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What is a Merchant Banker?

Definition. A Merchant Bank invests its own capital in deals or the equity of companies. Banks in the United States are prohibited from making equity investments in companies. The Glass-Steagall Act or the Banking Act of 1933 established the FDIC and separated commercial banking from investment banking and merchant banking. A merchant bank makes investments where a commercial bank makes loans. A merchant banker acts as a principal rather than an intermediary. A merchant bank invests primarily in unregistered equity. Merchant Banks invest using their own capital in privately negotiated equity investments and in so doing perform a merchant banking function rather than acting as an investment banker or intermediary.

History. Historically, many major international banks such as Royal Bank of Scotland, Deutsche Bank, Barings, Rothschild's, Warburg and Mellon Bank became substantial by merchant banking. Today, certain investment banks such as Goldman Sachs, Bear Stearns, Raymond James Capital and EquiCap Partners, LLC have merchant banking divisions. Certain securities oriented investment banks may make investments in companies with the anticipation of later securities offerings. Non-securities oriented investment banking firms usually make investments for their own account expecting to add value with both their intellectual capital and investment capital.

Pervasiveness. Examine the financial/capital markets structure today and one will see a wide array of financial companies and financial products. Private equity firms, venture capital firms, buyout funds, hedge funds and more all provide private equity investment capital together with intellectual capital to the market. So these financial companies are all acting as principals providing merchant banking functions. Interestingly, they are all different.

Conclusion. These firms tend to focus on niches that are consistent with their target market. The result provides the market with an access to capital greater than ever before in history. The key is to find the right niche capital provider for the right company.