**Investment banking functions**

Investment Banking is a segment of the financial services industry that offers strategic advisory services to corporate and institutional clients on mergers and acquisitions (M&A) and underwriting in the capital markets.

Investment banks are a bridge between large enterprises and the investor. Their primary roles are to advise businesses and governments on how to meet their financial challenges and to help them procure financing, whether it be from stock offerings, bond issues, or derivative products.

Investment banks help their clients with financing, research, trading and sales, wealth management, asset management, IPOs, mergers, securitized products, hedging, and more.

The investment bank serves as a financial intermediary between clients and corporations (or institutional investors) to ensure proper guidance is delivered based on the firm’s expertise, network, and past transactions.

The Clients of an investment banking firm are most often corporations or institutional investors, such as private equity firms, mutual funds, hedge funds, pension funds, and sovereign wealth funds (SWF).

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| Function | Description |
| M&A Advisory | * M&A—an abbreviation for "Mergers and Acquisitions"—is an umbrella term referring to the consolidation of two companies. * The M&A function in investment banking refers to the strategic M&A advisory services provided on behalf of the acquirer or the acquiree (i.e., the subject of the purchase). * Therefore, the M&A division of an investment bank is assigned with the task of navigating a client through the complexities of an M&A deal to ensure a favorable outcome is reached (i.e., the "best interests" of stakeholders). |
| Underwriting | * Underwriting in investment banking comprises matching corporations in need of capital, either in the form of equity or debt issuances, with institutional investors. * The capital raising process is rather complicated with countless moving pieces and risks, such as timing (e.g., undergoing an IPO in adverse market conditions). * The necessity to hire an investment bank is to ensure the terms of the securities underwriting are structured in the "best interests" of existing stakeholders. |

**Investment Banking Market Leaders**

1. J.P. Morgan Chase & Co.
2. Goldman Sachs Group Inc
3. Morgan Stanley
4. BofA Securities Inc.
5. Citi Group Inc

* The Top investment banks are divisions within large full-service banks referred to as “bulge brackets”, like JPMorgan, Morgan Stanley, Goldman Sachs, and Citigroup.
* The “elite boutiques” are independent advisory firms that specialize in financial and strategic advisory services, with the most prestigious firms being Evercore, Moelis, Lazard, Centerview, PJT, and Qatalyst.
* JPMorgan Chase was the largest investment bank in the world by revenue in 2023.

The U.S. investment banking industry includes about 3,000 companies with combined annual revenue of about **$140 billion**. The 50 largest firms generate more than 90 percent of the industry's revenue.

Investment banking industry has not fully recovered from the aftermath of 2008 financial crisis. The post-crisis period has witnessed a flurry of constraints on the industry in the form of more stringent and intrusive regulations such as Pillar 3, meeting BCBS 239 in addition to IFRS 9 requirements and many other mandatory regulatory requirements which have been impacting the business behaviour as a whole.

Fintech markets globally are evolving on a faster pace disrupting the end-to-end investment banking value chain. Blockchain is rapidly changing the face of cross-border lending activity.

**Mergers and acquisitions (M&A)**

The core function of an investment banker in M&A is to provide financial and strategic advisory services to guide corporate clients through the complexities of M&A deals.

* **Buy-Side M&A ➝** On a “buy-side mandate”, investment bankers serve as advisors to the acquirer (i.e. the buyer) and must determine if the client’s proposed transaction is reasonable. The priority is to ensure the offer price is justified to reduce the risk of overpaying for the underlying asset (e.g., an entire company or individual business segment).
* **Sell-Side M&A ➝** In contrast, investment bankers on a “sell-side mandate” are hired by the seller to advise on the deal and ensure the offer price is fair, without “money left on the table”

The volume of M&A activity—the number of deals closed—tends to rise substantially amid periods of economic expansion, which reverses amid periods of economic contraction.

The performance of the industry is thereby sensitive to the macroeconomic environment and the current state of the capital markets.

If the economy and credit markets are strong, the volume of M&A transactions tends to increase, resulting in more revenue for investment banks via the collection of fees.

Conversely, if financial markets and economic conditions are poor, investment banks experience much lower activity (and thus lower deal fees).

**The Purpose of M&A?**

Corporations engage in M&A for the sake of [growth](https://www.wallstreetprep.com/knowledge/growth-rate/), and there are two methods to achieve that outcome:

* **Organic Growth ➝** Companies can increase their revenue growth rate and profit margins through their internal initiatives, such as cost-cutting, to improve their operating efficiency.
* **Inorganic Growth ➝** Growth can also be achieved by acquiring other companies to increase their collective market share and access to new end markets (i.e., customers).

**CASE STUDY**

eBay decided to sell its majority stake in Skype at a steep loss in 2009 to a group of private investors that included Silver Lake, the Canada Pension Plan (CPP), Index Ventures, and Andreessen Horowitz (a16z).

eBay had acquired the fast-growing VoIP communications platform Skype in 2005 for $2.6 billion to integrate the innovative technology into its e-commerce auction site.

However, eBay soon after acknowledged that the integration of Skype was a failure because buyers and sellers on the site were uninterested in building relationships or even communicating on a personal level.

The privacy aspect and post-acquisition cultural issues contributed to eBay’s decision to “cut their losses” by divesting Skype for $1.9 billion in cash while retaining approximately 30% of their initial investment.

The divestiture valued Skype at $2.75 billion, exceeding the original purchase price paid by eBay in 2005.

eBay hired Merrill Lynch as the investment bank advising on the acquisition of Skype back in 2005 and then later hired Goldman Sachs to advise on the divestiture in 2009.

The partial divestiture, where eBay retained a 30% stake to participate in the potential upside of Skype, proved to be a profitable decision after Microsoft’s buyout of Skype in 2011 for $8.5 billion.

The outcome: eBay obtained a net gain of $1.4 billion from the transaction, reflecting the inherent unpredictability of M&A in investment banking.

A screenshot of a computer

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