SRINIVASAN COLLEGE OF ARTS & SCIENCE

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PERAMBALUR - 621 212

MERCHANT BANKING AND FINANCIAL SERVICES
TWO MARKS QUESTIONS AND ANSWERS

UNIT-(I-V)

1.**What is merchant banking?**

A bank that deals mostly in (but is not limited to) international finance, long-term loans for companies and underwriting. Merchant banks do not provide regular banking services to the general public.

2.What is OTCEI?

'Over-The-Counter Exchange of India an electronic stock exchange based in India that is comprised of small- and medium-sized firms looking to gain access to the capital markets. Like electronic exchanges in the U.S. such as the Nasdaq, there is no central place of exchange and all trading is done through electronic networks

3. What do you mean by private placement?

The sale of securities directly to an institutional investor, such as a bank, mutual fund, insurance company, pension fund, or foundation. Does not require SEC registration, provided the securities are bought for investment purposes rather than resale, as specified in the investment letter.

4. How is forfeiting different from export factoring?

Forfeiting and factoring are services in international market given to an exporter or seller. Its main objective is to provide smooth cash flow to the sellers. The basic difference between the forfeiting and factoring is that forfeiting is a long term receivables (over 90 days up to 5 years) while factoring is short termed receivables (within 90 days) and is more related to receivables against commodity sales.

5. Define green shoe

A provision contained in an underwriting agreement that gives the underwriter the right to sell investors more shares than originally planned by the issuer. This would normally be done if the demand for a security issue proves higher than expected. Legally referred to as an over-allotment option. A green shoe option can provide additional price stability to a security issue because the underwriter has the ability to increase supply and smooth out price fluctuations if demand surges

6. What is book building?

The process of determining the price at which an Initial Public Offering will be offered. The book is filled with the prices that investors indicate they are willing to pay per share, and when the book is closed, the issue price is determined by an underwriter by analyzing these values.

7.Who is an issue manager?

The issue can be through offer of sale or private placements, prospectus, and so on. The issue management includes the following functions with respect to issue through prospectus:

- To obtain approval for the issue from the SEBI.
- To arrange underwriting for the proposed issue.
- To draft and finalise the prospectus and to obtain clearance from the stock exchange, auditors, underwriters and registrar of companies.
- To select registrar of the issue, advertising agencies, underwriters, bankers and brokers to the issue and finalise the charges to be paid to the registrar.
- To arrange press conferences, and investors and brokers through advertising agency.

8.What do you know about the IPO method of marketing securities?

IPO (Initial Public Offer) is a type of public issue of securities where an unlisted company makes a fresh issue of securities or an offer for sale of its existing securities for the first time to the public.

9. Define underwriting.

A significant intermediary in issue market is the underwriters to issue of capital who take up securities which are not fully subscribed. Underwriter is a person who agrees to take up shares specified in the underwriting agreement of the public, who fails to subscribe them. SEBI has allowed merchant bankers and registered underwriters to act as underwriters. To act as underwriter, a certificate of registration must be obtained from SEBI. The underwriter makes profit on the difference between the public offering price and the price paid to the issuer; and that is called the underwriting spread or price spread. Underwriters are appointed by the issuing companies after consulting with the merchant bankers to the issues

10. Write short note on bankers to an issue.

The bankers to an issue engage in activities such as acceptance of applications along with the application money from the investors with respect to issues of capital and refund application of money. Bankers to an issue accept applications with the subscriptions offered at their designated branches and forward them to the registrar in agreement with instructions issued to them. They undertake publicity to the issue by distributing publicity material, prospectus and application forms. They are entitled for brokerage on shares allocated against applications bearing their stamps. In case of large issues, sufficient numbers of banks with branches at major centres are appointed. According to SEBI regulations, registration of bankers to issues with SEBI is compulsory. Under the regulations, inspection of bankers to an issue is done by Reserve Bank on request from SEBI.

11.Write short note on brokers to an issue.

Brokers are mainly concerned about obtaining the subscription to the issue from the prospective investors. The appointment of brokers is not compulsory. Members of established stock exchange are appointed as brokers to issue. Companies are permitted to appoint any number of brokers. The official brokers together with the managers to the issue coordinate the preliminary distribution of securities and acquire direct subscription from many investors. The stock exchange laws prohibit the members from acting as brokers to the issue. The stock exchange grants permission to the members if the members give their approval and the company conforms to the requirements and undertakes to have its securities listed on a recognized stock exchange. The company appoints the broker to the issue at every centre where stock exchanges are located.

12.Securities underwriting

Securities underwriting refers to the process by which investment banks raise investment capital from investors on behalf of corporations and governments that are issuing securities (both equity and debt capital).

This is a way of selling a newly issued security, such as stocks or bonds, to investors. A syndicates of bank (the lead managers) underwrite the transaction, which means they have taken on the risk of distributing the securities. Should they not be able to find enough investors, they will have to hold some securities themselves. Underwriters make their income from the price difference (the "underwriting spread") between the price they pay the issuer and what they collect from investors or from broker-dealers who buy portions of the offering.

13.Risk, exclusivity, and reward

Once the underwriting agreement is struck, the underwriter bears the risk of being unable to sell the underlying securities, and the cost of holding them on its books until such time in the future that they may be favorably sold.

If the instrument is desirable, the underwriter and the securities issuer may choose to enter into an exclusivity agreement. In exchange for a higher price paid upfront to the issuer, or other favorable terms, the issuer may agree to make the underwriter the exclusive agent for the initial sale of the securities instrument. That is, even though third-party buyers might approach the issuer directly to buy, the issuer agrees to sell exclusively through the underwriter.

14.Bank underwriting

In banking, underwriting is the detailed credit analysis preceding the granting of a loan, based on credit information furnished by the borrower, such as employment history, salary and financial statements; publicly available information, such as the borrower's credit history, which is detailed in a credit report; and the lender's evaluation of the borrower's credit needs and ability to pay. Examples include mortgage underwriting.

Underwriting can also refer to the purchase of corporate bonds, commercial paper, government securities, municipal general-obligation bonds by a commercial bank or dealer bank for its own account or for resale to investors. Bank underwriting of corporate securities is carried out through separate holding-company affiliates, called securities affiliates or Section 20 affiliates.

15.Insurance underwriting

Insurance underwriters evaluate the risk and exposures of potential clients. They decide how much coverage the client should receive, how much they should pay for it, or whether even to accept the risk and insure them. Underwriting involves measuring risk exposure and determining the premium that needs to be charged to insure that risk. The function of the underwriter is to protect the company's book of business from risks that they feel will make a loss and issue insurance policies at a premium that is commensurate with the exposure presented by a risk.

16.Real estate underwriting

In evaluation of a real estate loan, in addition to assessing the borrower, the property itself is scrutinized. Underwriters use the debt service coverage ratio to figure out whether the property is capable of redeeming its own value or not.

17.Forensic underwriting

Forensic underwriting is the "after-the-fact" process used by lenders to determine what went wrong with a mortgage. Forensic underwriting refers to a borrower's ability to work out a modification scenario with their current lien holder, not to qualify them for a new loan or a refinance. This is typically done by an underwriter staffed with a team of people who are experienced in every aspect of the real estate field.

18.Sponsorship underwriting

Underwriting may also refer to financial sponsorship of a venture, and is also used as a term within public broadcasting (both public television and radio) to describe funding given by a company or organization for the operations of the service, in exchange for a mention of their product or service within the station's programming.

19.Definition of Forfeiting

The terms forfeiting is originated from a old French word 'forfait', which means to surrender ones right on something to someone else. In international trade, forfeiting may be defined as the purchasing of an exporter's receivables at a discount price by paying cash. By buying these receivables, the forfeiter frees the exporter from credit and the risk of not receiving the payment from the importer.

20.Forfeiting

The forfeiting typically involves the following cost elements:

1. Commitment fee, payable by the exporter to the forfeiter 'for latter's' commitment to execute a specific forfeiting transaction at a firm discount rate with in a specified time.
2. Discount fee, interest payable by the exporter for the entire period of credit involved and deducted by the forfaiter from the amount paid to the exporter against the availised promissory notes or bills of exchange.

21.Definition of Factoring

Definition of factoring is very simple and can be defined as the conversion of credit sales into cash. Here, a financial institution which is usually a bank buys the accounts receivable of a company usually a client and then pays up to 80% of the amount immediately on agreement. The remaining amount is paid to the client when the customer pays the debt. Examples includes factoring against goods purchased, factoring against medical insurance, factoring for construction services etc.

22. Disclosed Factoring

In disclosed factoring, client's customers are aware of the factoring agreement.

Disclosed factoring is of two types:
Recourse factoring: The client collects the money from the customer but in case customer don't pay the amount on maturity then the client is responsible to pay the amount to the factor. It is offered at a low rate of interest and is in very common use.
Nonrecourse factoring: In nonrecourse factoring, factor undertakes to collect the debts from the customer. Balance amount is paid to client at the end of the credit period or when the customer pays the factor whichever comes first. The advantage of nonrecourse factoring is that continuous factoring will eliminate the need for credit and collection departments in the organization.
23· Issue management – A major function of merchant banking is issue management. The issue can be through offer of sale or private placements, prospectus, and so on. The issue management includes the following functions with respect to issue through prospectus:
- To obtain approval for the issue from the SEBI.
- To arrange underwriting for the proposed issue.
·24. Pre-investment studies of investors – The merchant bankers undertake the practicality surveys in selected areas of client's interest. It also includes the studies for foreign organisations which are planning for joint ventures in India. The survey covers the advice on the nature of participation and Government regulations. Pre-investment study covers the study of the project and includes the following aspects:
- Developing or reviewing of project profile.
- Preparing project reports after analysing financial, market and economic feasibility.
25· Corporate counselling – Corporate counselling refers to the activities undertaken to ensure effective running of a corporate enterprise through efficient management of finance. A merchant banker guides the clients on organisational goals, choice of product and market survey, forecasting a product, cost analysis, investment decisions, pricing methods, capital management and expenditure control, market strategy and so on. Corporate counselling is a facility provided by merchant bankers to corporate enterprises free of charge. This is to improve the performance of the enterprise. Merchant bankers also provide services such as building a good image among the investors which help in increasing the market value of investor's equity shares.
26· Project counselling – Project counselling is a part of corporate counselling which is related to project finance. A merchant banker provides the clients project counselling that involves providing advice on procedural aspects of project implementation, conducting financial study of the project, providing assistance in project profiles, providing assistance in seeking approvals from Government of India for foreign technical and financial collaboration agreements.
27· **Loan syndication** – A merchant banker helps the clients to get loan for the project. They also help in conducting appraisal and designing capital structure.
28· **Portfolio management** - Portfolio management refers to making decisions related to investment of cash resources of a corporate enterprise in marketable securities by deciding the type of security to be purchased. A merchant banker helps the clients in making the right choice of investment to obtain optimum investment, undertaking investment in securities conducting critical evaluation of investment portfolio, and so on.
29· Project finance – A merchant banker who undertakes a project scheme also assists in arranging a comprehensive package for the project funding. The process involves the study of the pattern of financing available from merchant banks and financial institutions. The merchant bankers work closely with the client and the technical consultant and submit a complete financial report to the client. They also provide assistance in legal documentation for the finance arranged.
30· Working capital – Merchant bankers assist in arranging finance for working capital particularly for new ventures. For existing firms, the merchant bankers arrange the funds from non-traditional sources such as through issue of debentures, and so on. For example, Central Bank of India (CBI) has started working capital finance as one of the merchant banking service area.
31· **Managerial and technical services** – Merchant bankers provide services to deal with problems in technical, financial and managerial fields
32.Bankers to an issue

The bankers to an issue engage in activities such as acceptance of applications along with the application money from the investors with respect to issues of capital and refund application of money. Bankers to an issue accept applications with the subscriptions offered at their designated branches and forward them to the registrar in agreement with instructions issued to them. They undertake publicity to the issue by distributing publicity material, prospectus and application forms. They are entitled for brokerage on shares allocated against applications bearing their stamps. In case of large issues, sufficient numbers of banks with branches at major centres are appointed. According to SEBI regulations, registration of bankers to issues with SEBI is compulsory. Under the regulations, inspection of bankers to an issue is done by Reserve Bank on request from SEBI.

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34.Debenture trustees

Debenture trustee is the trustee of debenture stock. A debenture stock is issued as loan security to secure debts of the company. It is necessary to get a certificate of registration from the SEBI to act as a debenture trustee. The debenture trustee holds a secured property on behalf of the issuer of security. The trustee has the right to carry on with the sale of secured property in case of default by the issuer of security, according to the procedure in the Transfer of Property Act. The profits of sales will be applied to redeem the debentures. The appointment of debenture trustee is mandatory. A company appoints debenture trustees when there is a need for executing a trust deed. This occurs when the company wants to issue a prospectus or letter of offer to the public for securing subscription to its debentures. A debenture trustee is an intermediary between the issuer of debentures and the holder of debentures. The main responsibility of the debenture trustee is to safeguard the interest of holders of debentures. This includes creation of security by the company issuing the debenture and to compensate their grievances.

35. Portfolio managers

Portfolio manager is a person responsible for investing a mutual, exchange-traded fund asset and also responsible for implementing investment strategy and managing the day-to-day portfolio trading. The portfolio manager is an important factor that needs to be considered regarding fund investing. He undertakes the management and administration of portfolio of securities and funds of clients on their behalf. Portfolio management is the art of making decisions about investments and policy, allocating assets for individuals and balancing risk against performance. Portfolio management can be classified into two types-

36· Discretionary portfolio management – It permits the use of discretion regarding investment and management of the portfolio of the securities and funds. In this type of management the manager independently manages the capital of each client.

37.· Non-discretionary portfolio management – In this type of management the manager manages funds according to the directions of the client.

It is mandatory to obtain a certificate from SEBI in order to carry on portfolio management services.

38.BSE's Book Building System

· BSE offers a book building platform through the Book Building software that runs on the BSE Private network.

· This system is one of the largest electronic book building networks in the world, spanning over 350 Indian cities through over 7000 Trader Work Stations via leased lines, VSATs and Campus LANS.

· The software is operated by book-runners of the issue and by the syndicate members , for electronically placing the bids on line real-time for the entire bidding period.
· In order to provide transparency, the system provides visual graphs displaying price v/s quantity on the BSE website as well as all BSE terminals.

39.IPO Process Explained

We all know what an IPO is and what the purpose of an IPO is for the company issuing the share. But, not many of us know the different requirements that a company must satisfy in order to go public and the different stages in the life cycle of an IPO. The purpose of this article is to elaborate on this. So, lets get started.

40.What is an IPO

An IPO stands for Initial Public Offering, wherein a company issues its shares to the public for the first time. Investors can place requests to buy these shares and once done, the share gets listed in a registerd stock exchange and the company uses the share issue proceeds for its development/growth. Before we take a look at the steps in an IPO process, lets take a look at the entry norms for an IPO.

41.Entry Norms for an IPO:

Not all company's can issue shares to the public. SEBI has provided a list of requirements that need to be met by a company if they wish to go public. A company that wishes to go public needs to meet all of the below mentioned criteria…

Entry Norms I or EN I:

1. Net Tangible assets of atleast Rs. 3 crores for 3 full years
2. Distributable profits in atleast 3 years
3. Net worth of atleast 1 crore in 3 years
4. If there was a change in name, atleast 50% of the revenue in the preceeding year should be from the new activity
5. The issue size should not exceed 5 times the pre-issue networth of the company

42.types of lease agreements

Lease agreements are basically of two types. They are (a) Financial lease and
(b)Operating lease.
(c) Sale and lease back
(d) Leveraged leasing and
(e) Direct leasing.

43. Financial Lease

Long-term, non-cancellable lease contracts are known as financial leases. The essential point of financial lease agreement is that it contains a condition whereby the lessor agrees to transfer the title for the asset at the end of the lease period at a nominal cost. At lease it must give an option to the lessee to purchase the asset he has used at the expiry of the lease. Under this lease the lessor recovers 90% of the fair value of the asset as lease rentals and the lease period is 75% of the economic life of the asset. The lease agreement is irrevocable. Practically all the risks incidental to the asset ownership and all the benefits arising there from are transferred to the lessee who bears the cost of maintenance, insurance and repairs. Only title deeds remain with the lessor. Financial lease is also known as 'capital lease'. In India, financial leases are very popular with high-cost and high technology equipment.

44.Operatiional Lease

An operating lease stands in contrast to the financial lease in almost all aspects. This lease agreement gives to the lessee only a limited right to use the asset. The lessor is responsible for the upkeep and maintenance of the asset. The lessee is not given any uplift to purchase the asset at the end of the lease period. Normally the lease is for a short period and even otherwise is revocable at a short notice. Mines, Computers
hardware, trucks and automobiles are found suitable for operating lease because the rate of obsolescence is very high in this kind of assets.

45.Sale And Lease Back

It is a sub-part of finance lease. Under this, the owner of an asset sells the asset to a party (the buyer), who in turn leases back the same asset to the owner in consideration of lease rentals.

However, under this arrangement, the assets are not physically exchanged but it all happens in records only. This is nothing but a paper transaction. Sale and lease back transaction is suitable for those assets, which are not subjected depreciation but appreciation, say land. The advantage of this method is that the
lessee can satisfy himself completely regarding the quality of the asset and after possession of the asset convert the sale into a lease arrangement.

46.Leveraged Leasing

Under leveraged leasing arrangement, a third party is involved beside lessor and lessee. The lessor borrows a part of the purchase cost (say 80%) of the asset from the third party i.e., lender and the asset so purchased is held as security against the loan. The lender is paid off from the lease rentals directly by the lessee and the surplus after meeting the claims of the lender goes to the lessor. The lessor, the owner of the asset
is entitled to depreciation allowance associated with the asset.

47. Direct Leasing

Under direct leasing, a firm acquires the right to use an asset from the manufacturer directly. The ownership of the asset leased out remains with the manufacturer itself. The major types of direct lessor include manufacturers, finance companies, independent lease companies, special purpose leasing companies etc

48.Finance Leasing

Finanace Lease. Generaaly a lease called to be fianace lease when lessee granted right to use leased asset, over a whole period of useful life of the asset.

49.Hire purchase (abbreviated HP, colloquially sometimes never-never[1]) is the legal term for a
contract, in which persons usually agree to pay for goods in parts or a percentage at a time. It was developed in the United Kingdom and can now be found in Australia, China, India, Jamaica, Japan, Malaysia, New Zealand, and South Africa. It is also called closed-end leasing. In cases where a buyer cannot afford to pay the asked price for an item of property as a lump sum but can afford to pay a percentage as a deposit, a hire-purchase contract allows the buyer to hire the
goods for a monthly rent. When a sum equal to the original full price plus interest has been paid in equal installments, the buyer may then exercise an option to buy the goods at a predetermined price (usually a nominal sum) or return the goods to the owner. In Canada and the United States, a hire purchase is termed an installment plan; other analogous practices are described as closed- end leasing or rent to own.

Mergers

A type of business combination where two or more firms amalgamate into one single firm is known as a merger. In a merger, one or more companies may merge with an existing company or they may combine to form a new company.

Objectives

The main purpose of merges is to achieve the advantage of fusion and synergy through expansion and diversification.

OTHER FEE BASED MANAGEMENT INTRODUCTION:

Mergers and Acquisitions (M&A) as forms of business combination are increasingly being used for undertaking restructuring of corporate enterprises the world over. In fact, the corporate world is in the grip of merger-mania (mega mergers and hostile takeovers). The merger wave which began in the U.S. first occurred during the period between 1890 and 1904. Of late, mergers happen in all the sectors of the economy, the prime driving force being the accomplishment of synergetic effect for both the acquiring and the acquirer companies.

MERGERS

A type of business combination where two or more firms amalgamate into one single firm is known as a merger. In a merger, one or more companies may merge with an existing company

or they may combine to form a new company. In India mergers and amalgamations are used interchangeably. In the wider sense, merger includes consolidation, amalgamation, absorption and takeover. It signifies the transfer of all assets and liabilities of one or more existing companies to another existing or new company.

Objectives The main purpose of merges is to achieve the advantage of fusion and synergy through expansion and diversification.

STEPS IN M & A Following are:

1. Review of Objectives: The first and foremost step in M&A is that the merging companies must undertake the review of the purpose for which the proposal to merge is to be considered. Major objectives of merger include attaining faster growth, improving profitability, improving managerial effectiveness, gaining market power and leadership, achieving cost reduction, etc. The review of objectives is done to assess the strengths and weaknesses, and corporate goals of the merging enterprise. In addition, the need for elimination of inefficient operations, cost reduction and productivity improvement, etc. should also be considered. Such a move would help the acquiring company to decide as to the kind of business units that must be acquired.

2. Data for analysis: After reviewing the relevant objective of acquisition the acquiring firm needs to collect detailed information pertaining to financial and other aspects of the firm and the industry. Industry-centric information will be needed to make an assessment of market growth, nature of competition, case of entry, capital and labor intensity, degree of regulation, etc. Similarly, firm-centric information will be needed to assess quality of management, market share, size, capital structure, profitability, production and marketing capabilities, etc. The data to be collected serves as the criteria for evaluation

3. Analysis of information: After collecting both industry-specific and firm-specific information, the acquiring firm undertakes analysis of data and the pros and cons are weighed. Data is to be analyzed with a view to determine the earnings and cash flows, areas of risk, the maximum price payable to the target company and the best way to finance the merger.

4. **Fixing price:** Price to be paid for the company being acquired shall be fixed taking into consideration the current market value of share of the company being acquired. The price shall usually be above the current market price of the share. A merger may take place at a premium. In such a case, the firm would pay an offer pri market value. This would happen where the acquiring firm is of the firm opinion that such an option would augment operational results of the target firm owing to synergic effect.

5. Finding merger value: Value created by merger is to be found so that it is possible for the merging firms to determine their respective share. Merger value is equal to the excess of combined present value of the merged firms over and above the sum of their individual present values as separate entities. Any cost incurred towards the merging process is subtracted to arrive at the figure of net economic advantage of merger. This advantage is shared between the shareholders of the merging firms.

2 Take Over

Takeover is the case where one company obtains control over the management of another company. Under both acquisition and takeover, it is possible for a company to have effective control over another company even by holding minority ownership. For instance, the Monopolies and Restrictive Trade Practices (MRTP) Act prescribes that a minimum of 25 percent voting power must be acquired as to constitute a takeover. Similarly, section 372 of the Companies Act

defines the limit of a company's investment in the sh than 10 percent of the subscribed capital so as to constitute a takeover.

DISTINCTION BETWEEN ACQUISITION AND TAKE OVER

Where a distinction between acquisition and takeover is made, takeover usually takes the form of hostile or forced or unwilling acquisition and acquisition happens at the instance and the willingness of the company management and the shareholders. It is for this reason that willingness of the company management and the shareholders. It is for this reason that acquisition is generally referred to as 'friendly"Acquisition": takeover' an example of. e.g. acquisition is Mahindra and Mahindra Ltd., a leading manufacturer of jeeps and tractors, acquiring equity stake of Allwyn Nissan Ltd. "Hostile takeovers":The acquisition of Shaw e.g. Wallace, Dunlop, Mather and Platt and Hindustan Dorr Oliver by Chablis and Ashok Leyland by Hindujas, etc.

Hosile Takeovers Where in a merger one firm acquires another firm without the knowledge and consent of the management of the target firm, it takes the form of a 'hostile takeov acquiring firm makes a unilateral attempt to gain a controlling interest in the target firm, by purchasing shares of the later firm directly in the open (stock) market.

An example of hostile takeover was the takeover of TMBL by Sivasankaran of the Sterling Group. Since this type of takeover is generally prejudicial to the interest of the stakeholders, SEBI has come out with relevant code of conduct for the purpose of regulating the takeover practice in India.

Distinction between Mergers vs. Takeovers

The following are the differences between Mergers and Takeover:

Distinction Mergers Vs Takeover

1. Definition

Mergers: Defined as an arrangement whereby the assets of two companies become vested in, or under the control of, one company (which may or may not be one of the original two companies), which has as its shareholders all, or substantially all, the shareholders of the two companies.

Takeover: Defined as a transaction or series of transactions whereby a person (individual, group of individuals or company) acquires control over the assets of a company, either directly by becoming the owner of those assets or indirectly by obtaining control of the management of the company

2. Mode

Mergers: Effected by the shareholders of one or both of the merging companies exchanging their shares (either voluntarily or as the result of a legal operation) for shares in the other or a third company, the arrangement being frequently effected by means of a takeover bid by one of the companies for the shares of the other, or of a takeover bid by a third company for the shares of both

Takeover: Effected by agreement with the holders of the whole of the share capital of the company being acquired, where the shares are held by the public generally, the takeover may be effected by agreement between the acquirer and the controllers of the acquired company, or by purchases of shares on the Stock Exchange, or by means of a —takeover

3. Control over assets

Mergers: Shareholding in the combined enterprise will be spread between the shareholders of the two companies

Takeover: Direct or indirect control over the assets of the acquired company passes to the acquirer

4. Bid
Mergers: Bid is generally by the consent of the management of both companies
Takeover: Bid is frequently against the wishes of the management of the offeree company.

Major Issues of M&A in India

Business combinations and re-structuring in the form of merger, etc. have been attempted to face the challenge of increasing competition and to achieve synergy in business operations. The major issues of M&A are as follows:
Depreciation The acquiring firm claims depreciation in respect of fixed assets transferred to it by the target firm. The depreciation allowance is available on the written down value of fixed assets. Further, the depreciation charge is based on the consideration paid and without any revaluation.

R&D Expenditure It is possible for the acquiring firm to claim the benefit of tax deduction under section 35 of the Income Tax Act, 1961 in respect of transfer of any asset representing capital expenditure on R&D.

Tax Exemption The fixed assets transferred to the acquiring firm by the target firm are exempt from capital gains tax. This is however subject to the condition that the acquiring firm is an Indian Company and that shares are swapped for shares in the target firm. Further, as the swap of shares is not considered as sale by the shareholders, profit or loss on such swap is not taxable in the hands of the shareholders of the amalgamated company.

Carry Forward Losses The Indian Income Tax Act, 1961 contains highly favorable provision with regard to merger of a sick company with a healthy company. For instance, section 72A (1) of the Act gives the advantage of carry forward of losses of the target firm. The benefit is however available only:
• Where the acquiring from is an Indian Company;
• Where the target firm is not financially viable;
• Where the merger is in public interest,
• Where the merger facilities the revival of the business of the target firm; and
• Where the scheme of amalgamation is approved by a specified authority.

Characteristics of Consumer Credit
The nature of consumer credit may be the transfer of wealth to consumers for purchase of semi durables or durables except real estate where the payment is deferred in whole or in part upon agreed terms the agreed terms for repayment may be in the form of EMI.

Consumer Finance Transactions

The nature of consumer finance transactions may be

(a) Parties and Structure of the Transaction: The parties and the structure of the transaction may be either (i) Bipartite (ii) Tripartite.

A bipartite transaction involves two parties i.e.
1. Dealer-Cum-Financer and
2. Borrower or Customer.

A tripartite transaction involves three parties
1. The dealer
2. The financier

3. Borrower or customer

Transactions can either be structured in the form of hire purchase, conditional sale or credit sale, but a majority of the tripartite consumer finance transactions are of the hire purchase type.

(b) Payment for the transaction: The payment for specific transactions is divided into two categories: (i) Down Payment Schemes (ii) Deposit Linked Schemes.
The down payment varies from initial payments ranging from 20%-25% of the value of goods and financing is available for 75%-80% or as the case may be.
In a deposit-linked scheme, the down payment in the form initial deposit varying from 15% and 25% of the total value of the asset. The financier pays the full amount to the seller. Deposits carry a prescribed interest rate. Zero Deposit schemes are also available, under which the Equated Monthly Installment (EMI) is higher than the EMI under normal deposit schemes.

(c) Repayment Period The repayment period ranges from 12-60 months. Finance companies notify the customer indicating the amount of equated monthly installments to be paid through postdated Cheques.
(d) Security: The asset is secured through first charge on it for the credit provided. The borrower is prohibited from disposing, pledging or hypothecating the asset during above said credit period.
(e) Eligibility Criteria for Borrowers There is no specific criteria for borrowers, all the borrowers in the form of individuals, partnership firms, private and public limited companies are eligible to borrow.

UNIT – I MERCHANT BANKING

INTRODUCTION

The evolution of the financial system in India is nothing but the reflections of its political and economic history. The evolution process has been influenced by the factors of urbanization of society, advent or large scale industrialization, introduction of railways and telegraphic communications in the 19th century, nationalization of financial institutions in 20th century and implementation of information technology on the eve of the 21st century.

AN OVERVIEW OF INDIAN FINANCIAL SYSTEM

Financial system is a system to canalize the funds from the surplus units to the deficit units. Deficit units are a case where current expenditure exceeds their current income. There are other entities whose current income exceeds current expenditure which is called as Surplus units.

An efficient financial system not only encourages savings and investments, it also efficiently allocates resources in different investment avenues and thus accelerates the rate of economic development. The financial system of a country plays a crucial role of allocating scarce capital resources to productive uses. Its efficient functioning is of critical importance to the economy.

Financial System

• It is a system for the efficient management and creation of finance.

According to *Robinson*, "Financial system provides a link between savings and investment for the creation of new wealth and to permit portfolio adjustment in the composition of the existing wealth".

According to *Van Horne*, "Financial system is defined as the purpose of financial markets to allocate savings efficiently in an economy to ultimate users – either for investment in real assets or for consumption".

Objectives of Financial System/Service

- Accelerating the growth of economic development.
- Encouraging rapid industrialization
- Acting as an agent to various economic factors such as industry, agricultural sector, Government etc.
- Accelerating rural development
- Providing necessary financial support to industry

The functions of financial system can be classified into two broad categories:

1) Controlling functions
2) Promotional functions.

Structure of Indian Financial System

Financial system is a system of arranging different types of funds required for the Business. It deals about the following:

1) Financial Institutions
2) Financial Markets
3) Financial Instruments
4) Financial Services

 Financial Institutions

The Commercial Banks form the structure of financial institutions in India. They can be classified as under:

- o Central Bank
- o Banking and Non-Banking Companies
- o Financial Institutions
- o Non-Banking Financial Intermediaries
- o Co-operative Banks
- o Regional Rural Banks

 Financial Markets

(a) Capital Market: It is the market for long term funds i.e., raising capital for Companies through issue of shares and debentures. The Capital market can further divided into (a) Primary Market and (b) Secondary Market

Classification of Capital Market

(i) *Primary Market*: It is the market for primary needs of the company. The Company sells its shares at the time of promotion and the investors directly buy the shares from the company through application.

(ii) *Secondary Market*: It is the market for secondary needs of the company. The sale and purchase of securities i.e., shares and debentures will take place through the recognized stock exchanges.

(b) Money Market: It is a market for short term funds. Money market provides working capital.

(c) Foreign Money Market: It is a market for foreign exchange which is bought and sold. In India the foreign market is controlled by Reserve Bank of India. Foreign Exchange Management Act (FEMA) deals with foreign exchange.

(d) Government Securities Market: It is a market for Government securities like Treasury Bills and Bonds. Treasury Bills are bills issued for meeting the short term revenue expenditure of the Government.

 Financial Instruments

Financial instruments include both instruments and products. Instruments include cheques, drafts, letter of credit, travellers‟ cheques, commercial papers, GDR‟s, Bonds etc. Products may be in the form of Credit Cards, Debit Cards etc.

 Financial Services

Financial service, as a part of financial system provides different types of finance through various credit instruments, financial products and services. It enables the user to obtain any asset on credit according to his convenience and at a reasonable interest rate.

MERCHANT BANKING IN INDIA

In India, the merchant banking sector has grown at a faster pace in the last two decades with the growth of the capital market and the money market. However, there have been ups and downs in the fortunes of this industry in the past. Over the years, the number of players in the merchant banking industry came down and currently we find only a few large firms surviving in the industry.

The first merchant banking activity in India started in 1969 by the Grindlays Bank by opening a merchant banking division. Initially they were issue mangers looking after the issue of shares and raising capital for the company. But subsequently they expanded their activities such as working capital management; syndication of project finance, global loans, mergers, capital restructuring, etc., initially the merchant banker in India was in the form of management of public issue and providing financial consultancy for foreign banks.

According to SEBI, "*a merchant banker is one who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to the securities as manager, advisor or rendering corporate advisory services in relation to such issue management*".

Investment Banking Vs Merchant Banking

The term „merchant banking" and „investment banking" are often used interchangeable in the financial literature. However, we can make out a subtle distinction between these two. The term „Investment Banking" has the US origin whereas the term „merchant banking" is in vogue in countries such as the UK and India.

RECENT DEVELOPMENTS AND CHALLENGES AHEAD

The recent developments in Merchant banking are due to certain contributory factors in India. They are the Merchant Banking was at its best during 1985-1992 being when there were many new issues. It is expected that 2010 that it 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 in Indian Economy.

The challenges faced by merchant bankers in India

- SEBI guideline has restricted their operations to Issue Management and Portfolio Management to some extent. So, the scope of work is limited.
- In efficiency of the clients are often blamed on to the merchant banks, so they are into trouble without any fault of their own.
- The net worth requirement is very high in categories I and II specially, so many professionally experienced person/ organizations cannot come into the picture.
- Poor New issues market in India is drying up the business of the merchant bankers.

Thus the merchant bankers are those financial intermediary involved with the activity of transferring capital funds to those borrowers who are interested in borrowing. The activities of the merchant banking in India is very vast in the nature of

- The management of the customer"s securities
- The management of the portfolio
- The management of projects and counseling as well as appraisal
- The management of underwriting of shares and debentures
- The circumvention of the syndication of loans
- Management of the interest and dividend etc.

INSTITUTIONAL STRUCTURE

In tracing the history of the merchant banking in India, the structure of merchant bankers appeared as follows at one point of time:

1. Merchant banking divisions of commercial banks, both Indian and Foreign.
2. Merchant banking divisions of financial institutions (e.g. IDBI, IFCI, etc.)
3. Merchant banking companies promoted by stock broking firms. (e.g. JM Financial, DSP)
4. Merchant banking services of NBFCs

However, the above structure has undergone a transformation now. The merchant banking divisions of the commercial banks exist now as independent subsidiary companies of the parent firms. For example, the SBI Capital Markets Ltd is the subsidiary of SBI. The merchant banking activities of the NBFCs almost cease to exist.

FUNCTIONS OF MERCHANT BANK

A merchant banker is not merely an issue manager. The scope of his activities extends beyond issue management. He undertakes new responsibilities such as syndication of project financing, global fund raising, designing new financial instruments and deal making in corporate takeovers. From dealing in shares for major industrial houses to takeovers, the merchant bankers have come a long way in the spectrum of services that are offered. Their operations have considerably widened and have become more specialized.

The following are the functions of merchant bankers in India:

- Corporate Counseling
- Project Counseling
- Pre-investment Studies
- Capital Restructuring
- Credit Syndication and Project Finance
- Issue management and Underwriting
- Portfolio Management
- Working Capital Finance
- Acceptance Credit and Bill Discounting
- Mergers, Amalgamation and Takeovers
- Venture Capital
- Lease Financing
- Foreign Currency Finance

- Fixed Deposit Broking
- Mutual Funds
- Relief to Sick Industries
- Project Appraisal

LEGAL AND REGULATORY FRAMEWORK

An application should be submitted to SEBI in Form A of the SEBI (Merchant Bankers) Regulations, 1992. SEBI shall consider the application and on being satisfied issue a certificate of registration in Form B of the SEBI (Merchant Bankers) Regulations, 1992.

The registration fee payable to SEBI is Rs.5 lakhs which should be paid within 15 days of date of receipt of intimation regarding grant of certificate. The validity period of certificate of registration is Three years from the date of issue.

Categories of Merchant Bankers

Originally, as per SEBI regulations, merchant bankers were required to get authorization to act as an issue manager, underwriter or advisor. This authorization was granted by SEBI based on the net worth limits, professional competence, experience in the business, general reputation and the past performance record.

The categories for which registration may be granted are given below:

- Category I – To carry on the activity of issue management and to act as adviser, consultant, manager, underwriter, portfolio manager.
- Category II – To act as adviser, consultant, co-manager, underwriter, portfolio manager.
- Category III – To act as underwriter, adviser or consultant to an issue
- Category IV – To act only as adviser or consultant to an issue

Accordingly, four categories of merchant bankers should full fill the capital requirement as under:

- Category I Capital adequacy of Rs.5 crores
- Category II Capital adequacy of Rs.50 lakhs
- Category III Capital adequacy of Rs.20 lakhs
- Category IV No capital adequacy requirement

The functions rendered by these four categories were also stipulated by SEBI. Category I merchant banker could act as an issue manager, underwriter, advisor, consultant and portfolio manager. Although the advisory or consultancy function could be performed by all the four categories, it will not possible for Categories III and IV merchant bankers to act as an issue manager or portfolio manager.

RELEVANT PROVISIONS OF COMPANIES ACT

The Companies Act, 1956 sets out the code of conduct for companies with regard to issue, allotment and transfers of securities. It provides for disclosure to be made in the prospectus about the project, means of financing, particulars of company management and the perceptions of management with regard to risk factors. The legal aspects concerning dividends, rights and bonus issues are covered in the Companies Act.

- *Company* means a company formed and registered under this Act or an existing company as defined in clause (ii);

- *Existing company* means a company formed and registered under any of the previous companies laws specified below:
  Any Act or Acts relating to companies in force before the Indian Companies Act, 1866 (10 of 1866) and repealed by the Act;
  - The Indian Companies Act, 1866
  - The Indian Companies Act, 1882
  - The Indian Companies Act, 1913
  - The Registration of Transferred Companies Ordinance 1942

- P*rivate company* means a company which has a minimum paid-up capital of one lakh rupees or such higher paid-up capital as may be prescribed, and by its articles. a) restricts the right to transfer its shares, if any;
  b) limits the number of its members to fifty not including
  c) persons who are in the employment of the company, and
  d) persons who, having been formerly in the employment of the company, were members
  e) of the company while in that employment and have continued to be members after the employment ceased; an
  f) prohibits any invitation to the public to subscribe for any shares in, or debentures of, the company;
  g) prohibits any invitation or acceptance of deposits from persons other than its members, directors or their relatives Provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this definition, be treated as a single member;

- *Public company* means a company which a)
  is not a private company;
  b) has a minimum paid-up capital of five lakh rupees or such higher paid-up capital, may be prescribed
  c) is a private company which is a subsidiary of a company which is not a private company.

The various provisions and regulations of Companies Act, 1956 which govern the merchant bankers:

- o Prospectus (Sec. 55 to 68A)
- o Allotment (Sec. 55 to 75)
- o Commissions and discounts (Sec. 76 & 77)
- o Issue of shares at premium and at discount (Sec. 78 & 79)
- o Issue and redemption of preference shares (Sec. 80 & 80A)
- o Further issues of capital (Sec. 81)
- o Nature, numbering and certificate of shares (Sec. 82 to 84)
- o Kinds of share capital and prohibition on issue of any other kind of shares (Sec. 85 & 86)

SCRA (Securities Contracts (Regulations) Act)

The Securities Contract (Regulation) Act, 1956 provides for regulation of securities trading and control of stock exchanges. Recognition and supervision of stock exchanges and laying down the criteria for listing of securities are some of the salient features

of the SCRA. The government and the SEBI are empowered by the SCRA to issue appropriate orders for ensuring the smooth flow of transactions in stock exchanges.

The Securities Contracts (Regulations) Act was passed in 1956 by Parliament and it came into force in February 1957. An act to prevent undesirable transactions in securities by regulating the business of dealing therein, by providing for certain other matters connected therewith.

1. This Act may be called the Securities Contracts (Regulation) Act, 1956.
2. It extends to the whole of India.
3. It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint.

SEBI GUIDELINES

The SEBI Act, 1992 established SEBI as market regulator with all statutory powers. SEBI was established with the objective of protecting the interest of investors and for regulation and development of securities market in India. It has the powers to regulate all the market intermediaries. The SEBI grants registration to the market intermediaries and has powers to inspect, monitor and take penal actions on them in case of violations of any provisions of the Act or rules, Issues of securities, stock exchanges and other market intermediaries are subject to regulatory power of SEBI.

Merchant banking in India is governed by *SEBI (Merchant Bankers) Regulations* 1992. It provides for registration of merchant bankers, general obligations and responsibilities of merchant bankers, procedures for inspection and procedures for action in case of defaults. Besides these, the code of conduct for merchant bankers is also specified. To become a merchant banker the following are the pre-requisites:

- The applicant must be corporate body.
- The applicant should not carry on a business other than the securities market business.
- He should have the necessary infrastructure in terms of office space and experienced man-power.
- The associate company or the group company should not have been a registered merchant banker.
- The applicant should not have been involved in security scams.
- The minimum net worth of the applicant firm should be Rs.50million

Obligations and Responsibilities of Merchant Bankers

In the conduct of his business, a merchant banker is supposed to observe certain codes of conduct. SEBI has issued some guidelines for regulating the merchant banking activities and the code of conduct for the merchant banks is specified in the Schedule III of the *SEBI (Merchant Bankers) Regulations* 1992.

1. *High standards:*
2. *Due diligence:*
3. *Dealing with competing merchant bankers:*
4. *No tall claims:*
5. *Cost-effective service:*
6. *Confidentially:*
7. *Disclosure of information:*
8. *Avoid market manipulative practices:*
9. *Restrain on advisory role:*

SEBI has pronounced the following guidelines for Merchant Bankers:

1. Submission of Offer Document:

2. Dispatch of issue material
3. Underwriting:
4. Compliance Obligations:

5) Redressed of investor grievances:
6) The concerned lead merchant banker
7) Issue of No objection Certificate (NOC):
8) Registration of Merchant Bankers:
9) Renewal of Registration:
10) Impositions of Penalty Points:

FEMA (Foreign Exchange Management Act)

The Foreign Exchange Management Act (FEMA) is a 1999 Indian Law "to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India".

FEMA was passed in the winter session of Parliament in 1999, replacing the Foreign Exchange Regulation Act (FERA). This act seeks to make offenses related to foreign exchange civil offenses. It extends to the whole of India, replacing FERA, which had become incompatible with the pro-liberalization policies of the Government of India. It enabled a new foreign exchange management regime consistent with the emerging framework of the World Trade Organization (WTO). It is another matter that the enactment of FEMA also brought with it the Prevention of Money Laundering Act of
2002, which came into effect from 1 July 2005.

Switch from FERA

FERA, in place since 1974, did not succeed in restricting activities such as the expansion of translational corporations (TNCs). The concessions made to FERA in 1991-1993 showed that FERA was on the verge of becoming redundant. After the amendment of FERA in 1993, it was decided that the act would become the FEMA.
This was done in order to relax the controls on foreign exchange in India, as a result of economic liberalization. FEMA served to make transactions for external trade (exports and imports) easier – transactions involving current account for external trade no longer required RBI‟s permission.

Some Highlights of FEMA

FEMA is applicable in all over India and even branches, offices and agencies located outside India, if it belongs to a person who is a resident of India.

- It prohibits foreign exchange dealing undertaken other than an authorised person;
- It also makes it clear that if any person residing in India received any Forex payment (without there being a corresponding inward remittance from abroad) the concerned person shall be deemed to have received they payment from an unauthorized person.
- There are 7 types of current account transactions, which are totally prohibited, and therefore no transaction can be undertaken relating to them. These include transaction relating to lotteries, football pools, banned magazines and a few others.

RELATION WITH STOCK EXCHANGES AND OTCEI

A good example of a financial market is a ***stock exchange***. A company can raise money by selling shares to investors and its existing shares can be bought or sold.

We have two leading stock exchanges – the BSE and the NSE that have nationwide terminals in almost 400 towns. The turnover of these two stock exchanges constitutes 99.9% of the total turnover. Now, the concept of regional stock exchanges has lost the significance. We had 22 stock exchanges in India and out of these, 4 have been derecognized by SEBI and at present we have only 18 recognized stock exchanges. All these stock exchanges have been corporatized and demutualized as the SEBI norms on demutualization.

Capital Market Segments

The capital market has two main segments namely, the *primary market* and *secondary market*. In the primary market, new capital issues of public limited companies and the debt issues of the government takes place. A secondary market, on the other hand, deals with securities already issued. In a primary market, capital can be raised through a public issue or through private placement.

Secondary market is the stock market wherein the listed securities are traded in stock exchange. The Securities Contract Regulation Act (SCRA) governs the function of stock exchanges in the country. The regulations relate to recognition of stock exchanges, membership in stock exchanges and the listing of securities. In India, we have regional stock exchanges and national stock exchanges. Now that the stock exchanges have been permitted to setup trading terminals throughout the country, the concept of regional stock exchanges has lost its importance.

The Bombay Stock Exchange (BSE) dating back to 1875 is one of the oldest stock exchanges in the world and still it continues to be active. The National Stock Exchange of India Ltd (NSE) started in 1994 has emerged as stock exchange of repute with technologically superior trading systems. The BSE and the NSE are the two apex stock exchanges in the country. The inter-connected Stock Exchange of India (ICSE) is a stock exchange promoted by the regional stock exchanges and it is yet to make headway in the business of stock trading. Now, by using information and communication technology, the investors can have access to select stock exchanges through mobile devices too.

Stock Exchanges:

- It is the market for exchange of stocks.
- Stocks‟ refers to the old securities i.e., those which have been already issued and listed on a stock exchange.
- These securities are purchased and sold continuously among investors without the involvement of companies.
- Stock exchange provides not only free transferability of shares but also makes continuous evaluation of securities traded in the market. It is also called a

Secondary Market for securities.

- It is considered to be sine qua non for the primary market. In fact, the success of the issues taking place in the primary market depends much on the soundness and the depth of the secondary market.

According to Section 2(3) of the Securities Contract Regulation Act 1956 – "The stock exchange has been defined as anybody of individuals whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities".

The Securities that are traded at the Stock Exchanges

- Shares, scrips, stock, bonds, debentures, debentures stocks or other marketable securities of a like nature in or of any incorporated company or other body corporate
- Government securities; and
- Rights or interests in securities

Objectives of Stock Exchanges

1. Assisting in buying and selling of securities
2. Regulating the business of buying and selling or dealing in securities.

Functions of Stock Exchanges

The stock market occupies a pivotal position in the financial system. It performs several economic functions and renders invaluable services to the investors, companies, and to the economy as a whole. They may be summarized as follows:

1) *Liquidity and Marketability of Securities:*
2) *Safety of Funds:*
3) *Supply of Long Term Funds:*
4) *Flow of Capital to Profitable Ventures:*
5) *Motivation for Improved Performance:*
6) *Promotion of Investment:*
7) *Reflection of Business Cycle:*
8) *Marketing of New Issues:*
9) *Miscellaneous Services:*

Demutualization of Stock Exchanges

1) The transition process of an exchange from a "mutually-owned" association to a company "owned by Shareholders" is called demutualization.
2) Demutualization is transforming the legal structure, of an exchange from a mutual form to a business corporation form.
3) In a mutual exchange, the three functions of ownership, management and trading are intervened into a single group. It means that the broker members of the exchange are owners as well as traders on the exchange and further they themselves manage the exchange.

These three functions are segregated from one another after demutualization.

The demutualized stock exchanges in India are;

1. The National Stock Exchange (NSE)
2. Over the Counter Exchange of India (OTCEI)

Methods of Trading in a Stock Exchange

The stock exchange operation at follow level is highly technical in nature. Non-members are not permitted to enter into the stock market. Hence, various stages have to be completed in executing a transaction at a stock exchange. The steps involved in the methods of trading have been given below:

- *Choice of Broker:*
- *Placement of Order:*
- *Execution of Orders:*
- *Preparation of Contract Notes:*
- *Settlement of Transactions:*

NSE (National Stock Exchange of India)

- It is the screen based trading established to counter the influence of Bombay Stock Exchange and to reduce the influence of certain powerful intermediaries in the stock market.
- Both securities of companies and debt instruments are traded here. The success of this stock exchange is quite evident that within a few years of its promotion the volume and the value of transactions have surpassed the Bombay Stock Exchange.
- Apart from this, the prices of securities prevailing in this market have its influence on the Bombay Stock Exchange.

OTCEI (Over the Counter Exchange of India)

It is a Stock Exchange without a proper trading floor. All stock exchanges have a specific place for trading their securities through counters. But, OTCEI is connected through a computer network and the transactions are taking place through computer operations. Thus, the development in information technology has given scope for starting this type of stock exchange. This stock exchange is recognized under the Securities Contract (Regulation) Act and so all the stocks listed in this exchange enjoy the same benefits as other listed securities enjoy.

Features of OTCEI

1) Use of Modern Technology: It is an electronically operated stock exchange.
2) Restrictions for other stocks: Stocks and shares listed in other stock exchanges will not be listed in the OTCEI and similarly, stock listed in OTCEI will not be listed in other stock exchanges.
3) Minimum issued capital requirements: Minimum issued equity capital should be Rs.30 lakhs, out of which minimum public offer should be Rs.20 lakhs.
4) Restrictions for large companies: No company with the issued equity share capital of more than Rs.25 crores is permitted for listing.

Objectives of OTCEI

- Assisting and guiding small companies to raise funds from the capital market in a cost-effective manner
- Providing a convenient and an efficient avenue of capital market investments for small investors
- Strengthening investors‟ confidence in the financial market by offering them the two-way best prices to them
- Ensuring transparency, redressing investors‟ complaints and unifying the country‟s securities market to cover even those places which do not have a stock exchange
- Acting as a launch pad to an IPO
- Providing liquidity advantage to the securities traded
- Promoting organized trading in Unlisted Securities
- Providing a source of valuation for securities traded

Securities Traded on the OTCEI

1. *Listed Equity (exclusive):*
2. *Listed Debt:*
3. *Gilts:*
4. *Permitted Securities:*
5. *Listed Mutual Funds:*

To counter the influence of Bombay Stock Exchange and reduce the influence of certain powerful intermediaries in the stock market, a new stock market was promoted in which both securities of companies and debt instruments are traded, namely the National Stock Exchanges. NSE takes into account the screen based trading and so it is the most advanced. The success of this stock exchange is quite evident that within a few years of its promotion the volume and the value of transactions have surpassed the BSE.

Text Books & References:

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3. *Machiraju, "Indian Financial System", Vikas Publishing House, 2nd Edition, 2010.*
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5. *Website of SEBI.*

ROLE OF MERCHANT BANKING IN APPRAISAL OF PROJECTS

Merchant Banking, as a commercial activity, took shape in India through the management of Public Issues of capital and Loan Syndication. It was originated in 1969 with the setting up of the Merchant Banking Division by ANZ Grind lays Bank. The main service offered at that time to the corporate enterprises by the merchant banks included the management of public issues and some aspects of financial consultancy.

Merchant Bankers and Capital Issues Management

Merchant Banker has been defined under the Securities & Exchange Board of India (Merchant Bankers) Rules, 1992 as 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, advisor or rendering corporate advisory service in relation to such issue management.

The capital issue management comprises of the effective management of market related factors. They are:

Transition to rolling settlement on the equity market
Impact on different classes of market users
Obtaining a liquid bond market
Impact of reforms of 1990s
Law and taxation
Taxation of capital
Legal reforms
Political economy of financial sector reforms
Market design, market inefficiencies, and trading profits

Issue Management

The management of issues for raising funds through various types of instruments by companies is known as issue management. The function of capital issues management in India is carried out by merchant bankers. The Merchant Bankers have the requisite skill and competence to carry out capital issues management. The funds are raised by companies to finance new projects, expansion / modernization/ diversification of existing units etc.

Merchants of Public Issue Management

Classification of Securities Issue

- Public Issue
- Right Issue
- Private Placement

Merchant Bankers Functions

The different functions of merchant bankers towards the capital issues management are as follows:

1) Designing Capital Structure
2) Capital Market Instruments
3) Issue Pricing
4) Book Building
5) Preparation of Prospectus
6) Selection of Bankers
7) Advertising Consultants
8) Role of Registrar
9) Bankers to the Issue
10) Underwriters to the Issue
11) Brokers to the Issue

DESIGNING CAPITAL STRUCTURE

The term capital structure refers to the proportionate claims of debt and equity in the total long-term capitalization of a company.

According to *Weston and Brigham*, "Capital structure is the permanent financing of the firm, represented primarily by long-term-debt, preferred stock and common equity, but excluding all short-term credit. Common equity includes common stock, capital surplus and accumulated retained earnings".

Decisions on Capital Structure: The decisions regarding the use of different types of capital funds in the overall long term capitalization of a firm are known as capital structure decisions. Any decisions on Capital Structure are based on different principles.

a) Cost Principle
b) Control Principle
c) Return Principle
d) Flexibility Principle
e) Timing Principle

CAPITAL MARKET INSTRUMENTS

Financial instruments that are used for raising capital resources in the capital market are known as Capital Market Instruments. The changes that are sweeping across the Indian capital market especially in the recent past are something phenomenal. It has

been experiencing metamorphic in the last decade, thanks to a host of measures of liberalization, globalization, and privatization that have been initiated by the Government. Pronounced changes have occurred in the realm of industrial policy such as Licensing policy, Financial services, Interest rates, etc. The competition has become very intense and real in both industrial sector and financial services industry. As a result of these changes, the financial services industry has come to introduce a number of instruments with a view to facilitate borrowing and lending of money in the capital market by the participants.

Types of Capital Market Instruments: The various capital market instruments used by corporate entities for raising resources are as follows:

1. Equity Shares
2. Non-voting Equity shares
3. Preference Shares
4. Cumulative Convertible Preference Shares
5. Company Fixed Deposits
6. Warrants
7. Debentures and Bonds

ISSUE PRICING

A listed company can freely price equity shares/convertible securities through public/ rights issues. An unlisted company eligible to make a public issue and desirous of getting its securities listed on a recognized stock exchange can also freely price shares and convertible securities. The free pricing of equity shares by an infrastructure company 8is subject to the compliance with disclosure norms as specified by the SEBI from time to time. While freely pricing their initial public issue of share/convertibles, all banks require approval by the Reserve Bank of India (RBI).

Differential Pricing: Listed/unlisted companies may issue shares/convertible securities to applicants in the firm allotment category (i.e. Allotment on a firm basis made to Indian and multilateral development finance institutions.

Price Band: The issuer/issuing companies can mention a price band of 20 percent (cap in the price band should not exceed 20 percent of the floor price) in the offer document filed with the SEBI and the actual price can be determined at a later date before filing it with the ROCs (Registrar of Companies). If the Board of Directors (BOD) of the issuing company has been authorized to determine the offer price within a specified price band, a resolution would have to be passed by them to determine such a price.

Payments of Discounts/Commissions: Any direct/indirect payment in the nature of discount/commission/allowance or otherwise cannot be made by the issuer company/promoters to any firm allotted in a public issue.

BOOK BUILDING

A method of marketing the shares of a company whereby the quantum and the price of the securities to be issued will be decided on the basis of the bids received from the prospective shareholders by the lead merchant bankers is known as Book-Building method.

Under the book-building method, share prices are determined on the basis of real demand for the shares at various price levels in the market. For discovering the price at which issue should be made, bids are invited from prospective investors from which the demand at various price levels is noted. The merchant bankers undertake full responsibility for the same.

The book-building process involves the following steps:

1) Appointment of Book-Runners
2) Drafting Prospectus
3) Circulating Draft Prospectus
4) Maintaining Offer Records
5) Intimation about Aggregate Orders
6) Bid Analysis
7) Mandatory Underwriting
8) Filling with ROC
9) Bank Accounts
10) Collection of Completed Applications
11) Allotment of Securities
12) Payment Schedule and Listing
13) Under-subscription

Advantages of Book Building: Book-building process is of immense use in the following ways:

a. Reduction in the duration between allotment and listing b.
Reliable allotment procedure
c. Quick listing in stock exchanges possible
d. No price manipulation as the price is determined on the basis of the bids received

PREPARATION OF PROSPECTUS

Prospectus is defined a document through which public are solicited to subscribe to the share capital of a corporate entity. Its purpose is inviting the public for the subscription/purchase of any securities of a company.

Prospectus for public offer a)
Regular Prospectus b)
Abridged Prospectus
c) Prospectus for Rights Issue

d) Disclosures in Prospectus
e) Disclosures in Abridged Prospectus and Letter of Offer

Regular Prospectus: The regular prospectus is presented in three parts:

PART I

a. General Information about the company e.g. Name and address of the registered office consent of the Central Government for the issue and names of regional stock exchanges etc.,
b. Capital Structure such as authorized, issued, subscribed and paid up capital etc.,
c. Terms of the issue like mode of payment , rights of instruments holders etc., d. Particulars of the issue like project cost , means of financing etc.,
e. Company, Management and project like promoters for the project, location of the project etc.,
f. Disclosures of public issues made by the Company, giving information about type of issue, amount of issue, date of closure of issue, etc.,
g. Disclosure of Outstanding Litigation, Criminal Prosecution and Defaults
h. Perception of risk factors in marketing the products, of raw materials etc.,

PART II

a. General Information
b. Financial Information like Auditor"s Report, Chartered Accountant"s Report etc.,
c. Statutory and Other Information

PART III

a. Declaration i.e., by the directors that all the relevant provisions of the companies Act, 1956 and guidelines issued by the Government have been complied with.
b. Application with prospectus

Abridged Prospectus

The concept of abridged prospectus was introduced by the Companies (amendment) Act of 1988 to make the public issue of shares an inexpensive proposition. A memorandum containing the salient features of a prospectus as prescribed is called as Abridged Prospectus.

SELECTION OF BANKERS

Merchant bankers assist in selecting the appropriate bankers based on the proposals or projects. Because the commercial bankers are merely financiers and their activities are appropriately arrayed around credit proposals, credit appraisal and loan sanctions. But merchant banking include services like project counseling , corporate counseling in areas of capital restructuring amalgamations, mergers, takeover etc., discounting and rediscounting of short term paper in money markets, managing, underwriting and supporting public issues in new issue market and acting as brokers and advisers on portfolio management in stock exchange.

ADVERTISING CONSULTANTS

Merchant bankers arrange a meeting with company representatives and advertising agents to finalize arrangements relating to date of opening and closing of issue, registration, of prospectus, launching publicity campaign and 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 conference etc.

The merchant bankers help choosing the media, determining the size and publications in which the advertisement should appear. The merchant Bankers role is limited to deciding the number of copies to be printed, checking accuracy of statements made and ensure that the size of the application form and prospectus conform to the standard prescribed by the stock exchange.

The Merchant banker has to ensure that the material is delivered to the stock exchange at least 21 days before the issue opens and to brokers to the issue, branches of brokers to the issue and underwriter in time. Securities issues are underwritten to ensure that in case of under subscription the issues are taken up by the underwriters.

ROLE OF REGISTRARS

Role of Registrars to an Issue (and Share Transfer Agents): The registrars to an issue, as an intermediary in the primary market, carry on activities such as collecting application from the investors, keeping a proper record of applications and money received from investors or paid to the seller of securities and assisting companies in determining the basis of allotment of securities in consultation with stock exchanges, finalizing the allotment of securities and processing/dispatching allotment letters, refund orders, certificates and other related documents in respect of issue of capital.

The share transfer agents maintain the records of holders of securities or on behalf of companies, and deal with all matters connected with the transfer/redemption of its securities. To carry on their activities, they must be registered with the SEBI which can also renew the certificate of registration.

They are divided into two categories:

- Category I – To carry on the activities as a registrar to an issue and share transfer agent;
- Category II – To carry on the activity either as a registrar or as a share transfer agent.

The registration is granted by the SEBI on the basis of consideration of all relevant matters and, in particular, the necessary infrastructure, past experience and capital adequacy. It also takes into account the fact that any connected person has not been granted registration and any director/partner/principal officer has not been convicted for any offence involving moral turpitude or has been found guilty of any economic offence.

ANKERS TO THE ISSUE

The bankers to an issue are engaged in activities such as acceptance of applications along with application money from the investors in respect of issues of capital and refund of application money.

Registration: To carry on activity as a banker to issue, a person must obtain a certificate of registration from the SEBI. The SEBI grants registration on the basis of all the activities relating to banker to an issue in particular with reference to the requirements: The applicant has the necessary infrastructure, communication and data processing facilities and manpower to effectively discharge his activities,

a) The applicant/any of the directors of the applicant is not involved in any litigation connected with the securities market/has not been convicted of any economic offence;
b) The applicant is a scheduled bank and
c) Grant of a certificate is in the interest of the investors. A banker to an issue can apply for the renewal of his registration three months before the expiry of the certificate.

General Obligations and Responsibilities furnish Information

When required, a banker to an issue has to furnish to the SEBI the following information;

a. The number of issues for which he was engaged as a banker to an issue;
b. The number of application/details of the application money received,
c. The dates on which applications from investors were forwarded to the issuing company /registrar to an issue;
d. The dates/amount of refund to the investors.

Books of Account/Record/Documents

A banker to an issue is required to maintain books of accounts/records/documents for a minimum period of three years in respect of, inter-alia, the number of applications received, the names of the investors, the time within which the applications received were forwarded to the issuing company/registrar to the issue and dates and amounts of refund money to investors.

Disciplinary action by the RBI

If the RBI takes any disciplinary action against a banker to an issue in relation to issue payment, the latter should immediately inform the SEBI. If the banker is prohibited from carrying on his activities as a result of the disciplinary action, the SEBI registration is automatically deemed as suspended/cancelled.

UNDERWRITERS

Another important intermediary in the new issue/primary market is the underwriters to issues of capital who agree to take up securities which are not fully subscribed. They make a commitment to get the issue subscribed either by others or by themselves. Though underwriting is not mandatory after April 1995, its organization is an important element of the primary market. Underwriters are appointed by the issuing companies in consultation with the lead managers/merchant bankers to the issues. A statement to the effect that in the opinion of the lead manager, the underwriters‟ assets are adequate to meet their obligation should be incorporated in the prospectus.

Registration: To act as underwriter, a certificate of registration must be obtained from the SEBI. In granting the certificate of registration, the SEBI considers all matters relevant/relating to the underwriting and in particular.

Fee: Underwriters, had to, for grant or renewal of registration, pay a fee to the SEBI from the date of initial grant of certificate, Rs. 2 lakhs for the first and second years and Rs.1 lakh for the third year. A fee of Rs.20,000 was payable every year to keep the certificate in force or for its renewal. Since 1999, the registration fee has been raised to Rs.5 lakhs. To keep the registration in force, renewal fee of Rs.2 lakhs every three years from the fourth year from the date of initial registration is payable. Failure to pay the fee would result in the suspension of the certificate of registration.

Agreement with Clients: Every underwriter has to enter into an agreement with the issuing company. The agreement, among others, provides for the period during which the agreement is in force, the amount of underwriting obligations, the period within which the underwriter has to be subscribe to the issue after being intimated by/on behalf of the issuer, the amount of commission/brokerage, and details of arrangements, if any, made by the underwriter for fulfilling the underwriting obligations.

Inspection and Disciplinary Proceedings: The framework of the SEBI„s right to undertake the inspection of the books of accounts, other records and documents of the underwriters, the procedure for inspection and obligations of the underwriters is broadly on the same pattern as applicable to the lead managers.

SEBI’s General Obligations and Responsibilities Code of Conduct for Underwriters:

1) Make all efforts to protect the interests of its clients.
2) Maintain high standards of integrity, dignity and fairness in the conduct of its business.
3) Ensure that it and its personnel will act in an ethical manner in all its dealings with a body corporate making an issue of securities (i.e. the issuer).
4) Endeavour to ensure all professional dealings are effected in a prompt, efficient and effective manner.
5) At all times render high standards of service, exercise due diligence, ensure proper care and exercise independent professional judgment.

BROKERS TO THE ISSUE

Brokers are the 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. The managers to the issue and the official brokers organize the preliminary distribution of securities and procure direct subscriptions from as large or as wide a circle of investors as possible.

The issuing company is expected to pay brokerage within two months from the date of allotment and furnish to the broker, on request, the particulars of allotments made against applications bearing their stamp, without any charge. The Cheques relating to brokerage on new issues and underwriting commission, if any, should be made payable at par at all Centre where the recognized stock exchanges are situated. The rate of brokerage payable must be is enclosed in the prospectus.

- Banking
- Issuing and underwriting
- Corporate Finance
- Management Services
- Product Knowledge

Marketing the public issue arises because of the highly competitive nature of the capital market. Moreover, there is a plethora of companies, which knock at the doors of investors seeking to sell their securities. Above all the media bombards the modern investors with eye catching advertisement to sell their concepts to prospective investors.

OFFER FOR SALE

Where the marketing of securities takes place through intermediaries, such as issue houses, stockbrokers and others, it is a case of „Offer for Sale Method". Under this method, the sale of securities takes place in two stages:

1) In the first stage, the issuer company makes an en-block sale of securities to intermediaries such as the issue houses and share brokers at an agreed price.
2) Under the second stage, the securities are re-sold to ultimate investors at a market-related price. The difference between the purchase price and the issue price constitutes profit for the intermediaries. The intermediaries are responsible for meeting various expenses such as underwriting commission, prospectus cost, advertisement expenses, etc.

The issue is also underwritten to ensure total subscription of the issue. The biggest advantage of this method is that it saves the issuing company the hassles involved in selling the shares to the public directly through prospectus. This method is, however, expensive for the investor as it involves the offer of securities by issue houses at very high prices.

GREEN SHOE OPTION

Definition of 'Greenshoe Option': A provision contained in an underwriting agreement that gives the underwriter the right to sell investors more shares than originally planned by the issuer. This would normally be done if the demand for a security issue proves higher than expected. It is legally referred to as an over-allotment option.

A „Greenshoe option" can provide additional price stability to a security issue because the underwriter has the ability to increase supply and smooth out price fluctuations if demand surges.

The term is derived from the fact that the Green Shoe Company was the first to issue this type of option.

Before investing in an IPO, we go through the offer document of the company to know more about it. A listed company is legally bound to abide by commitments made in the document. Besides providing information about the company's competitive strengths, industry regulation, corporate structure, main objects, subsidiary details, risk factors, etc. the offer document also mentions a technical word
called "Green shoe option".

Origin of the Greenshoe: The term "Greenshoe" came from the Green Shoe Manufacturing Company (now called Stride Rite Corporation), founded in 1919. It was the first company to implement the Greenshoe clause into their underwriting agreement.

Green Shoe Option in India: Green shoe options or over-allotment options were introduced by the Securities and Exchange Board of India (SEBI) in 2003 to stabilise the aftermarket price of shares issued in IPOs.

E-IPO

What is an e-IPO?: A company proposing to issue capital to public through the on-line system of the stock exchange for offer of securities can do so if it complies with the requirements under Chapter 11A of DIP Guidelines. The appointment of various intermediaries by the issuer includes a prerequisite that such members/registrars have the required facilities to accommodate such an online issue process.

Initial Public Offering (IPO):

Initial Public Offering (IPO), also referred to simply as a "Public Offering" is the first
sale of stock by a private company to the public. IPOs are often issued by smaller, younger companies seeking capital to expand, but can also be done by large privately- owned companies looking to become publicly traded.

In a IPO, the issuer may obtain the assistance of an underwriting firm, which helps it determine what type of security to issue (common or preferred), best offering price and time to bring it to market.

PRIVATE PLACEMENT

A method of marketing of securities whereby the issuer makes the offer of sale to individuals and institutions privately without the issue of a prospectus is known as Private Placement Method. This is the most popular method gaining momentum in recent times among the corporate enterprises.

Advantages of Private Placement

- Less expensive as various types of costs associated with the issue are borne by the issue houses and other intermediaries.
- Less troublesome for the issuer as there is not much of stock exchange requirements connecting contents of prospectus and its publicity etc. to be complied with.
- Placement of securities suits the requirements of small companies.
- The method is also resorted to when the stock market is dull and the public response to the issue is doubtful.

Disadvantages of Private Placement

- Concentration of securities in a few hands.
- Creating artificial scarcity for the securities thus jacking up the prices temporarily and misleading general public.
- Depriving the common investors of an opportunity to subscribe to the issue, thus affecting their confidence levels.

BOUGHT-OUT DEALS

A method of marketing of securities of a body corporate whereby the promoters of an unlisted company make an outright sale of a chunk of equity shares to a single sponsor or the lead sponsor is known as „bought-out deals‟.

Characteristics of Bought out deals

- *Parties*: There are three parties involved in the bought-out deals. They are promoters of the company, sponsors and co-sponsors who are generally merchant bankers and investors.
- *Outright Sale*: Under this arrangement, there is an outright sale of a chunk of equity shares to a single sponsor or the lead sponsor.
- *Syndicate*: Sponsor forms syndicate with other merchant bankers for meeting the resource requirements and for distributing the risk.
- *Sale Price*: The s ale price is finalized through negotiations between the issuing company and the purchaser, the sale being influenced by such factors as project evaluation, promoter‟s image and reputation, current market sentiments,

prospects of off-loading these shares at a future date, etc.

- *Fund-based*: Bought-out deals are in the nature of fund-based activity where the funds of the merchant bankers get locked in for at least the prescribed minimum period.
- *Listing*: The investor-sponsors make a profit, when at a future date, the shares get listed and higher prices prevail. Listing generally takes place at a time when the company is performing well in terms of higher profits and larger cash generations from projects.
- *OTCEI:* Sale of these shares at Over-the-Counter Exchange of India (OTCEI) or at a recognized stock exchanges, the time of listing these securities and off- loading them simultaneously are being generally decided in advance.

Benefits of Bought-out Deals: Bought-out deals provide the following benefits:

1. *Speedy sale*
2. *Freedom*
3. *Investor protection*
4. *Quality offer*

PLACEMENT WITH FIs, MFs, FIIs

Listed companies have been allowed by SEBI to make preferential allotment to registered FIIs subject to certain conditions. A company desiring to make a preferential allotment should obtain the shareholders" consent. The allotment should be in accordance with ceilings of 10% of total issued capital for individual FII and 30% of all FIIs and nonresident Indian investors. The preferential allotment should be made at a price not less than the highest price during the last 26 weeks on all stock exchanges where the company securities are listed.

FIIs (Foreign Institutional Investors): Guidelines of Government of India

Government of India through Guidelines issued on September 14, 1992 has allowed reputed foreign Institutional Investors (FIIs) including pension funds, mutual funds, asset management companies, investment trusts, nominee companies and incorporated or institutional portfolio managers to invest in the India capital market subject to the condition that they register with the Securities and Exchange Board of India and obtain RBI approval under FERA.

FII and SEBI Regulations, 1995: The regulations stipulate that foreign institutional investors have to be registered with SEBI and obtain a certificate from SEBI. For the purpose of grant of the certificate SEBI takes into account,

1. The applicant„s track record, professional competence, financial soundness, experience, general reputation of fairness and integrity
2. Whether the applicant is regulated by appropriate foreign regulatory authority
3. Whether the applicant has been granted permission by RBI under Foreign Exchange Regulating Act for making investments in India as a foreign institutional investor and

OFF-SHORE ISSUES

Off Shore Finance: Merchant bankers help their clients in Long term foreign currency loan, Joint venture abroad, Financing exports and imports, Foreign collaboration arrangement.

Banks Providing Merchant Banking Services In India:

- Commercial banks, Foreign banks like National Grindlays Bank, Citibank, HSBC bank etc.
- Development banks like ICICI, IFCI,IDBI etc.
- SFC, SIDCs Private firms like JM Financial and Investment service ,
- DSP Financial Consultants, CEAT Financial Services, Kotak Mahindra, VMC Project Technologies, Morgan Stanley, Jardie Fleming, Klienwort Benson etc.

ISSUE MARKETING

Merchant Banking and Marketing of New Issues: Following are the steps involved in the marketing of the issue of securities to be undertaken by the lead manager:

- Target Market
- Target Concentration
- Pricing
- Mobilizing Intermediaries
- Information Contents
- Launching Advertisement Campaign
- Brokers and Investors Conferences

A critical factor that could make or break the proposed public issue is its timing. The market conditions should be favorable. Otherwise, even issues from a company with an excellent track record, and whose shares are highly priced, might flop. Similarly, the number and frequency of issues should also be kept to a minimum to ensure success of the public issue.

ADVERTISING STRATEGIES

SEBI issued Guidelines in 1993 to ensure that the advertisement are truthful fair and clear and do not contain statements to mislead the investors to imitate their judgment. All lead managers are expected to ensure that issuer companies strictly observe the code of advertisement set-out in the guidelines.

For the purpose of these guidelines the expression advertisement, means notices, brochures, pamphlets, circulars show cards, catalogues, hoardings, placards, posters, insertions in newspapers, pictures, films, radio/television program or through any electronic media and would also include the cover pages of the offer documents.

NRI MARKETING

The term NRI includes the following categories of persons:

- Indian national holding Indian passports with non-resident status (INNR),
- Person of Indian origin, foreign nationals of Indian origin, living in foreign countries including such persons of Indian origin as is in the status of stateless, because no foreign country has as yet accepted them as their national and they are not Indian national either by birth or residence, (FNIO).
- The term NRI also includes companies, partnership firms, trusts, societies and other corporate bodies called OCBs where 60% of the equity is owned by the NRIs.

Avenues for Investment by NRIs

- NRIs can have three different types of bank accounts, buy securities in the primary and secondary markets, and do business on non- repatriable basis as well as repatriable basis.
- NRI„s have also made in the past large investments in specific bonds.
- Development Bond in 1991, the Resurgent India Bond in 1998 and India Millennium Deposits in 2000.

Foreign Direct Investment under New Industrial Policy (1991)

a) Repatriable Basis
b) Non Repatriable Basis

Investment in New Issues (Primary Market)

1) Forty percent scheme - Indian companies engaged in industry and manufacturing, Hotel (3,4, and 5 star category), hospitals and diagnostic centers, shipping companies, development of computer software and oil exploration services are allowed by RBI to issue shares/debentures to NRIs with repatriation benefits to the extent of 40% of new issue.
2) No permission for investment is required in cases where the company has obtained permission from RBI. This is generally granted in the green field project (e.g. Chambal Fertilizers, Mangalore Refineries). NRI has to obtain permission from RBI even if the sale is to be effected after 12 month. Blanket permission can be obtained before completing 12 months of each investment.
3) Generally RBI does not permit NRI investment at issue prices in case of
    a. Right issues of existing companies (excluding existing NRI shareholders)
    b. Public issues of an existing profit making company.
4) NRI can repatriate original investment, profit and dividend provided they are held for a minimum period of one year. On long term capital gains a rate of 10% is applicable.
5) If the investment is sold before one year the investment and all related receipts become non-repatriable unless RBI permission is taken in advance with clearance from Income

Investment in Money Market Mutual Funds (MMFs)

NRIs are permitted to invest on non – repatriation basis in MMFs floated by commercial banks and public/private sector financial institutions. The concerned bank/ institution should get authorization from RBI/SEBI. NRIs do not need separate permission.

Purchase of Share by Private Arrangement NRIs/OCBs requires permission of RBI for purchasing shares of Indian companies by private arrangement.

POST ISSUE ACTIVITIES

Post-Issue: The public issue closes on the stipulated closing date. Subsequently, the BRLM and the issuing company finalize the price. The prospectus will be updated with the mention of the final price of the shares. The finalized prospectus will be issued to QIBs. After making allotment to the QIBs on the discretionary portion, basis of allotment for the retail investors will be finalized by the issuer, Registrar, BRLM, stock exchange and a public representative. The basis of allotment is communicated to the stock exchange.

- *Finalization of Basis of Allotment:* If the public issue is oversubscribed to the extent of greater than five times, a SEBI nominated public representative is required to participate in the finalization of Basis of allotment (BoA).
- *Dispatch of Share Certificates:* Immediately after finalizing the Boa, share certificates are dispatched to the eligible allottees, and refund orders made to unsuccessful applications. In addition, a 78 days report is to be filed with SEBI. Permission for listing of securities is also obtained from the stock exchange.

Law Relating To Issue Management: It is important that the lead managers take into account the regulations of the capital issue as prescribed by the various enactments mentioned below:

1) Provisions of the Companies Act, 1956
2) The Securities Contracts (Regulations) Act, 1957 regarding transactions in securities
3) The Securities Contracts (Regulation (Rules, 1957)

Text Books & References

1. *M.Y.Khan, "Financial Services", Tata McGraw Hill Education Pvt. Ltd., New Delhi, 12th Edition, 2012.*
2. *Nalini Prava Tripathy, "Financial Services", Prentice Hall of India, New Delhi, 2nd Edition, 2008.*
3. *Machiraju, "Indian Financial System", Vikas Publishing House, 2nd Edition, 2010.*
4. *Dr.S.Gurusamy, "Merchant Banking and Financial Services", Tata McGraw Hill Education Pvt. Ltd., New Delhi, 3rd Edition, 2009.*
5. *Website of SEBI.*

MERGERS AND ACQUISITIONS

Mergers and Acquisitions (M&A) as forms of business combination are increasingly being used for undertaking restructuring of corporate enterprises the world over. In fact, the corporate world is in the grip of merger-mania (mega mergers and hostile takeovers). The merger wave which began in the U.S. first occurred during the period between 1890 and 1904. Of late, mergers happen in all the sectors of the economy, the prime driving force being the accomplishment of synergetic effect for both the acquiring and the acquirer companies. Mergers have started happening in India too.

Mergers

A type of business combination where two or more firms amalgamate into one single firm is known as a merger. In a merger, one or more companies may merge with an existing company or they may combine to form a new company. In India mergers and amalgamations are used interchangeably.

In the wider sense, merger includes consolidation, amalgamation, absorption and takeover. It signifies the transfer of all assets and liabilities of one or more existing companies to another existing or new company. The main purpose of merges is to achieve the advantage of fusion and synergy through expansion and diversification.

Forms of Merger

Merger takes place in the following forms:

1. Merger through absorption
2. Merger through consolidation

Major Issues Of M&A In India

Business combinations and re-structuring in the form of merger, etc. have been attempted to face the challenge of increasing competition and to achieve synergy in business operations. The major issues of M&A are as follows:

- *Depreciation*
- *R&D Expenditure*
- *Tax Exemption*
- *Carry Forward Losses*

Related Connotations

There are terms that sound relative to merger/amalgamation. These include acquisition and takeover.

Acquisition: The term ‘acquisition’ is used to refer to the act of acquiring of ownership right in the property and assets of another company and thereby bringing about change

in the management of the acquiring company. Acquisition could happen in any of the following ways:

1. Entering into an agreement with a person or persons holding controlling interest in the other company.
2. Subscribing new shares issued by the other company in the open market
3. Purchasing shares of the other company at a stock exchange
4. Making an offer to buy the shares of other company, to the existing shareholders of that company.

Takeover: Another term associated with merger is 'takeover'. In the case of a takeover, one company obtains control over management of another company. Under both acquisition and takeover, it is possible for a company to have effective control over another company even by holding minority ownership. For instance, the Monopolies and Restrictive Trade Practices (*MRTP*) Act prescribes that a minimum of
25 percent voting power must be acquired as to constitute a takeover. Similarly, section 372 of the Companies Act defines the limit of a company's investment in the shares of another company as anything more than 10 percent of the subscribed capital so as to continue a takeover.

An example, of acquisition in Mahindra and Mahindra Ltd., a leading manufacturer of jeeps and tractors, acquiring equity stake of Allwyn Nissan Ltd. On the other hand, the acquisition of Shaw Wallace, Dunlop, Mather and Platt and Hindustan Dorr Oliver by Chhabrias and Ashok Leyland by Hindujas, etc are the examples of 'hostile takeovers' that have happened in the post liberalization era of the Indian financial sector.

Hostile Takeover

Where in a merger one firm acquires another firm without the knowledge and consent of the management of the target firm, it takes the form of a 'hostile takeover'. The
acquiring firm makes and unilateral attempt to gain a controlling interest in the target firm, by purchasing shares of the later firm directly in the open (stock) market. An
example of hostile takeover was the takeover of TMBL by Sivasankaran of the
Sterling Group. Since this type of takeover is generally prejudicial to the interest of the stakeholders. SEBI has come out with relevant code of conduct for the purpose of disciplining the takeover practice in India.

Regulation of M&A under the SEBI Act

SEBI guidelines are aimed at protecting the interest of the shareholders especially
from the hazards of hostile takeovers. Most of these guidelines are applicable to the acquiring company. The salient features of the guidelines are as follows:

1. *Notification:* Where acquisition involves 5 percent or more of the voting capital of a company and the stock exchange shall be notified immediately.
2. *Acquisition limit:* An individual or a company can continue acquiring up to 10 percent of the voting capital of the target company without making any offer to
other shareholders.

3. *Offer to public:* Where the shareholding of the acquiring company exceeds 10 percent in a target company, a minimum offer of 20 percent of the shares shall be made to the remaining shareholders through a public announcement by the target company.
4. *Offer price:* The price at which the offer is to be made shall be so fixed as equivalent to the average of the weekly high and low of the closing prices during the last six months preceding the date of announcement.

PORTFOLIO MANAGEMENT SERVICES

Preserving and growing capital is as hard as earning it. Knowing what one want is as important as achieving those goals. Assessing one‘s risk profile and aligning potential returns for the risk assumed from various investment options is the crucial task. In today‘s fluid environment, that has become a hard task to achieve. As the investor‘s net worth increases, financial complexity expands exponentially and the investment needs and options multiply. And equities offer one of the best options for investments. Mutual funds as an investment vehicle are structured to reduce risks as far as possible, as they cater to thousands of investors.

Portfolio and Management Services: A list of all those services and facilities that are provided by a portfolio manager to its clients, relating to the management and administration of portfolio of securities or the funds of the client, is referred to as portfolio management services. The term portfolio means the total holdings of securities belonging to any person.

Objectives of Portfolio Discretionary Portfolio Manager Management

- Provide long term capital appreciation with lower volatility, compared to the broad equity markets.
- Takes long positions in the cash market and short positions in the index futures markets.
- Invests in the model portfolios thus downside the risk by selling index futures in the derivatives market.

CREDIT SYNDICATION

Credit syndication services are services rendered by the merchant bankers in the form of organizing and procuring the financial facilities form financial institutions, banks, or other lending agencies. Financing arranged on behalf of the client for meeting both fixed capital as well as working capital requirements is known as loan syndication service‘

Credit Syndication Services: Merchant bankers provide various services towards syndication of loans. The services may be either loan sought for long term fixed capital or of working capital funds.

Objectives: Arranging medium and long term funds for long term fixed capital and working capital fund needs.

Scope: The scope of syndicated loan services as provided by merchant bankers include identifying the sources of finance, approaching these sources, applying for the credit, and sanction and disbursal of loans to the clients.

While carrying out the activities connected with credit syndication, the merchant banker ensure due compliance with the formalities of the financial institution, banks and regulatory authority. They are:

1) *General Information*
2) *Promoter information*
3) *Company information*
4) *Project profile information*
5) *Project cost information*
6) *Project financing information*
7) *Project marketing information*
8) *Cash flow information*

(b) Statutory Compliance

In addition, compliance is also called for with regard to the provisions constrained in various enactments concerning the management and regulation of joint stock companies in India. Some of these enactments include Companies Act, 1956, Industries (Development and Regulation) Act, 1951, Foreign Exchange Regulation Act, 1973, Securities Contracts (Regulation) Act, 1956, The Foreign Trade (Development and Regulation) Act, 1992, and Income-Tax Act, 1961.

Documentation and Creation of Security

An important function of a merchant banker is to create an adequate documentation of security by working closely with the lead financial institution, so as to ensure quicker disbursement of loan. The type of documents to be prepared and executed by the merchant banker will be as per the requirements of the lead financial institution. Depending on the loan type, the merchant banker executes bridge loan document or interim loan document.

CREDIT RATING

Credit rating is a mechanism by which the reliability and viability of a credit instrument is brought out. When a company borrows or when a businessman raises loan, the lenders are interested in knowing the credit worthiness of the borrower not only in the present condition but also in future. Hence, credit rating reveals the soundness of any credit instruments issued by various business concerns for the purpose of financing their business.

Credit Rating of Individuals, Companies and Countries

(a) Individuals
(b) Companies
(c) Countries

Rating of Individuals: Individuals go for credit rating when they want to borrow from recognized institutions. In India, we have Onida Individual Credit Rating Agency (ONICRA) which gives credit rating for individuals.

Rating of Companies: As per the guidelines of SEBI and RBI, companies have to resort to credit rating when they:

(i) Accept public deposits
(ii) Issue credit instruments in domestic market
(iii) Issue credit instruments in overseas market.

Rating of Countries: Credit rating is resorted to by countries for borrowing in international market or for attracting foreign investments or for raising funds from the international institutions like IMF and IBRD.

Basis of Credit Rating

Various aspects are taken into account by a credit rating agency when a borrowing company applies for rating. They are:

1. Business Analysis
2. Evaluation of industrial risks
3. Market position of the company within the industry
4. Operating efficiency of the company
5. Legal position in terms of prospectus
6. Financial analysis based on accounting quality
7. Statement of profits
8. Earnings protection
9. Cash flow and their adequacy
10. Financial flexibility
11. Track record of management
12. Capacity to overcome adverse situations
13. Goals philosophy and strategy
14. Labor turnover
15. Regulatory and competitive environment
16. Asset quality
17. Financial position-interest/tax sensitivity

Credit Rating Companies in India

- Credit rating companies were started in India during the late 1980s.
- Credit Rating Information Services of India Ltd (CRISIL) was started in 1988 as a subsidiary of ICICI. Information
- Credit Rating Services Ltd., (ICRA) was started in 1990, which is a subsidiary of IDBI.
- Credit Analysis and Research Ltd. (CARE) were started In 1993.

Types of Credit Rating

We have seen the various rating symbols for different categories of the debt instruments. We can also classify credit rating as types of credit rating which are based on different securities. These are:

1. Equity rating
2. Bond rating
3. Promissory note rating
4. Commercial paper rating
5. Sovereign rating.

Features of Credit Rating

1. Credit rating is an *expression of opinion* of the credit agency about the risk of a security. This opinion is subject to change over the life of the security.
2. Credit rating indicates relative grading of risk in a security. Risk quality is expressed on a comparative basis.
3. Credit rating is revealed through *symbols* such as 'AAA', 'AA', etc.
4. The ratings are *instrument specific'*. It can differ from various instruments of the same company.
5. Rating being the opinions or perceptions of the rating agency, there could be a *difference in the ratings* of the same instruments by different agencies.
6. Rating is reflecting the relative credit risk; it does not reflect other investment risks that arise due to changes in the market conditions.
7. Credit rating is *not an investment recommendation.* It indicates just one aspect of investment, namely, risk. Other aspects like yield, risk preference of investor, etc. are not considered.
8. Credit rating is not a one-time task that is over with the assignment of ratings. It is a continuous process. The ratings assigned are subject to surveillance and if conditions change, the *rating may be revived.*

MUTUAL FUNDS

Mutual Fund: Concept and Rationale

What is mutual fund? A mutual fund is an institution that pools the savings of small investors for investment in capital market and money market securities. The mutual fund invests in diversified securities so as to reduce the investment risks. The portfolio is managed by the mutual fund and the returns from the investment are distributed to the mutual fund investors as dividends. Even a small amount can be invested in the units of mutual funds schemes. This enables the investors to derive the benefits of diversification which otherwise would have been possible with smaller investments.

Objectives: Mutual funds came into existence in order to attract the savings of lower and middle income group people and give them the benefit of corporate profits by distributing attractive dividends at the end of the year. Mutual funds cater the different

types of customers who are interested in

(a) fixed income or
(b) a higher return for investment or
(c) who is growth oriented.

The SEBI (Mutual Funds) Regulation 1996 define a mutual fund as *"a fund established in the form of a trust by a sponsor to raise monies by the trustees through the sale of units to the public under one or more schemes for investing in securities in accordance with the regulation"*

The Association of Mutual Funds in India (AMFI) defines a mutual fund as *"a trust that pools the savings of a number of investors who share a common financial goal"*

Mutual Funds set up in India: The structure of mutual fund operations in India envisages a three tier establishment namely:

1. A Sponsor institution to promote the fund
2. A team of Trustees to oversee the operations and to provide checks for the efficient, profitable and transparent operations of the fund and
3. An Asset Management Company is to actually deal with the fund and sponsoring Institution.
4. The Company which sets up the Mutual Fund is called the sponsor. The SEBI has laid down certain criteria to be met by the sponsor.
5. These criteria mainly deal with adequate experience, good past tract record, net worth etc.

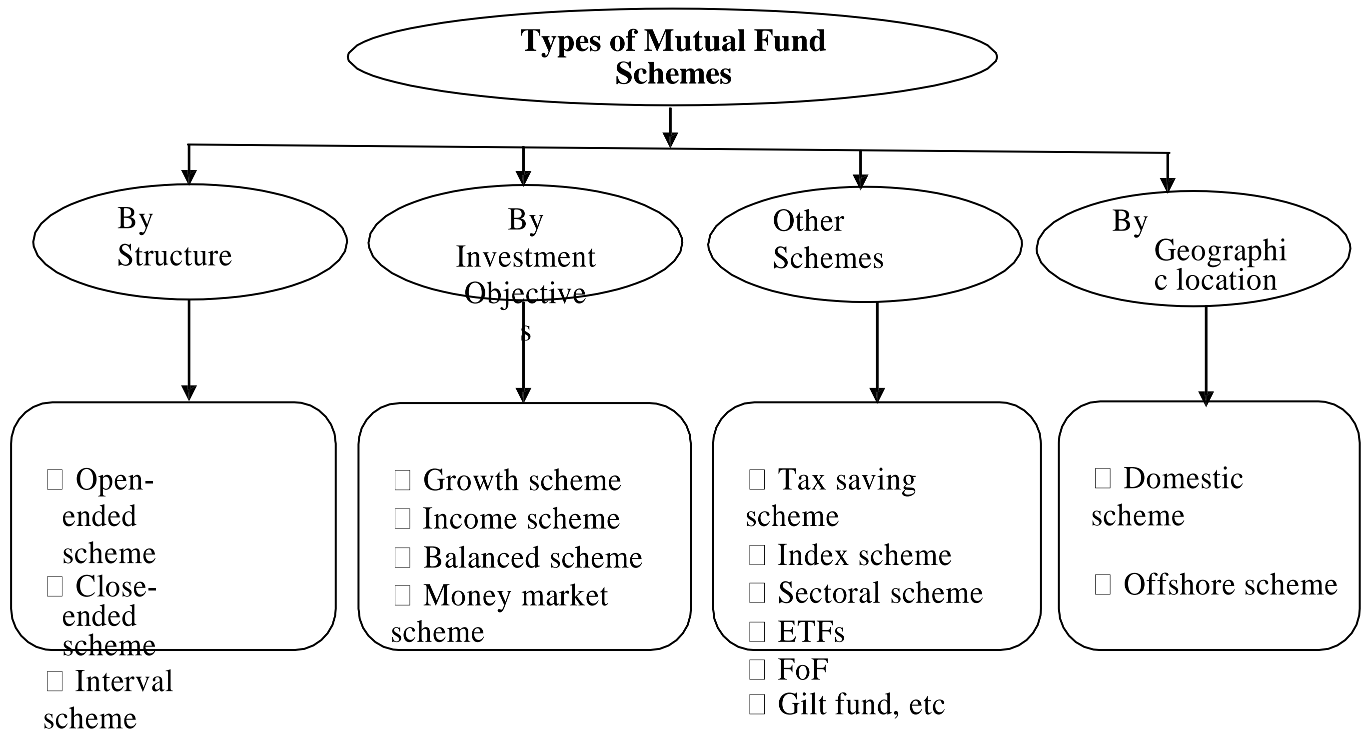
Trustees: Trustees are people with long experience and good integrity in their respective fields. They carry the crucial responsibility of safeguarding the interest of investors. For this purpose, they monitor the operations of the different schemes. They have wide ranging powers and they can even dismiss Asset Management Companies with the approval of the SEBI.

Asset Management Company (AMC): The AMC actually manages the funds of the various schemes. The AMC employs a large number of professionals to make investments, carry out research and to do agent and investor servicing. In fact, the success of any Mutual Fund depends upon the efficiency of this AMC. The AMC submits a quarterly report on the functioning of the mutual fund to the trustees who will guide and control the AMC.

TYPES OF MUTUAL FUNDS

Mutual funds offer a plethora of schemes to the investing public. There are close to 2000 schemes in India. An investor can be easily bewildered by the wider array of schemes in the market.

The mutual fund schemes can be classified according to the term structure, investment objectives and geographical location.



SEBI Guidelines for Mutual Funds

The SEBI has formulated guidelines and regulations of the mutual funds in India and it were introduced in December 1996. The objective of these regulations was to ordain the regulatory norms for the formation, operation and management of mutual funds in India. The regulations also lay down the broad guidelines on investment valuations, investment restrictions, advertisement code and code of conduct for mutual funds and asset management companies.

Regulation as to the Trust

1. A mutual fund shall be constituted in the form of a trust under the provision of Indian Registration Act, 1908 (U/s 16 of 1908) and the trust deed containing the provisions lay down by SEBI.
2. At least 50 percent of the trustees shall be independent trustees.
3. The trustees and the AMC, with the SEBI's prior approval, shall enter into an investment management agreement.
4. The trustees shall ensure that the AMC has been managing the schemes independently of other activities. They should also monitor securities transactions with brokers and avoid undue concentration of business with any single broker.
5. In the interest of unit holders, the trustees shall obtain the consent of the unit holders whenever SEBI requires decide to wind up or in the event of any change in the fundamental attributes of any scheme, etc.
6. The trustee shall call for the details of transactions in securities by the key personnel of the AMC.

BUSINESS VALUATION

The basic valuation methods of holdings by the Mutual funds should be done by keeping in view the following elements:

1. For listed securities – take last sale price quoted in the stock exchange dealing list
2. For OTCEI securities – take bid/ask price as may be relevant on case to case basis
3. Trustees may determine market value at a reasonable price as per current market at which the investors would buy at fairly reasonable rate.
4. For short term investments the basis of valuation should be the amortized cost.

Net Asset Value (NAV): NAV is another parameter used to measure the operational efficiency of mutual funds. The intrinsic value of a unit under a particular scheme is referred to as the 'NAV' of the scheme. The value gives an idea of the amount that may be obtained by the unit holder on its sale to the mutual fund company. NAV of a unit is calculated as follows:

$$NAV \text{ per unit} = (TMV - CL) \div SU$$

Where,

TMV = Total market value of investment portfolio + the written down value of fixed assets + the cost value of other current assets

CL = Current liabilities

SU = Number of outstanding units in that scheme

For the purpose of determining the NAV, the scheme of accounting practices are prescribed by the SEBI regulations of 1996 should be followed.

Calculation of NAV:

The NAV calculation should include the following elements for open end funds.

1. Investment at value recorded on first business day after trade transaction.
2. Changes in outstanding shares on first business day after trade transaction.
3. Dividend and distribution to shareholder ex-date.
4. Expenses (estimated and accrued to date of calculation)
5. Dividends receipts from investments ex-date
6. Interest and other income (estimated and accrued to date of calculation)
7. Other assets /organization costs.

Treynor Model: Jack Treynor evolved this model, which can be used to calculate the return per unit of risk. This is done by assuming that all investors averse to risk would like to maximize this value. The performance measure is calculated as follows:

$$PM = [Ar_i - Ar_f] \div \beta_t$$

Where,

PM = The Treynor portfolio performance measure for the period

Ar_i = Average rate of return for portfolio 'i' during a period

Ar_f = Average rate of return on risk free investment during the period

β_t = Slop of portfolio 'i' characteristic line which represents the portfolio relative volatility and it systematic risk.

A positive measure show a superior, risk adjusted performance of a fund

Sharpe Model: William F.Sharpe developed this model in 1966. It measures the total risk, not merely systematic risk (as in Treynor model). The relevant performance measure is computed as follows:

$$PM = [Ar_i - Arf] \div N_t$$

Where,

N_t = Standard deviation of rate of returns for the portfolio for the period.

A positive performance measure value is indicative of good performance.

Text Books & References

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4. *Dr.S.Gurusamy, "Merchant Banking and Financial Services", Tata McGraw Hill Education Pvt. Ltd., New Delhi, 3rd Edition, 2009.*
5. *Website of SEBI.*