CHAPTER III

EVOLUTION AND PROGRESS OF MERCHANT BANKING IN INDIA

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1) A BRIEF OUTLINE OF THE CHAPTER:

The chapter No. III is entitled "Evolution & Progress of Indian Merchant Banking. In this chapter an attempt is made to study the history of origin and development of Merchant Banking in England, its regulation in general & evolution, progress & regulatory framework of Merchant Banking in India in particular. The history of origin and growth of Merchant Banking throughout the world has established, beyond doubt the fact that the role of Merchant Bankers had never been determined. They had followed a strategy of assuming different roles according to the need of time and situation to maintain their existence in the business environment. This is one of the reasons that no fixed definition could be ascribed to Merchant Banking.⁽¹⁾

According to the requirements of a particular period, they adjusted their roles and places. That is why, Merchant Banking business has remained a business of severe competition right from its birth. Merchant Bankers are rendering extraordinary multipurpose services, under different titles in different countries of the world, today. In the modern time of globalization and privatisation, Merchant Bankers are bound to play a key role for the rapid and allround development of corporate sector in any economy.

With this background, a sincere effort is made here to trace out the origin, role and functions of Merchant Bankers in India. Being the true development center of this banking England, we thought it better to throw light on the development of British Merchant Banking system.

2) ORIGIN AND HISTORY OF MERCHANT BANKING IN ENGLAND:

The origin of Merchant Banking is traceable in the literature of economic history focussing on areas including, in particular, international trade and commerce. According to the findings of the economic historians, a few family owned and managed firms engaged in coastal trade and finance in Italy during the thirteenth century. This situation existed throughout the European Continent. The first known such firms were Riccardi of Lucca, Medici with offices in London, Bruges (Belgium), Avign (France) and Figger.⁽²⁾ The available literature provides no
detailed history of Merchant Banking. Economic literature available and international trade and finance contains lucid information on the evolution of Merchant Banking and makes a fascinating reading that provides the historical background to the origin of Merchant Banking.\(^{(3)}\)

In the beginning these firms occupied themselves principally in over seas trade. Some used their own ships and chartered ships to convey manufactured goods from the them to developed countries of Europe. They sold goods directly, through agents or through their own offices set up in those countries. With the proceeds, indigenous products were purchased usually, in fact, in earliest days by direct barter and shipped back to Europe. Form the beginning while they were buying, shipping and selling for their own accounts, these firms developed a network of overseas connections for whom they bought in Europe, subsequently selling products from overseas for account of the same parties. These houses, besides their customary trading operations, were associated with financial activities of providing funds to the kings and distressed businessmen. The ultimate object of these firms was of maximization of profits. However, the performance of these firms did not remain constant. There are ample examples of the collapse of these houses. Riccoardi of Lucca, the Italian Merchant Banker, had opened an office in England to serve the English Government of Edward -1 of England and had to succumb to the closer when the king confiscated its properties on its refusal to finance the war in 1294. Fugger banker had to suffer in 1650, when Habsburg Emperors Maximilian and Charles defaulted in payments. In this way there were so many instances of collapse of existing Merchant Bankers, abandonment of the activity or commencement of some other new venture and ultimately revert back to Merchant Banking.

During the seventeenth century and the greater part of the eighteenth century, the international finance was centered around Amsterdam. According to the writings of the British historian Professor Charles Wilson on Dutch trade and finance, Much of the business affairs to and from Amsterdam was monitored by the Dutch merchants. These agents became the first masters of the various financial techniques and developments which, in the course of the nineteenth century, became identified with the emergent profession of Merchant Banks then known as the commission agents.\(^{(4)}\)
These commission agents did big business and acquired huge wealth. It gave a push to Merchant Banking activities and involved them in the acts of lending in addition to their business of commission agents. There are so many references which prove facts that during the 17th century also, the Dutch traders lent heavily to finance continental wars. William III of England borrowed huge sums in Amsterdam to fight the continental wars. Many European states including Germany, Russia and Sweden have borrowed in Amsterdam huge sums during the 18th century.\(^5\) During Napoleon war, Margrave of Hesse,

the richest merchant of Europe at that time, had financed the German prince known as Jews of Kessel and the Franank furt made loans to the rulers in the name of bankers.\(^6\)

In the real sense, the activities of the Merchant Bankers were boosted up with the industrial revolution in England. This ultimately widened the periphery of industrial trade through-out the world and allured more persons and firms to participate in Merchant Banking business. In Germany, a schaffhausen was a private bank, acted as Merchant Banking house, traded in wine for export and hides and leather for imports in 1848, then went in to trouble but survived.\(^7\)

It is also an evidence that, the bank of France was formed by Merchant Bankers in 1800 in France.\(^8\)

The list of the leading Merchant Bankers include Bank of France (France,) Meyer Amschei Rothschild (Frankfurt), John Hope and Company etc. During the French wars, during the period 1793 - 1815, the Dutch, French and Sephardic Jewish emigres were overtaken by the Ashkenazi Jews from Hamburg, Frankfurt Berlin and Leipzig. The profuse wealth of Amsterdam also gave rise to international loan business because of providing lending opportunities to various foreign governments and within the states of particular countries to share a sequence of loans. These borrowing facilities of Dutch merchants were largely centered around the British Government because of their financial needs during the French wars and for the speedy development of post war economy.
3) DEVELOPMENT OF MERCHANT BANKING IN ENGLAND

Though the concept of Merchant Banking is the brain child of some Dutch and Scottish traders, the activities of these institutions came in to reckoning in Britain, Particularly, in London. The period of development was late eighteenth and early nineteenth centuries. Several causes contributed towards making London an international trade and financial center.

These reasons were movement of young partners of merchant houses from Europe countries to London, well developed acceptance business in England, opening of the first Transatlantic Cable in 1866; movement of wealthy and experienced Jew merchants to England due to wars in Europe. Merchant Bankers were counted as one of the six great powers of Europe along with England, France, Russia, Austria and Prussia.

The industrial revolution made England a leading center of international trade and finance. The young professionals of merchant houses of Germany concentrated around London. To name a few of the most successful imigrants were, van Neeks, who acquired landed estate and entered the ranks of the English aristocracy. Nathan Rothschild was sent to Britain by his father a dealer in coins, earned handsome profit by encashing government bills at half the price. The others included Boyd, Benfield and Co., J.J. Angerstein, Peter de the lussion, David Ricardo and the Goldsmild Brothers. The following list provides details about their establishment years and origins.
<table>
<thead>
<tr>
<th>Year of foundation</th>
<th>Name</th>
<th>Origin</th>
</tr>
</thead>
<tbody>
<tr>
<td>1770</td>
<td>Baring</td>
<td>Bremen</td>
</tr>
<tr>
<td>1795</td>
<td>H.S.Lefevre</td>
<td>do</td>
</tr>
<tr>
<td>1804</td>
<td>J.Henry schroter</td>
<td>Hamburg</td>
</tr>
<tr>
<td>1805</td>
<td>N.M.Rothschild</td>
<td>Frankfurt</td>
</tr>
<tr>
<td>1805</td>
<td>Wm. Brand Sosn and Co.</td>
<td>St.Peterburg</td>
</tr>
<tr>
<td>1808</td>
<td>Antony Gibbs and sons</td>
<td>do</td>
</tr>
<tr>
<td>1809</td>
<td>Frederick Huth</td>
<td>Hanover</td>
</tr>
<tr>
<td>1810</td>
<td>Brown shipleys</td>
<td>do</td>
</tr>
<tr>
<td>1814</td>
<td>Fruhling and Goschen</td>
<td>Leipzig</td>
</tr>
<tr>
<td>1830</td>
<td>Hambro</td>
<td>Compenhagen</td>
</tr>
<tr>
<td>1830</td>
<td>Kleinwort</td>
<td>Holstein</td>
</tr>
<tr>
<td>1831</td>
<td>M.Samul</td>
<td>do</td>
</tr>
<tr>
<td>1833</td>
<td>Arbuthnot Latham and Com Ltd.</td>
<td>N.A.</td>
</tr>
<tr>
<td>1836</td>
<td>Guinness Mahon and Co.</td>
<td>N.A.</td>
</tr>
<tr>
<td>1838</td>
<td>Morgan Grenfell and Co. Ltd. USA</td>
<td>Germany and France</td>
</tr>
<tr>
<td>1853</td>
<td>Erlangeers Ltd.</td>
<td>Germany &amp; America</td>
</tr>
<tr>
<td>1864</td>
<td>Seligman Brothers Ltd.</td>
<td>France</td>
</tr>
<tr>
<td>1872</td>
<td>A. Ruffer and sons Ltd.</td>
<td>Ex. Hanseatic Bank</td>
</tr>
<tr>
<td>1873</td>
<td>London Merchant Bank Ltd.</td>
<td>USA and France.</td>
</tr>
<tr>
<td>1877</td>
<td>Lanzard Brothers and co. Ltd.</td>
<td>USA</td>
</tr>
<tr>
<td>1889</td>
<td>Grance Brothers and Co.Ltd.USA</td>
<td>Germany.</td>
</tr>
<tr>
<td>1907</td>
<td>Higginson and Co.</td>
<td>do</td>
</tr>
<tr>
<td>1921</td>
<td>S.Japhet and Co.Ltd.</td>
<td>do</td>
</tr>
</tbody>
</table>

It may be observed from the Table No 3-1 that London was the centre of Merchant Banking activities during the period from 1770 to 1921. Many of the Merchant Bankers from all the corners of the world preferred to establish their Merchant Banks in London because, it was the premier trade centre of the world at that time.

The great growth of Merchant Banking business in and through London was not merely to be ascribed to some special skill brought to these shores by the Baring, Kleinworts, Hambros and Rothschilds. Some of the skills were already in existence in Britain and overseas. It was what was happening in the United Kingdom and in the lands of British settlement that transformed the nature of banking and enhanced the role of banking houses the foundation on which they built their reknown trade with the Americans and Asia, one fresh asset was brought to London by the immigrant European Merchant Bankers which combined with the country’s power and influence in world. These Merchant Banks acquired skill in arranging large loans through issues of bonds placed internationally. Margrave of Hesse was supposed as the richest Merchant Banker at that time. All rulers turned to him when they were short of funds. Nathan Rothschild was sent by his father to operate in London who brought with him a highly developed technique of which the Britain stood a dire need.

During most of the nineteenth century it was the wealth of Britain which was put at the service of the world; by the end of the century it was the created wealth of the world which was being put at Britain’s disposal. London could become the house of Merchant Bankers due to age-old skill of money changing of Merchants, centre of foreign exchange, political security, safe currencies, absence of governmental restrictions on the movement of funds etc.
By the end of the nineteenth century, Merchant Banking became more competitive and embraced many branches of activities. Some Merchant Bankers survived and most of them retained in their old names. Banking business was controlled by the Merchant Banks. They represented on various boards. Such representation was seen more prominently on the boards of Anglo Foreign banks and Bank of England during the years 1890-1914 and onwards.\(^9\)

The Merchant Bankers initially executed short term credit in the form of acceptance houses, short term and medium term loans and issue houses through discounting of bills and promoting issue of shares, stocks, bonds for the new entities. Following two tables compare two leading Merchant Bankers with respect to various activities.
<table>
<thead>
<tr>
<th>Year</th>
<th>Baring Brothers</th>
<th>N.M. Rothschild and Sons</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Foreign and colonial, Govt., State and city</td>
<td>Commercial</td>
</tr>
<tr>
<td></td>
<td>No. of issues</td>
<td>Amount (£m)</td>
</tr>
<tr>
<td>1815</td>
<td>5 (100)</td>
<td>43.2 (100)</td>
</tr>
<tr>
<td>1837</td>
<td>8 (60)</td>
<td>20.8 (-52)</td>
</tr>
<tr>
<td>1859</td>
<td>62 (1140)</td>
<td>560.7 (1198)</td>
</tr>
<tr>
<td>1890</td>
<td>20 (300)</td>
<td>69.4 (61)</td>
</tr>
<tr>
<td>1904</td>
<td>23.75 (173.5)</td>
<td>(32.6 (17)</td>
</tr>
</tbody>
</table>


Source: Stanley D. Chapman, ch2, P-16

Note: Figures in the brackets indicate percentage growth over the base year.
The above mentioned Table No. 3.2 produces the excellent performance of the two major Merchant Bankers during the period between 1815 to 1904 in England. The table contains the figures related to contribution of loans by these two major Merchant Bankers. One can observe one similarity in the contribution of loans that both Merchant Bankers lent more loans to foreign, colonial or state governments as compared to loans to commercial purposes. When we compare figures of these two Merchant Bankers, one conclusion can easily and safely be drawn that the performance of N.M. Rothschild and Sons is better than Baring Brothers. During 1815-1837, Baring Brothers served five issues of loans lending 43.2 m. pounds loans where as issues of loans served during 1891 to 1904 where 20 of the value of 69.4 m. pounds, showing an increase of 300 % and 61 % in case of issues and amount respectively. It was the story of loans to foreign, colonial and state governments. Such percentages for issues and amount stood at 2600 and 591 in case of commercial lending during the same period. N.M. Rothschild and Sons served 24 issues of loans to foreign colonial and state governments of the value of 105.5 million pounds, and this amount reached to the tune of 200.7 million pounds during 1891 - 1904 leaving an increase of 90%. The table easily prove that there is no consistency in the working of these merchant Banks as the figures are volatile nature. From the security point of view these banks preferred to lend to governments than commercial ventures.
### Table 3.3

Comparison of Acceptance of the Leading N.M. Rothschild and Sons and Baring Bros. at Key Dates 1825 - 1913 (in million£)

<table>
<thead>
<tr>
<th>Year</th>
<th>Rothschild</th>
<th>Barings</th>
</tr>
</thead>
<tbody>
<tr>
<td>1825</td>
<td>0.30</td>
<td>0.52</td>
</tr>
<tr>
<td>1850</td>
<td>0.50</td>
<td>1.90</td>
</tr>
<tr>
<td>1890</td>
<td>1.39</td>
<td>c.15.00</td>
</tr>
<tr>
<td>1900</td>
<td>1.47</td>
<td>4.53</td>
</tr>
<tr>
<td>1913</td>
<td>3.19</td>
<td>6.63</td>
</tr>
</tbody>
</table>


**Source:** D. Chapman. Ch.2. P-17
The above mentioned Table No. 3.3 attempts to make a comparative study of acceptance of bills by the N.M. Rothschild & Sons and Baring Brothers. The figures are for some selected years only. Many Merchant Bankers including these two shifted their houses to London as acceptance of bills provided tremendous opportunities to these Merchant Bankers. In the bills accepted activities the picture is vice-versa as Baring Brothers was riding its horse high as compared Rothschild and Sons. In the year 1825 bills accepted by Rothschild and Sons and Baring Brothers were to the tune of 0.30 m ponds and 0.52 million ponds respectively. This amount shot up to 3.19 million ponds and 6.63 million ponds in case of Rothschild and Sons and Baring Brothers respectively. One conclusion we can derive that acceptance Bills was a major activity of these banks during that period also. Baring Brothers did more business of acceptance bill than Rothschild and Sons.
Today, a great majority of them are of English nationality. The exceptionally high reputation attached to the signatures of these houses caused the birth of a new form of credit which is known as acceptance credit. The granting of acceptance credits was the dominant activity of Merchant Bankers during the whole of the nineteenth and the beginning of the twentieth centuries. They were often better known under the title of acceptance houses. By the very nature of their activities, these Merchant Bankers were the first to distribute this type of credit. Merchants were ready to discount at their best rates, such paper as bore, the signature of certain great reputable houses in the city. The Merchant Banker the sort of ruler and his perfect knowledge of the market enabled him to guarantee deliberately transactions of whose healthy commercial parties he knew to be solvent. It was naturally understood that the debtor on whose account he accepted the bill would provide the necessary funds to meet the bill before the due date, without expense; therefore he collected a commission for simply lending his signature in order to make a bill negotiable at the best rates. Due to the great development during nineteenth century this system was adopted not only to import but export also. London became the center of world trade. The prestige of the pound sterling the only coin freely and constantly intercachngable for gold become such that the whole words traders opened accounts in London. The system of bank acceptances passed in to its last stage of development when it began to serve to finance the transfer of goods between one foreign country to another. Due to this reasons London became an international market and center of distribution of vast quantities of raw materials and overseas products. New acceptance houses were founded. From the beginning of the nineteenth century foreign governments had no scrupulous about using the wealth of these rich bankers. Rothschild lend money to the sovereigns of central Europe, Baring to the Russians and South Americans, Hambro to the king of Denmark and later to the Greek and Norwegian courts. If these governments were not in a position to repay these loans when they fell due they entrusted the banker with the issuing of a public loan. They lent to British government to purchase shares of Suez Canal.

In this way, the merchants became, "Merchant Bankers" and further more evolving more and more into pure bankers. They accepted deposits, granted loans and saw the placing and management of foreign issues. The first world war brought about a new phase of evolution in the Merchant Bankers. The guarantee which the acceptor gave to bill of exchange was brought in to play with very great suddenness by events in 1914. The moratorium which was declared at the beginning of August 1914 did indeed prevent the failure of the several houses, and the Bank of England had to give its support to some of them in order to enable them to put their houses in order. This should have resulted in an increase in the rate of the acceptance commission.
Owing to the growth of fresh competition, both from new London houses and from abroad, this increase did not come about. The rates come down due to competition. There was the very great risk for those Merchant Banks who have accepted risk three to four times their own capital. Most of Merchant Bankers were converted in to partnership. House of Baring in 1890 was first to adopt the form of limited company. In 1919 Lazard Bros. became a private limited company. In 1920 C.J.Hambro and Sons amalgamated with the British Bank of Northern Commerce limited and changed into a public limited company in 1923. Since the war and depression of 1920-21, they saw legal form which made the partners responsible to the extent of their entire personal fortunes for the debts of the bank. This movement denoted a state of disquietude and showed that they were fearful of being submerged if they assumed too heavy risks. In becoming more and more like bankers and less and less like merchants, the Merchant Bankers had gradually connected them-selves with certain branches of commerce.

During the post world war period, despite of inflation, currency depreciation and indebtedness, the Merchant Banking business expanded as the developmental activity both in the underdeveloped countries. During the year 1960 these banks had spectacular growth and prosperity for the main reasons -

i. The boom in industrial mergers and takeovers.


iii. London became as international city.

The second development in UK's Merchant Banking area was observed when Bank of England in 1960 issued directives for the clearing banks to involve in Merchant Banking activities directly but permitted these banks to form their subsidiary companies to undertake Merchant Banking business. During the late seventies and early eighties, more clearing banks entered in to the field of Merchant Banking. During the late seventies and early eighties, more clearing banks entered in to the field of Merchant Banking.

The third development in UK's Merchant Banking setup has been the growing awareness and activity of the Government with a view to "protect investors," and to
exercise more effective supervision and better defense against sophisticated financial frauds.\textsuperscript{(11)}

The regulatory regime for Merchant Banks, and indeed for other investment business, changed considerably in the spring of 1988, when the Financial Services Act, 1986 came into force. This was due to three developments.

i. During the 1970 and early 1980's a number of collapses and scandals in the investment world had pointed up gaps in the regulatory system then in force. That system was based around the prevention of fraud (Investments Act, 1958), but the regime did not. For example, core dealing in commodity and other futures because at the time it was introduced there was no likelihood of any real public investment in these markets. Small investors lost their money due to collapse of such banks. A High Court judge in 1983 warned small investors about the risk inherent in this form of investment and called on parliament to establish safeguards.

ii. the second reason was increasing participation of private investors in financial markets. Previously, only individuals were participated. An increasing number of people were entrusting money to financial advisors and managers either for personal portfolio management services or pooled investments.

iii. The third reason for introducing a new system of regulation was the need to adapt to changing conditions in the stock market. Particularly, significant from a regulatory point of view was the abolition of minimum commissions and single capacity in 1986, and are consequent stimulus for a spate of mergers and takeovers among jobbers and brokers.

The regulatory system introduced under the Financial Services Act is based on the recommendations of professor Gower, who submitted a report on investor's protection to the Government in 1984. His basic recommendation was that any one conducting investment business in the United kingdom should need authorization in order to the above business.
4) REGULATION OF MERCHANT BANKING IN ENGLAND-NEW REGIME (1986 - ONWARDS):

The power of authorize and regulate investment business was vested by the Act in the Secretary of State at the Department of Trade and Industry. This right delegated to the Securities and Investment Board (SIB) which received designation order in the middle of 1987. Investment of any kind came to SIB for authorization. But it was never intended that large number of firms should receive their authorisation from SIB. The Act provides for SIB to delegate much of the responsibility for regulating and monitoring individual investment business to self regulating organisation, and to Recognise Professional Bodies (RPBs) such as Institute of Chartered Accountants and Law Societies. The results is that SROs and RPBs have rule-books which provide investors with a level of protection equivalent to that enjoyed under the SIB rule book, and for monitoring the recognised bodies themselves, together with the relatively small number of investment businesses which have decided to come to SIB for direct authorisation. These are five SROs, each responsible for different areas of the financial services market.

1. The Association of Futures, Brokers and Dealers (AFBD) -

It authorises and monitors firms which deal, arrange deals and advise on deals on futures, options and contracts for differences and which manage portfolio of such investments.

2. The financial Intermediaries, Managers and Brokers Regulatory Association (FIMBRA) -

It authorises and monitors firms which advice on life insurance and units in collective investment schemes. It also provides investment and advisory services to retail investors.

3. The Investment Management Regulatory Organisation (IMRO)

The task of IMRO is to authorise and monitore firms which offer discretionary management services, which manage and operate collective investment schemes and in house pension funds.
4. The life Assurance and Unit Trust Regulatory Organisation (LAUTRO)

It regulates insurance companies and friendly societies engaged in retail marketing of life insurance products and operations of collective investment schemes.

5. The Securities Association

This association regulates firms which deal and arrange deals in shares, debentures, gifts, warrants, certificates representing securities, rights and interest in securities and financial futures and options on securities. It also covers corporate finance.

The RPBs are nine in number. They are Three Law Societies, three Institutes of Chartered Accountants, the Insurance Brokers Registration Council and the Institute of Actuaries. According to the Financial Services Act, professional firms can obtain their authorisation from these professional bodies provided that their business is not wholly or mainly investment business.

In addition to recognising the SROs and RPBs, SIB can also recognise under the Financial Services Act investment exchanges and clearing houses. In order to gain recognition and investment exchange must satisfy SIB that it has adequate financial resources, adequate safeguards for investors, adequate monitoring and enforcement procedures, arrangements for the investigation of complaints. All the regulatory bodies recognised under the Financial Services Act must offer investor protection equivalent to that in SIB’s own rule-book.

Merchant Banking groups today under take a very wide range of investment activities, and within any one group these will usually be a number of companies operating with authorisation from several different SROs. In many cases, the group will be structured in such a way that securities and futures, for instance, will be looked after by different companies within the group. But there is one major area where dual membership is usually required. Unit trust managers will normally join both IMRO (for the fund management side of their business) and LAUTRO (to cover retail marketing). IMRO disappplies its marketing rules where a member company is also a member of LAUTRO. So that regulatory overlap is minimised.
European Community directives on investment business developed in preparation for single European Market in 1992, fully involved the SIB in discussions on the form, these important pieces of community legislation should take place. Valuable work has already been done. The next priority must be to make further progress towards the harmonisation of key areas in the various regimes operated by different effective regulation and great minimum standards of investor protection across the world.

5) ORIGIN OF MERCHANT BANKING IN INDIA :-

The subject, Merchant Banking is of recent origin in India. Indian Merchant Banking does not have long historical background as compared to British Merchant Banking. But, there are so many evidences which support the use of Hundis, as a credit instrument even before the use of London bill. Indian indigenous bankers served Hundies for the limited purposes and limited people like kings and local merchants. Use of Hundis remained limited to within the groups of known persons much depending upon their personal image and credibility in the local business community.

6) ROLE OF AGENCY HOUSES :-

India's commerce developed after 1813 due to private adventures who came as merchants from European Countries, Britain and France. Trade and commerce developed in India through the agency houses established in India by the well known Merchant Bankers based at London. For example, John Palmer and Company was the leading agency house during that period, that operated from Calcutta. They accepted deposits from foreign merchants at the rate of 4 to 5 percent and lent it to local merchants at 10 to 12 percent interest. They charged commission also for their services.¹²

The different nature of trade transactions and availability of the cash resources at the spot from the agency houses had completely eliminated the role of acceptance houses or the Merchant Bankers in India. Thus, “local capital and expertise left little scope to utilise the facility at London or Liverpool excepting that participated by leading to French, German. United State merchants trading with India.”¹³
This state prevailed before the formation and appearance of the East India Company on the trade scene of India. British merchants who were trading with India through agency houses had been put under restrictions as the East India Company has the privilege to exploit the Empire market. There are numerous instances when the London based Merchant Bankers had their complete involvement in India's overseas trade and commerce. As much as there were eighteen firms with major interest in India, who represented European Merchant Bankers:

Cropper Benson and Rathbones of Liverpool and Peabody of USA 1820, Ogily Gillanders and Company with Henry Nevitte in Calcutta in 1833, Arbuthnot Ewart and Company, Rallies 1840, David Sassoon and Co. 1860, Jardine Matheson and Wallace 1883, Gladstone, Raj Henderson. The foreign Merchant Bankers operated in India through an agency house which was very well known as East India House representing a group that produced several Merchant Bankers during the 19th century. They failed in competition with new comers. East India House members' moved in to real estate business like tea, rubber plantation, cotton mills. Actually, stiff competition came from Persson Finance House. These houses gained much popularity in 1836 in Calcutta and were straight in competition with London Merchant Bankers. They provided credit facilities to the local Indian traders. Due to the above mentioned reasons banking industry did not develop in India. But after 1860 these agency house could not meet the growing credit requirements of the local merchants. It was late in 1860, when the merchants interest in joint stock banking system started growing and with their own investment they floated joint stock banks. Such a move was opposed by East India Company to safeguard its traditional interests in the country. Yet, East India Company could not prevent the establishment of Orient Bank, Chartered Bank of India and Chartered Bank of Asia, Chartered Mercantile Bank of India etc. The period of establishment of these banks was from 1845 to 1860. It was a major set back for the establishment of Merchant Banking in India. These joint stock banks used to provide finance to trade and other activities. These banks were under full control of London based Merchant Bankers through their management agents.

All these developments led the East India Company's monopoly of trade in British dominion in Indian subcontinent to recede. The British firms started establishing their subsidiaries to reap the benefits of the trade in the shape of the agency houses to manage the group concerns on their behalf. The managing agency system enabled a single firm to look after a number of firms in complementary industries.
MANAGING AGENTS ACTING AS MERCHANT BANKERS:

Managing agency was a lion in the path for the development of Merchant Banking system in India. However, these agents performed some important functions of modern Merchant Bankers. Generally, they financed for trade, commerce and industry. Managing agency houses acted as issue house for securities, undertook preliminary investigations and inquiry in to projects before promoting them, planning for long term investment, providing risk capitals, nursing the project in the initial stage of development. This is supposed as the principal reasons of the non development of India's capital market. It also made adverse effect on the industrial development of the country. Indian industry was virtually controlled by these managing agents. It was reported that in the year 1951 more than 600 industrial establishments were managed under the managing agency systems. It is also reported that out of these, 250 industrial houses were controlled and managed by nine leading British managing houses. They were Jardine, Henderson, Duncan, Andrew yule, Mcleods, Martin, Bird Octavins Gillanders and British India Corporations. Some Indian firms copied the agency system from British firms. At first these houses started this system at family level. To match the need of the time, family level agencies were converted into partnership and later in to public limited companies. Birlas, Tatas, Singhanias, Dalmias, Ruias, Narangs, Thapars, Poddars and J.K. These agencies played a very important role for floating shares in the securities market. It offered avenues to the common investor to hold shares of new companies. There were no special institutions acting as intermediaries except a few managing houses and broking firms. It was beyond the doubts that, very few securities were traded on stock exchanges.

With a view to provide adequate information to investors, the Indian Companies Act, 1936 was amended. It made obligatory to include in the prospectus the names of the underwriters, the commission payable to them, and a statement by the directors to the effect that the underwriters have to requisite financial resources, the contracts between the company and underwriters have been made accessible to the share holders.

In the immediate post independence period things did not improve fast because of the unchanged economic environment, concentration of money power, managerial skills and entrepreneurship, all rested with the handful of managing houses which wanted to move with gains and individual achievements creating acute dearth of long term capital for industrial ventures.
The managing agency system was sought to be abolished from the horizon of corporate management vide Companies Act, 1956, to do away with the stumbling blocks it had created in the development of free capital market. To improve investment climate in the country and boost capital market activities following corporations and institutions were formed. Industrial Finance Corporation of India (IFCI), State Finance Corporations (SFCs), Industrial Credit and Investment Corporation of India (ICICI), Life Corporation of India (LIC), Industrial Development Bank of India (IDBI), Unit Trust of India (UTI), National Industrial Development Corporation of India (NIDC) 1965, State Industrial Development Corporation of India (SIDC) 1966, Industrial Reconstruction Corporation of India (IRDC), General Insurance Corporation of India (GIC) 1972, with a view to boost capital market for long term and medium term finance for industrial development. These institutions had taken up underwriting the capital issues of corporate units in mid 1950s along with the stock-brokers and dealers. "Of the total amount of Rs. 14.4 crore underwritten in 1962 about on half was underwritten by financial institutions viz. LIC 20%, banks 18%, ICICI 7%, and IFCI 4% . The balance 50% was underwritten by brokers and the investment companies." This move helped a lot to prosper Merchant Banking in India, as many of these have entered in the business of Merchant Banking today.


8) REGULATORY AND DEVELOPEMENTAL FRAMEWORK OF MERCHANT BANKING ACTIVITIES IN INDIA

Industrial development and the development of Merchant Banking are co-related or complementary to each other. One is effect and another is cause. Industrial growth in India was given a big push only with the launching of second five year plan in 1955. Earlier companies used to float their capital issues with the help of a team of brokers under the leadership of one managing broker. But this system proved itself out-dated after the commencement of second five year plan.
The multifarious activities of the corporate sector and spectacular growth of industries in the country created a need for having expert advice on many aspects for the success of industrial projects. The entire process right from the conception of an idea of starting a new venture, its promotion, expansion, diversification, marketing of product, availability of finances, requires the services of professionals. Further, there are large number of industrial enactments in the country governing among others, industrial licensing, registration of units, capital issues, control foreign exchange regulations, joint venture abroad, complying with the provisions of Companies Act etc. which are beyond the knowledge of a single unit or its personnel. Following was the regulatory framework of capital market before formation of SEBI.


All these services were in fact not available under one roof like a departmental store in India and that was the major crux of the problem.
So corporate sector required a package of financial consultancy such a project, planning, the uses and sources of funds, getting clearance of the proposed issues, assessing the temper of capital market, placing of the issue at the right time etc. With the termination of managing agency system in India, the problem of providing of legal and financial services to the corporate sector arose which necessitated an alternative agency. The spurt of joint stock companies and simultaneously development of stock exchanges in India largely contributed to rapid innovations in Indian Banking. One such innovation is emergence of Merchant Banking with opening new vistas in industrial sector. The saying, “Never a borrower or a lender be” dominated prospective of medium entrepreneurs and industrialists who preferred to rely solely on their own resources borrowings. Today, there is rare entrepreneur which organises its business without reliance on borrowings from banking system.\(^{(20)}\)

Merchant Banking activity was formally initiated in to the Indian capital markets when Grindlays Bank received the license from Reserve Bank of India in 1967. By this way, Grindlays, a foreign banker laid down the foundation of Merchant Banking profession in the country. And as per the saying, fortune favors the brave, it gained much popularity within a short period. This bank started with management of capital issues, recognised the needs of emerging class of entrepreneurs for diverse financial services ranging from production, planning and system design to market research. A part from meeting specially the needs of small scale units, it provided management consultancy services to large and medium sized companies. The credit of formation of second Merchant Banking division also goes to the another foreign banker known as City Bank, which started this profession in the year 1970. The division took up the task of assisting new entrepreneurs and existing units in the evaluation of new projects and raising funds through borrowing and issue of equity. Management consultancy services were also offered.

The Banking Commission 1972, had considered the need of specialised financial institutions in its report. As regard, Merchant Banking institutions the Commission came to the conclusion that such institutions can help in the growth of economic process in the wake of the following circumstances.

Firstly India has built up a wide base of industrial structure. With the expected pace of acceleration of the process of industrialisation, the demand for both, financial and other services required by the industrial sector will grow faster. Industries like fertilisers, pesticides, petrochemicals and electronics, which are
highly sophisticated will require specialised services both the scale of operation and the investment outlays, in these industries would grow bigger than hitherto.

Secondly, the policy of decentralisation and encouragement of small and medium industries necessarily involves, the problem of providing technical and financial advice to these industries in much large scale than available at present.

Thirdly, with the changing emphasis in lending policies of organised credit institutions from security to the credit worthiness of business, corporate enterprises require the services of a financial intermediary in the wake of elimination of managing agency system which used to offer its services to companies under its management for securing financial resources from financial institutions. Middle sector industries which do not have benefits of the services of managing agencies continue to feel vehemently the need for services.\(^{(1)}\)

The commission was of the opinion that the present set up of banking field was unable to meet these challenges. The Commission recommended for setting up Merchant Banking institutions in Bombay, Calcutta, Madras and Delhi by commercial banks and financial institutions, later branches can be set up in other important centers.

Again, Grindlays and City Bank, as issue managers in the field of new issue activity made serious inroads in the traditional business of Indian investment broking firms. The banks were not giving any new technical know-how or services in these matters. But these banks passed a serious threat to the existence of indigenous market. This threat emerged because of their large resources derived from deposits and capacity to extend credit to their existing as well as the prospective clients. They started approaching the principals of foreign based companies operating in India at UK and other places overseas with instances to pass on the capital issues and other Merchant Banking business to them which used to be handled in part by the Indian investment broking firms. The union Government viewed these developments with serious concern of new issue business in the hands of powerful foreign banks. It was necessary to prevent the monopoly of foreign banks.
The recommendations of Banking Commission and the above described threat provided an opportunity for the Indian bankers to enter into the Merchant Banking field. The state Bank of India was the first Indian commercial bank to have entered in the field of Merchant Banking in the year 1972. Among the financial institutions, ICICI was the first to start Merchant Banking operations in the year 1973. Formation of other Merchant Banking divisions were, Central Bank of India, Bank of India and Syndicate Bank in 1977, Bank of Baroda, Standard Chartered Bank and Mercantile Bank in 1978, and United Bank of India, United Commercial Bank, Punjab National Bank, Canara Bank and Indian Overseas Bank in the seventies and early 80s. IFCI and IDBI development banks started their Merchant Banking divisions in the year 1986 and 1991 respectively.

Many managing brokers and underwriters also started Merchant Banking business for making hay of shining sun. Some of leading broker firms of Mumbai were quick to realise the Merchant Banking business has tremendous scope in India and accordingly decided to project themselves as experienced financial consultants. With a view to cater exclusively to the needs of their clients, as many as many four leading broker firms of Bombay started separate financial consultancy firms. In this context, mention may be made of H.L. Financial Consultants and Management Services Pvt. Ltd. (FICOM) floated by known brokers, Harikison Dass Lukshmi Dass in 1973, J.M. Financial and Investment Consultancy Services Pvt. Ltd. started by another well known broker Jamnadas Morarji, DSP Financial Consultancy Ltd., sponsored by yet another famous broking firm of Bhupendra Champaklal Devidas, Bajaj capital Invest centre (p) Ltd., Universal Finance Traders Ltd. and so on.

India had tortoise speed of development up to 1973. The capital market Merchant Banking business did not flourish on account of this reason. There was a big push to the speedy development of capital market in form of Foreign Exchange Regulation Act, 1973. Actually, this act came in to force on 1st January, 1974. FERA compelled several companies to enter in to the primary capital market with the issues of their shares for the purpose of diluting the nonresident holding to a lower level. It offered a very good opportunity to the Indian investors to share in the good and attractive equity investment. From this time onwards, the capital market started showing buoyancy. Simultaneously, the other phenomena of the resources of the financial institutions and banks prompted the companies with a good track record of satisfactory financial operations to their credit to enter the capital market for mobilising their long term requirements either for expansion or modernisation and diversification.
These developments gave an unique opportunity to investors in the country to invest in various instruments. Obviously, these factors offered a good business to Merchant Banking.

Subsequently, the liberalisation of industrial, fiscal, licensing, import-export, foreign collaboration, import of foreign capital and new capital issues policies in 1984-85 gave a real shot in the arm to the stock market. The sharp increase in the inflow of Non Resident Indian funds resulting from a package of concessions, incentives and facilities provided by the government and the relaxation of the norms relating to foreign investment, foreign equity participation, and foreign collaboration in 1988 helped to sustain the impetus to the stock market.²³

The boom in the capital market in the early eighties followed by the gradual deregulation in the economy and the immense strain on the profitability margin of the banks, primarily due to reduced spread on interest income and subsidised financing can be treated as the transformational period for the banking system, where in a strong need was felt for diversification simply for survival.²⁴ Due to the reduction in interest rates and subsidised financing, the commercial banks were caught in financial crux. To overcome this situation, they were in search of better opportunities. Merchant Banking came as an angel due to the rapid development of the Indian capital market. So those banks who were on fence of diversification jumped in this prestigious profession. Following the issue of a Notification under Section 6(1)(o) of the Banking Regulation Act, during 1984, commercial banks were permitted to set up subsidiaries with not less than 51 percent of shareholding for undertaking equipment leasing business or to invest in shares within the limits specified in section 19(2) of the above Act. This Notification provided the real impetus to the banks, especially among the early initiators, and a number of subsidiaries were established to undertake Merchant Banking business. The division of SBI was accorded a new identity in 1986—as SBI Capital Markets Limited (SBICAP). This wholly owned subsidiary of the SBI was launched to harness and capitalise of the new buoyancy in Indian capital market. SBICAP is India’s premier Merchant Bank. As per Mr. R. Vishwanathan, Managing Director, the creation of separate identification for SBICAP was required mainly for two reasons. The first was to expand and go deep in to the smallest area relating to the Merchant Banking business including new issues management. The second reason was to diversify and take new activities relating to capital markets. The subsidiary of Canara Bank known as the Can Bank Financial Services Ltd. was formed in 1987, followed by other subsidiaries of commercial banks.
If one attempts to analyse the reasons of mad rush among the banks to grab this new line of business, it will not be difficult to see the point. The major stories go like this that, while on the one hand, the Indian economy during the eighties was experiencing an unprecedented growth of capital market due to emergence of a share culture among the public and the demand for specialised financial services was gradually increasing the financial institutions, on the other hand, were increasingly getting burdened on account of rising costs of funds, establishment costs, bad debts and sticky advances all resulting in strain on their profitability. It was, therefore, in the fitness of things for them to diversify their operations in to other profitable non fund /non conventions by siness areas in order to strengthen their earning base. The result was an appropriate, and timely decision to enter in the Merchant Banking field.

To exploit the benefits of growing capital market in India, many commercial banks, private banks, development banks, brokers etc. entered in this sophisticated and gainful profession. Following table shows the progress of Merchant Banking at this stage along with capital issues.
Table No. 3.4  
Capital Issues through prospectus

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Issues</th>
<th>No. of issues over subscribed.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1965</td>
<td>75 (19)</td>
<td>14</td>
</tr>
<tr>
<td>1966</td>
<td>76 (101)*</td>
<td>08 (11)**</td>
</tr>
<tr>
<td>1967</td>
<td>74 (99)*</td>
<td>17 (23)**</td>
</tr>
<tr>
<td>1968</td>
<td>73 (57)*</td>
<td>11 (15)**</td>
</tr>
<tr>
<td>1969</td>
<td>50 (67)*</td>
<td>22 (44)**</td>
</tr>
</tbody>
</table>

Source: Stock Exchange Division, Ministry of Finance, Government of India.
* Represents percentage over the base year.
** Indicates % of total issues.

A review of the comparative position of the capital issues made through prospectus was made by Stock Exchange, Division of Ministry of Finance. These issues were managed by agencies other than Merchant Bankers. The review relates to the securities - equities, preference shares, debentures and bonds. India's capital market did not produce good result during this period because of India-China and India-Pakistan wars during 1962-63 and 1964-65. During the above whole period capital market could not develop. The percentage of oversubscribed issues to total remained some what constant except the year 1965 in which such a percentage was 44%.
### Table No. 3.5

**Capital Issues Through prospectus**  
From 1970-71 to 1986-87

<table>
<thead>
<tr>
<th>Year</th>
<th>Total No. of Co. going to public</th>
<th>Total Amount of public offer</th>
<th>Times Issues over subscribed (Rs. in crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970-71</td>
<td>64</td>
<td>33</td>
<td>NA</td>
</tr>
<tr>
<td>1971-72</td>
<td>58</td>
<td>31</td>
<td>NA</td>
</tr>
<tr>
<td>1972-73</td>
<td>84</td>
<td>50</td>
<td>NA</td>
</tr>
<tr>
<td>1973-74</td>
<td>157</td>
<td>51</td>
<td>NA</td>
</tr>
<tr>
<td>1974-75</td>
<td>108</td>
<td>21</td>
<td>NA</td>
</tr>
<tr>
<td>1975-76</td>
<td>111</td>
<td>56</td>
<td>NA</td>
</tr>
<tr>
<td>1976-77</td>
<td>97</td>
<td>43</td>
<td>1.5</td>
</tr>
<tr>
<td>1977-78</td>
<td>108</td>
<td>76</td>
<td>2.97</td>
</tr>
<tr>
<td>1978-79</td>
<td>122</td>
<td>51</td>
<td>8.13</td>
</tr>
<tr>
<td>1979-80</td>
<td>129</td>
<td>55</td>
<td>6.93</td>
</tr>
<tr>
<td>1980-81</td>
<td>192</td>
<td>93</td>
<td>5.23</td>
</tr>
<tr>
<td>1981-82</td>
<td>351</td>
<td>306</td>
<td>4.15</td>
</tr>
<tr>
<td>1982-83</td>
<td>565</td>
<td>250</td>
<td>2.63</td>
</tr>
<tr>
<td>1983-84</td>
<td>756</td>
<td>20</td>
<td>4.22</td>
</tr>
<tr>
<td>1984-85</td>
<td>555</td>
<td>231</td>
<td>4.55</td>
</tr>
<tr>
<td>1985-86</td>
<td>764</td>
<td>564</td>
<td>7.7</td>
</tr>
<tr>
<td>1986-87</td>
<td>293</td>
<td>616</td>
<td>2.74</td>
</tr>
<tr>
<td>Mean</td>
<td>266</td>
<td>161</td>
<td></td>
</tr>
</tbody>
</table>

Source: Bombay Stock Exchange Division, Ministry of Finance, Government of India.
Indian Capital market has substantially improved during 1970s and 1980s. It was the result of rapid industrialisation and dependence of many companies on primary capital market for the funds. Merchant bankers as professionalised bodies took charge of managing the public issues with skill developed for the purpose and leading to the reduction of eventualities of under subscription and development upon the underwriters. Investors developed their habit of investment in securities due to relaxation in tax provisions made by the government.

The above given table makes it clear that the No. of companies which had gone for public issues was the highest during 1985-86 ever in the history of capital market in India. About 764 companies had offered Rs. 564.48 crores worth of securities to public which were oversubscribed. On the other hand the year 1986-87 reflects the state of sluggishness in the capital market when lesser number of companies offered Rs. 616.52 crores securities to public but the response was very poor. The data produced in the table amply prove that primary capital market had developed rapidly after 1980-81 only. The reasons for sluggishness in capital market during 1986-87 were as follows. Lack of investors confidence was the major cause. Many issues which were brought to public by Merchant Banker during 1985-86 lost their existence immediately after utilising the public subscription money and investors had to repent for their investments. During this period Merchant Banking experienced mushroom growth. Many of them were ignorant of the role of Merchant Banker. Lack of adequate knowledge, training and skill development were the some reasons which created unhealthy atmosphere in primary capital market. The degree of government interference with the stock market was suspected to be very high because the G.S.Patel High Power Committee had submitted the Report on Stock Exchange Reforms and government had started implementing the recommendations in piece meal keeping the investors, the stock exchanges, brokers etc. in suspense about the next step of the government.
<table>
<thead>
<tr>
<th>Institution</th>
<th>Capital Issues Handled</th>
<th>Loan Syndication</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. of companies served</td>
<td>Amount Rs. in crore</td>
</tr>
<tr>
<td>SBI</td>
<td>122</td>
<td>130</td>
</tr>
<tr>
<td>ICICI Ltd.</td>
<td>40</td>
<td>200</td>
</tr>
<tr>
<td>Bank of Baroda</td>
<td>8</td>
<td>4.7</td>
</tr>
<tr>
<td>Grindlays Bank</td>
<td>66</td>
<td>NA</td>
</tr>
<tr>
<td>Mercantile Bank</td>
<td>3</td>
<td>3.3</td>
</tr>
<tr>
<td>Bank of India</td>
<td>18</td>
<td>100</td>
</tr>
<tr>
<td>Indian overseas</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The above mentioned table of some representative Merchant Banks make it clear that, as per the saying "The early bird catches the worm," SBI stood first in rank in case of no. of companies served leaving second position to Grindlays Bank. In case of capital issues amount, ICICI came off with flying colour with the total amount of Rs. 200 crore.

The next phase of development of Merchant Banking business commences from April 1988, when The Securities and Exchange Board of India came into existence. It was formed with the objectives of monitoring and regulating the capital market and protecting the investors. On 30.1.1992, SEBI was given statutory status by regulation of SEBI Ordinance. The SEBI Act, followed in April, 1992.

The freedom to make public issues has placed greater responsibility on the intermediaries like Merchant Bankers and lead managers to the issues involved in the marketing of the issues. As per the new guidelines issued by the SEBI on 11th June 1992, laying new norms for the free pricing of shares. The pricing of the issues will be done by the issuer and the lead manager. The skill of Merchant Bankers will now come into play as never before their services are going to be greatly in demand and the Merchant Banking business is going to become intensely competitive as pressure is amounted on them by the companies wanting higher premia for their share offerings. Merchant Bankers also feel more exposed, with Controller of Capital Issues (CCI) going, they will be required to become most responsible. Earlier they could heap a lot of blame on the CCI. Now that alibi will no longer be there.

It may also be noted that with effect from December 22, 1992, no one can act as Merchant Banker without obtaining a certificate of registration from SEBI. To reap the benefits deregulations and flood of new issues attracted many new merchant bakers. Following table provides the number of Merchant Bankers:
### Table 3.7

**Merchant Bankers Registered**

*With SEBI From 31-03-93* to 31-03-98*

<table>
<thead>
<tr>
<th>Year</th>
<th>Categories</th>
<th>Total Nos.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>I</td>
<td>II</td>
</tr>
<tr>
<td>31-03-1993</td>
<td>127</td>
<td>9</td>
</tr>
<tr>
<td></td>
<td>(100)</td>
<td>(100)</td>
</tr>
<tr>
<td></td>
<td>(73)**</td>
<td>(5)**</td>
</tr>
<tr>
<td>31-03-1994</td>
<td>211</td>
<td>28</td>
</tr>
<tr>
<td></td>
<td>(166)*</td>
<td>(200)*</td>
</tr>
<tr>
<td></td>
<td>(50)**</td>
<td>(07)**</td>
</tr>
<tr>
<td>31-03-1995</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td></td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>31-03-1996</td>
<td>404</td>
<td>72</td>
</tr>
<tr>
<td></td>
<td>(318)*</td>
<td>(800)*</td>
</tr>
<tr>
<td></td>
<td>(40)**</td>
<td>(8)**</td>
</tr>
<tr>
<td>31-03-97</td>
<td>440</td>
<td>107</td>
</tr>
<tr>
<td></td>
<td>(346)*</td>
<td>(1889)*</td>
</tr>
<tr>
<td></td>
<td>(38)**</td>
<td>(9)**</td>
</tr>
<tr>
<td>31-03-98</td>
<td>343</td>
<td>82</td>
</tr>
<tr>
<td></td>
<td>(270)*</td>
<td>(911)*</td>
</tr>
<tr>
<td></td>
<td>(43)**</td>
<td>(10)**</td>
</tr>
</tbody>
</table>

**Source:** SEBI’s Annual Reports 1995-96 & 1997-98.

**Note:** * Represents percentage over base year

** Indicates % to total.
The Table No. 3.7 discloses registration of various categories Merchant Bankers with SEBI up to 31.3.1996. The registration requirement arise from the need for the market participants general and the investors in particular to develop confidence that the intermediaries like Merchant Bankers with whom they deal are efficient, have financial soundness and integrity and will treat them in a fair and transparent manner. As Merchant Bankers are one of the key intermediaries in the primary market, associated with issue management, their registration is therefore important measure for investors’ protection. The SEBI (Merchant Banking) Rules & Regulations, 1992, divided Merchant Bankers into four categories according to their nature of activities and net worth.

Up to 31.3.1993 total Merchant Banks registered with SEBI were 173. Prior to the issue of the regulations, the Merchant Bankers were regulated by the Guidelines for Merchant Bankers issued by the Ministry of Finance which had empowered SEBI to authorise Merchant Bankers. Under these guidelines effective from August 1, 1990, SEBI authorised 99 Merchant Bankers under various categories. As on March 31, 1993, SEBI granted registration to 74 new Merchant Bankers in different categories under the regulations. Up to 31.3.1993, out of the total registered Merchant Bankers 173, the % of category I was 73, followed by categories IV, III & II. The keen observation of the data reveals that the % of category I MBs to the total is showing declining trends as it is reduced to 40% on 31.3.1996. It may be on account of heavy amount of net worth (Rs 5 crore) for category I MBs & lack of getting sizeable business to retain in the profession. Category III & IV MBs have experienced speedy growth during the study period. Category IV MBs have nil net worth requirement. Many brokers have registered for this category. Total No. of these banks as on 31.3.1993 was 29, which reached to 364 on 31.3.1996, showing an increase of 1155%. Such an increase is highest in case of category III Merchant Bankers i.e. 1925%. Category III & IV MBs have tremendous scope in future as the demand for advisory services by corporate sector is bound to increase. The % of category I Merchant Bankers to the total is on the way of declining. It is just 40% on 31.3.1996.
If the base year 1993 is considered for the analysis the data reveals that the
No. of all category Merchant Bankers increased to the tune of 802 from 173 during
our whole study period showing an increase of 364%.

During the year 1997-98, there were a few changes in the Merchant Bankers
Regulations in order to streamline and strengthen the role of SEBI and RBI to impart
transparency to Merchant Banking activities. Before it most of the Merchant Bankers
were carrying on both fund based activities and nonfund based activities including
leasing, hire purchase etc., where as fee based activities included Merchant Banking
and underwriting. However, it was seen that fund based activities, which were
regulated by the R.B.I. were resulting in erosion of net worth. The SEBI requires
Merchant Bankers (Category I) registered with it to have minimum net worth of Rs5/-
crore. Since this was an essential condition to grant registraton and erosion of the
same was not in the interest of Merchant Bankers. One entity was regulated by two
regulatory bodies viz-SEBI and RBI. So close monitoring of the networth on a
continuous basis was not possible. So it was decided to clearly segregate these
activities. To achieve this end, Merchant Banking Regulations were amended with
effect from December 9, 1997. As per the amended guidelines, a Merchant Banker
category 1 (excluding banks and financial institutions) is disallowed from carrying on
any activity other than that related to securities market. The amendment stipulates
that a Merchant Banker carrying on fund based and Merchant Banking activities
would have to either discontinue the activities not related to the securities marketer
hivw off its Merchant Banking activity. The rational to segregate the two functions of
the Merchant Banker & to eliminate the overlapping of accounts of Merchant Banking
and fund based activities. It will facilitate greater accountability and better monitoring
on repeated representations from Merchant Bankers for extension of time to comply
with the aforesaid notifications the Merchant Bankers were given 6 months up to
June 30, 1998 to segregate their activities. The above amendment also abolished
the pre-existing multiple categories of Merchant Bankers viz category II,III and IV.
Category II Merchant Banker could carry on activities of a portfolio manager and
underwriter where as category III Merchant Banker could carry on activities of
underwriter only. The SEBI already has separate Regulations for portfolio managers
and underwriters and to take care of the overlapping, it was felt that the category II
and III Merchant Bankers could continue to carry on their activities but by applying for
registration under the Underwriters and Portfolio Managers Regulations. However,
existing category II and III Merchant Bankers could continue to carry on underwriting
and portfolio management until their registration expires. Thus there is only one entity
i.e. category I Merchant Banker, who can carry on issue management activity only.
Table 3-8
Distribution of Registered Merchant Bankers (Zone-wise)
(From the inception of SEBI to July 1993)

<table>
<thead>
<tr>
<th>Zone</th>
<th>I</th>
<th>%</th>
<th>II</th>
<th>%</th>
<th>III</th>
<th>%</th>
<th>iv</th>
<th>%</th>
<th>Total</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>West</td>
<td>77</td>
<td>46.9</td>
<td>14</td>
<td>73.6</td>
<td>10</td>
<td>47.6</td>
<td>61</td>
<td>69.3</td>
<td>162</td>
<td>55.6</td>
</tr>
<tr>
<td>North</td>
<td>38</td>
<td>23.3</td>
<td>2</td>
<td>105</td>
<td>7</td>
<td>33.3</td>
<td>15</td>
<td>17.1</td>
<td>162</td>
<td>21.2</td>
</tr>
<tr>
<td>South</td>
<td>35</td>
<td>21.3</td>
<td>2</td>
<td>105</td>
<td>3</td>
<td>14.2</td>
<td>8</td>
<td>9.0</td>
<td>4.8</td>
<td>16.4</td>
</tr>
<tr>
<td>East</td>
<td>14</td>
<td>8.5</td>
<td>1</td>
<td>5.3</td>
<td>1</td>
<td>4.8</td>
<td>4</td>
<td>4.6</td>
<td>20</td>
<td>6.8</td>
</tr>
<tr>
<td>Total</td>
<td>164</td>
<td>100</td>
<td>19</td>
<td>100</td>
<td>21</td>
<td>100</td>
<td>88</td>
<td>100</td>
<td>292</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Bharat's Compendium on SEBI, Capital Issues and Listing 1994
The above table proves that near about 56 percent Merchant Banks are located in west Zone, i.e. at Mumbai, being the capital city of the country almost head offices of the Merchant Bankers are located here other cities which have Merchant Banking centers are Delhi, Calcutta, Chennai, Ahmedabad, Bangalore etc. These banks are concentrated in metropolitan cities only.

The free pricing, compulsory registration with SEBI, globalisation, liberalisation, capital market reforms etc. have brought about a drastic change in the role of Merchant Bankers. The Merchant Banking industry in India has been kin to mushrooms sprouting almost everywhere and in a very short span of time, the number has swelled from 312 in April, 1992 to 816 in April 1995. But more than the number, quality of service and responsibility towards investors is important.

Today, bankers all seem to jump on the same bandwagon at once, and in international business these days, the bandwagon to jump on is Merchant Banking. In India there is a mad rush for joining Merchant Banking field. Every financial or consultancy institute wants to join this profession. It has caused cut-throat competition only handful Merchant Bankers are doing major business of Merchant Banking business and others are trying to keep their heads over the water. This is the age of "Survival of the Fittest."

Merchant Banks in India have over the years, become one of the most important intermediaries in the capital markets. The main business of Merchant Banks (MBS) succinctly summarised by the Narasimhan Committee, comprise "Management of underwriting of new issues, syndication of credit and provision of advisory services to corporate clients on fund raising and other financial aspects." Till now, Indian Merchant Banks have been concentrated on issue management. In this area, the regulatory framework has undergone a sea change over the last five years. The Indian Merchant Banking is proceeding from close regulation to deregulation the issue House Business of MBs is regulated by SEBI.

The MBs regulate which seek to regulate the raising of funds in the primary market would assure for the issuer a market for raising resources at low cost, effectively and easily, ensure a high degree of protection of the interests of the investors and provide for the Merchant Banker a dynamic and competitive market with high standard of professional competence, honesty integrity and solvency.
The regulations would promote a primary market which is fair, efficient, flexible and inspires confidence. The Regulations stipulate that any person or body proposing to engage in the business of Merchant Banking or presently engaged as managers, consultants or advisors to issue would need authorisation by securities and exchange Board of India. According to the Notification of the Ministry of Finance a Merchant Banker can engage in the business of issue management or can render corporate advisory services.

From December 22, 1992 registration of Merchant Bankers has been made compulsory. No one can act as Merchant Banker without obtaining a certificate of registration from SEBI.

AUTHORISED ACTIVITIES:

As per the guidelines of SEBI, the authorised activities include issue management which consists of preparation of prospectus, determining financing structure, tie up of finances, allotment of shares debentures/bonds etc, refund of subscription, Corporate advisors to the issue managers, consultants or advisors to issue and underwriting other authorised activities would be portfolio management services. Recently, vetting of offer document is also performed by Merchant Bankers.

CRITERIA FOR AUTHORISATION:

The criteria of authorization, as per SEBI, take in to account mainly:

a. Professional competence.

b. Infrastructure like adequate office space, equipment and manpower.

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c. Employment of two persons who have the experience to conduct the business of Merchant Bankers.

d. Capital adequacy.

e. Past track record, experience, general reputation and fairness in all their transactions.

In regard to existing Merchant Bankers, SEBI fixed 3 months ceiling with in which the authorisation had to be obtained. SEBI has classified MBs in to four categories having regard their nature and range of activities and the responsibilities to SEBI, investor and issuers of securities.
<table>
<thead>
<tr>
<th>Category</th>
<th>Minimum Net Worth (Rs.)</th>
<th>Registration Fees (First two years) (Rs.)</th>
<th>Registration Fees (After two years) (Rs.)</th>
<th>Renewal Fees (First two years) (Rs.)</th>
<th>Renewal Fees (After two years) (Rs.)</th>
<th>Authorized Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Category I</td>
<td>5,00,00,000</td>
<td>2,50,000</td>
<td>10,000</td>
<td>10,000</td>
<td>20,000</td>
<td>To carry on activities of issue management i.e., preparation of prospectus determination of financial structure, allotment and refund of subscriptions, to act as advisor, consultant, co-manager, underwriter, portfolio manager etc.</td>
</tr>
<tr>
<td>Category II</td>
<td>50,00,000</td>
<td>150,000</td>
<td>50,000</td>
<td>75,000</td>
<td>10,000</td>
<td>To act as co-manager/advisor, consultant, underwriter, portfolio manager.</td>
</tr>
<tr>
<td>Category III</td>
<td>20,00,000</td>
<td>100,000</td>
<td>25,000</td>
<td>50,000</td>
<td>5000</td>
<td>To act as an underwriter, advisor or consultant to an issue.</td>
</tr>
<tr>
<td>Category IV</td>
<td>Nil</td>
<td>5,000</td>
<td>1,000</td>
<td>5000</td>
<td>2500</td>
<td>To act as an advisor or consultant to an issue.</td>
</tr>
</tbody>
</table>

RESPONSIBILITIES OF LEAD MANAGER

It could be broadly divided into:

i. Pre Issue.

ii. Post-Issue.

In the pre-issue phase, lead manager or managers is / are responsible for:

i. Allocating inter-se responsibilities among the lead managers and giving a suitable certificate to SEBI.

ii. Compulsorily underwriting of the issue i.e. minimum 5% of the issue or Rs. 2500000 whichever is lower. Recently underwriting has made optional by SEBI for the whole issue.

iii. Ensuring that the prospectus, Application Forms, Issue Literature, Publicity etc conform strictly to the extant rules.

iv. Preparation and vetting of Due Diligence certificate.

v. Submitting of particulars of the issue, draft prospectus or letter of offer to SEBI.

RESPONSIBILITIES IN POST-ISSUE PHASE:

i. Ensuring that the issue attracts at least 90% subscription, otherwise the entire amount should be refunded to applicants.
ii. Ensuring timely allotment / refund and dispatch of allotment / refund certificates in a proper manner.

iii. Publishing of every matter in connection to issue management within 10 days.

iv. Handling all the matters of investor grievances.

Due to free pricing and transfer of right of vetting of Due Dilligence certificate from SEBI to Lead Manager have added the responsibilities of Head Managers at the time of exercising their functions.

SELF REGULATORY ORGANISATIONS (SRO)

In many capital markets, there is an irresistible temptation for the Governments to lay down rules, regulate and monitor the capital markets efficiently. In the developing economy like ours, this issue becomes much sensitive and even complicated. The needs of the developing markets are rather different rather than that of developed capital markets. It is stated by sir William Ryrie, IFC(W), "Efficient competitive financial markets transmit efficiency to real sectors of the economy controlled, directed markets disseminate inefficiency." But on the other hand untrammeled self regulation would not also be in the best interests of the user community. After all, self regulation is necessary because every aspect of MBs function can not be controlled from outside and such external control could become arbitrary.

OBJECTIVES OF SROs

The main objectives of self regulation are the ensure that.

a. MBs act fairly and honestly in the best interests of the customers.

b. MBs develop and maintain high standards of professional conduct.
c. Follow the principle of "self regulation is the best regulation".

d. A high degree of integrity is established and maintained in the market.

**INDIAN SCENARIO:**

Indian Merchant Banking business has gone under seachange from last six to seven years. In 1989-90 there were 78 Merchant Bankers who handled 187 issues and helped companies to raise Rs. 2,793 crore through equity issues. In 1994-95 over 800 Merchant Banks handled a record 1343 public issues raising Rs. 13311 crore in the process. Another development can be told regarding free pricing of issues. There is no control on the prices on new issues, which are decided by the Merchant Bankers. With the passage of time investors have become more mature and demanding controls over the Merchant Banking.

**DEVELOPMENTS IN INDIA:**

More than decades ago, a selected group of Merchant Bankers used to congregate at regular intervals the Industrial credit and Investment Corporation of India (ICICI) board room in south Bombay. These meetings were relaxed affairs, the with good reason. While this informal club eventually died a natural death, it was later resurrected in a new avatar the Association of Merchant Bankers of India (AMBI) whose task is of more arduous than that of its predecessor. The genesis of AMBI can be traced to the efforts of former securities and Exchange Board of India (SEBI) chairman G.V.Ramkrishna who said while SEBI should be in-charge of market discipline, the various players should regulate themselves. He visualize AMBI as the self Regulatory Organisation(SRO) for Merchant Bankers.

Ramkrishna's hopes remain largely unfulfilled. While AMBI still has some way to go before it becomes a proper SRO, other market intermediaries too have failed to set up their own SROs. While Mutual Funds through the Association of Mutual Funds of India (AMFI) have at least made an attempt here, other important players have not even reached this for3. (28)
At the insistence of SEBI, MBS have taken concrete steps towards SRO by enlarging the scope of association of Merchant Bankers of India (AMBI). The following major areas have been addressed so far by AMBI.

a. Code of conduct in advertisement and publicity.

b. Ensuring rigorous standards for disclosures in prospectus and spelling out minimum standards of performance in Due Diligence by MBs.

c. Post issue responsibilities.

Three separate expert committees of AMBI were formed to study in the above three areas. They have come up with suitable codes which would ensure proper professional conduct on the part of the MBs as would also be in the best interest of the customers. These views are yet to be formally adopted and implemented. One committee was formed to evolve a code of conduct manual and the second a due diligence manual. Says ICICI securities chairman and AMBI chairman N.J.Jhaveri. The purpose of the code of conduct manual is to ensure to stop undercutting each other and have a more mature response while the due diligence manual would set minimum standards like disclosure and other legal aspects. According to Jhaveri the MS Shoes Fiasco has catalysed AMBI in the action more ever, with SEBI coming down heavily on Merchant Bankers and the community at large feeling prosecuted. To the investor, the MB should ensure that all possible information about the issue is given and the post issue management, i.e. allotment of shares, refunds etc. are effected with at most expedition. In the pre-issue phase, MB should ensure that complete and true information is provided to public through prospects. AMBI is also hammering out a code of conduct for pre-issue publicity so that no room is given to an over enthusiastic issuer to misrepresent-directly or indirectly the attractive features of the issue.

Post issue management has become as arduous task in India especially because of heavy oversubscriptions for a vast majority of issues due primarily to unrealistically low flotation pricing of issues by existing companies. The problem is compound with rigid rules of allotment prescribed by the stock exchanges. The banking system is extensively used for this purpose, but the system is unable to cope with the load. MBs are expected to ensure that allotments are made in time and refunds are also effected promptly. It is the need of the hour to minimize the abnormal delay in such activities.
AMB has setup suitable codes of business in regard to post issue management by MBs. Our capital market is developing fast in quantity aspect, but qualitative developments can be assured by bearing high standards and ethics in the profession of Merchant Banking. MBs should perform their duties with due diligence, and we think this is the cry of time. Fortunately, these areas are also covered by AMB in publicity code and prospectus and due diligence requirements.

CONCLUSION

Though the concept of Merchant Banking is the brainchild of some Dutch and Scottish traders, the activities of these banks came in to reckoning in Britain, particularly in London. The period of true development was late eighteenth and early nineteenth centuries. Merchant Bankers all over the world started their functioning in England. Reknown of them were Baring Brothers and N.M. Rothschild and sons.

Managing agency was a major problem for the development of Merchant Banking in India. The multifarious activities of the corporate sector and spectacular growth of industries in the country created a need for having expert advice of Merchant Banking. There is tremendous growth of Merchant Bankers from 173 on 31-3-1993 to 1012 on 31-3-1996, showing an increase of 585 percent. The percentage growth is highest in case of category III Merchant Bankers (2025%) followed by category IV MBs (1265%) over 1993. Capital raised from primary capital market through public and rights issues stood at Rs. 3954 crore in 1990-91 and it reached to the tune of Rs. 20,105 crore in 1994-95 showing an increase of 508 percent over the base year. The percentage of Merchant Bankers in 1994-95 over their base year were 350 (public issues) and 261 (Right issues).
REFERENCES


5) I bid P.2.


8) I bid p.100.


14) I bid P.57.


17) I bid p. 81


