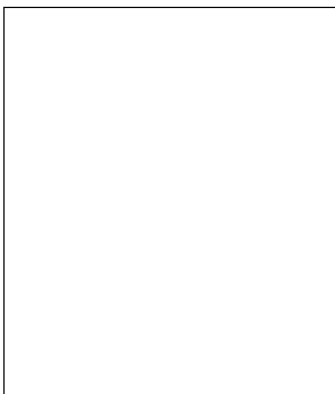


Investment Banking : The Emerging Challenges



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Investment Banking is perhaps one of the most dynamic and fast changing professions in the world. The Indian capital market today is, more than ever, sensitive to overseas markets. Last year, the sensex fell from a whopping high of over 6000 pts to a level of less than 4000 points, largely influenced by the fall in valuations of tech stocks in the NASDAQ. The changes in US Fed rates also have had an impact on domestic markets. The increasing influence of the global markets on India cannot be undermined. Further, the integration of the global and domestic markets has opened up a new segment of investors, the FIIs, who are very active players in the Indian capital markets. Market movements and investor interest have seen a virtual “see-saw” over the last two years. In such a fast changing environment, investment bankers have a very important role, a challenging one too, for they have to play the balancing act between achieving optimum benefit to the client, maintaining their credibility and taking care of the investors’ interests.

Over the years, investment banking as a profession has matured. The investment banker, once seen as an underwriter or a selling agent, has now matured into a consultant or an advisor, who takes the client through the entire transaction and continues to effectively build relationships even after a transaction is brought to a close.

Relationship Management

At the outset, let us look at relationship management—the cornerstone of investment banking. In the days gone by, where marketing of services was purely transaction based, did we ever focus so much on relationship building? But, in today’s investment banking era, it is relationship management that is given the most attention, for it is important to nurture clients, understand their needs and structure products that suit their needs. Thus, a very basic element in marketing will have to be applied to the investment banking business: ‘know thy customer’s needs well’. The thrust will have to be on Customer Relationship Management. The role of an investment bank today is not limited to handling an acquisition

or a placement or a capital market floatation, but is extended to selling financial solutions to clients and without relationship management, effective investment banking would but be a distant dream.

Structuring Skills

The increased sophistication of the corporates has led to their financial requirements becoming more complex. They are no longer satisfied with plain vanilla kind of products and expect their investment banks to provide customised products to suit their specific needs. Further, the opening up of the economy and the thrust on infrastructure over the past few years is increasingly presenting situations, where the financing needs of certain transactions cannot be met through conventional financing methods. In the circumstances, it becomes necessary to engineer solutions, which are tailor-made for the transaction. Thus, there is a need to build skills and expertise in introducing and developing new financial products.

Deal Execution

Investment Banks need to have strong distribution/ placement capabilities. The ever-widening investor universe makes it incumbent upon investment banks to have a clear understanding of the investors’ preferences in order to facilitate focussed marketing efforts. While this would be particularly relevant for capital market floatations, the concept could also be extended to corporate mergers, buy-outs and hive-offs. The essence is that the investment banks should have the ability to get across, find the right unit/ company, and maximise value for the client. After all, a deal done to the satisfaction of a client is the best form of Customer Relationship Management that one could think of.

Competition

The entry of global players has had a significant effect on the Indian investment banking scenario. The global players bring with them substantial experience, deal structuring capabilities and financial muscle and Indian investment banks do face stiff competition from global players, who are formidably entrenched in the Indian markets. Notwithstanding the entry of foreign banks, the domestic investment banks within the country too are witnessing stiff competition. Fee levels are shrinking by the day, leading to an increased pressure on margins. To be in a position of charging a premium (in terms of fee), an Investment Bank has to have an edge over its competitors and that would come from providing better value to the client.

New Business Opportunities

The Union Budget announced this year is likely to

result in some exciting business opportunities for domestic investment banks. Two-way fungibility between domestic shares converted from ADRs and GDRs has now been allowed and this would improve the liquidity in the Indian markets. Besides, special concessions have been granted to domestic companies, which are listed abroad. Concessions have also been granted in order to encourage foreign investments in India. These measures could very well see more activity in the areas of overseas offerings as also an increased participation by overseas investors in domestic issues.

Privatisation of Public Sector Units is another area that would benefit from the experience and the deal structuring abilities of the investment banks. The challenge here would not only be striking the deals at the right prices but also enriching the value of the shareholders who remain in the Company.

Investment Banks have spread their wings to advisory services and consultancy, quite often competing with reputed consultancy firms. This is particularly relevant for advisory services in the infrastructure sector. In my view, strategy consulting along with the capability to devise and implement a financial restructuring package is the maximization of an investment bank's knowledge and expertise.

Worldwide, M& A deals for the year ended December 2000 aggregated as high as USD 172192 mn. Corporate India too is on a restructuring and consolidation phase, evidenced by quite a few mergers and hive offs in the recent months. An emerging area of business would be Cross border Mergers and Acquisitions, which have been increasing steadily over the last few years.

Index futures were introduced in India, followed by options on individual stocks. This is probably the beginning and many more derivative products like credit derivatives, which are well-established in developed countries, would find their way into the country in future years.

The debt market has come a long way from the fixed coupon instruments of the past. A variety of instruments have hit the market and some credit is certainly due to the investment banking community. Securitisation of receivables, which is now gaining acceptance with the Indian investors, is another area that deserves mention here. Further refinements are expected to follow, as investment banks unravel and explore this idea further and educate the investors suitably.

These opportunities require investment banks to be alert to the changing needs of the economy, to develop adequate market intelligence, continuously develop the required skills and rise to the challenges that emerge at any point of time.

Research

No investment bank can survive without in-depth capabilities in research. Information technology has

brought a surfeit of information at our doorstep or shall we say "at the click of a mouse". This probably has made **research** easy and difficult. Easy because of the speed at which the data/information can be obtained. Difficult because one needs to understand and have the ability to analyse and process the information available. Globalization has also made it imperative for any investment bank to be aware of the happenings worldwide. We are moving towards an era of knowledge-based services, of sectoral expertise and of having a thorough insight into the companies/units being tracked.

Size is important

An investment bank has to be a **one-stop shop** for all services. This policy is synonymous with Customer Relationship Management. Times have shown that talent and experience has been gravitating towards larger investment banks and it has been extremely difficult for the smaller firms to hold on to expertise. The future belongs to well-integrated investment banks and it may not be long before niche-players are sidelined.

Skilled Personnel

Recruitment and retention of efficient and fast learning employees is a must. The investment banking field is knowledge based and one of its key assets is its human resource. An Investment Bank cannot afford not to provide regular and intensive training to its employees.

Technology

Technology can have drastic changes on the way business is done. An Investment Bank will need to keep itself abreast with the latest technology. A particular technology could not only help in reducing costs but also facilitate improving quality and reducing the time of product delivery.

Growing Need for Professionalism

The ever changing dynamics of the market and the increasing number of participants in a transaction demand a high degree of professionalism from the merchant banks. This is particularly true for public offerings with high retail participation.

A peek into the history of investment banking will bear testimony to the fact that merchant banks have not always lived up to expectations and many issuers of the "run of the mill" kind have lapped up funds from the market.

In recent times, the new economy has thrown up immense challenges to the investment banks. In a way, an Investment Bank shapes the way one lives! Many investment banks in the USA were extremely bullish on the internet economy even when valuation of these companies was a mystery. The USA stock markets rose to great heights and then crashed when the bubble burst. This resulted in great losses all over the world, as world over, most markets were affected by the sentiments in US stocks. This places

an onerous responsibility on the investment banks recommending stocks to clients. An Investment Bank, in this uncertain e-age economy, will have to be extremely careful, should have the ability to foresee and look beyond sudden market movements. Needless to say, Investment Banks should strive to act within a self-proposed framework of business ethics.

Development of the Market

While merchant banks are agents of the clients and are responsible for the transactions they handle, they do have a broader role with the responsibility for development of the markets as a whole. There is

a need to sensitise market regulators on important issues to bring about suitable policy changes and capital market reforms.

Thus, in conclusion, investment banks of the millennium would have to be :

- Diverse and comprehensive in their product range
 - Proactive and innovative
 - Globally networked
 - Customer focussed
 - Conscious of their duties and responsibilities towards clients, the regulators and the investors and have a well defined system of business ethics.
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