III Semester MBA

Investment Banking and Financial Servi

16 MBA FM 302

Unit 1
Investment Banking

Investment Banking

Introduction

- Modern banking finds its roots in Italy in the 13th century. World's oldest bar
Monte di Pietà, or Monte Pio was set up in 1472.

- Traditionally banks are either engaged in commercial banking or investment

- In commercial banking the institution collects deposits from clients and giv
to businesses and individuals.

- Investment banking is a field of banking that helps companies in acquiring

- Investment banking is a service oriented function that transfers capital from t
to those who can use it.

- Investment banking helps the companies in generating funds either by sel
capital market or through venture capital or private equity.

- In India investment bankers are often called as merchant bankers.

Investment Vs Merchant Banking

Investment Banking provide both fee based and fund based service to com
are traditionally engaged in trade financing activities.

Merchant Banking provide a fee based service to companies. Traditionally
into underwriting.

Meaning & Definition

- Investment bank is a financial intermediary that performs a variety of serv underwriting, acting as an intermediary between a securities issuer and t public, facilitating mergers and acquisitions, and acting as a broker and adviser for institutional clients.

- SEBI defines Merchant banker " any person who is engaged in the busi management either by making arrangements regarding selling, buying, or to securities as manager-consultant, advisor or rendering corporate advis in relation to such issue management".

Functions of Investment Banks

- **Underwriter** – The institution or an agency who undertake to take up sha subscription from public is not received is known as Underwriter. Even thoug is not obligatory they play a significant role in the development of the prima issuing company in consultation with the merchant banker appoints ur announces in the prospectus.

- **Banker** – Banks who are engaged in the function of acceptance of applicat application money and refund of money to applicants to whom securitie allotted are called Bankers to an issue

- **Broker** – are concerned with procurement of the subscription to the issue. T the issue and brokers together form the distribution channel for the issue.

- **Registrar** – carry on the activities such as collecting applications, kee applications, money received and paid, assisting companies in decidin allotment in consultation with stock exchange, finalising allotment Processing/dispatching allotment letters, refund orders, certificates etc.

- **Debenture trustees** – trustees who are appointed to safe guard the interest o holders are called debenture trustees. They have to be registered with SEBI.

- **Portfolio Managers** – Those who undertake/advise/direct management securities on behalf of their clients. Portfolio involves entire range of hol person.

Types of Investment Banks

- **Full service Investment banks** – it operates on a **global** provides a **complete set of services** to their clients. These investment firms which serve large corporations.

- **Regional Investment banks** – concentrated in a **particular re** specialised geographic knowledge and a **variety of product** These firms are also known as specialty investment banks.

- **Boutique Firms** – small investment banks organised at a **local** specialise in a **particular industry or product**. They are inc firms whose focus is on advisory services such as mer acquisitions.

Investment /Merchant Banking Services

- Corporate counselling
- Project counselling
- Loan syndication
- Management of capital issues
- Corporate Advisory services
- Portfolio management
- Advisory services to mergers and takeovers
- Consultancy to sick industrial units
- Leasing
- Foreign currency financing
- Providing venture capital financing

Issue Management

- Management of issues related to raising funds t
various instruments like shares, debentures etc

- Issue management involves planning, ma
procuring of private subscription to the securi
offering securities to existing share holders
company.

- Section 67 of the Companies Act stipulates t
offer for more than 50 persons is a public issu
has to comply with the Act and SEBI guidelin

Role of Merchant banks in Issue managemen

- **Appraisal of projects** – is a process of inves review, and evaluation of the project. Includes pre of a project report, deciding upon the financing appraising the project report with the financial instit

- **Designing of capital structure** – refers to the com of its capitalisation. It includes all long term resources such as loans, reserves, shares and deb Financial structuring includes determining the rig equity ratio and framing of appropriate capital s theory.

- Capital structure instruments include – Equity Preference shares, Retained earnings/ ploughing profits, Debentures, Sweat equity shares, W Secured premium notes (SPNs), Derivatives.

Issue management: Pre-issue and Post-is

Pre-issue Management: Steps involved

- Obtaining SEBI Approval for the issue
- Preparation of the prospectus and approval by
- Selection of the registrar for the issue, advertis agencies, underwriters, bankers and brokers.
- Arranging issue and publicity campaign
- Pricing the issue

Preparation of Prospectus

Is an invitation issued to the public to offer for purchase/subscribe shares or debentures of the company

Content of Prospectus:

- General information about the company
- Capital structure of the company
- Terms of the present issue
- Dates of opening and closing of the issue
- Name, address, functions and remuneration of Directors
- Auditors report with name and address of the auditors

Intermediaries to the issue

- Merchant Bankers to the issue or book running lead managers (BR
- Registrar to the issue
- Bankers to the issue
- Underwriters to the issue
- Brokers
- Advertising agencies
- Printers

Pre-issue obligations – SEBI guidelines

- Due Diligence
- Payment of requisite fees
- Submission of documents
  - ✓ MOU
  - ✓ Inter-se allocation of responsibilities
  - ✓ Due Diligence Certificate
  - ✓ Certificate in case of further issue by Listed companies
  - ✓ Undertaking
  - ✓ List of promoters group

Pre-issue obligations – SEBI Guidelines

- Appointment of Intermediaries
  - ➢Merchant bankers
  - ➢Co-managers
  - ➢Other intermediaries

- Underwriting
- Offer document made public
- Dispatch of issue material
- No complaints certificate
- Mandatory collection centers
- Authorised collection agents
- Advertisement for rights post-issue
- Appointment of compliance office
- Abridged prospectus
- Agreement with depositories

Post - issue Management

Steps involved:

- To verify and confirm that the issue is subscribed to the 90% including underwriters obligation
- To supervise and co-ordinate allotment procedure by the per Stock Exchange guidelines
- To ensure issue of refund order, allotment letters within the time limit of 10 weeks after the closure of the subscription
- To report periodically to SEBI about progress in allo refunds.
- To ensure listing of securities at the stock exchange
- To attend the investors grievances about the public issue.

Post-issue obligations - SEBI guidelines

- **Post-issue monitoring reports**
  - To be submitted third day from the date of allocation in the b portion or one day prior to the opening of the fixed price whichever is earlier. It is 3days from the date of closure of the is other cases.
  - Final post-issue report within 78 days from the date of closu subscription in case of book building and public issue, but 50 da of rights issue.

- **Redressal of investors grievances**

- **Co-ordination with intermediaries**
  - Stock invest
  - Underwriters
  - Bankers to an issue

- **Finalising the basis of allotment**

- **Dispatch of Share certificate**

Changing Landscape of Investment Banking

- Till 2007 Investment banking business was very profitable
- As a result of the sub-prime mortgage crisis in US investment banks co
- Several acquisitions took place in 2008.
- Impact was felt by the Indian Investment banks.
- Growth rate of Indian economy also slowed down.
- Indian Investment banks were forced to design new strategies for surviv
- Several important trends have emerged:
    - Faster growth opportunities for countries.
    - To maintain sustained earnings growth, firms pursue a strategy by dive balancing revenue streams.
    - Investment banks pursue balance sheet de-risk and diverse funding
    - Regulatory compliance and high standards of governance have become part of the business.
- Investment banks were expanding the products and services geographica financial supermarkets to the world.
- Investment banks rely on advanced technologies in the front office to e speed, high-frequency trading, as well as fast and accurate analytics for services.

Securities and Exchange Board of India (S

- Established in 1988.
- Upgraded as a statutory board in 1992.
- Securities and Exchange Board of India Act was passed on 30th Janua
- Objectives of SEBI:
  - To protect the interest of investors in securities
  - To promote the development of the securities market
  - To regulate the securities market
- Functions of SEBI:
  - To register and regulate the workings of stock brokers
  - To register and regulate the bankers to an issue
  - To control and regulate securities market
  - To exercise the powers under securities contracts Act
  - To regulate the working of mutual funds
  - To control fraudulent and unfair trade practices relating to securities
  - To control investment business
  - To regulate issue of securities
  - To regulate takeovers
  - To regulate insider-trading in securities.

SEBI Regulations for Merchant bank

- SEBI regulates capital markets in India.

- SEBI regulations on merchant banking:
    1. Registration of merchant bankers
    2. Responsibilities of merchant bankers
    3. Code of conduct for merchant bankers
    4. Procedure for inspection
    5. Procedure for action in case of default
    6. Amendments to SEBI (Merchant bankers) Regulat

1. Registration of Merchant bankers

➢ Categories of Merchant Bankers

- Category – I
    - Any activity under issue management including preparation o determination of financial structure, issue, allotment, refund of subscri
    - To act as adviser, consultant, co-manager, underwriter, portfolio mana

- Category – II
    - To act as adviser, consultant, co-manager, underwriter, portfolio man

- Category - III
    - To act as underwriter, adviser, and consultant to an issue

- Category – IV
    - To act only as advisor or consultant to an issue.

- Category II, III, IV were abolished through an amendment, dated 1997 to the SEBI Merchant Bankers Regulation, 1992. Since then category I exist.

- **Requirement for granting the certificate**

- Shall be a body corporate other than an NBFC
- Has the necessary infrastructure to effectively dis
activities
- Should have minimum two experienced employees to
business
- Should fulfill the capital adequacy requirement as spe
- His partner, director or principal officer should not be
any litigation connected with the securities market w
adverse bearing on the business of the applicant
- His partner, director or principal officer has not bee
for any offence or been found guilty of any economic
- Should have the professional qualification from an
recognised by the government in finance, law o
management
- Should be a fit and proper person.

➢ Capital Adequacy Requirements (CAR)

- CAR shall not be less than net worth of the person making the a for grant of registration.
- Net worth not less than Rs Five crores

➢ Procedure for registration

- Application must be submitted to SEBI in form A and S issue certificate of registration in form B. Application fee R
- On grant of certificate the applicant shall be liable to pay th accordance with schedule II
- Rs 20,00,000 for initial registration.

➢ Renewal of certificate

- Certificate of initial registration remains valid for 5 years.
- For renewal, apply in form A three months before the certificate
- Renewal application is to be treated similar as a fresh applic
- After the verification of application SEBI will grant cert form B
- ~~Applicant is liable to pay the fees of Rs. 9,00,000 for p~~ registration

2. Responsibilities of merchant banker

- **Code of conduct** – As per schedule III no merchant banker, other tha
  or a public financial institution and primary dealer as per RBI can enga
  activity other than securities market.

• **Maintenance of books of accounts** – copy of B/S, P&L account,
report and a statement of financial position. Information to SEBI wh
documents are maintained and furnish such documents when required by

• **Submission of half yearly results** – furnish to SEBI half yearly u
financial results with a view to monitor the capital adequacy of merchant

• **Appointment of lead merchant bankers** – Every issue must have
merchant banker. Lead merchant banker must sign an agreement with t
setting out their mutual rights, liabilities and obligations regarding t
allotment and refund.

•**Restriction on appointment of lead merchant banker -**

Issue size of less than 50 crore - 2 merchant banker

……………. Rs. 50-100 crore - 3………………….

……………..Rs 100-200 crore - 4…………………

……………...Rs. 200-400 crore - 5………………..

……… more than Rs500 crore - 5 or more ………. as agreed by SEBI

Responsibilities of lead merchant banker – Lead manager s
agree to manage an issue unless his roles and responsibilities p
relating to disclosures, allotment and refund are clearly defined and a
is submitted to SEBI at least a month prior to opening of the issue.

- In case of more than one lead merchant banker responsibilities must
demarcated.

-No lead merchant banker should agree to manage an issue if the body
is an associate of the lead merchant banker.

Underwriting Obligations – Every lead merchant banker must ta
5 per cent of total underwriting commitment or Rs 25 lakh whichever
it is unable to do so then it must make an arrangement with another
banker to the same issue and keep SEBI informed.

Appointment of Compliance officers – Every merchant ba
appoint a compliance officer who will monitor compliance to the A
other relevant rules and regulations.

- He shall report to SEBI any non-compliance observed and e
deficiencies observed by SEBI in draft prospectus do not recur.

3.Code of conduct for Merchant bankers

- Regulatory/Statutory compliance
- Confidentiality
- Accurate record keeping
- Conflict of interest
- Ethics in conducting business
- Public Disclosure and Reporting
- Gifts, entertainment and favours etc
- Inside information
- Trade secrets
- Compliance responsibility

4. Procedure for inspection

- **SEBIs right to inspect** – SEBI may appoint one or more p
inspect books of accounts/records/documents

-Purpose of inspection is to ensure proper book keeping, comp
law, to investigate into complaints , to investigate suo moto (own
in investors interest.

- **Notice before inspection** – SEBI shall give reasonable not
merchant banker before inspection . During the course of his
merchant banker is bound to discharge his obligations.

- **Submission of reports to SEBI -** Inspection authority sha
the inspection report to SEBI

- **Action on inspection report** – After consideration of the i
report SEBI or chairman may take action as deem it fit.

- **Appointment of auditors** – SEBI may appoint auditors to
the books of accounts provided that the auditors have the same p
inspection authorities.

5. Procedure for action in case of default

Suspension of registration may be imposed:

- When the merchant banker violates the provisions of the Act
- Fails to furnish information or furnish wrong information
- Doesn't submit periodical information as required by SEBI
- Doesn't co-operate in enquiry conducted by SEBI
- Fails to resolve complaints by investors or fails to give satisfact to SEBI
- Indulges in price rigging, cornering and manipulation
- Fails to maintain Capital adequacy requirement
- Fails to pay the fees
- Violates conditions of registration
- Fails to carry out his obligation as specified in the regulation

Cancellation of registration – Cancellation can be imposed

- Indulges in deliberate manipulation or price rigging
- Financial position deteriorates to the extent that SEBI feels that it i interest of the investors.
- Guilty of fraud or convicted in a criminal offence

Show-cause notice or order

- On receipt of the report from enquiry officer SEBI may issue show-cau
- Merchant banker shall reply to SEBI within 21 days of receipt of the no
- SEBI passes order within 30 days
- Every order must be self containing giving reasons for the conclusions imposed.
- SEBI shall send a copy of the order to the merchant banker

Effect of suspension and cancellation of registration of banker

- Merchant banker cease to carry-on any activity from the date of suspe the period of suspension
- Merchant banker cease to carry-on any activity from the date of cancell

Publication of order of suspension

- Must be published by SEBI in at least two daily news papers
- Any aggrieved merchant banker may appeal to Securities Appella having jurisdiction in the matter.

6. Amendments to SEBI (Merchant bankers) Regulatio

Amendments dated December 9, 1997

- Applicant should be fit and proper person
- Seek separate registration for its underwriting or portfolio manageme
- Categories like I,II,III,IV are dispensed with
- A merchant banker other than a bank a public financial institution is from carrying any activities not pertaining to the securities market
- Applicant should be a corporate body other than a non-bankin company

Amendment dated January 21, 1998

• Time provided up to June 30^{th} 1998 sever their activities not pertai securities market

• Merchant banker is exempted by Reserve Bank of India regarding c registration, maintenance of liquid assets, and creation of reserves if certain conditions.

•Amendments 2014 – Regarding Registration fees and change of contr

SEBI Regulations for Intermediaries

Intermediaries are stock brokers, sub brokers, share transfer agents bankers, underwriters, portfolio managers, investment advisers intermediaries associated with the securities market specified by the

Regulations

1. Registration of intermediaries

- Application to act as a intermediary should be made through conce exchange.
- Eligibility of the applicants will be examined and is forwarded alo fee and its recommendations to SEBI within 30days of receip application.
- Any change in in the material furnished should be update intermediary within 15days of the occurrence of change.

2. Obligations of intermediaries

- General obligations
- Redressal of investor grievances
- Appointment of compliance officer
- Investment advice

3. Code of Conduct

• Investor protection

• Disclose of information

• Conflict of interest

4. Inspection and disciplinary proceedings

5. Action in case of Default

• Procedure

• Effect of debarment

• Surrender of certificate of registration

• Securities Appellate Tribunal(SAT)

Underwriting

- SEBI Rules 1993 defines Underwriting as an agreement with or without subscribe to the securities of a body corporate when the existing shareho body corporate or the public do not subscribe to the securities offered to th
- Underwriting is similar to Insurance.
- Person who engages in the business of underwriting is called Underwriter
- Charges for the service rendered is called underwriting commission.

Advantages:

- Relieves the company from the risk and uncertainty of selling the securiti
- Specialised knowledge of the capital market
- Builds up investors confidence in the issue of securities
- Company is assured of the availability of funds
- Helps in raising capital for new enterprises and the expansion of the exist
- Facilitates the geographical dispersal of securities

Types of underwriting:

- Firm Underwriting
- Sub-underwriting
- Joint underwriting
- Syndicate underwriting
- Full underwriting
- Partial underwriting

Devolvement

- If an issue is unsubscribed, underwriter is required to subscrib remaining shares.
- Underwriter will not hold the shares for too long. He will sell at a lo
- SEBI publishes guidelines relating to the extent of devolvement.

In case of fixed price issue:

- The issuer company will communicate the devolvement by preliminary notice within7 days of closure of issue followed by a fi with the auditors certificate within 18 days.
- Underwriter shall subscribe subscription within7 days of the final n

Incase of book build issue:

- The syndicate member shall underwrite all shares allocated to bi have bid through them, receive underwriting commission on such bi devolved shares ,if any.
- If the underwriting is different from bids allocated to bidders members obligation is restricted to the amount underwritten by him.

Business Model

- Intention is to collect more in premium and investment income t
  out in losses, and to offer competitive price which the consumers

Earned Premium	………
Add: Investment income	……….
Less: Loss incurred	..……….
Less: Underwriting Expenses	……….

Profit	………
	======

Allotment

In case of book built issue:

1. In case an issuer company makes an issue of 100% of the ne
public through 100% book building process:
   - Not less than 35% of the net offer to the public shall be available for a
retail individual investors.
   - Not less than 15% for non-institutional investors
   - Not more than 50% for qualified institutional buyers
2. In case of compulsory book built issue at least 50% of the ne
public being allotted to the Qualified institutional buyers

In case of Fixed price issue

1. A minimum 50% of the net offer of securities to the public shal
be made available for allotment to retail individual investors
2. The balance net offer of securities to the public shall be made
for allotment to :
   - Individual investors other than retail individual investors
   - Other investors including corporate bodies/institutions irrespective of the
securities applied for.

Price fixation under underwriting

- Issuer in consultation with the Merchant Banker will decide the pr
does not play any role.
- **Fixed price offers:**
  - An issuer company is allowed to freely price the issue.
- **Book built offers:**
  - Book building is a process by which demand for the securities proposed to be
body corporate is elicited and built up and the price for the securities is assessed
of the bids obtained for the quantum of securities offered for subscription by the

Features	Fixed price process	Book building pro
Pricing	Price at which the securities are offered is known in advance to the investors	Not known in adva the investors . Onl indicative price ran known.
Demand	Demand is known only after the closure of the issue	Known every day a book is built
Payment	Made at the time of subscription wherein refund is given after allocation	Payment only afte allocation

Placement of the Issue

- **Through Prospectus** - invites offers for subscription or purchase of a debentures from the public
- **Offer for Sale/ Bought out deals** - Promoter places his shares with a banker who offer it to the public at a later date.
- **Private placements** - Small number of financial intermediaries purch and sell them to investors at a later date at a suitable price. E.g. UTI, I Insurance companies. **Advantages** -Cost effective, Time effective, St effective, Access effective.
- **Rights issue** - When a company comes out with additional issue, such first offered to the existing share holders.
- **Book building** - is a systematic process of generating, capturing, and investor demand for shares during an initial public offering (IPO), or ot during their issuance process, in order to support efficient price discove

- **Red herring Prospectus -** Prospectus without details of either price o shares being offered or the amount of issue.

- **Green shoe option -** An option of allocating shares in excess of the shares the public issue. Maximum of 15 per cent of the issue.

- **Qualified institutional Buyers -** Institutional investors who are perceive financial expertise to evaluate and invest in the capital market.

- **Objectives of investment banking**

Responsibilities of Lead Manager

- Drafting the Prospectus
- Preparing budget of expenses related to public issue
- Suggesting the appropriate timing of the public issue
- Assisting in marketing the public issue
- Advising the company in the appointment of intermediaries
- Co-ordinating with the intermediaries.

Link for you tube video

https://www.youtube.com/watch?v=T8K_75a90h