CHAPTER-I

INTRODUCTION
1.1 The problem

In India, during the pre-independence period, the managing agency houses were acted as issue houses and provided their skill and expertise in managing securities, planning long-term investments, contributing risk capital in project development. Management of new issues of corporate securities was performed by a few prominent houses and as a consequence, investment practices of common investors were not so encouraging. The post-independence era was striving an underdeveloped capital market and economy because of static economic environment and monopolistic managing agency system. The services rendered by these managing agency houses were found to be inadequate and their performances were subjected to rigorous criticism resulting in abolition of the system in 1956 when Indian Companies Act was drastically amended. With the passage of time, the Government of India decided to undertake some planned development programmes for the overall economic recovery of the country.

During late sixties, the developmental activities carried on by Indian trade and industries led to excess demand for funds for expansion, modernization and for diversification of corporate entities. However, these requirements could not be met by the financial institutions including banks, which ultimately prompted those entities to enter into the capital market for generating long-term funds. With the process of economic as well as technological development in India the absence of specialised institutions was seriously felt at every stage and the Government of India started to make a search for the like institutions and subsequently the outcome was the emergence of such institutions rendering financial services to the corporate sectors. As a result, the Banking Commission, in its report in 1972, recommended the necessity of merchant banking services as specialized services of the financial institutions. Fortunately, the recommendation had opened up new vistas for the commercial banks and financial institutions to enter into merchant banking activities with specialized skills, expertise and
updated knowledge.\textsuperscript{1} Basically, the vacuum of managing agency system, a gap was felt in this area which was ultimately filled up by the merchant bankers.

During late eighties, the Government of India took a bold step towards liberalisation by relaxing certain controls, which gave a fillip to industrialisation and brought a paradigm shift in the corporate environment. The capital market in India also transformed greatly since the early 1990s and its impact was felt by the corporate entities since then. The process of economic liberalisation was also accompanied by a corresponding and parallel growth of financial institutions. The boost from the Government and the initiation of de-bureaucratisation process had given tremendous opportunities to the merchant banking institutions helping industries in undertaking financial engineering effectively. As the entrepreneurs and promoters failed to arrange finance from the general public and manage them effectively, they approached the merchant bankers who took this opportunity to assist the corporate sectors in rendering multifarious financial advisory services. In fact, the concept of merchant banking assumed a serious concern only after the Securities and Exchange Board of India (SEBI) thought it positively in 1992 as an important intermediary in the functioning of the capital markets and performing other financial services. With the growth of this specialized profession, corporate sectors were able to raise the required finance from capital market to meet the growing requirements for funds and also to undertake expansion, modernisation and diversification programmes to face the heat of competition. This is witnessed from the increasing amount of capital raised from the capital market by the corporate enterprises from year to year\textsuperscript{2}.

In fact, merchant bankers are regarded as specialized banks having expertise in providing merchant activities like corporate counselling,

\textsuperscript{1} "Report of the Banking Commission", Government of India, 1972, pp.164-166.
project counselling and pre-investment study, credit syndication and project finance, corporate restructuring, capital issue management, underwriting, portfolio management, venture capital financing etc. These institutions also render exclusive services to their clients in procuring and managing funds from the public. The merchant bankers in India play a major role on capital issue management of corporate securities. Information in this specialized area of capital issue management is scarce and not yet explored in a big way and requires an exhaustive study of the related activities of the entities. The study, as such, makes a humble endeavour to find out the role of the merchant bankers in corporate financing through capital issue management in India during the period of 1990-2000. But collection of detailed information in this arena is very difficult as the merchant bankers are accountable to none excepting to the SEBI in this regard\(^3\). These institutions maintain balance sheet, profit and loss account for a specific period and submit them to the SEBI along with the particulars of issue of securities and such other documents relating to prospectus or letter of offer as per the stipulations imposed by the former\(^4\). However, they do not make any printed publications relating to issue management and other advisory services for the stakeholders. As they were reluctant to furnish any information, the researcher had to face an uphill task to gather relevant information. Efforts were also made to meet the Chief Executive Officers (CEOs) of

\(^3\) As per SEBI Guidelines "Every merchant banker shall keep and maintain the following books of accounts, records and documents namely: (a) a copy of balance sheet as at the end of each accounting period; (b) a copy of profit and loss account for that period; (c) a copy of the auditor's report on the accounts for that period; and (d) a statement of financial position".

"Every merchant banker shall, after the end of each accounting period furnish to the Board copies of the balance sheet, profit and loss account and such other documents for any other preceding five accounting years when required by the Board".

"Every merchant banker shall furnish to the Board half-yearly unaudited financial results when required by the Board with a view to monitor the capital adequacy of the merchant banker". [Vide SEBI (Merchant Bankers) Rules, 1992, Chapter-IV, p. 93]

\(^4\) As per SEBI Guidelines, the lead manager responsible for the issue shall furnish to the Board, the following documents, namely: (i) particulars of the issue; (ii) draft prospectus or where there is an offer to the existing shareholders, the draft letter of offer; (iii) any other literature intended to be circulated to the investors, including the shareholders; and (iv) such other documents relating to prospectus or letter of offer as the case may be.[Vide SEBI (Merchant Bankers) Rules, 1992, Chapter-IV, p.95]
leading entities to share their varied experiences on different occasions in this matter. But most of the efforts proved to be unsuccessful and futile as they showed their disinterests to reply in this matter which, according to them, was very personal to their entities and confidential as well. A very few well-wishers, however, have provided us some information which are accommodate in this study. All-out and sincere efforts are also made to collect information from the secondary sources comprising “Prime Directory” (an exclusive publication for secondary source highlighting the detail of merchant banking activities in India) which is published by Praxis Consulting and Information Services Pvt. Ltd. and some other publications for this study. A number of sites have also been used through internet to acquire more information.

Since the study is exploratory in nature, no hypotheses have been drawn. Published facts and information, already available, are considered and critically evaluated in pursuing the study. Efforts are also made to give a first-hand idea on capital issue management activities of merchant bankers in India. The present study, as such, aspires to review the role of selected merchant bankers on capital issue management based on the secondary sources of information.

1.1 Objectives of the Study

The process of economic liberalisation, deregulation and globalisation in India was accompanied by a corresponding and parallel growth of financial sector and development of the financial institutions as well.

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5 As per SEBI Guidelines “merchant banker shall not divulge to other clients, press or any other party any confidential information about his client, which has come to his knowledge”. [Vide SEBI (Merchant Bankers) Rules, 1992, Chapter-IV, p.104]


The Indian capital market also experienced increased momentum as was evidenced by increased volume of business in recognised stock exchanges in the country. Moreover, a prolonged increase in volume of financial transactions was the outcome of reforms in the financial arena. Merchant bankers in India also experienced a phenomenal growth during mid 1990s in respect to their number and diversified area of services. Under such situation, business of merchant banking assumed much significance during that period. The euphoria, however, faded away, to some extent, after that. These institutions, as mentioned earlier, are specialised in providing diversified services. However, it is quite difficult to make an empirical study on all of them. Merchant bankers, the link-pin between investors and corporate sectors, are an important means of channelising saver's money to the capital market. Hence, with the basic purpose of understanding what type of services merchant bankers have been rendering to the corporate sectors in the nineties of the last centuries, the study aspires to achieve the end with the help of realising the following objectives:

a) to make a brief review on the evolution of merchant bankers in general;

b) to portray on the diversified services rendered by the merchant bankers in India;

c) to discuss on the related rules and regulations framed by the appropriate authorities on the merchant banking operations in India;

d) to make an overview on the services rendered by selected merchant bankers on pre-issue and post-issue management of capital issues in the context of the economic growth in terms of GDP, savings and investments and growth of corporate sector expressed in terms of formation of companies, sales and profitability in India.
1.3 Review of Literature

A number of studies have been conducted on the various aspects of the merchant bankers in India and abroad. A sketch on the major ones is given below:

*Chapman Stanley* in his book *The Rise of Merchant Banking (1984, 1st Edition)* makes a broad survey on the origin of merchant bankers and considers a variety of themes central to the merchant banking scene embarking on the wider subject of the national and international political influence on the activities of the entities.

*Verma, J.C (Merchant Banking: Organisation and management, 1990, 1st Edition)* makes a quest for answering to the questions on the financial market in India, identifying the contribution of financial entities to industry, trade and commerce in accelerating the pace of development of Indian economy on the lines of the contributions of the merchant bankers in the European countries and North American States.

*Abadhani, V.A (Capital Market Management, 1994, 3rd Edition)* in his laudable work has depicted an overall picture of the merchant banking management in India, their contributions to the economy, their functions, recent trends and also the future prospectus of these organisations.

*Machiraju, H.R (Merchant Banking: Principles and Practices, 1995, 1st Edition)* points out that merchant bankers in India have a social responsibility to help building a financially viable industrial structure with latest developed technology.

*Bhole, L. M [Financial Institutions and Markets (Structure, Growth and Innovations), 1999, 3rd Edition]* makes an overview on non-banking financial companies (NBFCs) including merchant bankers in India.

*Khan, M.Y (Indian Financial System, 2000, 2nd Edition)* has made a comprehensive summary of the rules and regulations promulgated by
the Securities and Exchange Board of India (SEBI) on merchant banking operations in India.

Varshney, P.N and Metal, D.K (Indian Financial System, 2000, 3rd Edition) have made an elaborate discussion on the participating intermediaries including merchant bankers in new issue market in India. The authors have also discussed briefly on the SEBI guidelines in respect to operations of these entities.

Deodhar, S.B and Abhyankar, Aditi.A (Indian Financial System, 2001, 1st Edition) have described in brief on the multiple financial services performed by the merchant bankers in India.

Prasad, K. Nirmala and Chandradass, J (Banking and Financial System, 2002, 5th Edition) have tried to portray a historical background of merchant bankers and their functions in Indian corporate scenario.

Suneja, R (Merchant Banker, 2003, 1st Edition) has briefly highlighted the details on the merchant banking activities in India.

The above studies have covered the evolution of merchant bankers, the rules and regulations as pronounced by the SEBI from time to time and other regulatory authorities relating to their activities and their contributions in development of the economy. But so far known, no in-depth study has been made to enquire the roles played by these entities. Though merchant bankers perform a variety of services, they play a lead role in mobilising financial resources from the primary capital market to the corporate sectors through issue management activities. The present study, as such aims to survey the role of merchant bankers on capital issue management (both pre-issue and post-issue) on behalf of their clients. Since development of primary capital market is one of the resultants of economic growth of a country, a study on the role of merchant bankers and their contributions in the primary market are perceived relevant in this respect. Under this background an attempt has also been made to find out a relation among economic growth,
expansion of corporate sector, merchant banking activities and volume of transactions in primary market in India during 1990-2000.

1.4 Research Methodology

The present study is exploratory in nature. The methodology, as adopted in pursuing the study, has been organised in the following paragraphs;

- Searching underlying the Concept

To explore the area under study, at the outset, an attempt has been made to enquire the available books and journals on merchant banking. These books and journals have been studied to acquire a general knowledge on the conceptual issues on merchant banking, its problem areas and others. This part also tries to enquire the statutory requirements regarding merchant banking activity in India. On the basis of theoretical knowledge, a humble attempt has been made to chalk out the plan of work to make an empirical survey in order to enquire the role of merchant bankers on capital issue management to the corporate sectors in India.

- Sample Selection

A list of all categories of merchant bankers is maintained by SEBI. Merchant bankers were classified by SEBI under four categories (as prescribed by SEBI till December, 1997), i.e., Category-I, II, III and IV according to their nature and spread of work. Subsequently, SEBI had restricted the operation of Category-II, III and IV merchant bankers with effect from 9th December, 1997. But the study is being restricted to the role of Category-I merchant bankers. The reason is that they perform as lead managers and as underwriters participated in the capital issue management activity. Category-II, III and IV merchant bankers are not considered here as these categories of merchant bankers did not perform capital issue management function as lead
managers. However, information on how Category-I merchant bankers perform is not available from any source excepting "Prime Directory", published by Praxis Consulting & Information Services Pvt. Ltd. This work is primarily based on these available secondary data. For analytical purpose, the role of selected leading merchant bankers acting as lead managers on pre-issue and post-issue management of corporate securities in India has been enquired. Some leading merchant bankers belonging to both private and public sector undertakings have been selected based on their issue management activity during 1990 to 2000. The reason for selecting this period is that, these specialised institutions have experienced both the boom and the recession phase during this period. Since Category-I merchant bankers play issue management activity as lead manager and also act as underwriters, the role of selected leading merchant bankers on pre-issue management as underwriters has been analysed from two separate angles: (a) the number of public issues handled and (b) the amount involved in such public issues. The activity of 286 Category – I merchant bankers

8 As per SEBI Guidelines "Registration of Merchant Bankers(Application for grant of certificate) can be made as below:

1. An application by a person for grant of a certificate shall be made to the Board in Form A.
2. The application under sub-regulation (1) shall be made for any one of the following categories of the merchant banker namely:
   (a) Category I, that is—
      (i) to carry on any activity of the issue management, which will inter-alia consist of preparation of prospectus and other information relating to the issue, determining financial structure, tie-up of financiers and final allotment and refund of the subscription; and
      (ii) to act as adviser, consultant, manager, underwriter, portfolio manager.
   (b) Category II, that is, to act as adviser, consultant, co-manager, underwriter, portfolio manager;
   (c) Category III, that is to act as underwriter, adviser, consultant to an issue;
   (d) Category IV, that is to act only as adviser or consultant to an issue.
2A. Notwithstanding anything contained in this regulation, with effect from 9th December, 1997,
   (i) an application under sub-regulation (2) can be made only for carrying on the activities mentioned in clause (a) therein, and
   (ii) an applicant can carry on the activity as underwriter only if he obtains separate certificate of registration under the provisions of Securities and Exchange Board of India (Underwriters) Regulations, 1993, and
   (iii) an applicant can carry on the activity as portfolio manager only if he obtains separate certificate of registration under the provisions of Securities and Exchange Board of India (Portfolio Manager) Regulations, 1993.
3. Notwithstanding anything contained in sub-regulation (1), any application made by a merchant banker prior to coming into force of these regulations containing such particulars or as near thereto as mentioned in Form A shall be treated as an application made in pursuance of sub-regulation (1) and dealt with accordingly" [Vide SEBI (Merchant Bankers) Rules, 1992, chapter-IV, pp.87-88]
participated in the issue management (varying from year to year) as underwriters during 1990-2000 has been considered, studied and ranked individually. Out of them the top 25 are selected on the basis of maximum number of public issues handled. The other merchant bankers are not considered here as these 25 merchant bankers have underwritten almost 33.35% of the total number of public issues and the others have underwritten the balance 66.65% of the same. On the other, another set of 25 merchant bankers are selected as they have monitored almost 61.73% of the total amount involved in the public issues. It may happen that all the 25 merchant bankers selected on the basis of number of issues handled can not make it in the other set of 25 merchant bankers who have found a place on the basis of maximum amount of issues underwritten. Hence, these 25 merchant bankers are considered as the representative of the whole for the present study.

Like pre-issue management, the role of merchant bankers as lead managers on post-issue management has also been considered from four separate angles, namely, (a) the number of public issues managed, (b) the amount involved in such public issues, (c) the number of rights issues handled, (d) the amount involved in such rights issues. By pursuing the same principle while enquiring the role of merchant bankers as underwriters on pre-issue management, the top 25 merchant bankers as lead managers have also been considered for the four different areas of the study. Such selection is made out of 305 merchant bankers participated in public issues (varying from year to year) as lead managers during the period of 10 years because these 25 merchant bankers' contribution is almost 51.26% of the total number of public issues. Another set of top 25 merchant bankers who have managed more or less about 91.14% of the total amount involved in public issues are considered for the study.

Of the 186 merchant bankers participated as lead managers in rights issues (varying from year to year) during the same period, two separate lists of top 25 merchant bankers have been arranged in respect of
number as well as amount of rights issues. The first selected band of 25 has handled almost 74.75% of the total number of rights issues and the other 161 merchant bankers are involved in managing the rest 25.25% of the same during the period under study. In respect to amount involved in the rights issues another set of top 25 merchant bankers (selected separately) has managed almost 90.74% of the issues. Hence, the differently selected top 25 merchant bankers are considered as representative of each individual category for the present study.

Collection of Data

The enquiry has been made after going through only the relevant secondary data from "Prime Directory". Moreover, with the advancement of information technology, it is possible to gather a wide range of information through Internet. A number of sites have been visited and also various related information are collected for this study.

- **Problem of Data Collection:** Information regarding performance of merchant bankers as lead managers on capital issue management is not very much available because there is no printed report published by these institutions. Moreover, it is not possible to have either any primary or secondary information from individual merchant bankers as they do not disclose any such information publicly. Even an attempt had been made to contact personally with the CEOs of various leading merchant bankers performing issue management activity. But they were reluctant to meet the

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10 At the first stage of research, researcher tried to meet to the chief executive officers (CEOs) of leading merchant bankers selected for the study and also some of the officers of SEBI. But they showed their disinterest to meet him as any kind of primary information in this regard. Moreover, information in this area was considered confidential and could not be disclosed, they commented. They referred to only one secondary source, i.e., "Prime Directory". In fact, researcher failed to collect any primary individual data relating to merchant banking activities from the selected institutions after visiting some of the offices as well. Moreover, some e-mail of the executive officers of the leading institutions and also of the SEBI were used to get any related information. But no reply had been received from any sources. Formal letter by registered post on 07.10.05 had also been sent to them (Vide Photo copy of the postal receipts showing the letters issued to various merchant bankers and SEBI in Appendix: II) to have relevant information. But he could not have any reply from sources till date.
researcher as they were not interested to provide relevant information relating to issue management activities.\textsuperscript{11} Therefore, in this type of research, there is no alternative but to rely on only secondary data.

- **Striking Anomaly:** There are striking anomalies in relevant data analysis of merchant banking activities from “Prime Directory”. As per “Prime Directory” “if an issue has been handled by more than one merchant banker, full credit for such an issue (both in number and in respect to amount involved) has been given to all the concerned merchant bankers”. This statement is made in the Prime Directory as there is no alternative to have the exact share of lead merchant bankers' participation on capital issue management activities. When more than one merchant banker are appointed as lead managers by an issuing company for managing its securities, they, in fact play their role jointly on issue management activities. Therefore, it is impossible to have a clear idea on their exact share of activity on a particular issue to the researcher, as outsider in reality. In this connection, it is also significant to note that another study on performance of merchant bankers during 1994-95 was made in the *Quarterly Money Manager of The Business Standard Magazine of Finance*, August-October, 1995 and in this study it was also stated that “if an issue has been handled by more than one merchant banker, equal credit for such an issue has been given to all the concerned merchant bankers since it is very difficult to ascertain which lead manager was actively involved in a particular issue”.

Thus, the total number of corporate issues (shown in Table-7.1, Chapter-VII) made during 1990-2000 will not be equal when accumulating participation of individual merchant bankers in any specialised assignment as is depicted in Table-7.3 (A) and Table-7.3 (B)

\textsuperscript{11} As per SEBI guidelines “merchant banker shall not divulge to other clients, press or any other party any confidential information about his client, which has come to his knowledge”. [Vide SEBI (Merchant Bankers) Rules, 1992, Chapter-IV, p. 104]
7.4 (A), 7.4 (B), 7.5 (A) and 7.5 (B), 7.6 (A) and 7.6 (B), respectively. Thus, in Chapter VII, the method of percentages calculation shown in Tables 7.3 (A), 7.3 (B), 7.4 (A), 7.4 (B), 7.5 (A) and 7.5 (B), 7.6 (A) and 7.6 (B), are sufficiently elaborated and clarified in the thesis after consulting the secondary data collected from "Prime Directory". In fact, the researcher did not calculate the percentages shown in Tables 7.3 (A), 7.3 (B), 7.4 (A), 7.4 (B), 7.5 (A) and 7.5 (B), 7.6 (A) and 7.6 (B). These percentages have been collected from Prime Directory and have been considered for the study to have a first-hand idea about the issue management activities of merchant bankers.

**Interpretation and Conclusion**

For analysing and interpretation of the relevant data for the study, while only accounting tool like percentage is used, hypotheses are not considered and statistical tools like testing of hypotheses have also not been used in pursuing the present study. It is important to note that there is little scope for measuring efficiency of merchant bankers in this study. The study is exploratory in nature. That is why, those facts or information already available are used and critically interpreted to enquire the present position of merchant bankers on capital issue management.

1.5 **Limitations of the Study**

The study is not free from limitation. As mentioned earlier in this chapter, there is inadequacy of information on the services provided by the merchant bankers in India as these institutions are hesitant to publish any printed document for public use. However, for the purpose of our study, a sincere effort has been made to collect some information on capital issues handled by these entities and to derive certain conclusion out of them. The study, as such, has certain limitations, which are presented in the following lines:

12 Vide Chapter-VII, pp. 179-181
(1) As mentioned earlier, the study does not cover any primary information because of their unavailability. Basically, merchant bankers are required to submit their half yearly as well as yearly performance reports as per the guidelines framed by SEBI. But SEBI does not disclose the same in detail for the public, rather they provide a brief account of the same through websites from which it is quite difficult to draw any conclusion. So, the study has been made only on the basis of secondary sources and some other publications which are relevant for this study.

(2) The study is being restricted to the role of Category-I merchant bankers as lead managers participated in the capital issue management. Category-II, III and IV merchant bankers are not considered here. The reasons behind such consideration of only Category-I merchant bankers have already been cited earlier.

(3) Merchant bankers managing the public issues as lead managers have to take decision on the issue amount to be underwritten in consultation with the issuing company. Since underwriting activity is linked with the management of public issues, the Category-I merchant bankers have been studied while evaluating their role of merchant bankers as underwriters.

(4) The study has been restricted to assessing the role of differently selected 25 merchant bankers on capital issues (public issues and right issues) based on their overall consistent role during 1990-2000 (as discussed in detail in Research Methodology). The main reason is that these 25 merchant bankers are the consistent performers on these issues.

(5) Measurement of performance of merchant bankers requires the comparison between the projections of their activities and their actual activities. But data on the projections of their activities are not available at all. However, a bit of information on their actual activities is available only through Prime Directory. That is why, the researcher could not enquire how selected merchant bankers
have performed efficiently their issue management activities in India in relation to their projections.

1.6 The Scheme of Work

With a view to assessing the performance of merchant bankers on capital issue management in India, the study has been made through eight chapters. Chapter-I, i.e., the introductory one, deals in detail the basic ideas on merchant bankers in India, the objectives of study, the research methodology, the limitations of the study and also the plan of the study.

In Chapter-II, an attempt has been made to bring out a brief idea on the origin of merchant banking system in general. The necessity of merchant banking service in India as recommended by the Banking Commission in 1972 has also been briefly discussed.

Chapter-III gives a brief description on the various activities performed by merchant bankers in India and the scope of merchant banking services in India has also been briefly discussed here. Basically, out of different activities like corporate counselling, credit syndication, portfolio management, capital issue management, underwriting, venture capital financing, etc., the merchant bankers in India mainly concentrate their services on capital issue management. In this chapter, a brief idea on the overall activities undertaken by the merchant bankers has been dealt with.

The Securities and Exchange Board of India (SEBI) guidelines for merchant bankers in India have been discussed briefly in Chapter-IV to aware the individuals associated with these specialised services. The abolition of Capital Issue Control Act, 1947, origin of SEBI, the guidelines for merchant bankers prescribed by SEBI, control and management pattern of merchant bankers, and general obligation/ responsibilities prescribed by SEBI have also been highlighted.
The role of merchant bankers is largely depended on the economic growth as well as growth of corporate sector in India. As such, the economic growth and growth of corporate sector during the period under study is thoroughly discussed in Chapter-V.

Chapter-VI gives the basic idea about capital market and concentrates on the corporate financing through primary market. Secondary market and its operations and trends in stock market in India are also briefly discussed here. New era in the primary capital market and pricing of capital issues are explained briefly in this chapter. The methods of pricing of initial public offerings (IPOs), book-building mechanism of IPOs in India and management of capital issues are also dealt with in this chapter. The role of merchant bankers on pre-issue management of capital issues in India is thoroughly discussed and the role of the top 25 merchant bankers as underwriters is studied here from two separate angles.

The empirical results on post-issue management of capital issues have been discussed in Chapter-VII. This chapter tries to cover the post-issue obligations of merchant bankers prescribed by SEBI. The capital mobilisation in the primary market through public and rights issues and the role of the top 25 merchant bankers (selected separately) as lead managers have been studied here from four different angles.

A brief summary of the study has been furnished in Chapter-VIII. Suggestions and areas require further investigation are also provided in this chapter. Finally, an effort has been made to derive a suitable conclusion on the study.