



INVESTMENT BANKING - A PANACEA FOR ECONOMIC DEVELOPMENT IN
BANKING SECTOR

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Abstract

Banks are the financial institutions offering wide range of financial services which plays a pivotal role in the development of an economy. Investment banking is one of the special segments in banking operations that facilitates capital formation along with financial consultancies in investment, advisory services, trading of securities, custodian services, asset management services, corporate actions etc. Indian banking sector has transformed into a promising sector to boost the economy and to stabilize the financial services post globalisation in the year 1991. Hence, it becomes important to analyse the investment banking services offered in India by Indian banks with reference to gap between economic development and role of front office services. The purpose of this paper is to identify the challenges, areas of improvement with respect to role of front office operated by Indian banks in strengthening the economy. The researcher has attempted to explore the paradigm shift in operations being performed, role of front office in economic development of the country accelerating various employment opportunities, increase in foreign exchange reserves, FDI, foreign exchange earnings, increase in GDP. It promotes in bridging the gap between economic development and the services offered at global markets, capital formation and wealth management. RBI must ensure there is more avenues offered to Indian banks to set up investment banking wings that infuses economic development as GDP increases due to huge contribution in service sector.



Key words: Investment banking, clearing houses, custodian, brokerage firms, Net asset value, and Business Identifier code.

I. INTRODUCTION

Banks are the financial institutions which accept deposits, provide financial assistance, and create credit facilities. Banking operations can be classified into three major categories: commercial banking, retail banking, and investment banking. Among these, investment banking is a crucial area that involves the formation of capital, assisting in corporate actions such as tender offers, mergers and acquisitions, spin-offs, and split-offs, and providing advisory services to various financial institutions, trading, and hedging. These activities can influence the economy by increasing GDP, foreign reserves, foreign direct investment, employment, and the strength of financial markets. Some of the popular MNC investment banks operating in India include JP Morgan, BNP Paribas, Goldman Sachs, Credit Suisse, Societe Generale, and State Street Global Advisors. Some of the Indian investment banking firms include SBI, Yes Bank, Punjab National Bank, Kotak Mahindra Bank, and Bank of Baroda.

II. STRUCTURE OF INVESTMENT BANKING

The structure of investment banking is divided into three categories: back office, middle office, and front office operations.

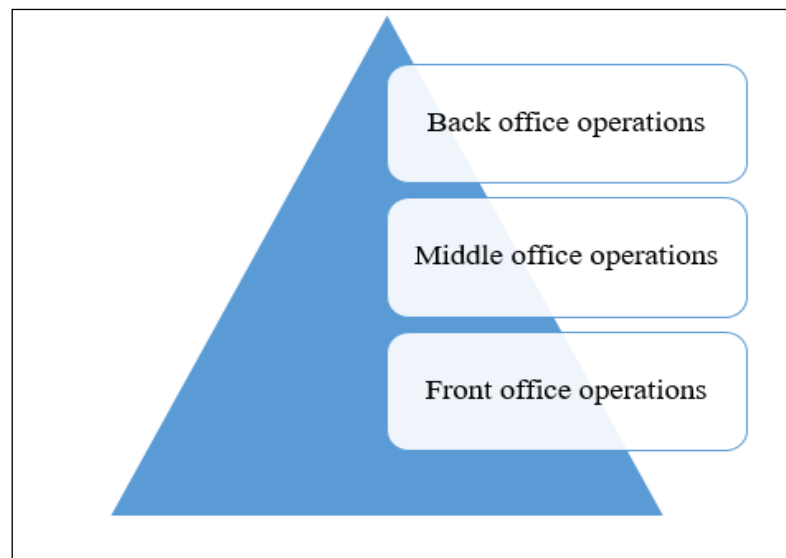


Fig 1: Structure of investment banking operations

1. Front office

It is the most important role in the structure of investment banking, which is the income-generating component. It also comprises advisory services in various financial activities offered to financial institutional investors in return for service fees. The other pivotal



functionality is to operate in organised markets embedded with activities like trading (buy & sell) of securities, market research, ancillary services like etc. The participants involves portfolio managers, portfolio analysts, custodians, brokerage firms. The portfolio manager books the trade (buy or sell) using Bloomberg, IDC, etc terminal where the details will be conveyed to both custodian and broker through BIC (Business identifier code) for verification and recording the transaction in their respective accounting systems.

2. Middle office

This level of operational structure consists of management of risk, evaluation, analysing of risks, confirming trade requests by sending swift messages with respect to trades to both custodian and brokerage firms, quality check on various risk reports generated by front office staff.

3. Back office

This is the most crucial level at which there is blend of technological division along with operational roles. The employees at this level are engaged in reconciliation, computing net asset values, performance calculation, client reporting, bookings of various fees, expenses or incomes generated on the portfolios etc, in connection with various portfolios managed by the firm.

III. PLAYERS IN INVESTMENT BANKING

The investment banking players are custodian, brokerage firms, clearing houses, software solutions firms, financial markets and clients.

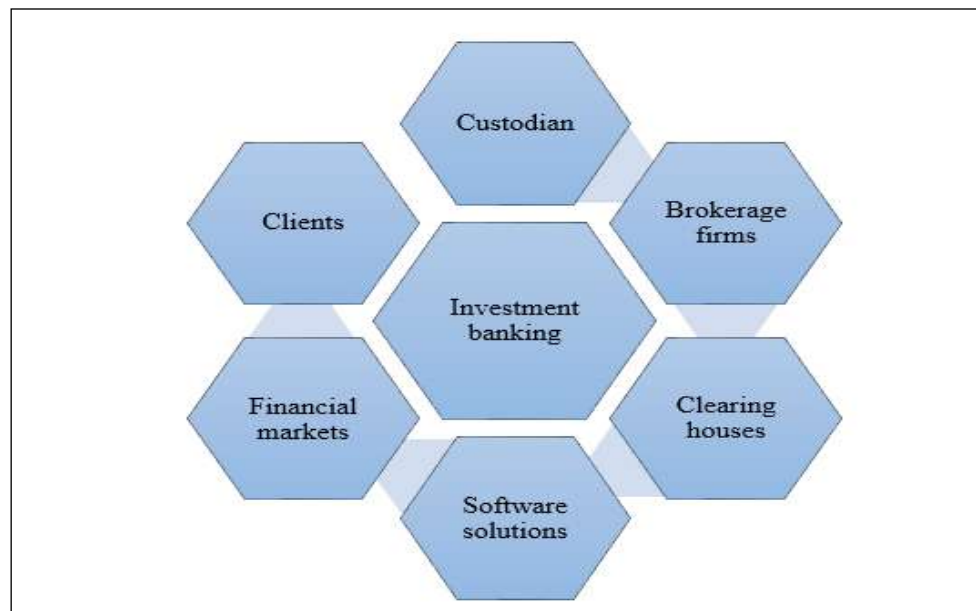


Fig 2: Players in investment banking

1. Custodian

Custodian is typically a financial institution responsible for safekeeping of physical stock and cash dealt by investment banking firms on behalf of the investors. They ensure the cash and



stock is managed at each portfolio level to the respective clearing house for settlement during buy transactions and sell transactions. They charge fees for the services rendered.

2. Brokerage firms

These are the financial institutions whose core business is pricing and trading of securities. They act as intermediaries between investment banking firms and custodians. They charge fees for the services rendered based on the number of transactions for a fixed price per transaction.

3. Clearing houses

The organisations whose sole responsible is to ensure there is settlements of transactions in terms of cash and stock exchanges between the parties of buyer and seller at the national or continent level. European countries rely on Euro clear, India relies on National clearing house etc. In case on non-settlement then the trade results in fail.

4. Clients

The clients are the financial institutions most probably central banks of various countries, asset management firms, large corporate firms, institutional investors approach investment banking firms to invest, advise on portfolio management. The clients have their relationship manager who would interact with respective investment banking firm's new business team for all business correspondences.

5. Software solutions firms

Investment banking firms ensure they have in-house designed accounting software packages, accounting systems, web portals, trading portals, reconciliation portals which creates an edge over others encouraging in generating reports for analysing, decision making for managers, analysts and employees. The accounting systems, reconciliation systems designed would be customized to suit the requirements of the investment banking firms to ease the middle office and back office operations.

6. Financial markets

The organised financial markers facilitates a platform for trading in various securities like equity, bonds, commodities, currencies, foreign exchanges, derivatives, debt, mutual funds and other products promoting capital formation, economic development of the nation. These markets provide the platform for trading the securities encouraging capital formation, hedging and economic stability.

IV. INVESTMENT BANKING ACTIVITIES

The functions of investment banking works at global levels comprises of client consultation, inception, portfolio activation, end to end operations and client reporting.



Fig 3: Stages in Investment banking activities

Stage 1 - Client consultation

The financial institutions approach the client relationship corporate office to query about the various investment portfolio combinations either from the existing products offered by the investment banking firms or request for customized product confirming the quantum of investment being made in specific currencies like USD, GBP, JPY, Euro etc.

Stage 2 - Inception

Client relation manager approaches new business team to decide on the composition of portfolio as per customer's specifications, asset class, portfolio details, set up in accounting systems and other software applications, seeding date, portfolio activation date in the market, portfolio manager and analyst in charge, custodian, brokerage firm etc.

Stage 3 - Portfolio activation

The portfolio or fund gets actively launched into the respective financial market where portfolio manager ensures the trading in various securities which is mainly front office operational activities. Generation of reports like cash forecasting, risk reports, cash contribution and redemption.

Stage 4 - End to end operations

The portfolio is reconciled between custodian and investment banking firm on daily basis to verify the accuracy of books of accounts for cash and stock held. At the end of each month, the books of accounts are closed and pushed for net asset value (NAV) reconciliation. Once after the net asset value of the portfolio is confirmed by the portfolio analyst then performance of fund is measured against the index set up to identify if the portfolio is under performed, over performed or matches the index.



Stage 5 - Client Reporting

The final stage is summarising the performance of the portfolio managed by the investment banking on behalf of the client to give an overview of the analysis and graphical representation of the same.

V. SCOPE OF INVESTMENT BANKING

Investment banking firms is one of its own type in the banking sector that enables in creating capital across various financial markets, generation of employment opportunities at front end, middle and back end operational levels, encourages foreign direct investment through clients resided in domicile countries through portfolio management, advisory services, acting also as custodian, expansion through global operations, creates foreign earnings, increases foreign reserves, strengthens the economy, stabilizes the financial markets, generates revenue to the government through taxes. Stock of private sector domestic debt has a percentage of gross domestic products has been steadily increasing in the economy. Foreign domestic investment is a good source of longer maturity capital inflows to fund a current deficit.

VI. CHALLENGES

The major challenges faced by most of the investment banking firms.

- (i) The structure of the organised financial markets, credibility of the banks.
- (ii) Lack of profitability in secondary trading in new issues, revenue streams, quantum of seeding capital.
- (iii) High leverage ratio of trading assets to owner's equity on capital.
- (iv) Poor internal control process.
- (v) Selling options to their clients.
- (vi) Banks focusing solely on advisory fees as revenue that plays on stable markets and economy at times could lead to downfall.
- (vii) Weak internal auditing system, extensive risk management, compliance risk, analytical and technical skills required by the staff, knowledge about the markets, active and timely decision making.
- (viii) Most of the Indian banks operate only at middle level and back level due to economic constraints, unstable foreign currency and unstable financial marks.

VII. IMPLICATIONS OF RBI

RBI is the regulatory body of banking sector which has designed a framework within which the investment banking firms are expected to operate. RBI has ensured that a bank has to set up a subsidiary firm to operate as investment bank to avoid the conflicting the interest rates, to generate separate source of revenue. The rates applicable for commercial banking and retail banking is pre- determined by the RBI and are minimal. However in case of investment banking the charges applied are based on the service fees where the quantum is huge based due to corporate action activities like mergers, tender offer, investment advisory etc.

VIII. CONCLUSION

Most of the Investment banking firms operating in India are MNCs banks.



- (i) There is less scope for front end office activities due to challenges faced by these banks and stiff competition from the foreign banks offering similar services in more proficiency. Hence there are more back end operation activities currently being performed by Indian banks when compared to their foreign counterparts.
- (ii) Front office has enormous avenues in generation of income in the form of advisory services, investment management in designed customized portfolios.
- (iii) Effective cash management when the client either contributes or withdraws cash from the portfolio predicting the future scope of investment through cash and stock forecasting, risk management through derivatives, huge inflow for foreign reserves through seeding capital.
- (iv) RBI must ensure there are more avenues offered to Indian banks to set up investment banking wings that infuses economic development, gross domestic product increases due to huge contribution in service sector, creation of job opportunities, increase in foreign exchange reserves and foreign direct investment.

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