INVESTMENT BANKING

1. CONCEPT OF INVESTMENT BANKING

What is an Investment Bank?

It is neither Investment banking nor I-banking, as it is often called. It is the term used to describe the business of raising capital for companies.

Capital essentially means money. Companies need cash in order to grow and expand their businesses; Investment banks sell securities to public investors in order to raise the cash. These securities can come in the form of stocks or bonds. Thus, Investment banks are essentially financial intermediaries, who assist their clients in raising capital either by underwriting their shares or bonds or by acting as an agent in the issuance of securities.

Please note that Investment banking isn't one specific service or function. It is an umbrella term for a range of activities including underwriting, selling, and trading securities (stocks and bonds); providing financial advisory services, such as mergers and acquisition advice; divestitures, private equity syndication, IPO advisory and managing assets.
1.1 The Players

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, J.P. Morgan and Barings (Lehman Brothers), among others.

1.2 The Components of Investment Bank

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

1.2.1 Corporate Finance

The bread and butter of a traditional investment bank, corporate finance, generally perform two different functions:

1) Mergers and acquisitions advisory and
2) Underwriting.

On the mergers and acquisitions (M&A) advising side of corporate finance, bankers assist in negotiating and structuring a merger between two companies. If, for example, a company wants to buy another firm, then an investment bank will help finalize the purchase price by coordinating with the bidders, performing due diligence, structuring the deal, negotiating with the merger target and generally ensuring a smooth transaction.

Mergers and acquisition advice include buy-side and sell-side advice where competent buy-side analysts and sell-side analysts are appointed by the Investment banking companies to advice their clients on lucrative merger targets in case a firm wants to buy another firm and potential purchasing companies if a firm wants to sell its assets.

The traditional investment banking world is considered the sell-side of the securities industry. Why? Investment banks create stocks and bonds, and sell these to investors. Sell is the key word, as I-banks continually sell their firms’ capabilities to generate corporate finance business. Who are the buyers of public stocks and bonds? They are individual investors (you and me) and institutional investors, firms like Fidelity and Vanguard. The universe of institutional investors is appropriately called the buy-side of the securities industry.

The underwriting function within corporate finance involves spearheading the process of raising capital for a company. In the investment banking world, capital can be raised by selling either stocks or bonds to the investors.

When a corporation wishes to issue new securities and sell them to the public, it makes an arrangement with an investment banker whereby the investment banker agrees to purchase the entire issue at a set price, known as underwriting. 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 are another core component of any investment bank. The primary job of the sales force of an Investment bank is to call on high net worth individuals and institutions to suggest trading ideas (on a caveat emptor basis) and take orders. Salespeople take the form of:

1) The Classic Retail Broker,
2) The Institutional Salesperson, or
3) The Private Client Service Representative.

Brokers develop relationships with individual investors and sell stocks and stock advice to them.

Institutional salespeople develop business relationships with large institutional investors. Institutional investors are those who manage large groups of assets, for example pension funds or mutual funds.

Private Client Service (PCS) representatives lie somewhere between retail brokers and institutional salespeople, providing brokerage and money management services for extremely wealthy individuals.

Salespeople make money through commissions on trades made through their firms.

### 1.2.3 Trading

Traders also provide a vital role for the investment bank. The salespeople communicate the client's orders to the trading people. Traders facilitate the buying and selling of stock, bonds, or other securities such as currencies, either by carrying an inventory of securities for sale or by executing a given trade for a client.

Traders deal with transactions large and small and provide liquidity (the ability to buy and sell securities) for the market. (This is often called making a market.) Traders make money by purchasing securities and selling them at a slightly higher price. This price differential is called the "bid-ask spread."

Sales and trading can also engage in proprietary trading. Proprietary trading involves a special group of traders who do not work with clients. These traders take on "principal risk", which involves buying or selling a product and does not hedge his total exposure. By managing the amount of risk on its balance sheet, an investment bank can maximize its profitability.
An investment bank’s sales and trading department also interacts with the corporate finance department on the issuance of IPOs and follow-on offerings. It is the sales and trading department that builds a book for a particular stock by calling up institutional and retail investors to judge the interest for the offering. They then price the initial sales value on the day of the offering and begin selling the new shares to their clients.

1.2.4 Research

Research analysts study stocks and bonds and make recommendations on whether to buy, sell, or hold those securities. Research analysts review companies and write reports on their prospectus often with buy or sell ratings. Stock analysts (known as equity analysts) typically focus on one industry and will cover up to 20 companies’ stocks at any given time. Some research analysts work on the fixed income side and will cover a particular segment, such as high yield bonds or Govt. Treasury bonds. The research department on its own does not generate a lot of income. What it does is influence trading volume, which results in more fees for sales and trading. When a research analyst changes his or her recommendation on a stock, many investors will then act on that recommendation and the sales and trading team earns more in trading fees. Salespeople within the I-bank utilize research published by analysts to convince their clients to buy or sell securities through their firm. Corporate finance bankers rely on research analysts to be experts in the industry in which they are working. Reputable research analysts can generate substantial corporate finance business as well as substantial trading activity, and thus are an integral part of any investment bank.

There exists, however, a conflict of interest between research and other parts on the investment bank. If an investment bank were about to issue new shares of stock for a company, for example, the research analyst could put out a strong recommendation for the stock just prior to the offering, and the bank could get a better price and potentially earn more fees.

Likewise, if the proprietary trading division wanted to boost the return on their holdings, they could have research analysts recommend some of the stock they held as a buy. There are a number of areas where the research department could be used to mislead investors and earn more profit for the investment bank.

To circumvent these conflicts of interests, regulators have insisted that investment banks implement a “Chinese wall” in their firms. The Chinese wall keeps information about the investment bank’s corporate finance and sales and trading activities from passing through to the research department.

A Chinese wall also exists between the corporate finance and sales and trading divisions because many corporate finance activities involve non-public information that could be used to profitably execute trading strategies.
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

Commercial and investment banking share many aspects, but also have many fundamental differences. After a quick overview of commercial banking, we will build up to a full discussion of what I-banking entails.

We'll begin examining what this means by taking a look at what commercial banks do.

1.3.1 Commercial Banks

A commercial bank may legally take deposits for current and savings accounts from consumers. Commercial banks must follow a myriad of regulations. The typical commercial banking process is fairly straightforward. You deposit money into your bank, and the bank loans that money to consumers and companies in need of capital (cash). You borrow to buy a house, finance a car, or finance an addition to your home. Companies borrow to finance the growth of their company or meet immediate cash needs. Companies that borrow from commercial banks can range in size from the dry cleaner on the corner to a multinational conglomerate.

1.3.2 Private Contracts

Importantly, loans from commercial banks are structured as private legally binding contracts between two parties - the bank and you (or the bank and a company). Banks work with their clients to individually determine the terms of the loans, including the time to maturity and the interest rate charged. Your individual credit history (or credit risk profile) determines the amount you can
borrow and how much interest you are charged.

Commercial banks thus collects funds and loan them to its customers for taking advantage of the large spread between their cost of funds (1 percent, for example) and their return on funds loaned (ranging from 5 to 14 percent).

1.3.3 Investment Banks

An investment bank operates differently. An investment bank does not have an inventory of cash deposits to lend as a commercial bank does. In essence, an investment bank acts as an intermediary, and matches sellers of stocks and bonds with buyers of stocks and bonds. Note, however, that companies use investment banks toward the same end as they use commercial banks. If a company needs capital, it may get a loan from a bank, or it may ask an investment bank to sell equity or debt (stocks or bonds). Because commercial banks already have funds available from their depositors and an investment bank does not, an I-bank must spend considerable time finding investors in order to obtain capital for its client.

1.3.4 Public Securities

Investment banks typically sell public securities (as opposed 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 ₹ 20 million. ITC has two choices

(a) It could obtain a commercial bank loan from State Bank of India for the entire ₹ 20 million, and pay interest on that loan.

(b) It could sell bonds publicly using an investment bank such as Merrill Lynch. The ₹ 20 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 20,000 bonds, each worth 1,000.) Once sold, the company receives its ₹ 20 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 redeem the bonds). Thus, we see that in a bond offering, while the money is still loaned to ITC, it is actually 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.

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

<table>
<thead>
<tr>
<th>Investment Banks</th>
<th>Commercial Banks</th>
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<tbody>
<tr>
<td>1. Investment Banks help their clients in raising capital by acting as an intermediary between the buyers and the sellers of securities (stocks or bonds)</td>
<td>1. Commercial Banks are engaged in the business of accepting deposits from customers and lending money to individuals and corporates.</td>
</tr>
<tr>
<td>2. Investment Banks do not take deposits from customers</td>
<td>2. Commercial banks can legally take deposits from customers.</td>
</tr>
<tr>
<td>3. The Investment Banks do not own the securities and only act as an intermediary for smooth transaction of buying and selling securities.</td>
<td>3. Commercial Banks own the loans granted to their customers.</td>
</tr>
<tr>
<td>4. Investment Banks earn underwriting commission</td>
<td>4. Commercial banks earn interest on loans granted to their customers.</td>
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2. FUNCTIONS OF AN INVESTMENT BANK

2.1 Issue of IPO

Investment banks underwrite stock offerings just as they do bond offerings. In the stock offering process, companies sell a portion of the equity (or ownership) of itself to the investing public. The very first time a company chooses to sell equity, this offering of equity is transacted through a process called an initial public offering of stock (commonly known as an IPO). Through the IPO process, stock in a company is created and sold to the public. After the deal, stock sold in the India is traded on a stock exchange such as the NSE or BSE.

Bankers to one of the largest IPO’s in Indian history, the ₹ 12,000 crores IPO of Coal India Limited included Citigroup, DSP Merrill Lynch, Morgan Stanley, Deutsche Bank, Enam Financials and Kotak Mahindra Capital Company.

The equity underwriting process is another major way in which investment banking differs from commercial banking. Commercial banks were able to legally underwrite debt, and some of the largest commercial banks have developed substantial expertise in underwriting public bond deals. So, not only do these banks make loans utilizing their deposits, they also underwrite bonds through a corporate finance department. When it comes to underwriting bond offerings, commercial banks have long competed for this business directly with investment banks. However,
only the biggest tier of commercial banks is able to do so, mostly because the size of most public bond issues is large and competition for such deals is quite fierce.

From an investment banking perspective, the IPO process consists of these three major phases: hiring the managers, due diligence, and marketing.

(i) Hiring the Managers: The first step for a company wishing to go public is to hire managers for its offering. The choice depends on the past transaction experience, the fee quotes, the valuations the bank promises to fetch for the company's offering etc.

The selection process also relies on the investment banker's general reputation and expertise as well as on 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 (i.e., the investment bank's distribution expertise). Prior banking relationships the issuer and members of its board (especially the venture capitalists) have with specific firms in the investment banking community also influence the selection outcome. Often, the selection process is a two-way affair, with the reputable investment banker choosing its clients at least as carefully as the company should choose the investment banker.

Almost all IPO candidates select two or more investment banks to manage the IPO process.

When there are multiple managers, one investment bank is selected as the lead or book-running manager. The lead manager almost always appears on the left of the cover of the prospectus, and it plays the major role throughout the transaction. The managing underwriter makes all the arrangements with the issuer, establishes the schedule of the issue, and has the primary responsibility for the due diligence process, 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 stock exchanges. Lawyers, accountants, I-bankers, and of course company management must all toil for countless hours to complete the filing in a timely manner. The Securities Act also makes it illegal to offer or sell securities to the public unless they have first been registered. It is important to note, however, that the SEC has no authority to prevent a public offering based on the quality of the securities involved. It only has the power to require that the issuer disclose all material facts.

Once the registration statement is filed with the SEC, it is transformed into the preliminary prospectus (or “Red Herring”.) The preliminary prospectus is one of the primary tools in marketing the issue. Within 20 days, the SEC responds to the initial filing and declares the issue effective. At this stage, the red herring is amended and transformed into a prospectus, which is the official offering document. During the period after the filing, the SEC examines the registration statement and engages in a series of communications with issuer's counsel regarding any changes necessary to bring about SEC approval. If the changes are minor, they are included in the “price amendment”; if the changes are extensive, a new prospectus is prepared and distributed.
(iii) Marketing: The third phase of an IPO is the marketing phase. Once the approval comes on the prospectus, the company embarks on a roadshow to sell the deal. A roadshow involves meeting potential institutional investors interested in buying shares in the offering. Typical road shows last from two to three weeks, and involve meeting numerous investors, who listen to the company's presentation, and then ask scrutinizing questions.

Often, money managers decide whether or not to invest thousands of rupees in a company within just a few minutes of a presentation.

The registration and marketing process can take several months, and it is therefore impossible for the underwriter to include certain information (such as the final IPO price, the precise discount to the dealers, and the names of all the syndicate members) in its initial filing with the SEC. On the day prior to the effective date, after the market closes, the firm and the lead underwriter meet to discuss two final (and very important) details: the offer price and the exact number of shares to be sold. After those final terms are negotiated, the underwriter and the issuer execute the Underwriting Agreement, the final prospectus is printed, and the underwriter files a “price amendment” on the morning of the chosen effective date. Once approved, the distribution of the stock begins. On this morning, the company stock opens for trade for the first time. The closing of the transaction occurs three days later, when the company delivers its stock, and the underwriter deposits the net proceeds from the IPO into the firm’s account.

But the IPO is far from being completed. Once the issue is brought to market, the underwriter has several additional activities to complete. These include the after-market stabilization, the provision of analyst recommendations, and making a market in the stock. The stabilization activities essentially require the underwriter to support the stock by buying shares if order imbalances arise. This price support can be done only at or below the offering price, and it is limited to a relatively short period of time after the stock has began trading. In general, the underwriter will continue to actively trade the stock in the months and years following the offering. By “making a market in the stock”, the underwriter essentially guarantees liquidity to the investors, and thus again enhances demand for the shares.

The final stage of the IPO begins 25 calendar days after the IPO when the so called “quiet period” ends. This "quiet period" is mandated by the SEC, and it marks a transition from investor reliance solely on the prospectus and disclosures mandated under security laws to a more open, market environment. It is only after this point that underwriters (and other syndicate members) can comment on the valuation and provide earnings estimates on the new company. The underwriter's role thus evolves in this aftermarket period into an advisory and evaluatory function.

2.2 Follow-on offering of stock

A company that is already publicly traded will sometimes sell stock to the public again. This type of offering is called a follow-on offering, or a secondary offering. One reason for a follow-on offering is the same as a major reason for the initial offering: a company may be growing rapidly, either by making acquisitions or by internal growth, and may simply require additional capital. Another
reason that a company would issue a follow-on offering is similar to the cashing out scenario in the IPO.

### 2.3 Issue of Debt

When a company requires capital, it sometimes chooses to issue public debt instead of equity. Almost always, however, a firm undergoing a public bond deal will already have stock trading in the market. (It is very rare for a private company to issue bonds before its IPO.) The reasons for issuing bonds rather than stock are various.

- **a)** The stock price of the issuer is down, and thus a bond issue is a better alternative.
- **b)** The firm does not wish to dilute its existing shareholders by issuing more equity.

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

Sometimes in an economic downturn, investor appetite for public offerings dwindles to the point where an equity deal just could not get done (investors would not buy the issue).

The bond offering process resembles the IPO process. The primary difference lies in: (1) the focus of the prospectus (a prospectus for a bond offering will emphasize the company’s stability and steady cash flow, whereas a stock prospectus will usually play up the company’s growth and expansion opportunities), and

*Importance of the bond’s credit rating:* The company will want to obtain a favorable credit rating from a debt rating agency like CRISIL, with the help of the credit department of the investment bank issuing the bond; the bank’s credit department will negotiate with the rating agencies to obtain the best possible rating. The better the credit rating - and therefore, the safer the bonds - the lower the interest rate the company must pay on the bonds to entice investors.

### 2.4 Merger and Acquisitions (M&A)

M&A advisors come directly from the corporate finance departments of investment banks. Unlike public offerings, merger transactions do not directly involve salespeople, traders or research analysts. In particular, M&A advisory falls into the domain of M&A specialists and fits into one of either two buckets: seller representation or buyer representation (also called target representation and acquirer representation).

<table>
<thead>
<tr>
<th>Representing the target (seller)</th>
<th>Representing the acquirer</th>
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<td><strong>Sell-side representation</strong> comes when a company asks an investment bank to help it sell a division, plant or subsidiary operation.</td>
<td>The advisory work itself is straightforward: the investment bank contacts the firm their client who wishes to purchase, attempts to structure a palatable offer for all parties, and make the deal a reality.</td>
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<tr>
<td>Generally speaking, the work involved in finding a buyer includes writing a Selling</td>
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Memorandum and then contacting potential strategic or financial buyers of the client.

Deals that do get done, though, are a boon for the I-bank representing the buyer because of their enormous profitability.

A buy-side Advisory and Sell-side Advisory services by Investment Bankers as Merger and Acquisitions Advisors has been briefly discussed as below:

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 insert 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 helps the client in the due diligence process and negotiates with the purchaser to close the deal.

### 2.5 Private Placements

A private placement, which involves the selling of debt or equity to private investors, resembles both a public offering and a merger. A private placement differs little from a public offering aside from the fact that a private placement involves a firm selling stock or equity to private investors rather than to public investors. Also, a typical private placement deal is smaller than a public transaction. Despite these differences, the primary reason for a private placement - to raise capital - is fundamentally the same as a public offering. Often, firms wishing to go public may be advised by investment bankers to first do a private placement, as they need to gain critical mass or size to justify an IPO.

They are usually the province of small companies aiming ultimately to go public. The process of raising private equity or debt changes only slightly from a public deal. One difference is that private placements do not require any securities to be registered with the stock exchanges, nor do they involve a road show. In place of the prospectus, I-banks draft a detailed Private Placement Memorandum (PPM) which divulges information similar to a prospectus. Instead of a road show, companies looking to sell private stock or debt will host potential investors as interest arises, and give presentations detailing how they will be the greatest thing since sliced bread.

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 PPM and then contacting potential strategic or financial buyers of the client.

Because private placements involve selling equity and debt to a single buyer, the investor and the seller (the company) typically negotiate the terms of the deal. Investment bankers function as negotiators for the company, helping to convince the investor of the value of the firm. Fees involved in private placements work like those in public offerings. Usually they are a fixed percentage of the size of the transaction.

### 2.6 Financial Restructurings

When a company cannot pay its cash obligations - for example, when it cannot meet its bond payments or its payments to other creditors (such as vendors) - it goes bankrupt. In this situation, a company can, of course, choose to simply shut down operations and walk away. On the other hand, it can also restructure and remain in business.

What does it mean to restructure? The process can be thought of as two-fold: financial
restructuring and organizational restructuring. Restructuring from a financial viewpoint involves renegotiating payment terms on debt obligations, issuing new debt, and restructuring payables to vendors. Bankers provide guidance to the firm by recommending the sale of assets, the issuing of special securities such as convertible stock and bonds, or even selling the company entirely.

So what do Restructuring bankers actually do, and how does it differ from what other investment bankers do?

The main difference is that Restructuring bankers work with distressed companies – businesses that are either going bankrupt, getting out of bankruptcy, or in the midst of bankruptcy. When a company's business suffers and it starts heading down the path of bankruptcy, its creditors – anyone that has lent it money, whether banks, hedge funds or other institutions – immediately take notice. A Restructuring group might be hired by a company to negotiate with its creditors and get the best deal possible, usually in the form of forgiven debt. Or they might advise a company on how best to restructure its current debt obligations either to get out of bankruptcy or to avoid it in the first place.

Another big difference is that Restructuring bankers must work within a legal framework – the Bankruptcy Code – and hence must have a more in-depth legal understanding than other bankers.

From an organizational viewpoint, a restructuring can involve a change in management, strategy and focus. I-bankers with expertise in "reorgs" can facilitate and ease the transition from bankruptcy to viability. Typical fees in a restructuring depend on whatever retainer fee is paid upfront and what new securities are issued post-bankruptcy. When a bank represents a bankrupt company, the brunt of the work is focused on analyzing and recommending financing alternatives. Thus, the fee structure resembles that of a private placement. How does the work differ from that of a private placement? I-bankers not only work in securing financing, but may assist in building projections for the client (which serve to illustrate to potential financiers what the firm's prospects may be), in renegotiating credit terms with lenders, and in helping to re-establish the business as a going concern.

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 the 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.

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, 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. Merill Lynch was acquired by Bank of America for $50 billion. Goldman Sachs and Morgan Stanley converted themselves into commercial banks.

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 and performing better than many developed countries in the world. Capital market is performing well. Nifty and Sensex are performing at an all-time high level. Many IPO's have successfully forayed in the year 2016-17.

However, investment 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.

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

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.

- An announcement regarding closure of issue shall be made only after the lead merchant banker(s) is satisfied that at least ninety per cent of the offer through offer document has been subscribed and a certificate has been obtained to that effect from the registrar to the issue.

5.2.2 Compliance Certificate

The merchant bankers shall submit a compliance certificate in the format specified in Part D of Schedule XIII, 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.

5.2.7 Other responsibilities

(i) The lead merchant bankers shall call upon the issuer, its promoters or directors or in case of an offer for sale, the selling shareholders, to fulfill their obligations as disclosed by them in the offer document and as required in terms of these Regulations.

(ii) The post-issue merchant banker shall continue to be responsible for post-issue activities till the subscribers have received the securities certificates, credit to their demat account or refund of application moneys and the listing agreement is entered into by the issuer with the stock exchange and listing/trading permission is obtained.

(iii) The responsibility of the lead merchant banker shall continue even after the completion of issue process.

(iv) In case of absence of definite information about subscription figures, the issue shall be kept open for the required number of days to avoid any dispute, at a later date, by the underwriters in respect of their liability.

(v) The issuer shall ensure that transactions in securities by the promoter and promoter group during the period between the date of registering the offer document with the Registrar of Companies or filing the letter of offer with the designated stock exchange, as the case may be and the date of closure of the issue shall be reported to the recognized stock exchanges where the specified securities of the issuer are listed, within twenty four hours of the transactions.

The pre issue and post issue obligations of the merchant banker have been discussed in detail later.

(vi) Where the shares are not frequently traded, the price determined by the promoters or shareholders having control and the merchant banker taking into account valuation parameters including book value, comparable trading multiples, and such other parameters as are customary for valuation of shares of such issuers.

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) Submitting Offer Document: Along with Offer Document, certain other documents are also required to be submitted. They are as follows:

- **Memorandum of Understanding (MOU)**

  An MOU 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 the draft offer letter along with the MOU to the Board (SEBI).

- **Inter Se Allocation of Responsibilities**

  In case of under subscription of securities, the lead merchant banker responsible for underwriting arrangements shall fulfill the underwriting obligations and make sure that underwriters pay the amount of devolvement and the same shall be incorporated in the inter-se allocation of responsibilities.

- **Due-diligence Certificate**

  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.

- In case of listed companies going for further issue of capital, a Chartered Accountant or a Company Secretary shall sign the following certificates certifying that :
  a) All refund orders of the previous issue and all security certificates to the allottees have been dispatched in a prescribed manner and within the prescribed time.
  b) The securities were listed in the stock exchange as specified in the offer document.

(ii) 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.

(iii) Submission of List of Promoters’ Group and Other Details such as PAN, Bank Account No. and passport no. of the promoters to SEBI.

(iv) Appointment of Intermediaries: The merchant banker shall ensure that intermediaries (bankers to the issue, registrar to the issue etc.) are duly registered with SEBI. He shall ensure that intermediaries are capable enough to discharge their duties. He shall also make sure that the issuer company enters into an MOU with the intermediaries.
(v) Underwriting: The merchant bankers shall satisfy themselves about the ability of the underwriters before their appointment. In respect of every underwritten issue, the merchant banker shall undertake a minimum underwriting obligation of 5% of the total underwriting commitment or 25 lakhs, whichever is less.

(vi) Offer document to be made public: The draft offer document filed with the SEBI shall be made public for a period of 21 days, from the date of filing the offer document with the SEBI.

(vii) No Complaint Certificate: The lead merchant banker shall file a Certificate with the SEBI after the expiry of 21 days as mentioned above highlighting the list of complaint received from the public.

(viii) The merchant banker shall ensure that every application form is accompanied by a copy of the abridged prospectus.

(ix) 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:

(i) Post Issue Monitoring Reports: The post issue lead merchant banker shall submit the following post issue monitoring report –

- A 3-day monitoring report in case of issue book-building route, which shall be submitted within 3 days from the date of allocation in the book built issue.
- A 3-day monitoring report in case of fixed portion of book built issue, which shall be submitted within 3 days of the closure of the issue.

A final post issue monitoring report shall be submitted within 3 days from the date of listing or 78 days from the date of closure of the subscription of the issue, whichever is earlier.

Further, the due diligence certificate shall be submitted with the final post issue monitoring report.

(ii) Redressal of Investor Grievances: The post issue lead merchant banker shall address the investor grievances with regard to certain post issue activities, such as allotment of securities, refund of securities, dispatch of share certificates and other correspondence, giving instructions to self-certified banks etc.

(iii) Coordination with Intermediaries: The post issue lead merchant banker maintains a close coordination with Registrar to the issue, and deputes 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.
(iv) **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.

(v) **Bankers to an issue:** The post issue lead merchant banker shall ensure that all the money received pursuant to the issue and kept in a separate bank shall be released only when listing permission is received from all the stock exchanges where it is proposed to be listed.

(vi) **Post-issue Advertisements:** A post issue advertisement has to be given by the merchant banker within ten days from the date of completion of the various activities in a leading English newspaper, one Hindi National Paper and a Regional language daily, circulated at the place where the registered office of the company is situated giving details of oversubscription, basis of allotment, value and percentage of successful allottees, date of dispatch of certificates and date of dispatch of refund orders.

The post-issue merchant banker shall ensure that issuer, advisors, brokers or any other entity connected with the issue do not publish any advertisement stating that issue has been oversubscribed or indicating investors' response to the issue, during the period when the public issue is still open for subscription by the public.