UNIT IV
FINANCIAL SERVICES

1. What are financial services? Write its features.

Ans. Financial services refer to economic services provided by various financial institutions that deal with money management. It is an intangible product of financial markets like a loan, insurance, stocks, credit card, etc. Financial services are products of institutions such as banking firms, insurance companies, investment funds, credit unions, brokerage firms and consumer finance companies

Features of Financial Services:

(i)Customer-Specific: Financial services are customer based. These services are designed and provided to the customers by financial institutions as per their needs. Various elements like cost, liquidity and maturity periods of these services are decided in accordance with the suitability of customers.

(ii) Intangibility: These services are intangible in nature. Financial institutions for selling their intangible product need to enhance their brand image by improving their service quality.

(iii)Concomitant: Financial services are manufactured and delivered simultaneously and cannot be separated. These both functions i.e. production and supply goes at the same time.

(iv)Perishable: These services are perishable in nature and cannot be store in advance of their need. Financial services are produced and supplied as and when required by peoples.

(v)Dynamic Activity: Financial services are dynamic in nature. It changes in accordance with the varying needs of customers and the socio-economic environment.

2. What is the Financial Services Sector? Give an overview of financial service sector/industry.

Ans. The financial services sector provides financial services to people and corporations. This segment of the economy is made up of a variety of financial firms including banks, investment houses, lenders, finance companies, real estate brokers, and insurance companies. The financial services industry is probably the most important sector of the economy, leading the world in terms of earnings and equity market capitalization. Large conglomerates dominate this sector, but it also includes a diverse range of smaller companies.

According to the finance and development department of the International Monetary Fund (IMF), financial services are the processes by which consumers or businesses acquire financial goods.

An overview of financial service sector/industry

Financial services form the lifeblood of economic growth and development. They facilitate the setting up of big and small businesses and the expansion of businesses. Employment and entrepreneurship created with the help of the services enable people to earn and save.

The financial services industry manages money for individuals and corporations. It comprises such organisations as commercial and investment banks, insurance companies, hedge funds, credit-card companies, consumer finance firms, accounting agencies, and brokerage firms. The industry's services are mainly related to banking and insurance services, asset management, investments, foreign exchange, and accounting. These are discussed below:

(i) Banking Services: The banking industry is the foundation of the financial services group. It is most concerned with direct saving and lending, while the financial services sector incorporates investments, insurance, the redistribution of risk, and other financial activities. Banking services are provided by large commercial banks, community banks, credit unions, and other entities.

Banking is made up of several segments—retail banking, commercial banking, and investment banking.

(a)Retail banking also known as consumer or personal banking, it serves consumers rather than corporations. These banks offer financial services tailored to individuals including checking and savings accounts, mortgages, loans, and credit cards, as well as certain investment services.

(b)Corporate, commercial, or business banking, on the other hand, deals with small businesses and large corporations. Like retail banking, it provides account services and credit products that are tailored to the specific needs of businesses.

(c)An investment bank typically only works with deal makers and high-net-worth individuals (HNWIs)—not the general public. These banks underwrite deals, secure access to capital markets, offer wealth management and tax advice, advise companies on mergers and acquisitions (M&A), and facilitate the buying and selling of stocks and bonds. Financial advisors and discount brokerages also occupy this niche.

(iii)Investment Services: Individuals may access financial markets like stocks and bonds through investment services.
(a)Brokers—either human or self-directed online services—facilitate the buying and selling of securities, taking a commission for their efforts.

(b)Financial advisors may charge an annual fee based on assets under management (AUM) and direct several trades in the pursuit of constructing and managing a well-diversified portfolio.

(c) Robo-advisors are the latest incarnation of financial advice and portfolio management, with fully-automated algorithmic portfolio allocations and trade executions.

(d)Hedge funds, mutual funds, and investment partnerships invest money in the financial markets and collect management fees in the process. These organizations require custody services for trading and servicing their portfolios, as well as legal, compliance, and marketing advice. There are also software vendors that cater to the investment fund community by developing software applications for portfolio management, client reporting, and other back-office services.

(e)Private equity funds, venture capital providers, and angel investors supply investment capital to companies in exchange for ownership stakes or profit participation. Venture capital was especially important to technology firms in the 1990s. Much of what goes on behind the scenes in the making of big deals is attributed to this group.

(iii)Insurance Services: Insurance is another important subsector of the financial services industry. Insurance services are available for protection against death or injury (e.g. life insurance, disability income insurance, health insurance), against property loss or damage (e.g. homeowners insurance, car insurance), or against liability or lawsuit.

(a)Insurance brokerage - Insurance brokers shop for insurance (generally corporate property and casualty insurance) on behalf of customers. Recently several websites have been created to give consumers basic price comparisons for services such as insurance, causing controversy within the industry.

(b)Insurance underwriting - Personal lines insurance underwriters actually underwrite insurance for individuals, a service still offered primarily through agents, insurance brokers, and stock brokers. Underwriters may also offer similar commercial lines of coverage for businesses. Activities include insurance and annuities, life insurance, retirement insurance, health insurance, and property insurance and casualty insurance.

(c)Finance and insurance - a service still offered primarily at asset dealerships. The F&I manager encompasses the financing and insuring of the asset which is sold by the dealer. F&I is often called "the second gross" in dealerships that have adopted the model

(d)Reinsurance - Reinsurance is insurance sold to insurers themselves, to protect them from catastrophic losses.

(iv)Tax and Accounting Services: The sector also includes accountants and tax filing services, currency exchange and wire transfer services, and credit card machine services and networks. It also includes debt resolution services and global payment providers such as Visa and MasterCard, as well as exchanges that facilitate stock, derivatives, and commodity trades.

Accountants ensure all financial records and statements—the balance sheet, income and loss statement, cash-flow statement, and tax return—are in line with federal laws and regulations and generally accepted accounting principles (GAAP).

Accountants also compile the information needed to prepare entries to company accounts such as the general ledger, and they document business financial transactions over time.

Accountants are often assigned other finance-related tasks in addition to analyzing financial records and statements. Ancillary job duties include monitoring the efficiency of accounting control procedures or software programs to ensure they are up to date with federal and state regulations.

In addition to these duties, accountants prepare and file taxes for companies and individuals. They analyze all company assets, income earned and paid, or anticipated expenses and liabilities to reach a total tax obligation for the year. With both company and individual tax preparation and filing, accountants are expected to provide a detailed analysis of tax efficiency or inefficiency and make recommendations on how to reduce total tax liabilities in the future.

3. What is Merchant Banking? Explain its functions.

Ans. Merchant banking is a combination of Banking and Consultancy Services. It provides consultancy to its clients for financial, marketing, managerial and legal matters. Consultancy means to provide advice, guidance and service for a fee. It helps a businessman to start a business. It helps to raise (collect) finance. It helps to expand and modernize the business. It helps in restructuring of a business. It helps to revive sick business units. It also helps companies to register, buy and sell shares at the stock exchange.

In simple words, Merchant banking can be defined as a skill-oriented professional service provided by merchant banks to their clients, concerning their financial needs, for adequate consideration, in the form of fee.

Functions of Merchant Banking: The important functions of merchant banking are given below

(i)Raising Finance for Clients: Merchant Banking helps its clients to raise finance through issue of shares, debentures, bank loans, etc. It helps its clients to raise finance from the domestic and international market. This finance is used for starting a new business or project or for modernization or expansion of the business.

(ii)Broker in Stock Exchange: Merchant bankers act as brokers in the stock exchange. They buy and sell shares on behalf of their clients. They conduct research on equity shares. They also advise their clients about which shares to buy, when to buy, how much to buy and when to sell. Large brokers, Mutual Funds, Venture capital companies and Investment Banks offer merchant banking services.

(iii)Project Management : Merchant bankers help their clients in the many ways. For e.g. advising about location of a project, preparing a project report, conducting feasibility studies, making a plan for financing the project, finding out sources of finance, advising about concessions and incentives from the government.

(iv)Advice on Expansion and Modernization: Merchant bankers give advice for expansion and modernization of the business units. They give expert advice on mergers and amalgamations, acquisition and takeovers, diversification of business, foreign collaborations and joint-ventures, technology up-gradation, etc.

(v)Managing Public Issue of Companies: Merchant bank advice and manage the public issue of companies. They provide following services:
(a)Advise on the timing of the public issue.
(b)Advise on the size and price of the issue.
(c)Acting as manager to the issue, and helping in accepting applications and allotment of securities.
(d)Help in appointing underwriters and brokers to the issue.
(e) Listing of shares on the stock exchange, etc.

(vi) Loan Syndication: Merchant banker helps an industrial concern to meet its working capital as well as fixed capital requirements through borrowings. It takes up the responsibility of preparing project files and loan application for financial assistance from the lending institutions.

(vi)Special Assistance to Small Companies and Entrepreneurs: Merchant banks advise small companies about business opportunities, government policies, incentives and concessions available. It also helps them to take advantage of these opportunities, concessions, etc.

(vii)Services to Public Sector Units: Merchant banks offer many services to public sector units and public utilities. They help in raising long-term capital, marketing of securities, foreign collaborations and arranging long-term finance from term lending institutions.

(viii)Revival of Sick Industrial Units: Merchant banks help to revive (cure) sick industrial units. It negotiates with different agencies like banks, term lending institutions, and BIFR (Board for Industrial and Financial Reconstruction). It also plans and executes the full revival package.

(ix)Portfolio Management : A merchant bank manages the portfolios (investments) of its clients. This makes investments safe, liquid and profitable for the client. It offers expert guidance to its clients for taking investment decisions.

(x)Corporate Restructuring: It includes mergers or acquisitions of existing business units, sale of existing unit or disinvestment. This requires proper negotiations, preparation of documents and completion of legal formalities. Merchant bankers offer all these services to their clients.

4. What is issue management? Explain in detail the pre-issue and post-issue management of merchant banking.

Ans. The management of securities of the corporate sector offered to the public on a regular basis, and existing shareholders on a rights basis, is known as issue management. Issue management is an important function for merchant bankers and lead managers.

Pre-Issue Management: The pre issue management refers to process of coordinating the activities on issuing of the shares and setting the price of the issue.
The pre-issue stage is the stage before issuing the securities to the subs. The merchant bankers are assumed to perform the following pre-issue obligations:

(i) Obtaining stock exchange approvals to memorandum and articles of associations.

(ii)Taking action as per SEBI guide lines

(iii)Finalizing the appointments of the following agencies:

(a)Co-manager/Advisers to the issue
(b)Underwriters to the issue
(c)Brokers to the issue
(d)Bankers to the issue and refund Banker
(e)Advertising agency
(f)Printers and Registrar to the issue

(iv)Advise the company to appoint auditors, legal advisers and broad base Board of Directors

(v)Drafting of prospectus

(vi)Obtaining approvals of draft prospectus from the company's legal advisers, underwriting financial institutions/Banks

(vii)Obtaining consent from parties and agencies acting for the issue to be enclosed with the prospectus.

(viii) Approval of prospectus from Securities and Exchange Board of India.

(ix) Filing of the prospectus with Registrar of Companies.

(x) Making an application for enlistment with Stock Exchange along, with copy of the prospectus.

(xi) Publicity of the issue with advertisement and conferences.

(xii) Open subscription list.

Post-issue Management: The post issue management deals with activities of collecting, evaluating the forms and allotting the certificates.

The post-issue obligation is the stage after the securities are issued to the subscribers. The major post-issue obligations relate to association with allotment procedure, post-issue monitoring reports, redressal of investor grievances and coordination with intermediaries, etc. This includes-

(i)Allotment procedure and basis of allotment: Merchant banker along with MD of the recognized stock exchange and registrar of the issue is responsible to ensure that the basis of allotment is finalized in a fair and proper manner. The allotment of such shares should be in such a way that the minimum allotment would be equal to the minimum application size as determined and disclosed in the offer document.

(ii)Post issue monitoring report: The merchant banker in case of IPO shall submit a post-issue monitoring report on the 3rd day from the date of closure of the subscription of the issue.

(iii)Post-issue advertisement: The merchant banker to ensure that a post-issue advertisement giving details relating to subscription, the basis of allotment, value, and percentage of all applicants, date of filing of listing application, etc is released within ten days from the date of various activities in at least one nationwide English and Hindi newspaper.

(iv) Redressal of investor's grievance: The Post -issue Lead Merchant Banker shall actively associate himself with post-issue activities namely, allotment, refund and despatch and shall regularly monitor redressal of investor grievances arising there from.

(v)Coordination with intermediaries: It includes coordinating with various agencies connected with the post-issue activity such as registrar to issue, bankers to the issue, bankers to the issue, self-certified banks, and underwriter.

(vi)Certificate regarding the realization of stock investors and other requirement: The Post-Issue Lead Merchant Banker shall submit within two weeks from the date of allotment, a Certificate to the Board certifying that the stock invests on the basis of which allotment was finalized, has been realized.

5. Name the regulatory authority for merchant banking in India. Explain the SEBI guidelines for merchant banking.

Ans. Securities and Exchange Board of India (SEBI) is the regulatory authority for merchant banking in India. Activities of merchant banks are regulated by the SEBI (Merchant Bankers) Regulations, 1992.

SEBI has laid the following conditions on the merchant bankers, for conducting their operations. They are

1. SEBI will give authorization for a merchant banker to operate for 3 years only. Without SEBI's authorization, merchant bankers cannot operate.

2. The minimum net worth of merchant banker should be Rs. 1 crore for 1st Category, Rs. 50 lakhs for 2nd Category, Rs.20 lakhs for 3rd Category and there is no Minimum net worth required for 4th Category.

3. Merchant banker has to pay authorization fee, annual fee and renewal fee.

4. All issue of shares must be managed by one authorized merchant banker. It should be the lead manager.

5. The responsibility of the lead manager will be clearly indicated by SEBI.

6. Lead managers are responsible for allotment of securities, refunds, etc.

7. Merchant banker will submit to SEBI all returns and send reports regarding the issue of shares.

8. A code of conduct for merchant bankers will be given by SEBI, which has to be followed by them.

9. Any violation by the merchant banker will lead to the revocation of authorization by SEBI.

10. SEBI has the right to send inspecting authority to inspect books of accounts, records etc. of merchant bankers.

11. Merchant bankers are prohibited from buying securities based on the unpublished price sensitive information of their clients.

6. What has been the policy of the Government towards merchant banking in India? Give various categories of merchant bankers as per the classification made by SEBI.

Ans. Government Policy for Merchant Banking:
The Government issued policy guidelines for merchant bankers to ensure sufficient physical infrastructure, necessary expertise, good financial standing, professional integrity and fairness in their transactions. The merchant bankers have to be competent to serve the investors also.

On 1st March, 1993 new policy guidelines have been issued by SEBI for the merchant bankers to ensure greater transparency in their operations and to make them accountable so as to protect the investor's interest. The guidelines relate to pre-issue obligations, underwriting, advertisements and post-issue obligations of the merchant bankers.

Various categories of merchant bankers:

A merchant banker will require authorization by SEBI to carry out the business. SEBI has classified the merchant bankers into four categories based on the nature and range of the activities and responsibilities.

(i)Category 1: It consists of merchant bankers who carry on the business of issue management which consists of preparation of issue management which consists of preparations of prospectus, determining the financial structure, tie-up of the financiers. Minimum net worth required is Rs. 1 crore.

(ii)Category 2: It consists of those authorized to act in the capacity of co-manager. They cannot act as issue manager of their own but can act co-manager. The Minimum net worth required is Rs. 50 Lakhs

(iii)Category 3: it consists of those authorized to act as underwriter, advisor or consultant to an issue. They can neither undertake issue management of their own nor they act as co-manager. They cannot undertake the activities of portfolio management also. The Minimum net worth required is Rs. 20 Lakhs.

(iv)Category 4: It consists of Merchant banker who acts as advisor or consultant to an issue. There is no Minimum net worth required.

7. Who is a merchant banker?

Ans. Merchant banker means any person who is engaged in the e business of issue management either by making arrangements regarding selling, buying or subscribing to securities as manager - consultant, advisor or rendering corporate advisory services in relation to such issue management.

8. Give the meaning of portfolio managers.
Ans. Portfolio managers are defined as persons who, in pursuance of a contract with clients, advise/direct/undertake, the management/administration of portfolio of securities/funds of clients on behalf of the latter. The term portfolio means the total holdings of securities belonging to any person.

9. What do you mean by project counselling?
Ans. Project counselling is a part of corporate counselling and relates to project finance. It broadly covers the study of the project, offering advisory assistance on the viability and procedural steps for its implementation.

10. Define loan syndication.

Ans. It refers to a loan arranged by a bank for a borrower who is likely to be a large company, a local authority, or a government department. So the merchant banker first finalizes the cost of the project before approaching to financial institutions for term loans.

11. What is the history of Merchant Banking in India?

Ans. Merchant Banking in India was started by the Grindlays Bank in 1967. Since then, many private and public banks such the State Bank of India, Citibank, ICICI Bank etc. and other national and international firms have set up their own Merchant Banking services.

12. What are the Regulations for the Merchant Bankers in India?

Ans. The Merchant Banks in India are regulated by the Securities and Exchange Board of India (SEBI) through the Securities and Exchange Board of India (Merchant Bankers) Regulations, 1992.

13. Distinguish between Commercial Banking and Merchant Banking.
Ans.

Basis	Commercial Banking	Merchant Banking
1.Meaning	A banking establishment involved with basic banking functions such as lending money and accepting deposits from the general public.	Merchant Banking is a combination of Banking and consultancy services. It provides consultancy to its clients for financial, marketing, managerial and legal matters.
2.Governing Body	Conducted in accordance with banking regulation Act of 1949	Conducted as per the rules and regulations laid down by SEBI
3.Services Offered	General banking services	Banking consultancy services
4.Role	Commercial Banking is financer	Merchant Banking is financial advisor.