.

(*b*) preparation of application to SEBI and assistance in obtaining the consent from SEBI.

(*c*) drafting of the prospectus.

(*d*) selection of underwriters, brokers, etc.

(*e*) selection of banker to the issue.

(*f*) selection of advertising agency for publicity.

(*g*) obtaining approval of institutional underwriters and stock exchanges for publication of the prospectus.

Companies are free to appoint one or more agencies as Manager's to the Issue". SEBI guidelines insist that all issues should be managed by atleast one authorised merchant banker, functioning either as the sole or lead manager to the issue. Ordinarily, not more than two merchant bankers should be associated as Lead Managers, Advisors and Consultants to a public issue.

In issues of over ₹ 100 crores, the maximum number could be upto four.

The responsibilities of merchant bankers, in management of public issues, are many. Some of these are —

(*i*) Merchant bankers are satisfied with the viability of the project, which can then sell to investors with confidence. It is, therefore, important for the reputation of merchant bankers to only associate themselves with good issues.

(*ii*) The merchant banker should act as the custodians of the investors' money and this puts a lot of responsibility on them. To discharge this function, the merchant bankers have to exercise due diligence, independently by verifying the contents of the prospectus and the reasonableness of the views expressed therein. Though they do not sign the prospectus, they have to give a certificate to that effect to SEBI.

(*iii*) It is the responsibility of merchant bankers to get the securities listed on all the stock exchanges mentioned in the prospective. It can be especially true of companies, who cannot list their shares on either NSE or BSE, but promising listing on several regional stock exchanges, but if they list them only on one or two exchanges and lose their corporate existence. A takeover is the purchase by one company acquiring controlling interest in the share capital of another existing company. Merchant banker appraises merger/takeover proposal with respect to financial viability and technical feasibility.

(*g*) Lead managers: As per Security and Exchange Board of India (SEBI) guidelines, it is mandatory that all public issues should be managed by merchant bankers in the capacity of lead managers. The number of lead managers to be appointed by a company depends upon the size of the issue as below:

Sl. No.	*Size of issue*	*Maximum No. of Lead Managers*
1.	Less than ₹ 50 crores	2
2.	₹ 50 crores to ₹ 100 crores	3
3.	₹ 100 crores to ₹ 200 crores	4
4.	₹ 200 crores to ₹ 400 crores	4
5.	Above ₹ 400 crores or more (as prescribed by SEBI)	5 or more

1.5 OBTAINING STOCK EXCHANGE APPROVALS — PROCEDURE

(*a*) As per section 40 of Companies Act, 2013, every company making public offer, shall before making such a offer, make an application to one or more stock exchange or exchanges and obtain permission for the securities.

(*b*) The company can offer public issue at premium (amount higher than the face value of the security) can be made by the Board of Directors of the company in consultation with lead manager to the issue.

(*c*) Appointment of merchant banker is mandatory.

(*d*) The company has to receive minimum subscriptions, as decided by Board from the issue within 3 to 30 days from the date of opening of issue.

(*e*) Underwriting of public issue is mandatory.

(*f*) Company's promoters have to hold minimum 25% in the total capital.

(*g*) All companies making public issue shall invariably issue an advertisement in at least two all India newspapers.

(*h*) In issue of shares, a particular number of shares are offered for sale to public at a stated price-band.

(*i*) Any document by which the offer of sale to the public is made shall for all purposes, be deemed to be a prospectus issued by the company. (Section 28 of Indian Companies Act, 2013)

(*j*) Company offering shares to public may convert its securities into dematerialised form or issue its securities in physical form in accordance with the provisions of Depository Act, 1996.

(*k*) Submission of documents to *Company-Registrar* of the state with *pro forma* prospectus with copies of contracts with lead manager, bankers, registrars and brokers entered for the issue of shares, for the registration.

(*l*) All the copies of above contracts with *pro forma* prospectus alongwith necessary registration fees to concerned stock exchanges, which includes one regional stock exchange. All this is to be done within 7 days of allotment of shares to public, thereafter the shares are listed in those stock exchanges.

Further, while issuing advertisement for public offer it is also mentioned that those shares have been applied for listing in stock exchanges.

1.6 ACTION AS PER SEBI GUIDELINES

SEBI has brought out number of guidelines, from time to time, for primary market, secondary market, mutual funds, merchant bankers, Foreign Institutional Investors (FII), investors' protection etc.

All these guidelines are described hereunder:

(i) Primary Market

New company: A new company is one which has not completed 12 months commercial production and does not have audited results and where the promoters do not have a track record. These companies will have to issue shares only *at par* (on the face value of shares)

New company set up by existing company: The existing company with a track record of 5 years of consistent profitability and contribution of at least 50% in the equity of the new company will be free to price its issue, *i.e.,* it can issue shares at premium (at high value than its face value).

Private and closely held companies: The private and closely held companies having a track record of consistent profitability for at least three years, shall be permitted to price their issues freely. The issue price here would be decided in consultation with the lead managers to the issue.

Existing listed companies: The existing listed companies will be allowed to raise fresh capital by freely pricing expanded capital provided the promoter's contribution is 50% on first ₹ 100 crore issue, 40% on next ₹ 200 crores, 30% on next ₹ 300 crores and 15% on balance issue amount.

Reservations in Issues

Reservation under public subscription for various categories is made in the following manner —

• Permanent employees	10%
• Indian Mutual Funds	20%
• Foreign Institutional Investors (FIIs)	05%
• Qualified Institutional Buyers (QIBs)	15%
• Indian shareholders	25%
• Investor's contribution	25%
	100%

Composite issues

In the case of composite issue, *i.e.,* right cum public issue by existing listed companies differential pricing is allowed. In other words, issue to the public can be priced differentially as compared to issue to rights shareholders. However, justification for the price difference should be given in the offer document.

Lock-in-period: Lock-in-period is three years for promoter's contribution from the date of allotment or from the commencement of commercial production whichever is later.

Secondary Market

(*i*) Board of directors of stock exchange be constituted to include non-members, public representatives, government representatives, to the extent of 50% of the total numbers.

(*ii*) Capital adequacy norms are laid down for members of various exchanges depending upon their turnover of trade and other factors.

(*iii*) Working hours for all stock exchanges have been fixed uniformly. [Presently 9 AM to 3.30 PM (Saturday and Sunday off)].

(*iv*) All the recognised stock exchanges have to inform about the transactions within 24 hours.

(*v*) Guidelines for introducing the system of market-making in less liquid scrips in all stock exchanges.

Brokers

(*i*) Registration of brokers and sub-brokers is compulsory.

(*ii*) In order to have professionally qualified and financially solvent, capital adequacy norms for registration of brokers evolved.

(*iii*) Compulsory audit of brokers books and filing of audit report with SEBI is mandatory.

(*iv*) Brokers have to disclose transaction price and brokerage separately in the contract notes issued to client.

(*v*) No broker is allowed to underwrite more than 5% of public issue.

(*vi*) Guidelines for persons who do the work on behalf of Credit Rating Agencies and brokers that such persons have to obtain certificate from National Institute of

Securities' Markets, after passing necessary examination. Such existing persons have to obtain such certificates within two years and new entrants within one year.

Foreign Institutional Investors (FII)

(*i*) FIIs are allowed to invest in all securities traded in primary and secondary markets for registered FIIs.

(*ii*) There is no restriction on the volume of investment for the purpose of entry of FIIs.

(*iii*) The holding of single FII will not exceed the ceiling of 5% of the equity.

Rights Issue

As per section 62 of the Companies Act, 2013 specifies the conditions to be satisfied by a public company for issuing rights shares. Its guidelines are —

(i) Composite Issue: The premium on rights issue is fixed by Board of Directors in consultation with lead manager to the issue.

(ii) Appointment of Merchant Bankers: Appointment of merchant bankers is mandatory where the rights issue amount exceeds ₹ 50 lakhs.

(iii) Rights of FCD/PCD Holders: The proposed rights issue should not dilute the value or rights of fully or partly paid convertible debenture holders. If the conversion of FCD/FCDs is due in the next 12 months from the date of rights issue, reservation of shares out of rights issue is to be made in proportion to the convertible part of FCD/PCDs.

(iv) Vetting of Letter of offer by SEBI: The letter of offer pertaining to rights issue has to be verified by SEBI and the concerned lead manager has to obtain SEBI clearance for the draft letter of offer before approaching stock exchange for fixing the record date for the proposed issue.

(v) **Advertisement in newspaper:** All listed companies making rights issue is required to issue advertisements in at least two all India newspapers about the despatch of offer, opening date, closing date, etc. Such advertisement shall be at least one week before the date of opinions of the subscription list.

1.7 FINALISING THE APPOINTMENT WITH VARIOUS PERSONS

There are various players in the stock market and in issue management. The important of them are the following. All agreement signed with the following players are submitted with the stock exchange.

1. Merchant bankers
2. Registrars
3. Bankers
4. Underwriters and Brokers
5. Advertising Agencies
6. Investment Bankers.
8. Foreign Financial Institutions
9. SEBI

We now discuss some of above players.

The appointments of various persons is essential ion issue of shares to public as per requirement of SEBI.

1. Brokers: When issue of share process is to start brokers are appointed by the company management, in consultation with merchant bankers to the issue.

It is the duty of every broker to make payments to his clients or deliver the securities purchased within 24 hours of payout. Broker is the member of the stock exchange his appointment is done. Merchant bankers appoints a broker of repute. Such persons alone ensures the sale of securities of this new company, or existing company.

Brokers alone can ensure prompt and quick execution of a transaction at the best possible and profitable price.

Functions of Brokers

First of all, a trading broker has to enter into an agreement in the specified format with his client before accepting any orders on his clients behalf. The said agrement has to be executed on the non-judicial stamp paper duly signed by both parties.

Apart from the brokers, there are other category of persons called sub-brokers. This sub-broker is not a member of the stock exchange. But he is a person who acts as an agent of a stock broker.

Brokers help in the floatation of new issues not only through underwriting or as a managing brokers but also as financial consultants, advising on the proper capital structure, methods of raising capital and requirements of Companies Act, 2013, Securities Contracts (Regulation) Act and listing requirements, etc. Brokers along with the network of sub-brokers market the new issue. They send their own circulars and applications to their clients and do follow-up to market the securities.

Bankers to the Issue

There are two types of activities performed by the banks, *viz.,* collecting bankers and coordinating bankers. Collecting and coordinating bankers may be the same bank or different banks. Collecting bankers collect the subscriptions for cash, cheques, or in ASBA form. While coordinating bankers collect information on subscriptions and coordinate the collection work. They monitor the work and inform it to the registrars and merchant bankers.

The intermediaries like merchant bankers, underwriters, broker, sub-brokers, bankers to the issue, etc., are required to be registered with SEBI.

Managers/Consultants or Advisors

The manager's to the issue assist in the drafting of prospectus, application forms and completion of formalities under the Companies Act 2013, appointment of Registrar for dealing with share applications and transfer and listing of shares of the company on the stock exchange. Companies are free to appoint one or more agencies as managers to the issue. SEBI guidelines insists that all issues should be managed by at least one authorised merchant banker. Ordinarily, not more than two merchant bankers should be associated as lead managers, advisors and consultants to a public issue. In issues of over ₹ 100 crores, upto a maximum of four merchant bankers could be associated as managers.

Underwriters

Underwriting and marketing of new issue is the major activity in new issues. In India, all financial institutions and brokers undertake this business. Banks do enter this market in a big way by starting their own divisions in merchant banking or their subsidiaries. Insurance and investment companies are also an important category of underwriters.

Underwriters and financial institutions subscribes more for preference shares and debentures than for equity shares as latter are more attractive to the investing public and thus devolve less on the underwriters.

Advertising Agencies

After despatch of prospectus to SEBI, the merchant bankers arrange of meeting with company representatives and advertising agents to finalise arrangement relating to —

- — date of opening and closing of issue.
- — registration of prospectus.
- — launching publicity campaign.
- — fixing date of board meeting to approve and sign prospectus and pass the necessary resolutions.

Publicity campaign covers the preparation of all publicity material and brochures, prospectus, announcement, advertisement in the press, radio, TV, investors' conferences, etc. The merchant bankers help choosing the media, determinating the size and publications in which the advertisement should appear.

The agreement with advertising agency is entered after finalisation of its name by the merchant bankers and the company.

1.8 DRAFTING AND APPROVAL OF PROSPECTUS

Prospectus means any document described or issued as a prospectus and includes a Red Herring Prospectus referred to in section 32 (Companies Act 2013) or staff prospectus referred to in section 31 or any notices, circular, advertisement, or other document inviting offers from the public for subscription of any securities of a body corporate.

Thus, any company's prospectus which is drafted includes details like total capital to be raised, issuable in number of equity/preference shares, closing price of securities, since these are required with every company.

The placement of issues be through prospectus, offer of sale, private placement and rights issue. Prospectus is issued for inviting subscription from the public. No allotment of any securities of a company offered to the public for subscription shall be made unless the amount stated in the prospectus as the minimum subscription have been paid to and received by the company by cheque or other instrument.

1.9 POST ISSUE MERCHANT BANKING ACTIVITIES

In post-issue management acts to *collect all the applications for shares,* statement from banks, sorting of proper application forms, starting allotment procedure and refund of subscribed money to those who are not allotted shares. This allotment base is required to be consented by the stock exchange and company secretary has to certify that allotment of shares as approved by the stock exchange.

In case of underwriters' activities, balance amount of shares not subscribed, the underwriter has to pay for the balance shares.

Registrars have to ensure that the application's are *proposed and allotment/refund orders* are sent within 10 days of the close of issue.

Portfolio refers to investment in different kinds of securities such as shares, debentures or bonds issued by different companies and securities issued by the government. It is not merely a collection of unrelated assets but a carefully blended asset combination within a unified framework. *Portfolio management refers to maintaining proper combination of securities* in a manner that they give maximum return with minimum risk.

Merchant bankers provide portfolio management service to their clients. Every prudent investor is interested in safety, liquidity and profitability of his/her investment. But investors cannot choose the appropriate securities. They need expert guidance. Merchant bankers have a role to play, in this regard. They have to conduct regular market and economic surveys to know:

— Monetary and fiscal policies of the government.

— Financial statements of various corporate sectors in which the investments have to be made by the investors.

— Secondary market position, *i.e.,* how the sale and purchase of securities are moving.

— Changing pattern of the economy.

— Competition faced by the industry with similar type of industries.

Advisory Services in Mergers and Acquisitions

A merger is a combination of two or more companies into a single company. Now the details of all activities are hereunder:

Issue Subscription

The Registrar's role in subscription currency is —

— Receive the collection figures everyday.

— Tabulate and classify the collection data on the basis of the standard *pro forma* and slabs of shares applied for.

— Inform the stock exchange for the closure of issue.

The role of registrar's pre-allotment work is —

- Get all the application forms from the collecting bankers and select the valid forms.
- The valid applications are to be categorised and group as cash, bank drafts and ASBA facility.
- Valid applications for allotment are selected and classified.
- Regional stock exchange is to be approached for finalising the basis for allotment in the event of oversubscription.

Allotment of Shares and Refunds

- Finalise the allotment as per the basis approved by the stock exchange.
- Allotment of shares among all categories especially the small investors with small investor with maximum subscription upto ₹ 3 lakhs.
- Allotment of shares and refund orders to be sent within 10 days.
- The amount payable on every security shall not be less than 5% of the nominal amount.
- Submit all statements to the company for final approval.
- Arrange to pay the brokerage and underwriting commission.
- Assist the company in getting the allotted shares listed on the stock exchange.

1.10 PERIODICAL REPORTS TO SEBI

There are various reports, at different stages, submitted to SEBI by companies:

(*i*) Periodical reports from recognised stock exchanges such as transactions in stock exchange, daily, within 24 hours.

(*ii*) Filing of audit report of brokers' books every year.

(*iii*) Companies buying back shares through stock exchanges must disclose purchase details daily to SEBI.

(*iv*) The company shall file SEBI a certificate from their banks that the assets on which security is to be created are free from encumbrances.

(*v*) The underwriter is to furnish within a period of six months from the end of the financial year a copy of the balance sheet profit and loss account of capital adequacy requirements and such other documents.

(*vi*) The draft prospectus is filed with SEBI by the lead merchant banker.

(*vii*) The merchant banker has to file a certificate of Due Diligence, before the issue.

1.11 QUESTIONS AND ANSWERS

I. State whether the statements are TRUE or FALSE:

(*i*) SEBI regulates the primary market by controlling the investors.

(*ii*) SEBI provides redressal for investors grievances.

(*iii*) A Red Herring Prospectus does not have any details of number of shares offered or price of shares.

(*iv*) Debt securities are mostly ownership based.

(*v*) Syndicated loans are credits granted by a group of banks to a borrower.

(*vi*) In the assessment of potential risks and returns of syndicated loans is done at fixed rate of interests.

(*vii*) Seniority and security are important in regular recovery.

(*viii*) Lenders demand additional compensation for the higher and more viable credit risk in syndicated loans.

[***Answer:*** (*i*) False, (*ii*) True, (*iii*) True, (*iv*) False, (*v*) True, (*vi*) False, (*vii*) False, (*viii*) True]

II. Fill in the Blanks:

(*i*) Post issue services of merchant bankers include collection of ________ forms.

(*ii*) Investment in different kinds of securities is called ________ management.

(*iii*) Merger is a combination of two or more companies into ________ company.

(*iv*) All merchant bankers manage the issue in the capacity of ________ managers.

(*v*) Every company making public offer shall before making such offer make an application to one or more stock ________.

(*vi*) Appointment of merchant banker is ________ in public offer.

[***Answer:*** (*i*) application, (*ii*) Portfolio, (*iii*) single, (*iv*) Lead, (*v*) exchanges, (*vi*) mandatory]

III. Objective Type Questions:

(*a*) Any offer to public is considered public offer where the offer is made to —

(*i*) maximum 1000 persons is made.

(*ii*) minimum 50 or more persons

(*iii*) minimum 100 or more persons

(*iv*) No limit.

(*b*) Any document by which the offer of sale, to the public is made shall be deemed.

(*i*) prospectus (*ii*) draft prospectus

(*iii*) shelf (*iv*) application form

(*c*) A company can offer public issue at —

(*i*) premium (*ii*) discount

(*iii*) at par (*iv*) both (*i*) and (*ii*)

(*d*) A public company has to receive subscription:

(*i*) 90% minimum

(*ii*) minimum as stipulated by company

(*iii*) 100% minimum (*iv*) 70% minimum

(*e*) Lead manager role is played by:

(*i*) Merchant banker (*ii*) Underwriter

(*iii*) Brokers (*iv*) registrar

[***Answer:*** (*a*) (*ii*), (*b*) (*i*); (*c*) (*iv*); (*d*) (*ii*); (*e*) (*i*)]

IV. Write Short Notes not exceeding 10 lines:

(*i*) What is portfolio management.

(*ii*) Define merchant banker

(*iii*) Write a note on project counselling

(*iv*) Advantages of underwriting

(*v*) What do you mean by public issues?

(*vi*) Banker's to the issue

(*vii*) Functions of a broker

(*viii*) Rights issue

(*ix*) Secondary market

V. Essay Type Questions:

(*i*) Scope of merchant banking in India. Discuss.

(*ii*) Write about the services of merchant bankers.

(*iii*) Explain the detail of pre-issue management.

(*iv*) Discuss the guidelines for merchant bankers issued by SEBI.

(*v*) Foreign institutional investors

(*vi*) Role of brokers in public issue.

VI. Match the Columns:

(*a*) The letter of offer to be verified by	(*i*) Prospectus
(*b*) Right's issue requires advertisement in	(*ii*) New issues
(*c*) Brokers help in the floatation of	(*iii*) SEBI
(*d*) Manager's to the issue assist in the drafting of	(*iv*) Two newspaper
(*e*) Manager's to the issue is appointed by	(*v*) Company

[***Answer:*** (*a*) (*iii*); (*b*) (*iv*) (*c*) (*ii*); (*d*) (*i*); (*e*) (*v*)]