

# INVESTMENT BANKING

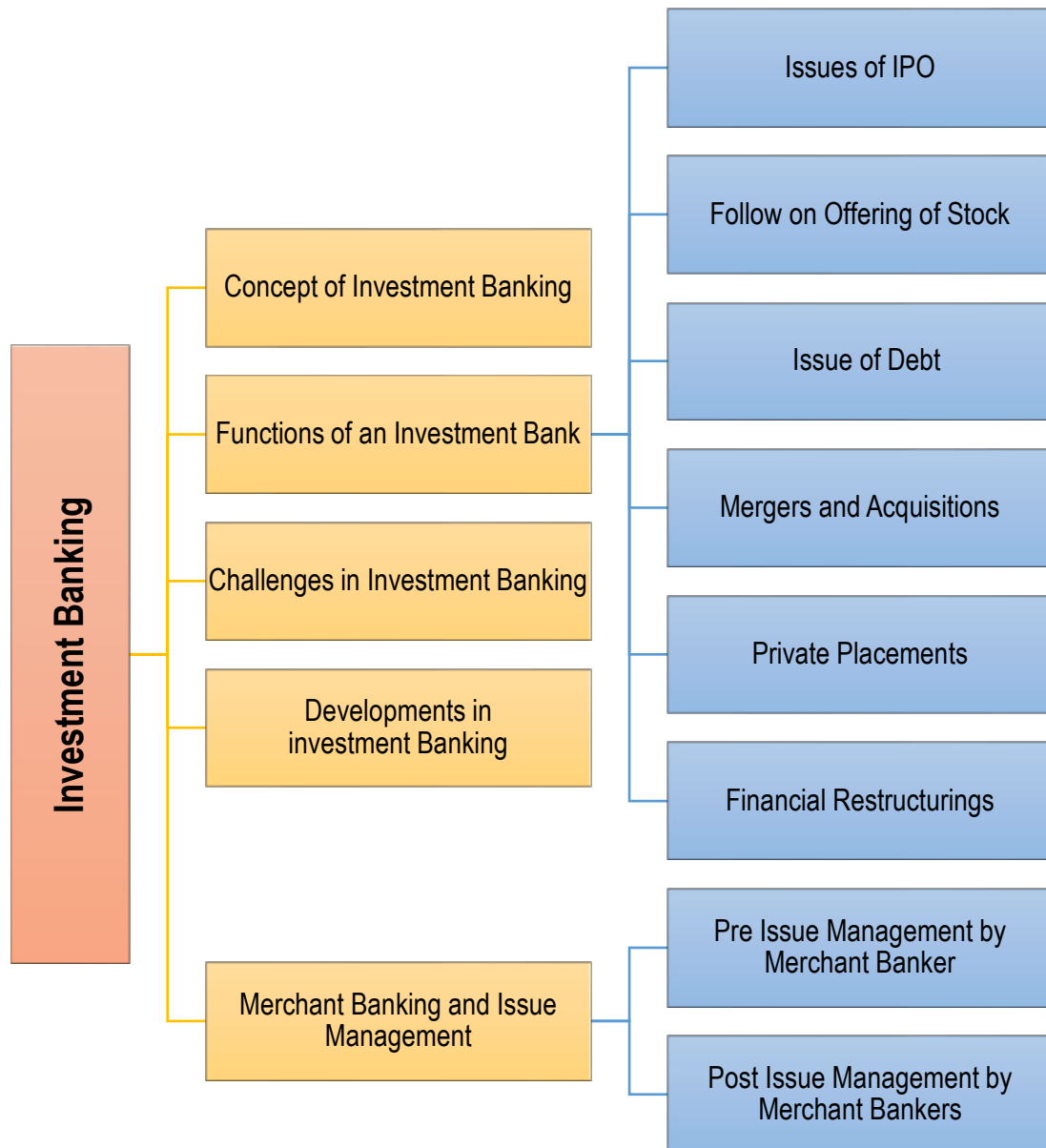


## LEARNING OUTCOMES

After going through the chapter student shall be able to understand:

- ☐ Concept
- ☐ Functions
- ☐ Challenges
- ☐ Developments in Investment Banking
- ☐ Merchant Banking and Issue Management

## CHAPTER OVERVIEW





## 1. CONCEPT OF INVESTMENT BANKING

Traditionally, businesses have been availing banking services for various purposes such as transfer of money, seeking bank guarantees and availing different kinds of loans. However, as the business expanded, they have felt the need for consultancy in various matters. Thus, came the concept of investment banking. The term investment banking is more popularly used in United States, while in other countries it might be referred to as merchant banking. In India, SEBI defines merchant banker as “any person who is engaged in the business of issue management either by making arrangement regarding buying, selling or subscribing to securities or acting as manager, consultant, or rendering corporate advisory services in relation to such issue management”.

In order to expand their businesses, companies need money. The company does this by selling their securities to investors. Investment bankers help the corporates in this respect. So, we can say that investment bankers are basically financial intermediaries who help their clients in raising capital either by underwriting their shares or bonds or by acting as an agent in the issuance of securities.

Further, it has to be noted that Investment banking isn't a specific function. It is a term used for a range of activities including underwriting, selling and trading securities; providing financial advisory services, such as mergers and acquisition advice; divestitures, private equity syndication, IPO advisory and managing assets.

### 1.1 The main players in Investment Banking

The biggest investment banks in global scenario include Goldman Sachs, Bank of America Merrill Lynch, Morgan Stanley, Salomon Smith Barney, Donaldson, Lufkin & Jenrette, Credit Suisse, Deutsche Bank, Citi, Barclays Capital, and J.P. Morgan among others.

Bank of America, Citigroup Investment banking, JP Morgan, Barclays capital and Deutsche Bank are some of the popular Investment bankers operating in India.

### 1.2 Main areas of Investment Banking

Generally, the breakdown of an investment bank includes the following areas:

#### 1.2.1 Corporate Finance

The corporate finance, generally perform two different functions:

- (i) Mergers and Acquisitions Advisory and
- (ii) Underwriting.

(i) **Mergers and Acquisitions Advisory:** Under this aspect of corporate finance, investment banking help in negotiating and structuring a merger deal between two companies. For instance, if ABC company wants to buy XYZ company, they may not know the exact valuation of the company. Infact, sometimes the selling company itself does not know what value it is worth off. In such cases, either ABC or XYZ may hire an investment banker to not only find out the valuation but also, to find a prospective buyer/seller and make the deal possible. The Investment banker can contribute by coordinating with the bidders, performing due diligence, structuring the deal, negotiating with the merger target, and generally ensuring a smooth transaction.

Moreover, mergers and acquisition advisory includes buy side and sell side advisory. However, sell side advisory holds the key because Investment Banker helps in placing the stocks and bonds in the public platform and sell these to investors. This selling aspect helps the companies to generate funds and consequently assists in expanding the corporate finance division of investment banking. Besides, this service is the major source of income for the Investment bankers who get commission as a percentage of the valuation.

(ii) **Underwriting:** Under the underwriting function, underwriters help their client companies in raising the required funds for the company. Whenever, a corporate wants to raise capital, it takes the help of underwriters who purchase the unsubscribed portion not taken by the investors. Underwriting can be done either through negotiations between underwriter and the issuing company (called negotiated underwriting) or by competitive bidding. A negotiated underwriting is a negotiated agreed arrangement between the issuing firm and its investment banker. Most large corporations work with investment bankers with whom they have long-term relationship. In competitive bidding, the firm awards offering to investment banker that bid the highest price.

### 1.2.2 Sales

Sales is an important part of any investment bank. The main task of the sales force of an Investment bank is to enable high net worth individuals and institutions to take orders from them. They make money through commissions received from their clients.

They make buy and sell recommendations. For example, if the share price of ABC Ltd. has a potential on the higher side, the sales guy of the investment bank will recommend buying the shares of that company.

### 1.2.3 Trading

Trading plays an important part for the investment bankers. Clients order is communicated to the trading people by the sales people. Traders help their client in buying and selling of shares, bonds, currencies etc. It also helps them in executing a trade.

Traders tackle all type of transaction, big or small and provide liquidity to the market. They generally make money by purchasing securities at lower price and selling them at a higher price.

Sales force of an Investment bank and traders also delve into propriety trading. Propriety trading is a form of trading in which the traders trades in stocks, bonds, derivatives in its own account using their own money. They do not touch client's account. The main advantage of this form of trading is that the traders can take the entire profit from the investment made. Otherwise, in other forms of trading they have to depend upon commission from their clients. The chances of making excess profits in this form of trading are much higher since the traders have the necessary expertise which an average investor doesn't have.

In case of IPOs and follow-on offers, an investment bank's sales and trading department keeps the communication channel open with the corporate finance department of the company. Generally, it is the responsibility of the sales and trading department of the investment banks to build books for a particular stock. After that, on the date of offering, they fixed the price of the shares and start selling the new shares to their customers.

#### 1.2.4 Research

Research analysts analyses the stock and bonds of various stocks and recommend whether to buy, hold and sell those securities. The job of research analyst is to review the company and wrote a report on the prospects of a company and gives a buy and sells rating. Some research analyst focuses on equity while some give its attention to fixed income securities such as bonds.

Actually, research activity by itself does not generate a lot of income. The recommendation of research workers influences the buying and selling of securities of a company. Because of this, the sales and trading people earns more fees. So, reputable research analyst are a very important part of an investment banking team as they help them in increasing their business and earn a hefty income.

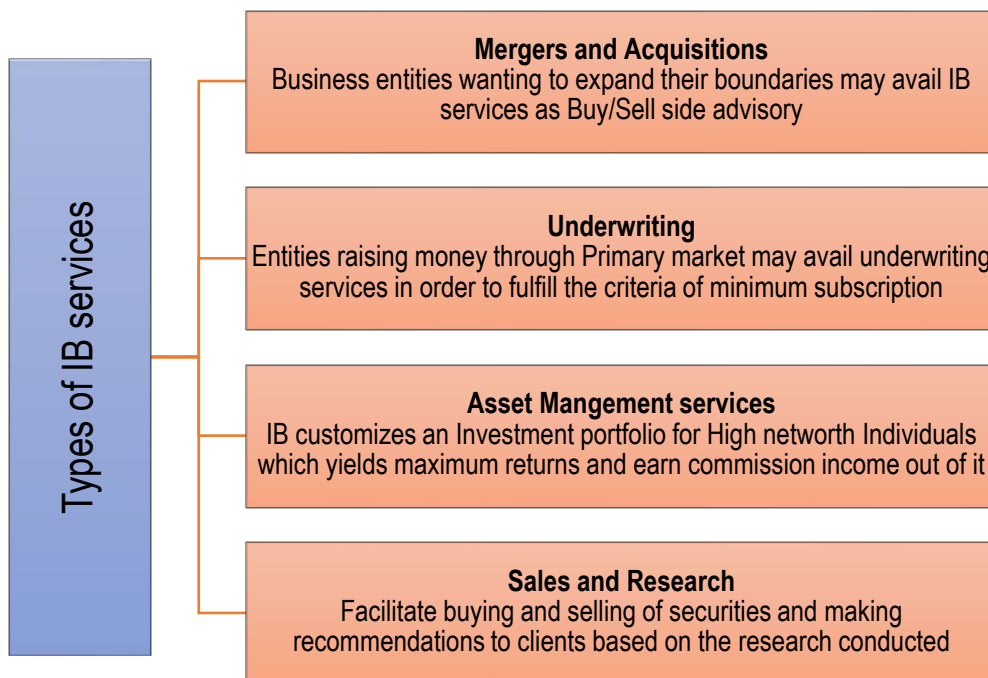
#### 1.2.5 Syndicate

The hub of the investment banking wheel, syndicate provides a vital link between salespeople and corporate finance. Syndicate exists to facilitate the placing of securities in a public offering, a knock-down drag-out affair between and among buyers of offerings and the investment banks managing the process. In a corporate or municipal debt deal, syndicate also determines the allocation of bonds.

In certain cases, for large or risky issues a number of investment bankers get together as a group, they are referred to as syndicate. A syndicate is a temporary association of investment bankers brought together for the purpose of selling new securities. One investment banker is selected to manage the syndicate called the originating house, which does underwriting of the major amount of

the issue. There are two types of underwriting syndicates, Divided and Undivided. In a Divided Syndicate, each member group has liability of selling a portion of offerings assigned to them. However, in Undivided Syndicate, each member group is liable for unsold securities up to the amount of its percentage participation irrespective of the number of securities that group has sold.

The breakdown of these fundamental areas differs slightly from firm to firm, but typically an investment bank will have these areas.



## 1.3 Commercial Banking vs. Investment Banking

In spite of sharing many aspects, commercial banking and investment banking contains some fundamental differences. After a quick overview of commercial banking, we will build up to a full discussion of what investment banking entails.

### 1.3.1 Commercial Banks

The job of commercial banks is pretty simple. They take deposits from the customers and then lend that deposited amount to consumers. If one wants to borrow money to buy a house, car, or for any of his personal purposes, he will approach a commercial bank. Also, the companies that borrow from commercial banks range from a small shopkeeper to a large multinational company.

If anyone wants to take loans from banks, they contact them and enter into a legal contract. Generally, a negotiation takes place in which the banks pursue their customers individually to determine the terms of the loans, including the time to maturity and the interest rates to be charged.

### 1.3.2 Investment Banks

The functioning of investment bank is different from a commercial bank. An investment bank does not lend from its cash reserve of deposits accepted from its customers as does a commercial bank. In fact, an investment bank acts as an intermediary and undertakes the matching of buyers and sellers of stocks and bonds.

However, the main purpose of companies to utilize the services of commercial banks and investment banks are the same. Whenever, the companies need funds, they contact the commercial banks for loan or an investment bank to sell their stocks or bonds. However, the investment banks have to comparatively work harder and spent sufficient time to find investors so that it's client company can get the required capital.

Investment banks typically sell public securities as opposed to private loan agreements initiated by commercial banks. Technically, for example, securities such as stock of TCS or Mahindra and Mahindra Financial Services AAA bonds, represent a high degree of safety and are traded either on a public exchange or through an approved dealer. The dealer is the investment bank.

The investment bank makes money by charging the client a small percentage of the transaction upon its completion. This is generally called "underwriting discount." However, a commercial bank making a loan actually receives interest on the money lent by it.

Thus the fundamental differences between an investment bank and a commercial bank can be outlined as follows:

Investment Banks	Commercial Banks
1. Investment Banks help their clients in raising capital by acting as an intermediary between the buyers and the sellers of securities.	1. Commercial Banks accept deposits from customers and lend money to individuals and corporates.
2. Investment Banks do not take deposits from customers.	2. Commercial banks can take deposits from customers.
3. The Investment Banks do not own the securities and only act as an intermediary	3. Commercial Banks have the ownership of loans granted to their customers.

for smooth transaction of buying and selling securities.	
4. Investment Banks earn underwriting commission.	4. Commercial banks earn interest on loans granted to their customers.
5. Regulated by market regulator SEBI	5. Regulated by the Central Bank of the country i.e. RBI.
6. It is a margin business i.e. huge fees from limited customers	6. It is a volume business i.e. small fees from many customers.
7. Services provided are more unique/customized in nature	7. Services provided are more routine in nature.

### 1.3.3 Public Securities

Investment banks typically sell public securities (as opposed to private loan agreements). Technically, securities such as Microsoft stock or Tata Steel AAA bonds, represent a high degree of safety and are traded either on a public exchange or through an approved dealer. The dealer is the investment bank.

Let's look at an **Example** to illustrate the difference between private debt and bonds.

Suppose ITC Ltd, the FMCG conglomerate needs capital, and estimates its need to be ₹ 2000 million. *ITC has two choices:*

- (a) It could obtain a commercial bank loan from State Bank of India for the entire ₹ 2000 million, and pay interest on that loan.
- (b) It could sell bonds publicly using an investment bank such as Merrill Lynch. The ₹ 2000 million bond issue raised by Merrill would be broken into many bonds and then sold to the public. (For example, the issue could be broken into 20,00,000 bonds, each worth ₹ 1,000.) Once sold, the company receives its ₹ 2000 million and investors receive bonds worth a total of the same amount. Over time, the investors in the bond offering receive coupon payments (the interest), and ultimately the principal (the original ₹ 1,000) at the end of the life of the loan, when ITC buys back the bonds (retires or redeems the bonds). Thus, we see that in a bond offering, while the money is still loaned to ITC, it is loaned by numerous investors, rather than a single bank.

As the investment bank involved in the offering does not own the bonds but merely placed them with investors at the outset, it earns no interest - the bondholders earn this interest in the form of regular coupon payments. The investment bank makes money by charging the client (in this case, ITC) a

small percentage of the transaction upon its completion. Investment banks call this upfront fee the "underwriting discount." In contrast, a commercial bank making a loan actually receives the interest and simultaneously owns the debt.



## 2. FUNCTIONS OF AN INVESTMENT BANK

### 2.1 Issue of IPO

Companies in need of funds resort to Initial Public Offering (IPO). This is the phase when securities are issued to the public for the first time. After the initial public offering, securities are listed on the stock exchange and sale and purchase of those listed securities can take place. The companies going for IPO, may not have an understanding of the compliances, SEBI rules and regulations, etc and it would be in best interest to appoint an agent who can take care of the documentation and legal compliances. With this objective, the companies approach Investment bankers who not only help in compliance but also contribute by underwriting the issue and/or getting good deals for the company. The Investment banker is chosen based on their networking, market reach, experience, and quality of research.

Further, commercial banks have also developed expertise in underwriting public bond deals. So, commercial banks not only lend money by utilizing depositor's money but also they underwrite bonds through their corporate finance department. So, the commercial banks have directly competed with investment banks for this business of bond underwriting. But, in reality, only a handful of big commercial banks are able to compete in this business with the investment banks that generally have a larger share of the pie.

*From the perspective of an investment banker, the IPO process consists of two major phases: hiring the managers and due diligence.*

(i) **Hiring the Managers:** Before going for a public issue, the first task that the company does is to hire a merchant banker for the issue which is also called a manager to the issue. The selection process depends upon the investment banker's general goodwill, expertise as well as the quality of its research coverage in the company's specific industry. The selection also depends on whether the issuer would like to see its securities held more by individuals or by institutional investors. Almost all IPO candidates select two or more investment banks to manage the IPO process.

When there is more than one investment bank, one among them is selected as the lead or book-running manager, also referred as BRLM. The lead manager almost always appears on the left cover of the prospectus, and it plays a major role throughout the transaction. The task of the manager is

to make all arrangements with the issuer, make the schedule of the issue and fulfills all the requirements of the due diligence process. He is also responsible for the pricing and distribution of the stock.

**(ii) Due Diligence and Drafting:** Once managers are selected, the second phase of the process begins. For investment bankers on the deal, this phase involves understanding the company's business as well as possible scenarios (called due diligence), and then filing the legal documents as required by the SEBI.

The merchant banker would be closely associated in preparing the new applicant's prospectus and other related listing documents. The Merchant Banker shall conduct a due diligence on the applicant and provide due diligence certificate as per Form A of Schedule VI of the ICDR including additional confirmations as provided in Form H of Schedule VI along with the offer document to the exchange. The other certifications as mentioned in ICDR, Schedule VI will be provided, if applicable.

*[Source: [www.nseindia.com](http://www.nseindia.com)]*

## 2.2 Follow-on offering of stock

Sometimes an already listed company issue shares to the public again. This is called a Further Public Offer or Follow-on Offering. The main reason for a company to go through this offer is that – it is growing rapidly and it needs funds for that.

## 2.3 Issue of Debt

Sometimes, the company instead of choosing equity for their funding requirements chooses public debt.

The reasons for issuing bonds rather than stock are explained as follows:

- (a) When the stock price of the company is down, a bond issue is a better alternative.
- (b) The firm does not want to dilute its existing shareholding by issuing more equity.

These are both valid reasons for issuing bonds rather than equity.

Further, in case the economy is not doing well investors generally avoid the share issue and in such cases issuance of bonds may be resorted to satisfy the company's appetite for funds.

In case of a bond issue, the focus of the prospectus is on highlighting the importance of the company's stability and steady cash flow. On the other hand, a share issue prospectus will highlight the company's growth and expansion opportunities.

In case of a debt issue, the importance of a bond's credit rating cannot be undermined. It is necessary to obtain a good credit rating from a reputed credit rating agency like CRISIL, ICRA, CARE etc. So, better credit rating gives an impression that the bond is safe. In order to encourage investors to receive lower rate of interest, the credit rating of debt issue should be high.

## 2.4 Merger and Acquisitions (M&A)

M&A advisors come directly under the corporate finance departments of investment banks. As in the case of public offerings, merger and acquisition transactions do not directly involve salespeople, traders or research analysts. Particularly, M&A advisory comes under the domain of M&A specialists and fits into one of either two: seller representation or buyer representation (also called target representation and acquirer representation). Executing a deal may be a long-term process and may take 6-12 months' time depending upon the amount involved, legal complications, domestic and international laws amongst others.

Representing the target	Representing the acquirer
<p>Sell-side representation is used when a company asks an investment bank to help it to sell a division, plant, or subsidiary operation.</p> <p>In this respect, the first step is to write a selling memorandum and then contact the future buyers of the client.</p>	<p>Under this approach, the investment bank contacts the parties who wish to purchase. The investment banker also attempts to prepare an offer which can be feasible for all parties and helps to crack the deal.</p>

### 2.4.1 Buy Side Advisory

The Investment Banks provide advisory services to clients who have identified particular companies which are to be acquired and help them in negotiating, due diligence, financing and documentation of the transaction. These are being divided into following four steps for easy understanding:

**Short-listing of companies to be acquired** – In this step, the investment banker helps its client companies to short list the companies to be acquired. To extend this service, it uses its network of relationships with companies, private equity funds and other intermediaries to identify the suitable companies that are to be acquired.

**Preparing and executing Term Sheet** – After the companies are shortlisted, the investment banker prepares term sheet which includes all the terms and conditions of the merger transaction. It then facilitates negotiations with the target company and ensures that the term sheet is entered into by the client with the target company.

**Due Diligence** – The next step is due diligence which means investigating the deal from legal, commercial and financial point of view. It basically includes verifying assets and liabilities, identifying risks, knowing the amount of risk involved and protection against such risks.

**Transaction Closure** – After the completion of the due diligence process, the investment banker negotiates on the final agreement with the target company to close the merger and acquisition deal. It also arranges finance for the deal, if required.

### 2.4.2 Sell Side Advisory

The Investment Banks helps the client companies in identifying suitable buyers which may include private companies, public companies, private-equity funds, hedge funds and international buyers. These are also being divided into following four steps for clarity of the process involved:

**Preparation of information** – An investment banker helps in the preparation of information on the purchasing companies' business profile which helps to present the deal in a structured manner in front of the potential acquirers.

**Target short-listing** – After going through the client companies extensively and short listing of potential buyers, the investment bankers enables the client company chooses its partner. As in the case of buy side advisory services, it uses its network of relationships with companies, private equity funds and other intermediaries to identify the suitable companies to whom the client company has to be sold.

**Preparing and executing Term Sheet** – In this step, the investment banker helps his client enter into a term sheet with the potential acquirer.

**Due diligence and deal closure** – After entering into a term sheet, the investment banker help the client in the due diligence process and negotiates with the purchaser to close the deal.

## 2.5 Private Placements

A private placement involves selling of debt or equity to few private parties. A private placement is different from a public offer because in case of a private placement, shares are offered to a few people instead of offering it to the public in general. Sometimes, the investment bankers advice their client to go for a private placement first and then apply for the initial public offer. The reason is that the bankers want to accumulate sufficient funds to justify the IPO.

The investment banker's work involved in a private placement is quite similar to sell-side M&A representation. The bankers attempt to find a buyer by writing the selling memorandum and then contacting potential strategic or financial buyers of the client.

Actually, the task of the investment banker is to convince the private investors to invest in the company and get the deal done. They charge fees for this service which is almost equal as is offered in the case of an IPO.

## 2.6 Financial Restructurings

When a company is not able to meet its obligations, the chances are that it may go bankrupt. In this situation, the company may either shut down its operations or it can restructure and remain in business.

Financial restructuring involves renegotiating payment terms on debt obligations. It also includes issuing new debt and restructuring payables to vendors. Investment bankers in this respect provide guidance to the companies by recommending sale of assets, issuing convertible stocks and bonds, or it even advises for the sale of the whole company.

The investment bankers who are in the restructuring business generally deal with distressed companies i.e. the companies who are either going for bankruptcy or in the middle of a bankruptcy process. In this regard, the investment bankers are hired to provide a best deal for the company in the form of forgiveness of a large part of the debt. The companies are also advised to restructure its debt in the most prudent manner possible and get out of the bankruptcy process. Moreover, the bankers in the restructuring arena are also legally adept. For example "*The Insolvency and Bankruptcy Code*" has a huge impact on the bankruptcy process.

As a company involved in a bankruptcy process faces enough cash problems, the investment banks often charge minimal monthly retainers. They hope that the company will revive and they then make a substantial profit. They also make good income in case new securities are issued to pay back the old debt.

Because a firm in bankruptcy already has substantial cash flow problems, investment banks often charge minimal monthly retainers, hoping to cash in on the spread from issuing new securities. Like other public offerings, this can be a highly lucrative and steady business.



## 3. CHALLENGES IN INVESTMENT BANKING

Some of the challenges in the Investment Banking business are in existence due to the reason that in 1990s broking firms, credit rating and other financial services firms are owned by the Investment Bankers. Hence, due to reasons of losing the other businesses from the company they may not be so fair in assigning the credit rating to the company concerned. Further in order to keep the favorable perception of new stock in post issue they might sell the shares (holding on behalf of their client) in the market.

Pricing in new issue is a big challenge for an investment banker as it should not only result in fair pricing but should be a win-win situation for both the investor as well as the company.

Valuation of shares for the exchange is another big challenge for the investment banker as it should be acceptable to both the companies involved in the process.

In new issue management compliance of various related law is a challenge for investment banker as any lapse at stage can bring the whole effort to a zero level and invite regulatory penalties.

Retention of talented employees is another challenge. Fintech industry, startups have become a big attraction to finance professionals and long hours of job, procedural aspects may appeal lesser.

## 4. DEVELOPMENTS IN INVESTMENT BANKING

Investment banking was a lucrative business till the arrival of the financial crisis in 2008. However, the sub-prime mortgage crisis took a toll in the global investment banks. A major reason for the crisis is that these investment banks were not under the control of either the Federal Reserve Bank or the US Securities Exchange Commission, which made it easier for them to take risks. As a result of the financial crisis worsening in late 2008, some of the biggest investment banks collapsed.

Bear Stearns was acquired by JP Morgan Chase in March 2008. Lehman Brothers filed for Bankruptcy and was declared bankrupt in September 2008. The Asian and European operations of Lehman Brothers were bought by Nomura and the North American Lehman operations by Barclays Capital. Merrill Lynch was acquired by Bank of America for \$50 billion. Goldman Sachs and Morgan Stanley converted themselves into commercial banks.

The effect of the collapse of these towering investment banks were felt in the Indian Investment Banks also. There were drop in fat fees and revenue for these banks. However, in the middle of the gloomy environment, there is opportunity for investment banks to go global with properly designed strategies.

Presently, the growth rate of Indian economy is slow but it is resilient after the onslaught of the pandemic and performing better than many developed countries in the world. Capital market is performing better now. Nifty and Sensex were performing at an all-time high level in December 2023.

However, investment banks can enhance their growth by exploring new and alternate markets, developing strong and long term relationship with the existing and new clients, giving quality advice to clients and assisting them in every stage of their growth, hiring qualified staff and promoting ethical behavior. Indian Companies have broken the shackles and are now going global. With India moving at a fast pace towards 5 trillion-dollar economy, global mergers and acquisitions are common to happen and Indian Investment banking companies can be of great help.



## 5. MERCHANT BANKING AND ISSUE MANAGEMENT

### 5.1 Introduction

SEBI (Merchant Banker) Regulations, 1992, define 'Merchant Banker' as any person who is engaged in the business of issue management, either by making arrangements regarding selling, buying, or subscribing, or acting as a manager, consultant, or advisor, or rendering corporate-advisory services in relation to such issue management.

In case of both the public issues and right issues, it is mandatory to appoint a Merchant Banker. The task of Merchant Banker is basically that of a facilitator or coordinator. It coordinates the process of issue management by helping the underwriters, registrars and bankers, in pricing and marketing the issue and complying with the SEBI guidelines.

Merchant Bankers are prohibited from carrying on certain activities such as acceptance of deposits, leasing and bill discounting. They are not allowed to borrow any money from the market. They are also debarred from engaging in the acquisition and sale of securities on a commercial basis.

### 5.2 Responsibilities of Merchant Bankers as per SEBI (ICDR) Regulations, 2018

#### 5.2.1 Communication

In respect of all public communications, issue advertisements and publicity materials, the issuer shall obtain approval from the lead merchant bankers responsible for marketing the issue and shall also make copies of all issue related materials available with the lead merchant bankers at least till the allotment is completed. SEBI has imposed certain compliances to be observed by the issuing company when they issue any publicity material. Once a merchant banker is appointed, the company can delegate the task of ensuring such compliance with the merchant banker.

#### 5.2.2 Compliance Certificate

The merchant bankers shall submit a compliance certificate in the format specified in Part E of Schedule X, for the period between the date of filing the draft offer document with the Board and the date of closure of the issue, in respect of news reports appearing in any of the following media:

- (a) newspapers mentioned in sub-regulation (3) of regulation 9;
- (b) major business magazines;
- (c) print and electronic media controlled by a media group where the media group has a private treaty/shareholders' agreement with the issuer or Promoters of the issuer.

### 5.2.3 Copies of offer documents to be available to public

- (i) The issuer and lead merchant bankers shall ensure that the contents of offer documents hosted on the websites as required in these regulations are the same as that of their printed versions as filed with the Registrar of Companies, Board, and the stock exchanges.
- (ii) The lead merchant bankers and the recognized stock exchange shall provide copies of the draft offer document and final offer document to the public as and when requested.

### 5.2.4 Redressal of investor grievances

The post-issue lead merchant bankers shall actively associate him with post-issue activities such as allotment, refund, dispatch and giving instructions to syndicate members, Self Certified Syndicate Banks and other intermediaries and shall regularly monitor redressal of investor grievances arising therefrom.

### 5.2.5 Due diligence

The lead merchant bankers shall exercise due diligence and satisfy himself about all the aspects of the issue including the veracity and adequacy of disclosure in the offer documents.

### 5.2.6 Audited financial statements in the offer document

The merchant banker shall ensure that the information contained in the offer document and the particulars as per audited financial statements in the offer document are not more than six months old from the issue opening date.

## 5.3 Pre-Issue Management by Merchant Banker

Merchant Bankers play an important role in the issue management process. Besides the above discussions on responsibilities of Merchant Banker, Pre-Issue Management by Merchant Banker has been separately discussed in the following paragraphs to induce more clarity in the minds of the students:

- (i) **Entering into an agreement with Merchant Banker:** An agreement has to be entered into between a lead merchant banker and the issuer company, specifying their rights, liabilities and obligations. The lead merchant banker has to submit three copies of the draft offer letter along with the copy of the agreement to the Board (SEBI).
- (ii) **Filing of the draft offer document and other documents:** The lead manager(s) shall submit the following to the Board along with the draft offer document:
  - a) a certificate, confirming that an agreement has been entered into between the issuer and the lead manager(s);

- b) *a due diligence certificate as per Form A of Schedule V*; The Merchant Banker shall exercise Due Diligence and submit a due diligence certificate to the Board confirming that all the disclosures made in the draft prospectus are true and fair and they are capable of ensuring that the investors take a well-informed decision on that basis.
- c) in case of an issue of convertible debt instruments, a due diligence certificate from the debenture trustee as per Form B of Schedule V;

**(iii) Disclosures in the draft offer document and offer document**

- a) The lead manager(s) shall exercise due diligence and satisfy themselves about all aspects of the issue including the veracity and adequacy of disclosure in the draft offer document and the offer document.
- b) The lead manager(s) shall call upon the issuer, its promoters, and its directors or in case of an offer for sale, also the selling shareholders, to fulfill their obligations as disclosed by them in the draft offer document and the offer document and as required in terms of these regulations.
- c) The lead manager(s) shall ensure that the information contained in the draft offer document and offer document and the particulars as per restated audited financial statements in the offer document are not more than six months old from the issue opening date.

**(iv) Submission of Documents :** The lead manager(s) shall submit the following documents to the Board after issuance of observations by the Board or after expiry of the period stipulated in sub-regulation (4) of regulation 25 if the Board has not issued observations:

- a) a statement certifying that all changes, suggestions and observations made by the Board have been incorporated in the offer document;
- b) a due diligence certificate as per Form C of Schedule V, at the time of registering of the offer document;
- c) a copy of the resolution passed by the board of directors of the issuer for allotting specified securities to promoter(s) towards amount received against promoters' contribution, before opening of the issue;
- d) a certificate from a statutory auditor, before opening of the issue, certifying that promoters' contribution has been received in accordance with these regulations, accompanying therewith the names and addresses of the promoters who have contributed to the promoters' contribution and the amount paid and credited to the issuer's bank account by each of them towards such contribution;

e) a due diligence certificate as per Form D of Schedule V, in the event the issuer has made a disclosure of any material development by issuing a public notice pursuant to para 4 of Schedule IX.

(v) **Availability of issue material :** The lead manager(s) shall ensure availability of the offer document and other issue material including application forms to stock exchanges, syndicate members, registrar to issue, registrar and share transfer agents, depository participants, stock brokers, underwriters, bankers to the issue, and self-certified syndicate banks before the opening of the issue.

(vi) **Undertaking:** The merchant banker shall also submit an undertaking that transactions in securities by the promoter between the date of filing of offer documents with Registrar of Companies (ROC) and the date of closure of issue shall be reported to the stock exchange within 24 hours of the transaction.

(vii) **Appointment of Intermediaries:** The issuer shall, in consultation with the lead manager(s), appoint other intermediaries which are registered with the Board after the lead manager(s) have independently assessed the capability of other intermediaries to carry out their obligations.

(viii) **Underwriting:** The merchant bankers shall satisfy themselves about the ability of the underwriters before their appointment. The lead merchant banker shall include a statement in the offer document stating that in his opinion the underwriter is financially capable of meeting its obligations.

In respect of every underwritten issue, the merchant banker shall undertake a minimum underwriting obligation of 5% of the total underwriting commitment or Rs. 25 lakhs, whichever is less.

**In case of a book built issue, the following requirements as to Underwriting shall be undertaken by the merchant banker:**

- (a) The lead manager(s) shall compulsorily underwrite the issue and the syndicate member(s) shall sub-underwrite with the lead manager(s).
- (b) The lead manager(s) / syndicate member(s) shall enter underwriting/ sub underwriting agreement on a date prior to filing of the prospectus.
- (c) The details of the final underwriting arrangement indicating actual numbers of shares underwritten shall be disclosed and printed in the prospectus before it is registered with the Registrar of Companies.
- (d) In case of an under-subscription in an issue, the shortfall shall be made good by the lead manager(s) and the same shall be incorporated in the inter-se allocation of responsibility as specified in Schedule I.

**(ix) Offer document to be made public**

- (1) The issuer and the lead manager(s) shall ensure that the offer documents are hosted on the websites as required under these regulations and its contents are the same as the versions as filed with the Registrar of Companies, Board and the SME exchange(s).
- (2) The lead manager(s) and the SME exchange(s) shall provide copies of the offer document to the public as and when requested and may charge a reasonable sum for providing a copy of the same.

**(x) No Complaint certificate:** Twenty one days after the draft offer document is made public, the Merchant banker shall file a statement with SEBI specifying list of complaints received from public, a statement if the company plans to revise the draft offer document and highlight the amendments if any.

**(xi) Appointment of Compliance Officer:** The issuer shall appoint a compliance officer who shall be responsible for monitoring the compliance of the securities laws and for redressal of investors' grievances.

**(xii)** The merchant banker shall also ensure that the issuer company has entered into an agreement with depositories for dematerialization of securities.

## 5.4 Post Issue Management by Merchant Bankers

Post Issue Management by Merchant Bankers has been explained in detail as below to enable the students to have more clarity on the topic:

### 5.4.1 Redressal of Investor grievances

The issuer and lead manager(s) shall ensure that post issue activities such as allotment, issuing refunds, release of money for ASBA applicants in case of non-allotment is timely completed. Any investor complaint received regarding this matter shall not remain unattended and the matter will be resolved at the earliest possible.

### 5.4.2 Post-Issue Advertisements

The lead manager(s) shall ensure that an advertisement giving details relating to subscription, basis of allotment, number, value and percentage of all applications including ASBA, number, value and percentage of successful allottees for all applications including ASBA, date of completion of despatch of refund orders, as applicable, or instructions to self-certified syndicate banks by the registrar, date of credit of specified securities and date of filing of listing application, etc. is released within ten days from the date of completion of the various activities in at least one English national

daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language daily newspaper with wide circulation at the place where registered office of the issuer is situated.

#### 5.4.3 Post-issue reports

The lead manager(s) shall submit a final post-issue report as specified in Part A of Schedule XVII, along with a due diligence certificate as per the format specified in Form F of Schedule V, within seven days of the date of finalization of basis of allotment or within seven days of refund of money in case of failure of issue.

#### 5.4.4 Coordination with Intermediaries

The post issue lead merchant banker maintains a close coordination with Registrar to the issue, and deputed officers at the offices of various intermediaries to monitor the process of application including ASBA applications till allotment is done. It supervises and ensures that security certificates are properly dispatched, refund orders completed and securities listed. Any negligence on the part of any of the intermediaries should be duly reported by the Merchant banker.

#### 5.4.5 Underwriters

In case of unsubscribed issue, the merchant banker shall ensure that the underwriters shall honour their commitments within 60 days from the date of closure of the issue. The lead merchant banker shall furnish information to SEBI in respect of the underwriters who have failed to meet their underwriting obligations.

### TEST YOUR KNOWLEDGE

#### Multiple Choice Questions (MCQs)

1. Which of the following services are not provided by a Merchant banker?
  - (a) Mergers and Acquisition
  - (b) Trading of shares
  - (c) Custodian
  - (d) Underwriting

2. Which of the following services are most important for a Merchant banker from the point of view earning revenue?
  - (a) Mergers and Acquisition
  - (b) Trading of shares
  - (c) Underwriting
  - (d) Asset management services
3. State the order of steps followed by a merchant banker while conducting Buy side Advisory.
  1. Short listing of companies
  2. Conducting due diligence
  3. Preparing term sheet
  4. Transaction closure
  - (a) 1,2,3,4
  - (b) 1,3,2,4
  - (c) 1,3,4,2
  - (d) 1,2,4,3
4. Merchant banker is responsible for the following services except\_\_\_\_\_.
  - (a) Documentation
  - (b) Compliances
  - (c) Reporting
  - (d) Allotment of securities
5. Whose services will be availed; in case you want to raise money through public?
  - (a) Commercial bank
  - (b) Investment bank
  - (c) Central bank
  - (d) Payment bank

### Theoretical Questions

1. What are the main areas of Investment Banking?
2. Differentiate between Commercial Banking and Investment Banking.
3. Discuss the main functions of Investment Banking.
4. Briefly describe the buy side advisory and sell side advisory provided by the investment bankers.
5. Explain the responsibilities of Merchant Bankers as per the SEBI (ICDR) Regulations, 2018.

### ANSWERS/SOLUTIONS

#### Answer to Multiple Choice Questions

1.	(c)	2.	(a)	3.	(b)	4.	(d)	5.	(b)
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#### Answers to the Theoretical Questions

1. Please refer to paragraph 1.2
2. Please refer to paragraph 1.3
3. Please refer to paragraph 2
4. Please refer to paragraph 2.4
5. Please refer to paragraph 5.2