

Merchant Banking in Bangladesh: A Thematic Review of Prospects and Challenges

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ABSTRACT

The skill-oriented professional service that merchant banks offer to their customers regarding their financial needs in exchange for fair compensation in the form of fees is known as merchant banking. The merchant banking plays a pivotal role in strengthening capital markets, fostering industrial development, and enhancing investment opportunities. In the context of Bangladesh, merchant banking has emerged as a key financial service, yet it faces several structural and regulatory hurdles. This review paper provides a thematic analysis of the evolution, functions, regulatory framework, current trends, challenges, and future prospects of merchant banking in Bangladesh. Drawing on existing literature, policy documents, and reports, the paper critically evaluates the state of merchant banking and identifies opportunities for reform and innovation. The review concludes by offering recommendations for strengthening the merchant banking sector to better support economic growth.

Keywords: Merchant Banking, Bangladesh, Financial Sector, Capital Market, Challenges, Prospects.

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I. INTRODUCTION

Merchant banking is a specialized segment of the financial sector, primarily engaged in providing services such as advisory, underwriting, issue management, and portfolio management. The merchant banks are excellent at doing business with big businesses. By providing businesses with information and funding, merchant banking services help a nation's economy flourish. The economy is expanding quickly, thus merchant banking services are crucial. These financial institutions also help businesses make wise financial decisions by acting as corporate advisory groups.

The concept of merchant banking dates back to the seventeenth and eighteenth centuries in countries like France and Italy, when grain merchants provided nominal assistance to other merchants who were having financial difficulties. By giving businesses access to capital and information, merchant banking services support a nation's economy. Business giants, important industries, massive domestic and foreign corporations, well-known banks, insurance and finance companies, service sectors, and so forth are frequently found in the corporate sector. The business sector is therefore essential to the nation's swift economic growth. The importance of the corporate sector stems from its vast financial resources, large-scale commercial transactions, use of cutting-edge technology, employment of highly skilled workers, and adherence to worldwide quality standards. A merchant banker is defined as "any person engaged in the business of issue management, either by making arrangements for selling, buying, or subscribing to securities as manager, consult, adviser, or rendering corporate advisory service in connection to such issue management. Merchant banks are global in nature. Merchant banking encompasses a broad spectrum of operations and services. These are all major tasks of merchant banks. The range of contemporary merchant bank activities is extensive, with new functions being added on a regular basis. Merchant bankers are organisations founded solely for the business sector. In the United States, it is known as an investment bank, but in the United Kingdom, it is known as an issuing house (Natarajan & Parameswaran 2004). The capital market serves as an intermediary that allows society's excess funds to be mobilized and directed into profitable ventures, thereby promoting the growth of the nation's economy. The growth of a more structured and authenticated capital market and the formation of a more stable economy are both significantly aided by merchant banks. By producing goods, creating jobs, earning foreign

exchange, and strengthening the capital market's base through equity investment participation, it benefits the country. Underwriting, portfolio management, and management services make up merchant banking's main business. A severe lack of funding is a problem for young business owners in Bangladesh. Since there aren't any investment banks in the nation that can give entrepreneurs direct equity funding, merchant banks act as investment banks in this scenario. When it comes to listing securities on stock exchanges, merchant banks are crucial. Initial Public Offering (IPO), Repeat Public Offering (RPO), Rights Share Offer, and Direct Listing are just a few of the ways it combines funds for entrepreneurs. It can be used to sell existing paid-up capital, issue preference shares, or issue convertible or non-convertible shares. The expansion and development of the securities market are contingent upon the faith of investors. Through the SEC's rules and guidelines for merchant banks, issuers can raise funds cheaply, efficiently, and conveniently, guarantee a high level of investor interest protection, and offer a vibrant, competitive market with a high standard of professional competence, honesty, integrity, and solvency. The rules support an equitable, effective, and adaptable capital market (Huda & Chowdhury 2017). In developing economies like Bangladesh, the evolution of merchant banking is closely linked to the maturation of capital markets and overall financial sector reforms. However, despite its foundational role, merchant banking in Bangladesh faces considerable challenges, including regulatory rigidity, limited scope of services, and operational inefficiencies. This review aims to critically explore the thematic areas surrounding the current state and future prospects of merchant banking in Bangladesh.

II. LITERATURE REVIEW

The academic discourse surrounding merchant banking in Bangladesh has evolved in tandem with the development of the country's capital market and financial sector reforms. Existing literature offers a foundational understanding of the roles, limitations, and regulatory frameworks that shape the performance of merchant banks. Chowdhury and Ahmed (2015) conducted a seminal study highlighting the constraints faced by merchant banks in Bangladesh, such as insufficient diversification of services, lack of investor confidence, and a restrictive regulatory environment. Their research underscores the need for more robust institutional frameworks and market-driven reforms. Rahman (2020) emphasized the strategic importance of merchant banks in mobilizing capital and fostering investment, particularly through portfolio management and public issue services. He notes that while these institutions contribute significantly to the primary market, their impact on secondary market dynamics and broader economic development remains underexplored. This gap points to a need for expanded services and better integration within the financial system. Uddin and Alam (2018) examined the regulatory landscape governing merchant banks and pointed out that the rigidity of existing policies has inhibited innovation. They argue that outdated regulations not only discourage the introduction of new financial products but also complicate operational efficiency. Their work calls for harmonization of regulations and greater coordination among regulatory bodies like the Bangladesh Securities and Exchange Commission (BSEC) and the Bangladesh Bank. Global comparative studies, such as those from the World Bank (2022), have further contextualized Bangladesh's merchant banking system within the broader spectrum of emerging markets. These studies indicate that Bangladesh lags in areas such as financial innovation, technological adoption, and investor education. The World Bank report advocates for structural reforms, emphasizing the importance of digital transformation, stronger corporate governance, and improved access to finance for SMEs and startups. Despite these valuable contributions, the literature remains fragmented, with limited comprehensive thematic reviews focused specifically on Bangladesh. Most studies tend to adopt either a regulatory or service-based lens, overlooking the interconnected challenges and opportunities across the sector. This paper aims to address this gap by offering a holistic thematic review that synthesizes historical trends, functional roles, regulatory issues, and future prospects of merchant banking in Bangladesh.

III. METHODOLOGY

This paper adopts a qualitative, thematic review approach, synthesizing insights from academic journals, government publications, policy reports from the Bangladesh Securities and Exchange Commission (BSEC), and relevant financial news sources. Literature published between 2000 and 2024 was selected based on relevance, credibility, and contribution to understanding the merchant banking sector in Bangladesh. The study aims to capture both historical evolution and contemporary dynamics through a thematic lens.

HISTORICAL BACKGROUND AND EVOLUTION

Medici, Fugger, and Riccardi of Luca were among the first merchant banks in Italy, where the idea of merchant banking first emerged. As the name suggests, the main objective of these organizations was to support or finance the production and exchange of commodities. Prior to 1932, when the word "merchant banking" was coined, there was no differentiation between the roles of commercial and merchant banking. In India, the Hundi was the main form of credit utilized by local bankers. European merchants did not start trade with India until 1813, at which point London-based commercial bankers established agency companies (Animesh 2016). In

order to provide loans in India, these agency houses collected deposits from their homes at lower interest rates. In the late 19th century, J.P. Morgan & Co. emerged as the leading merchant bank with a direct connection to London, which at the time was the global financial hub. These days, merchant banks provide a variety of services, such as underwriting, portfolio management, and investment banking. They offer financial advising services, aid in mergers and acquisitions, and assist clients in raising capital. Merchant banks also follow the law when it comes to approving investments and verifying working capital needs. National Grindlays Bank began offering merchant banking services in India in 1967. After learning about the history of merchant banking, it is simple to understand why these financial organizations have been so crucial to the expansion and advancement of the world economy (Keyurkumar & Nayak 2015). The merchant banking sector in Bangladesh emerged in the early 1990s, coinciding with broader financial liberalization efforts and capital market reforms. Initially, merchant banks focused predominantly on issue management and underwriting services. Over time, their functions expanded to include portfolio management, corporate advisory services, and investment consultancy. Regulatory frameworks established by BSEC and the Bangladesh Bank have significantly influenced this development trajectory. Although some institutional growth has occurred, the sector's evolution remains uneven, hampered by policy inconsistencies and underdeveloped market infrastructure (Chowdhury & Ahmed, 2015).

Characteristics of Merchant Banking

Merchant banks are distinguished by offering specialist financial services with an emphasis on corporate finance, capital markets, and investment banking to businesses, especially large firms. In contrast to conventional commercial banks, they usually don't provide services to the general public and instead focus on providing advice on complicated financial transactions, fundraising, and mergers and acquisitions. As their financial advisors, merchant banks mainly assist businesses in raising capital, managing assets, and navigating intricate financial plans. Underwriting (selling securities), advising on mergers and acquisitions (M&A), and offering portfolio management services are just a few of the investment banking operations in which they specialize. They help their clients raise money through a variety of financial instruments by facilitating their access to capital markets. They provide clients with specialized advice on financial strategies, mergers and acquisitions, and other business-related issues as part of their consulting services. Fees and commissions from the provision of their specialized services are the main source of revenue for merchant banks. Generally speaking, merchant banks don't provide services to the general public like retail or commercial banks do.

Functions and Services of Merchant Banks in Bangladesh

Merchant banks in Bangladesh provide a range of services aimed at facilitating investment and capital mobilization. Issue management remains one of the core functions, where banks assist companies in raising capital through initial public offerings and rights issues. Underwriting services ensure subscription security by guaranteeing the purchase of unsold securities. Portfolio management services cater to individual and institutional investors by offering investment strategies aligned with market dynamics. Additionally, merchant banks provide corporate advisory services on mergers, acquisitions, and restructuring, while also engaging in custodial services and credit syndication. These services contribute to the diversification of financial products and enhance the operational efficiency of capital markets (Rahman, 2020). Merchant banking mostly consists of private equity investments in company stocks that are not directly tied to the bank's core banking activities. This includes services including advising, financial management, and corporate and affluent person fundraisers. Merchant banks assist companies in raising capital through a variety of means, including the issuance of stocks and bonds and private placements. They might buy shares or debentures that haven't been fully acquired by the public during an IPO. They help companies finance important projects by arranging and managing financial agreements. They design and manage investment portfolios for their clients, which include both individual and institutional investors. Merchant banks often provide managerial support and make long-term investments in private companies. They provide companies with guidance on commercial dealings including mergers and acquisitions. They provide advice on a range of financial matters, including strategic planning, valuations, and restructuring. In their role as brokers, they buy and sell securities for their customers. In addition to other consulting services, they offer market research and strategy advice to large corporations and other financial institutions. They provide wholesale currency conversion assistance. They may participate in the deposit and short-term loan markets. They exchange currencies with other nations. Merchant banks primarily serve high-net-worth people, institutional investors, and huge corporations rather than the general public, even if they have retail and commercial departments.

Areas Covered by Merchant Bankers

In Bangladesh, merchant banks engage in a variety of activities, mostly related to the capital markets, such as mergers and acquisitions, underwriting, issue management, and portfolio management. They also help firms raise money, offer financing choices for securities investments, and give advice services. In order to

guarantee that shares or debentures are subscribed for, even in the event that the initial public offering (IPO) or right issue is undersubscribed, merchant banks take part in underwriting new issues. They oversee the creation of prospectuses, promotion, and share distribution, among other aspects of introducing new securities to the market. For their customers, merchant banks create and oversee investment portfolios with the goal of maximizing profits while lowering risk. They manage capital market investments, offer financial advice, and serve as guardians of their clients' funds. In addition to offering advice services, negotiating agreements, and assisting with the financial side of transactions, merchant banks are essential in completing mergers and acquisitions. They offer firms financial guidance on a range of topics, such as investment choices, finance, and corporate strategy. For their customers who are making capital market investments, merchant banks provide financing choices including margin loans. Additionally, certain merchant banks provide services including overseas trade finance and SME lending. Riverstone Capital Limited, Uttara Finance and Investment Limited (UFIL), IDLC Investment Limited (IDLCIL), LankaBangla Investment Limited (LBIL), and Prime Finance Capital Management Limited (PFCML) are a few examples of merchant banks in Bangladesh.

Regulatory Framework

The operation of merchant banks in Bangladesh is governed by a set of regulatory instruments primarily administered by the BSEC. The Merchant Banker and Portfolio Manager Regulations of 1996 serve as the foundational legal framework. Additionally, the Securities and Exchange Ordinance of 1969 and subsequent directives from BSEC provide guidelines for compliance, risk management, and investor protection. While these regulations have brought necessary structure to the industry, they are often criticized for being outdated and overly prescriptive. The lack of regulatory adaptability has been cited as a barrier to innovation and service diversification within the sector (Uddin & Alam, 2018).

IV. THEMATIC ANALYSIS

Market Development and Capital Mobilization Merchant banks have contributed significantly to capital formation in Bangladesh through services related to public offerings and portfolio management. However, the overall depth and liquidity of the capital market remain constrained. Limited investor participation, lack of sophisticated financial instruments, and shallow secondary markets has hindered the optimal functioning of merchant banking activities (World Bank, 2022).

Investor Confidence and Governance The erosion of investor confidence due to poor corporate governance and opaque financial reporting practices among listed companies poses a significant challenge. Merchant banks, although instrumental in facilitating investments, often bear the brunt of negative market perceptions. Strengthening governance standards and ensuring transparency are critical to restoring trust and enabling sustained market participation (Chowdhury & Ahmed, 2015).

Regulatory Compliance and Institutional Constraints Merchant banks operate in an environment characterized by stringent regulatory compliance requirements. While these regulations aim to protect investors and ensure systemic stability, they often result in operational delays and restrict the agility of merchant banks to respond to market opportunities. Furthermore, inadequate coordination among regulatory bodies exacerbates institutional inefficiencies (Uddin & Alam, 2018).

Technological Adaptation In an era where financial technology is reshaping global banking practices, the technological adoption among Bangladeshi merchant banks remains modest. Limited integration of digital tools and reliance on manual processes has impeded operational efficiency and customer service. This technological lag places the sector at a disadvantage compared to regional and global counterparts (Rahman, 2020).

Human Resource Capacity The development of skilled human capital is crucial for the advancement of merchant banking. The sector currently suffers from a dearth of professionals trained in investment analysis, risk management, and financial advisory services. This talent gap restricts the ability of merchant banks to offer innovative and customized solutions to clients, thereby limiting their competitive edge (World Bank, 2022).

Current Landscape and Performance As of 2024, more than 60 licensed merchant banks operate in Bangladesh. These institutions predominantly focus on issue and portfolio management, with a limited presence in advanced investment banking services. The market is marked by high competition, service duplication, and limited product diversification. Regulatory reforms have been initiated to address these issues, but their implementation remains slow and inconsistent. Moreover, the dominance of a few large players has created market concentration, limiting opportunities for smaller firms to expand and innovate (BSEC Reports, various years).

CHALLENGES FACING MERCHANT BANKING IN BANGLADESH

The merchant banking sector faces several interlinked challenges. One of the most pressing is the lack of product diversification, which has resulted in a dependence on a narrow range of services. Regulatory rigidity continues to impede innovation, while market inefficiencies such as poor investor education, weak research

infrastructure, and underdeveloped secondary markets further constrain growth. Operational risks, including insufficient risk management practices and a lack of robust internal controls, make merchant banks vulnerable to market volatility. Additionally, the sector's limited technological integration hampers the speed and quality of service delivery (Rahman, 2020; Uddin & Alam, 2018).

In addition, in recent years, Bangladeshi merchant banks have had low earnings. There has been pressure on several merchant banks in Bangladesh to resolve their negative equity. Certain merchant banks in Bangladesh have not complied with the terms of their licenses. Businesses might not be able to pay the fees associated with merchant banks' services since they can be costly. Because of disparate currencies, regulatory frameworks, and global compliance, merchant bankers encounter difficulties while handling cross-border transactions. Banks compete fiercely with non-bank financial institutions (NBFIs). The current bank liquidity crisis makes it challenging for NBFIs to obtain capital at a fair price. NBFIs struggle with a shortage of skilled personnel. The secondary market for loan products is lacking for NBFIs.

PROSPECTS AND OPPORTUNITIES

Despite these challenges, the merchant banking sector in Bangladesh holds significant potential for expansion. The deepening of capital markets, driven by increasing financial literacy and government incentives, presents new opportunities for merchant banks. The sector can also play a pivotal role in financing small and medium enterprises (SMEs) and startups by offering equity support and strategic advisory services. Moreover, the emergence of public-private partnership (PPP) projects creates avenues for merchant banks to contribute to infrastructure development. Embracing digital transformation and exploring cross-border investment services could further enhance the sector's growth trajectory (World Bank, 2022).

Merchant banking has the ability to boost economic expansion by assisting startups and firms in raising capital. However, low profitability and poor financial health have been problems for some Bangladeshi merchant banks. Businesses can raise the money they need for operations or expansion by using the range of funding options that merchant banks offer, such as debt and equity financing. Businesses navigating difficult financial settings can benefit greatly from their technical advice on market trends, investment strategy, and financial management. Merchant banks frequently focus on providing M&A consulting services, which aid businesses in locating possible acquisition targets, negotiating agreements, and overseeing the integration procedure. These banks can improve a company's financial stability by helping to detect and manage financial risks using a variety of tools and techniques. Instead than offering one-size-fits-all financial solutions, merchant banks customize their offerings to match the unique requirements of their customers. Businesses can access worldwide markets and prospects and handle cross-border transactions thanks to the global networks of several merchant banks. Building enduring relationships with their customers is a common goal of merchant banks, as this can result in continued assistance and collaboration in a range of financial activities. They can aid firms with strategic planning and development, assisting in the alignment of financial plans with overarching business objectives. Because they are typically knowledgeable about regulatory standards, merchant banks assist clients in navigating compliance challenges and avoiding potential hazards.

V. POLICY RECOMMENDATIONS

To realize the full potential of merchant banking, several strategic interventions are required. Regulatory reforms must be prioritized to eliminate outdated provisions and foster an environment conducive to innovation. Investment in human capital through training and professional development programs is essential to address the talent shortage. Technological modernization should be accelerated to streamline operations and improve service delivery. Moreover, public awareness campaigns are needed to educate investors and encourage greater participation in capital markets. Finally, enhancing corporate governance among listed companies is critical for restoring investor trust and ensuring long-term market stability (BSEC Reports, various years; Rahman, 2020). The government of Bangladesh may take necessary actions for the sustainable development of merchant banks in Bangladesh. The Bangladesh Bank takes pivotal role in easing the registration and operational activities in the merchant banks. The SEC may take action to monitor the merchant banks and helps the poor performer merchant banks by providing proper guidelines and ensuring other necessities for continuing the operations of the merchant banks. The merchant banking must take care in recruitment and payment policy for ensuring qualified employees.

VI. CONCLUSION

Merchant banking in Bangladesh stands at a crossroads. While the sector has made notable contributions to capital market development, it remains constrained by regulatory, operational, and institutional challenges. A comprehensive approach that includes regulatory modernization, capacity building, and technological integration is necessary to unlock the sector's full potential. By addressing these foundational

issues, merchant banking can evolve into a dynamic force that supports Bangladesh's economic development and financial inclusion goals.

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