

Merchant banking and its function : A Review

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Abstract

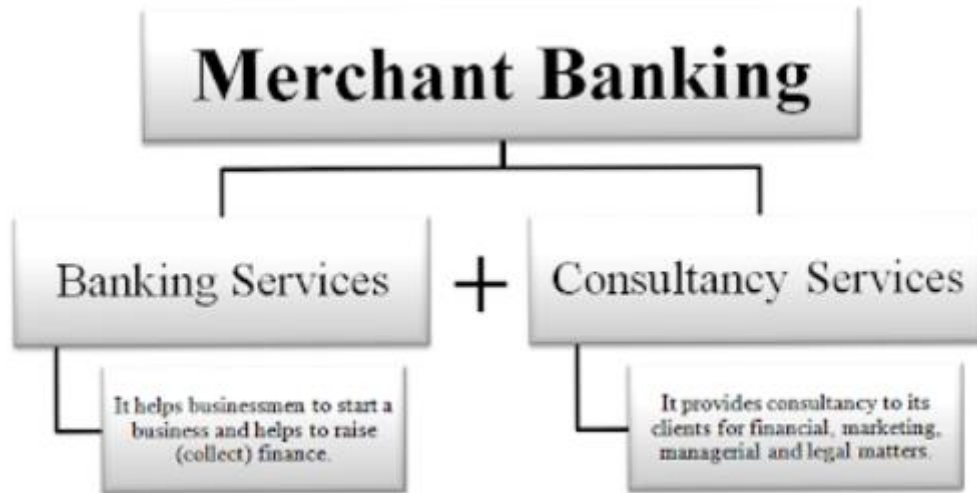
A merchant bank is historically a bank dealing in commercial loans and investment. In modern British usage it is the same as an investment bank. Merchant banks were the first modern banks and evolved from medieval merchants who traded in commodities, particularly cloth merchants. Historically, merchant banks' purpose was to facilitate and/or finance production and trade of commodities, hence the name "merchant". Few banks today restrict their activities to such a narrow scope. In modern usage in the United States, the term additionally has taken on a more narrow meaning, and refers to a financial institution providing capital to companies in the form of share ownership instead of loans. A merchant bank also provides advisory on corporate matters to the firms in which they invest.

Key word: merchant, financial, bank, loans etc.

Introduction

Merchant Banking is a combination of Banking and consultancy services. It provides consultancy to its clients for financial, marketing, managerial and legal matters. Consultancy means to provide advice, guidance and service for a fee. It helps a businessman to start a business. It helps to raise (collect) finance. It helps to expand and modernize the business. It helps in restructuring of a business. It helps to revive sick business units. It also helps companies to register, buy and sell shares at the stock exchange. Merchant banks provide financial services including underwriting, loan services, fundraising services, and financial advising to high net-worth individuals and small/mid-sized corporations. It is not the bank for the general public. It's similar to the investment bank, but a merchant bank and an investment bank are not the same. This bank provides services only to high net-worth individuals and multinational companies that have businesses all around the globe. On the other hand, an investment bank provides finance-related services to individuals, corporations, and government. Merchant bankers, lead managers and registrars play a key role and facilitate primary market activities by their advice and guidance. Merchant bankers provide advice to entrepreneurs right from the stage of conception of the project till the commencement

of production. Merchant bankers are in charge of the issue process. They act as intermediaries between the company and the investors. They are also responsible for preparing the prospectus and marketing the issue.



Definition:

Merchant banking can be defined as a skill-oriented professional service provided by merchant banks to their clients, concerning their financial needs, for adequate consideration, in the form of fee. Merchant banks are a specialist in international trade and thus, excel in transacting with large enterprises.

Review of literature:

(KAGAN, 2019) studied "*Merchant Bank*" and found that A merchant bank is a company that conducts underwriting, loan services, financial advising, and fundraising services for large corporations and high net worth individuals. Unlike retail or commercial banks, merchant banks do not provide services to the general public. They do not provide regular banking services like checking accounts and do not take deposits.

(Ferris, 2007) studied "*Merchant bank History*" and observed that Merchant banks were in fact the first modern banks. They emerged in the middle Ages from the Italian grain and cloth merchant’s community and started to develop in the 11th century during the large European fair of St. Giles (England), then at the Champagne fair (France). As the Lombardy merchants and bankers grew in stature based on the strength of the Lombard

plains cereal crops, many displaced Jews fleeing Spanish persecution were attracted to the trade. The Florentine merchant banking community was exceptionally active and propagated new finance practices all over Europe. Both Jews and Florentine merchants perfected ancient practices used in the Middle East trade routes and the Far East silk routes. Originally intended for the finance of long trading journeys, these methods were applied to finance the medieval "commercial revolution these banks are experts in international trade, which makes them specialists in dealing with multinational corporations. Some of the largest merchant banks in the world include J.P. Morgan, Goldman Sachs, and Citigroup

(S.K, n.d.) Studied "*What is a Merchant bank?*" and found that Merchant banks provide financial services including underwriting, loan services, fundraising services, and financial advising to high net-worth individuals and small/mid-sized corporations. It is not the bank for the general public. It's similar to the investment bank, but a merchant bank and an investment bank are not the same.

(Kumar, 2016) studied "*Role of Merchant Bankers*" and observed that they engage in business loans as well as underwriting. They mostly cater to large enterprises and individuals of high net worth. They perform a combination of consultancy and banking services. They provide consultancy on matters pertaining to the finances, marketing, management, and law. Such consultancy services assist in starting of businesses, raising finance, modernising, expanding or restructuring a business, revival of sick units as well as providing assistance to companies in registering, buying and selling shares.

Services offered by Merchant Banks:

Merchant Banks offer a range of financial and consultancy services to customers, which are related to:

- Marketing and underwriting of the new issue.
- Merger and acquisition related services.
- Advisory services, for raising funds.
- Management of customer security.
- Project promotion and project finance.
- Investment banking
- Portfolio Services

- Insurance Services

Merchant banking helps in reinforcing the economic development of the country, by acting as a source of funds and information to the business entities.

Functions of Merchant Banking:

The functions of merchant banking are listed as follows:

- 1) **Raising Finance for Clients:** Merchant Banking helps its clients to raise finance through issue of shares, debentures, bank loans, etc. It helps its clients to raise finance from the domestic and international market. This finance is used for starting a new business or project or for modernization or expansion of the business.
- 2) **Broker in Stock Exchange:** Merchant bankers act as brokers in the stock exchange. They buy and sell shares on behalf of their clients. They conduct research on equity shares. They also advise their clients about which shares to buy, when to buy, how much to buy and when to sell. Large brokers, Mutual Funds, Venture capital companies and Investment Banks offer merchant banking services.
- 3) **Project Management:** Merchant bankers help their clients in the many ways. For e.g. advising about location of a project, preparing a project report, conducting feasibility studies, making a plan for financing the project, finding out sources of finance, advising about concessions and incentives from the government.
- 4) **Advice on Expansion and Modernization:** Merchant bankers give advice for expansion and modernization of the business units. They give expert advice on mergers and amalgamations, acquisition and takeovers, diversification of business, foreign collaborations and joint-ventures, technology up-gradation, etc.
- 5) **Managing Public Issue of Companies:** Merchant bank advice and manage the public issue of companies. They provide following services:
 - Advise on the timing of the public issue.
 - Advise on the size and price of the issue.

- Acting as manager to the issue, and helping in accepting applications and allotment of securities.
 - Help in appointing underwriters and brokers to the issue.
 - Listing of shares on the stock exchange, etc.
- 6) **Handling Government Consent for Industrial Projects:** A businessman has to get government permission for starting of the project. Similarly, a company requires permission for expansion or modernization activities. For this, many formalities have to be completed. Merchant banks do all this work for their clients.
- 7) **Special Assistance to Small Companies and Entrepreneurs:** Merchant banks advise small companies about business opportunities, government policies, incentives and concessions available. It also helps them to take advantage of these opportunities, concessions, etc.
- 8) **Services to Public Sector Units:** Merchant banks offer many services to public sector units and public utilities. They help in raising long-term capital, marketing of securities, foreign collaborations and arranging long-term finance from term lending institutions.
- 9) **Revival of Sick Industrial Units:** Merchant banks help to revive (cure) sick industrial units. It negotiates with different agencies like banks, term lending institutions, and BIFR (Board for Industrial and Financial Reconstruction). It also plans and executes the full revival package.
- 10) **Portfolio Management:** A merchant bank manages the portfolios (investments) of its clients. This makes investments safe, liquid and profitable for the client. It offers expert guidance to its clients for taking investment decisions.
- 11) **Corporate Restructuring:** It includes mergers or acquisitions of existing business units, sale of existing unit or disinvestment. This requires proper negotiations, preparation of documents and completion of legal formalities. Merchant bankers offer all these services to their clients.
- 12) **Money Market Operation:** Merchant bankers deal with and underwrite short-term money market instruments, such as:
- Government Bonds.
 - Certificate of deposit issued by banks and financial institutions.
 - Commercial paper issued by large corporate firms.

- Treasury bills issued by the Government (Here in India by RBI).

13) **Leasing Services:** Merchant bankers also help in leasing services. Lease is a contract between the less or and lessee, whereby the less or allows the use of his specific asset such as equipment by the lessee for a certain period. The less or charges a fee called rentals.

14) **Management of Interest and Dividend:** Merchant bankers help their clients in the management of interest on debentures / loans, and dividend on shares. They also advise their client about the timing (interim / yearly) and rate of dividend.

Conclusion

A merchant bank works with clients that are not big enough to go for initial public offering (IPO) but are privately held. That's why to helps them in unique ways to raise capital. As for example, we can talk about private placements. Since private placements don't require a privately held company to disclose as per the Security Exchange & Commission (SEC), it becomes easier for the privately held companies. On the other hand, an investment bank works with huge clients that have the funds large enough to go for IPO and they are large enough to provide time, effort, money to raise the capital through the traditional means. Plus, an investment bank also helps companies in mergers & acquisitions and also provides investment research to the clients.

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