
UNIT 8 ISSUE MANAGEMENT SERVICES

Objectives

After reading this unit you should be able to:

- Discuss the basics of Capital market.
- Explain the concept of merchant banker.
- Explain the role of merchant banker as issue manager.
- Describe the responsibilities of merchant banker.
- Identify the regulations governing the merchant banking activity.

Structure

- 8.1 Introduction
- 8.2 Merchant Banking in India
- 8.3 The Capital Market
- 8.4 Issue Management
- 8.5 Role of an Issue Manager
- 8.6 Other Agencies Involved in Issue Management
- 8.7 Monitoring by SEBI
- 8.8 Self-Assessment Questions
- 8.9 Further Readings

8.1 INTRODUCTION

Merchant Banking as defined in the Narasimhan Committee Report means:

"Management and underwriting of new issues, syndication of credit and provision of advisory services to corporate clients on fund raising and other financial aspects."

A Merchant Banker has been defined by Securities and Exchange Board of India (Merchant Bankers) Rules 1992, as "any Person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities or acting as manager, consultant, adviser or rendering corporate advisory services in relation to such issue management".

Services provided by the Merchant Bankers include:

- Management, marketing and underwriting of issues
- Corporate advisory services
- Syndication of credit,
- Project promotion services
- Investment advisory services
- Venture capital
- Financial collaboration
- Lease financing
- Hire Purchase financing
- Portfolio Management
- a Brokerage and market making

**Merchant Banking
and Allied Services**

- Project counselling
- Corporate restructuring and Financial engineering
- Factoring
- Stock-broking
- Custodial services
- Depository services
- Credit rating.

List out the merchant banking services given by your organisation. Find out the fee-based income earned by the bank through these services during the last 3 years.

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8.2 MERCHANT BANKING IN INDIA

Formal Merchant Banking activity in India originated with the setting up of a Merchant Banking division by the Grindlays Bank in 1969. This was later on picked up by other Banks and institutions.

Merchant Banker is required to be registered with SEBI for

- i) Activities related with Capital Issue,
- ii) debenture trusteeship,
- iii) takeover or acquisition of shares, and
- iv) portfolio management.

The merchant banker is an essential intermediary for Issue Management, in the Capital Market. The Merchant Banker may be registered under any one of the under-mentioned categories, as per SEBI Merchant Banking regulations 1992, given below:

Category I: To carry on any activity of the issue management, which will inter-alia consist of preparation of prospectus and other information relating to the issue, determining financial structure, tie-up of financiers and final allotment and refund of the subscriptions of and; to act as adviser, consultant, manager, underwriter portfolio manager.

Category II: to act as adviser, consultant, co-manager, underwriter, portfolio manager.

Category III: to act as underwriter, adviser, and consultant to an issue.

Category IV: to act only as adviser or consultant to an issue.

The capital adequacy requirement prescribed by SEBI for these four categories are as under:

Category	Minimum amount of Capital
Category I	Rs 1 crore
Category II	Rs 50 Lakh
Category III	Rs.20 Lakh
Category IV	Nil

The merchant Bank is required to pay requisite registration fees according to the category, as per regulations in this regard.

Appointment of Lead Merchant Bankers: (Article 19, of SEBI Regulations for MB)

All issues should be managed by at least one merchant banker functioning as the lead merchant banker.

Provided that in an issue of offer of rights to the existing member with or without the right of renunciation the amount of the issue of the body corporate does not exceed rupees fifty lakh, the appointment of a lead merchant banker shall not be essential.

Restriction on appointment of Lead Managers:

The number of lead merchant bankers may not exceed in case of any issue of:

Size of Issue	No of lead Merchant Bankers
a) less than 50 crores	two
b) 50 crore & above up to 100 crore	three
c) 100 crore & above up to 200 crore	four
d) 200 crore & above up to 400 crore	five
e) above Rs 500 crore	five or more as may be agreed by the Board

In relation to the company studied by you in Unit 3, (stock 1), prepare a plan for marketing any of the merchant services at your branch, with details about the risks and remedies there against.

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8.3 THE CAPITAL MARKET

The Financial Market consists of:

- i) Money Market , which involves raising or short term assets and
- ii) Capital Market, which refers to raising of long term financial assets.

The Capital Market is classified as: a) Primary Market and b) Secondary Market.

The Primary Market

This refers to the market of new issues of capital and debt instruments. The Primary Market operations include:

- i) New issues of shares by new and existing companies,
- ii) Rights issues to the existing shareholders,
- iii) Public offers and issue of debt instruments such as bonds, debentures.

The investor offers to invest in to the company directly, through the capital/debt issue mechanism. There is no trading of securities, and hence this market is called as a Primary market. The investor benefits by earning his share of profit through the dividend or rights issue/capital appreciation, and the Company gets the capital at cheaper rate from the general public.

The Institutions involved in the Primary Market

- 1. A regulatory body, (SEBI in India), to ensure fair play and protect interests of all the parties concerned,

2. The Company which desires to raise capital/debt through public issue,
3. The Merchant Banker, the registrar to the issue, the depository
4. The underwriters to the issue,
5. The Investors,
6. The Stock exchange for listing the shares after issue, the brokers and sub brokers.

Secondary Market

The secondary market is where the securities acquired by the investor are traded. The market provides liquidity to various capital market instruments.

The secondary market players are: the investors who are willing to sell or buy the scrip, the speculators who trade for profits only, the stock exchange which routes these transactions of purchase and sell, and the broker/member of the stock exchange, investment adviser and the transfer agent. The regulator body (SEBI in India), takes care of interest of all the parties involved, specially the investors.

The intermediaries involved in the **secondary** market

1. Broker/member of stock exchange-Buyer's broker and seller's broker
2. Investor/stock holder who wants to buy/sell the stock
3. Stock exchange
4. Company concerned which will note the change in ownership of stock
5. Portfolio Manager/Investment Adviser, which are optional from investor's point of view
6. Depository
7. SEBI, as a regulatory body to ensure safety of interest of all the parties.

8.4 ISSUE MANAGEMENT

This activity involve? the management of issues for raising long term funds through various types of instruments by the companies. The management of issue of securities involves the following activities:

- i) capital structure counselling to the company and deciding upon the instrument to be issued
- ii) pricing of the securities, and quotas of various groups such as NRI, promoters, general public etc.
- iii) assessing and appraisal of the project report
- iv) appointment of agencies such as bankers, underwriters, brokers, registrar, advertising agencies, lead managers
- v) meetings of all the concerned parties for finalisation of contracts/publicity
- vi) finalising the schedule of opening of subscription, closing of subscription,
- vii) getting the subscription for the floated instruments
- viii) stock exchange approval for basis of allotment
- ix) actual allotment of shares through Registrar
- x) listing of securities on the stock exchange

Types,of Issues

Companies raise capital or debt through various sources. The decision about a particular source of finance is based on various parameters such as: the capital structure, the cost of capital vis-a-vis cost of borrowing, the instruments to be floated, the ease of operation, the time period for which the funds are needed and market position of demand and supply from the various sources and so on.

The issues may be classified as under:

- i) **Public Issue** : It is the most common method of raising long term assets. The instruments normally offered to the public are shares, and debentures/bonds. Shares can be equity shares, preference shares. Preference shares can be either cumulative, non cumulative, redeemable or non redeemable. Debentures or bonds can be of various types such as: partly convertible, fully convertible, non-convertible, bearer bonds , mortgage bonds etc. The offer to the public is made through the issue of prospectus for a fixed number of shares at a stated price. Any person can apply for the shares. The prospectus is required to disclose all the material and essential factors of the company. Provisions of Companies Act, SEBI guidelines, Income Tax act, Indian Contract Act, are required to be followed strictly in the process of this issue.
- ii) **Rights Issue** : Shares offered to the existing shareholders of a company are called right shares , and the issue is called rights issue. While issuing such shares to the existing shareholders, a time limit within which they have the option of exercising the right is prescribed. After the limit, the directors of the company may dispose off the shares as they think fit.
- iii) **Private Placements** : It is a speedier and cost effective way of raising capital. When a company does not intend to go public through a prospectus and wants to issue securities to the public through a private arrangement then this process is called making a private placement of securities. SEBI has prescribed limits for the minimum number of shares and amount for such private placements, to be made with the individuals and corporates. The role of regulatory authority is limited, as it takes place mostly through bilateral negotiations between the investor and the company. The new companies which are new, and unknown to the public find this method of raising capital quite fast and cost effective.

The procedure and steps for managing public issues' fall under two phases. These phases are completed by the Issue Manager.

- 1) Pre issue management commencing with structuring of issues and up to the opening of subscription list
- 2) Post issue management: starts after opening of subscription list and up to listing of securities on the stock market.

Both these phases are monitored and regulated by SEBI through regulations.

Activity 3

Has your bank been involved with issue management?

In respect of the issue management services offered by your bank, or any other bank that you are familiar with, prepare a note on the basis of the last issue made on

I. Promotion of the issue

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2. Pricing aspect of the issue

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1. Processes involved in creating orders of the investor to the application form

8.5 ROLE OF AN ISSUE MANAGER

The merchant banker required to play this role is bound by many legal provisions and ethical issues. Comprehensive guidelines are given in various acts, such as the SEBI Merchant Bankers Rules, SEBI Merchant Bankers Regulations, SEBI Bankers to an Issue Rules, SEBI Underwriters Rules. All these acts are enclosed as Annexures to this unit.

SEBI Guidelines for issue managers

1. All issues should be managed by at least one merchant banker functioning as the lead manager. (Art18)
2. Merchant Banker must be registered with the SEBI.
3. Number of lead merchant bankers may not exceed in case of any issue of

Size of issue(Rupees)	No of lead mangers to issue
a) less than 50 crore	two
b) above 50 crore but less than 100 crore	three
c) above 100 crore but less than 200 crore	four
d) above 200 crore but less than 400 crore	five
e) above 400 crore	five or more as may be agreed by the board

Public Issue Management

Pre-Issue Activities

1. **Memorandum of understanding** : In terms of SEBI regulation (18-2), every merchant banker acting as lead manger, should enter into a Memorandum of Understanding with the company, before taking up the issue management. This MOU sets out authorities and responsibilities between all the concerned parties, including the other lead managers to the issue.
2. **Prepare and Submit the offer document to SEBI** : The lead manager drafts the offer document i.e. the prospectus, in the prescribed format, as per extant rules, and submits the same to SEBI, along with the due diligence certificate, and other documents namely: 1) undertaking from CEO of the Company to attend to compliances. 2) undertaking from the company secretary to get the issue listed within the stipulated time, 3) undertaking by the issuer that funds will be made available to the registrar for refund activities, 4) certificate of promoters contribution, and other such certificates as prescribed by the SEBI.
3. **Filing with RoC** : After incorporating the SEBI observations in the prospectus the complete document is filed with Registrar of Companies and acknowledgement is obtained.
4. **Appointment of other intermediaries** : The lead manager appoints the Bankers to the issue, underwriters, legal advisers, advertising agency and Registrar to the issue in consultation with the issuers, and enters in to MOU wherever necessary.
5. **Dispatch of Issue Material** : The dispatch of issue material to the stock exchanges, brokers, underwriters, bankers to the issue, well in advance.

6. **Underwriting obligations** : The lead manager is required to accept a minimum underwriting obligation of 5% of the total underwriting commitment or Rs 25 Lakh whichever is less.
7. **Publicity of the Issue** : In order to **ensure** the full subscription of the issue, the lead manager ensures adequate publicity through advertisements in media, through the advertising agencies .
8. **Opening of the Issue** : After due publicity through the media, 10 days before the opening date of the issue, newspaper advertisement is given, and the issue opens for subscription from the day declared in the prospectus. Applications for subscription along with the payment instrument are received at the collecting centers. The collection figures are obtained on daily basis and filed with SEBI in 3 days reports, > Announcement is also made in newspapers about the closure of the issue.

Post Issue Activities

After the closure of the issue, the Lead manager has to manage the Post Issue activities pertaining to the Issue.

1. **Post issue monitoring reports** : Whether an issue is subscribed fully or not, the Lead manager is required to submit various reports to SEBI. Within 7 days from the date of closure of the issue, lead manager shall inform to SEBI the exact position of the subscription. Certificate of 90% subscription from Registrar as well as final collection certificate from bankers are obtained and submitted to SEBI.
2. **Liaison with all agencies** : The lead manager keeps close liaison with all the intermediaries till all the formalities about the issue are completed. In case of under subscription, the invocation of underwriting is done, if within the limit. **Else** if the issue is not subscribed to the extent of 90% then refund of subscription is required to be completed.
3. **Stock exchange** : Inform the stock **exchange** about the closure of subscription list and advertise the closure of **issue**.
4. **Allotment of shares** : The registrar to the issue completes the **formalities** of allotment of shares on the basis of guidelines issued by SEBI. In **case** of over subscription, the allotment is done on the basis of applications received for total number of shares, and marketable lots, after approval to the basis of allotment, by Stock exchanges as per SEBI guidelines.
5. **Publicity to schedules of allotment/refund** : Publicity, to be given to the schedule of refund or allotment as the, **case may be**, is given in two dailies.
6. **Issue of share certificates/refund orders** : **Companies/Registrars** are required to **finalise** the basis of allotment and dispatch of refund orders within 30 days from the closure of the issue failing which the company is required to pay interest at the rate of 15% per annum from the 31st day of closure of issue.
7. **Listing formalities** : The Lead manager, completes the formalities for listing of the shares on the stock exchanges.
8. **Commission and fees payment** : Ensure that the **commission/fees** are paid the company to all the intermediaries.
9. **RBI Approval for NRI** : Obtain **permission** from RBI for allotment of securities to NRIs.
10. **Investor's grievances** : The lead manager is also required to handle the grievances of the investors .

Rights Issue

For rights issue the lead manager should submit the draft of the letter of offer to SEBI, **six** weeks before the issue is scheduled to **open** for subscription. Any suggestions **would** be received within 3 weeks from SEBI should be incorporated within the **draft** before filing the letter of offer. The copy of **final** letter of offer should be **sent** to SEBI **2** weeks before the opening **date** of issue. The issue should be offered to the **existing** share-holders. The **allotment** formalities for offers **received** from the right holders should be completed.

With respect to the Issue Management process studied by you for activity 3, list out the pre and post issue activities that were undertaken by the bank.

8.6 OTHER AGENCIES INVOLVED IN ISSUE MANAGEMENT

Besides the Merchant Banker who acts as the Lead Manager, the other agencies involved in the issue management are:

1. The Company which floats the issue
2. The Registrar to the Issue, who is so licensed by SEBI
3. The Legal Advisors to the issue
4. The Company Secretary
5. The Chartered accountants, for finalising the volume of issue
6. The Advertisers
7. The collecting bankers to the issue
8. The stock exchange where the issue is expected to be listed
9. The Stock exchange agents
10. Securities and exchange board of India

Bankers to the Issue

This is one of the important intermediaries in management of an Issue. Banks are involved in all the activities starting with the collection of application forms for securities, till the final refund in case of non-allotment. SEBI Bankers to an issue Rules, 1994 and Bankers to an issue Regulations 1994, are applicable to the banks. The various responsibilities entrusted to the bankers in the capital market are as under:

- a) **Controlling bank** : to control all the activities connected with issue, and control the branches designated for the issue work. Various functions of this bank are as under:
 - 1) To Issue consent letter to act as controlling bank to the Issuing company
 - 2) To finalise the branches which will act as collecting branches
 - 3) Follow the instructions from the lead managers, registrar and company of Issue
 - 4) Maintain account of the Issue, and submit reports as per requirements to the company/registrar/lead manager
 - 5) Ensure receipt of stationery at the collecting centers
 - 6) Ensure appropriate communication about the opening and closing of subscriptions of issue
 - 7) Receive daily collections and report the same to the lead manager
 - 8) Ensure proper functioning of role of the collecting branches
 - 9) Remove irregularities in the collection by the collecting branches

b) **Collecting bankers to the issue** : As a collecting banker, the branch of the bank is required to undertake the following functions:

- 1) Follow the instructions received from the Registrar and the main branch
- 2) Ensure receipt of stationery for issue procedure, and give adequate publicity to the issue
- 3) Ensure that the bank and branch name is branded under the name of broker/underwriters to the issue
- 4) Accept subscriptions as per applications from investors, and issue acknowledgement slips
- 5) Lodge the instruments and collect the same for credit to the special account opened in the name of the company for this purpose, remit the balance to the controlling branch, as per instructions
- 6) In case of return of cheques, return the applications with instruments to the applicant, at his address
- 7) Send reports about collection in the appropriate stationery/format
- 8) Forward the applications, along with reporting schedules, and final certificate to the Registrar to the issue
- 9) Claim the fees/out of pocket expenses from the controlling branch.

c) **Refund bankers to the issue** : for refund on account of non allotment

d) **Investor's bank** : working tither as portfolio manager, adviser, or his banker holding account of the investor,

e) **Bankers of the issuing company** : Holding bank account of the Company, on which dividend warrants, interest warrants may be drawn, or /and may be acting in any other capacity as Merchant Banker.

8.7 MONITORING BY SEBP

The work of the Merchant Banker in issue management is monitored by SEBY through the system of penalty points for non-observance or violation of the guidelines. Lapses up to a maximum of 4 penalty points per issue may be condoned by SEBI. These penalty points are of four types as under:

Type I	General Default	1 point penalty
Type II	Minor default	2 point penalty
Type III	Major default	3 point penalty
Type IV	Serious default	4 point penalty

Merchant Banker getting accumulated penalty points beyond 8 are liable for suitable punitive action by SEBI.

8.8 SELF-ASSESSMENT QUESTIONS

1. Define Merchant Banking.
2. Discuss the nature and scope of Merchant Banking functions.
3. State whether True or False:
 - a) A merchant banker registered with SEBI under Category II, is empowered more varieties of services than those under Category I merchant banker.
 - b) Category III merchant banker should have minimum capital of Rs 1 crore.
 - c) For the Capital issue of Rs 45 Lakhs, minimum number of lead merchant bankers is 2.
 - d) In primary capital market, shares are sold at market value.

- e) A partnership firm can raise a public issue of shares for Rs 25 Lakh.
- f) Minimum of 10 penalty points should be accumulated by a merchant banker, for a punitive action by SEBI.
- g) Dow Jones index is the index of shares prices traded on Mumbai Stock Exchange.

8.9 FURTHER READINGS

1. Securities and Exchange Board of India Merchant Banking Rules(updated).
2. Securities and Exchange Board of India Merchant Baking Regulations (updated).
3. Securities and Exchange Board of India Stock Brokers and Sub brokers Rules.
4. Securities and Exchange Board of India Stock Brokers and Sub brokers Regulations.
5. Securities and Exchange Board of India Underwriters Regulations.
6. Securities and Exchange Board of India Registrars to an issue and share transfer agents regulations.
7. Securities and Exchange Board of India Bankers to an issue regulations.
8. Government of India, Report of the Banking Commission.
9. Government of India, Ministry of Finance, guidelines for Merchant Bankers.
10. Inside Investment Banking, by Ernest Bloch, 1986.
11. What is a Merchant Banker, by Hans-Peter Bauer, The Banker, London.

UNIT 9 STOCK BROKING SERVICES

Objective

After reading this unit you should be able to:

- Describe the basics of the Stock Exchange and its functions.
- Comment upon role of the stock broker.
- Discuss duties and responsibilities of the broker/sub broker.
- Explain the code of conduct of the broker.
- Describe duties of the investor.

Structure

- 9.1 Introduction
- 9.2 Stock Exchange and Its Functions
- 9.3 Membership of the Stock Exchange (Stock Broker)
- 9.4 Role of the Member (Stock Broker)
- 9.5 Code of Conduct for the Brokers
- 9.6 The Duties of the Investor
- 9.7 Trading Procedure at the Stock Exchange
- 9.8 Related Institutions and Terminology
- 9.9 Summary
- 9.10 Self-Assessment Questions
- 9.11 Further Readings

9.1 INTRODUCTION

The working of the capital market is very technical, and highly sensitive, and hence requires an expert knowledge of the rules and regulations. The stockbroker acts as an important intermediary between the investor, the company, and the stock exchange. The stock-broker is a member of a recognised stock exchange and is engaged in buying, selling, and dealing in various capital market securities. He has to observe the discipline on maintaining adequate capital, registration with SEBI, payment of fees, maintenance of books and records for the investors, and ensure fair play in the dealings. He may or may not appoint a sub broker. A sub broker is also required to be registered with SEBI. The sub-broker cannot enter into direct dealing with stock exchange or other market players. He has to route his transactions through the broker only.

SEBI Stock Brokers Rules and SEBI Stock Brokers Regulations are important enactments, which protect the interests of the investor, the company and the stock exchange. *The Stock-broker or sub-broker who has to be the member of a Stock exchange* has to play his role within the frame work of these enactments,

9.2 STOCK EXCHANGE AND ITS FUNCTIONS

What is a stock market?

A stock market refers to the organised market, where securities are traded. It consists of investors, brokers or members of the stock exchange, stock exchange, companies, and regulatory authority. The securities traded on the stock exchange include various long term financial instruments, raised by the companies for meeting their financial requirements.