SRINIVASAN ENGINEERING COLLEGE, PERAMBALUR

DEPARTMENT OF MANAGEMENT STUDIES

BA9258-MERCHANT BANKING AND FINANCIAL SERVICES

TWO MARKS QUESTIONS AND ANSWERS

UNIT-(I-V)

1.What is merchant banking?

A bank that deals mostly in (but is not limited to) international finance, long-term loans for companies and underwriting. Merchant banks do not provide regular banking services to the general public.

2.What is OTCEI?

'Over-The-Counter Exchange of India an electronic stock exchange based in India that is comprised of small- and medium-sized firms looking to gain access to the capital markets. Like electronic exchanges in the U.S. such as the Nasdaq, there is no central place of exchange and all trading is done through electronic networks

3. What do you mean by private placement?

The sale of securities directly to an institutional investor, such as a bank, mutual fund, insurance company, pension fund, or foundation. Does not require SEC registration, provided the securities are bought for investment purposes rather than resale, as specified in the investment letter.

4. How is forfeiting different from export factoring?

Forfeiting and factoring are services in international market given to an exporter or seller. Its main objective is to provide smooth cash flow to the sellers. The basic difference between the forfeiting and factoring is that forfeiting is a long term receivables (over 90 days up to 5 years) while factoring is short termed receivables (within 90 days) and is more related to receivables against commodity sales.

5. Define green shoe

A provision contained in an underwriting agreement that gives the underwriter the right to sell investors more shares than originally planned by the issuer. This would normally be done if the demand for a security issue proves higher than expected. Legally referred to as an over-allotment option. A green shoe option can provide additional price stability to a security issue because the underwriter has the ability to increase supply and smooth out price fluctuations if demand surges

6. What is book building?

The process of determining the price at which an Initial Public Offering will be offered. The book is filled with the prices that investors indicate they are willing to pay per share, and when the book is closed, the issue price is determined by an underwriter by analyzing these values.

7.Who is an issue manager?

The issue can be through offer of sale or private placements, prospectus, and so on. The issue management includes the following functions with respect to issue through prospectus:

- To obtain approval for the issue from the SEBI.
- To arrange underwriting for the proposed issue.
- To draft and finalise the prospectus and to obtain clearance from the stock exchange, auditors, underwriters and registrar of companies.
- To select registrar of the issue, advertising agencies, underwriters, bankers and brokers to the issue and finalise the charges to be paid to the registrar.
- To arrange press conferences, and investors and brokers through advertising agency.

8.What do you know about the IPO method of marketing securities?

IPO (Initial Public Offer) is a type of public issue of securities where an unlisted company makes a fresh issue of securities or an offer for sale of its existing securities for the first time to the public.

9. Define underwriting.

A significant intermediary in issue market is the underwriters to issue of capital who take up securities which are not fully subscribed. Underwriter is a person who agrees to take up shares specified in the underwriting agreement of the public, who fails to subscribe them. SEBI has allowed merchant bankers and registered underwriters to act as underwriters. To act as underwriter, a certificate of registration must be obtained from SEBI. The underwriter makes profit on the difference between the public offering price and the price paid to the issuer; and that is called the underwriting spread or price spread. Underwriters are appointed by the issuing companies after consulting with the merchant bankers to the issues

10. Write short note on bankers to an issue.

The bankers to an issue engage in activities such as acceptance of applications along with the application money from the investors with respect to issues of capital and refund application of money. Bankers to an issue accept applications with the subscriptions offered at their designated branches and forward them to the registrar in agreement with instructions issued to them. They undertake publicity to the issue by distributing publicity material, prospectus and application forms. They are entitled for brokerage on shares allocated against applications bearing their stamps. In case of large issues, sufficient numbers of banks with branches at major centres are appointed. According to SEBI regulations, registration of bankers to issues with SEBI is compulsory. Under the regulations, inspection of bankers to an issue is done by Reserve Bank on request from SEBI.

11.Write short note on brokers to an issue.

Brokers are mainly concerned about obtaining the subscription to the issue from the prospective investors. The appointment of brokers is not compulsory. Members of established stock exchange are appointed as brokers to issue. Companies are permitted to appoint any number of brokers. The official brokers together with the managers to the issue coordinate the preliminary distribution of securities and acquire direct subscription from many investors. The stock exchange laws prohibit the members from acting as brokers to the issue. The stock exchange grants permission to the members if the members give their approval and the company conforms to the requirements and undertakes to have its securities listed on a recognized stock exchange. The company appoints the broker to the issue at every centre where stock exchanges are located.

12.Securities underwriting

Securities underwriting refers to the process by which investment banks raise investment capital from investors on behalf of corporations and governments that are issuing securities (both equity and debt capital).

This is a way of selling a newly issued security, such as stocks or bonds, to investors. A syndicates of bank (the lead managers) underwrite the transaction, which means they have taken on the risk of distributing the securities. Should they not be able to find enough investors, they will have to hold some securities themselves. Underwriters make their income from the price difference (the "underwriting spread") between the price they pay the issuer and what they collect from investors or from broker-dealers who buy portions of the offering.

13.Risk, exclusivity, and reward

Once the underwriting agreement is struck, the underwriter bears the risk of being unable to sell the underlying securities, and the cost of holding them on its books until such time in the future that they may be favorably sold.

If the instrument is desirable, the underwriter and the securities issuer may choose to enter into an exclusivity agreement. In exchange for a higher price paid upfront to the issuer, or other favorable terms, the issuer may agree to make the underwriter the exclusive agent for the initial sale of the securities instrument. That is, even though third-party buyers might approach the issuer directly to buy, the issuer agrees to sell exclusively through the underwriter.

14.Bank underwriting

In banking, underwriting is the detailed credit analysis preceding the granting of a loan, based on credit information furnished by the borrower, such as employment history, salary and financial statements; publicly available information, such as the borrower's credit history, which is detailed in a credit report; and the lender's evaluation of the borrower's credit needs and ability to pay. Examples include mortgage underwriting.

Underwriting can also refer to the purchase of corporate bonds, commercial paper, government securities, municipal general-obligation bonds by a commercial bank or dealer bank for its own account or for resale to investors. Bank underwriting of corporate securities is carried out through separate holding-company affiliates, called securities affiliates or Section 20 affiliates.

15.Insurance underwriting

Insurance underwriters evaluate the risk and exposures of potential clients. They decide how much coverage the client should receive, how much they should pay for it, or whether even to accept the risk and insure them. Underwriting involves measuring risk exposure and determining the premium that needs to be charged to insure that risk. The function of the underwriter is to protect the company's book of business from risks that they feel will make a loss and issue insurance policies at a premium that is commensurate with the exposure presented by a risk.

16.Real estate underwriting

In evaluation of a real estate loan, in addition to assessing the borrower, the property itself is scrutinized. Underwriters use the debt service coverage ratio to figure out whether the property is capable of redeeming its own value or not.

17.Forensic underwriting

Forensic underwriting is the "after-the-fact" process used by lenders to determine what went wrong with a mortgage. Forensic underwriting refers to a borrower's ability to work out a modification scenario with their current lien holder, not to qualify them for a new loan or a refinance. This is typically done by an underwriter staffed with a team of people who are experienced in every aspect of the real estate field.

18.Sponsorship underwriting

Underwriting may also refer to financial sponsorship of a venture, and is also used as a term within public broadcasting (both public television and radio) to describe funding given by a company or organization for the operations of the service, in exchange for a mention of their product or service within the station's programming.

19.Definition of Forfeiting

The terms forfeiting is originated from a old French word 'forfait', which means to surrender ones right on something to someone else. In international trade, forfeiting may be defined as the purchasing of an exporter's receivables at a discount price by paying cash. By buying these receivables, the forfeiter frees the exporter from credit and the risk of not receiving the payment from the importer.

20.Forfeiting

The forfeiting typically involves the following cost elements:

1. Commitment fee, payable by the exporter to the forfeiter 'for latter's' commitment to execute a specific forfeiting transaction at a firm discount rate with in a specified time.
2. Discount fee, interest payable by the exporter for the entire period of credit involved and deducted by the forfaiter from the amount paid to the exporter against the availised promissory notes or bills of exchange.

21.Definition of Factoring

Definition of factoring is very simple and can be defined as the conversion of credit sales into cash. Here, a financial institution which is usually a bank buys the accounts receivable of a company usually a client and then pays up to 80% of the amount immediately on agreement. The remaining amount is paid to the client when the customer pays the debt. Examples includes factoring against goods purchased, factoring against medical insurance, factoring for construction services etc.

22. Disclosed Factoring

In disclosed factoring, client's customers are aware of the factoring agreement.
Disclosed factoring is of two types:

Recourse factoring: The client collects the money from the customer but in case customer don't pay the amount on maturity then the client is responsible to pay the amount to the factor. It is offered at a low rate of interest and is in very common use.
Nonrecourse factoring: In nonrecourse factoring, factor undertakes to collect the debts from the customer. Balance amount is paid to client at the end of the credit period or when the customer pays the factor whichever comes first. The advantage of nonrecourse factoring is that continuous factoring will eliminate the need for credit and collection departments in the organization.

23· Issue management – A major function of merchant banking is issue management. The issue can be through offer of sale or private placements, prospectus, and so on. The issue management includes the following functions with respect to issue through prospectus:

- To obtain approval for the issue from the SEBI.

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·24. Pre-investment studies of investors – The merchant bankers undertake the practicality surveys in selected areas of client's interest. It also includes the studies for foreign organisations which are planning for joint ventures in India. The survey covers the advice on the nature of participation and Government regulations. Pre-investment study covers the study of the project and includes the following aspects:

- Developing or reviewing of project profile.

- Preparing project reports after analysing financial, market and economic feasibility.

25· Corporate counselling – Corporate counselling refers to the activities undertaken to ensure effective running of a corporate enterprise through efficient management of finance. A merchant banker guides the clients on organisational goals, choice of product and market survey, forecasting a product, cost analysis, investment decisions, pricing methods, capital management and expenditure control, market strategy and so on. Corporate counselling is a facility provided by merchant bankers to corporate enterprises free of charge. This is to improve the performance of the enterprise. Merchant bankers also provide services such as building a good image among the investors which help in increasing the market value of investor's equity shares.

26· Project counselling – Project counselling is a part of corporate counselling which is related to project finance. A merchant banker provides the clients project counselling that involves providing advice on procedural aspects of project implementation, conducting financial study of the project, providing assistance in project profiles, providing assistance in seeking approvals from Government of India for foreign technical and financial collaboration agreements.

27· **Loan syndication** – A merchant banker helps the clients to get loan for the project. They also help in conducting appraisal and designing capital structure.

28· **Portfolio management -** Portfolio management refers to making decisions related to investment of cash resources of a corporate enterprise in marketable securities by deciding the type of security to be purchased. A merchant banker helps the clients in making the right choice of investment to obtain optimum investment, undertaking investment in securities conducting critical evaluation of investment portfolio, and so on.

29· Project finance – A merchant banker who undertakes a project scheme also assists in arranging a comprehensive package for the project funding. The process involves the study of the pattern of financing available from merchant banks and financial institutions. The merchant bankers work closely with the client and the technical consultant and submit a complete financial report to the client. They also provide assistance in legal documentation for the finance arranged.

30· Working capital – Merchant bankers assist in arranging finance for working capital particularly for new ventures. For existing firms, the merchant bankers arrange the funds from non-traditional sources such as through issue of debentures, and so on. For example, Central

Bank of India (CBI) has started working capital finance as one of the merchant banking service area.

3**1· Managerial and technical services** – Merchant bankers provide services to deal with problems in technical, financial and managerial fields

32.Bankers to an issue

The bankers to an issue engage in activities such as acceptance of applications along with the application money from the investors with respect to issues of capital and refund application of money. Bankers to an issue accept applications with the subscriptions offered at their designated branches and forward them to the registrar in agreement with instructions issued to them. They undertake publicity to the issue by distributing publicity material, prospectus and application forms. They are entitled for brokerage on shares allocated against applications bearing their stamps. In case of large issues, sufficient numbers of banks with branches at major centres are appointed. According to SEBI regulations, registration of bankers to issues with SEBI is compulsory. Under the regulations, inspection of bankers to an issue is done by Reserve Bank on request from SEBI.

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34.Debenture trustees

Debenture trustee is the trustee of debenture stock. A debenture stock is issued as loan security to secure debts of the company. It is necessary to get a certificate of registration from the SEBI to act as a debenture trustee. The debenture trustee holds a secured property on behalf of the issuer of security. The trustee has the right to carry on with the sale of secured property in case of default by the issuer of security, according to the procedure in the Transfer of Property Act. The profits of sales will be applied to redeem the debentures. The appointment of debenture trustee is mandatory. A company appoints debenture trustees when there is a need for executing a trust deed. This occurs when the company wants to issue a prospectus or letter of offer to the public for securing subscription to its debentures. A debenture trustee is an intermediary between the issuer of debentures and the holder of debentures. The main responsibility of the debenture trustee is to safeguard the interest of holders of debentures. This includes creation of security by the company issuing the debenture and to compensate their grievances.

35. Portfolio managers

Portfolio manager is a person responsible for investing a mutual, exchange-traded fund asset and also responsible for implementing investment strategy and managing the day-to-day portfolio trading. The portfolio manager is an important factor that needs to be considered regarding fund investing. He undertakes the management and administration of portfolio of securities and funds of clients on their behalf. Portfolio management is the art of making decisions about investments and policy, allocating assets for individuals and balancing risk against performance. Portfolio management can be classified into two types-

36· Discretionary portfolio management – It permits the use of discretion regarding investment and management of the portfolio of the securities and funds. In this type of management the manager independently manages the capital of each client.

37.· Non-discretionary portfolio management – In this type of management the manager manages funds according to the directions of the client.

It is mandatory to obtain a certificate from SEBI in order to carry on portfolio management services.

38.BSE's Book Building System

- BSE offers a book building platform through the Book Building software that runs on the BSE Private network.
- This system is one of the largest electronic book building networks in the world, spanning over 350 Indian cities through over 7000 Trader Work Stations via leased lines, VSATs and Campus LANS.
- The software is operated by book-runners of the issue and by the syndicate members , for electronically placing the bids on line real-time for the entire bidding period.
- In order to provide transparency, the system provides visual graphs displaying price v/s quantity on the BSE website as well as all BSE terminals.

39.IPO Process Explained

We all know what an IPO is and what the purpose of an IPO is for the company issuing the share. But, not many of us know the different requirements that a company must satisfy in order to go public and the different stages in the life cycle of an IPO. The purpose of this article is to elaborate on this. So, lets get started.

40.What is an IPO

An IPO stands for Initial Public Offering, wherein a company issues its shares to the public for the first time. Investors can place requests to buy these shares and once done, the share gets listed in a registerd stock exchange and the company uses the share issue proceeds for its development/growth. Before we take a look at the steps in an IPO process, lets take a look at the entry norms for an IPO.

41.Entry Norms for an IPO:

Not all company's can issue shares to the public. SEBI has provided a list of requirements that need to be met by a company if they wish to go public. A company that wishes to go public needs to meet all of the below mentioned criteria…

Entry Norms I or EN I:
1. Net Tangible assets of atleast Rs. 3 crores for 3 full years
2. Distributable profits in atleast 3 years
3. Net worth of atleast 1 crore in 3 years
4. If there was a change in name, atleast 50% of the revenue in the preceeding year should be from the new activity
5. The issue size should not exceed 5 times the pre-issue networth of the company

42.types of lease agreements

Lease agreements are basically of two types. They are (a) Financial lease and

(b)Operating lease.

(c) Sale and lease back

(d) Leveraged leasing and

(e) Direct leasing.

43. Financial Lease

Long-term, non-cancellable lease contracts are known as financial leases. The essential point of financial lease agreement is that it contains a condition whereby the lessor agrees to transfer the title for the asset at the end of the lease period at a nominal cost. At lease it must give an option to the lessee to purchase the asset he has used at the expiry of the lease. Under this lease the lessor recovers 90% of the fair value of the asset as lease rentals and the lease period is 75% of the economic life of the asset. The lease agreement is irrevocable. Practically all the risks incidental to the asset ownership and all the benefits arising there from are transferred to the lessee who bears the cost of maintenance, insurance and repairs. Only title deeds remain with the lessor. Financial lease is also known as 'capital lease'. In India, financial leases are very popular with high-cost and high technology equipment.

44.Operatiional Lease

An operating lease stands in contrast to the financial lease in almost all aspects. This lease agreement gives to the lessee only a limited right to use the asset. The lessor is responsible for the upkeep and maintenance of the asset. The lessee is not given any uplift to purchase the asset at the end of the lease period. Normally the lease is for a short period and even otherwise is revocable at a short notice. Mines, Computers hardware, trucks and automobiles are found suitable for operating lease because the rate of obsolescence is very high in this kind of assets.

45.Sale And Lease Back

It is a sub-part of finance lease. Under this, the owner of an asset sells the asset to a party (the buyer), who in turn leases back the same asset to the owner in consideration of lease rentals. However, under this arrangement, the assets are not physically exchanged but it all happens in records only. This is nothing but a paper transaction. Sale and lease back transaction is suitable for those assets, which are not subjected depreciation but appreciation, say land. The advantage of this method is that the lessee can satisfy himself completely regarding the quality of the asset and after possession of the asset convert the sale into a lease arrangement.

46.Leveraged Leasing

Under leveraged leasing arrangement, a third party is involved beside lessor and lessee. The lessor borrows a part of the purchase cost (say 80%) of the asset from the third party i.e., lender and the asset so purchased is held as security against the loan. The lender is paid off from the lease rentals directly by the lessee and the surplus after meeting the claims of the lender goes to the lessor. The lessor, the owner of the asset is entitled to depreciation allowance associated with the asset.

47. Direct Leasing

Under direct leasing, a firm acquires the right to use an asset from the manufacturer directly. The ownership of the asset leased out remains with the manufacturer itself. The major types of direct lessor include manufacturers, finance companies, independent lease companies, special purpose leasing companies etc

48.Finance Leasing

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lease when lessee granted right to use leased asset, over a

whole period of useful life of the asset.

49.Hire purchase (abbreviated HP, colloquially sometimes never-never[1]) is the legal term for a contract, in which persons usually agree to pay for goods in parts or a percentage at a time. It was developed in the United Kingdom and can now be found in Australia, China, India, Jamaica, Japan, Malaysia, New Zealand, and South Africa. It is also called closed-end leasing. In cases where a buyer cannot afford to pay the asked price for an item of property as a lump sum but can afford to pay a percentage as a deposit, a hire-purchase contract allows the buyer to hire the goods for a monthly rent. When a sum equal to the original full price plus interest has been paid in equal installments, the buyer may then exercise an option to buy the goods at a predetermined price (usually a nominal sum) or return the goods to the owner. In Canada and the United States, a hire purchase is termed an installment plan; other analogous practices are described as closed-end leasing or rent to own.