

CHAPTER - VI

Development and Investment Banking ::

Development banking was a deliberate public policy initiative to accelerate economic growth and social and economic development by facilitating more access to investment capital by business enterprises. The existing conditions were a financial sector comprised almost entirely of highly risk averse commercial banks operating as short term lenders to established businesses mainly in commerce. The *raison d'être* for development banking is to be found in discordance between the credit allocation practices of the private financial institutions and the financial requirements for rapid and sustained economic growth. The era was one of plantation agriculture, mineral enclaves and oligopolistic market structures in foreign trade and commerce.

Governments when confronted by the social and economic challenges presented by slow and unstable economic growth, sought strategic solutions in terms of economic diversification and development of small farm agriculture. These sectors and sub-sectors did not attract funding from commercial banks. The creation of development banks was the answer.

FUNCTIONS OF DEVELOPMENT BANKS ::

There are four functions or aspects of the role of development banks to be especially noted here. One function is

1.to mobilise funds for onlending to domestic enterprises : Sources of funds have been highly liquid statutory corporations such as national insurance boards, the sub regional development bank, and extra-regional financial institutions and governments. The national development banks do not perform depository functions. Acceptance of deposits from the public would place them under the regulatory control of central banks and would most likely reduce their ability to leverage their liabilities. Cost of funds would also increase because of the need to provide support services for deposit account transactions.

2. To lower the cost of credit : for investment purposes by price-setting policies which are not intended to maximise profits. The requirement is that they operate on the principle of pricing that is concessionary by comparison with the pricing policies of commercial financial institutions.

3. To apply social cost-benefit principles : Development banks are expected to apply social cost-benefit principles in their appraisal of investment projects

submitted by clients. Externalities, particularly social and economic, which would be extraneous to commercial banks' considerations, are often central to development banks' appraisal of projects. For development banks, a project worthy of financing must not only be viable, it must also contribute to national development. In this latter regard, development banks apply national development criteria on behalf of government.

4. Inducing entry into the investment finance : Inducing entry into the investment finance segment of the market by demonstrating opportunities for relatively safe and remunerative medium and long term lending. This role is very important. It recognises that development banks cannot satisfy all of the demand for investment capital, that there will be room for other financiers.

THE NEXT ECONOMIC DECADE

The first problem or challenge of the next economic decade is that of revival of economic growth. The nature and pace of the recovery would be an overall constraint on the operations of development banks. The prospects for recovery are uncertain. Many Western Hemisphere economies have had to revise their growth forecasts downwards. There is also uncertainty about the degree to which economic recovery in developing countries will lag behind economic recovery in their industrialised trading partners.

It is possible that commercial banks, including the indigenous ones, will become more risk averse in response to the liquidity and earnings problems of enterprises. Some financial institutions have such a high level of exposure to government debt that they are adversely impacted by fiscal difficulties which erode governments' debt servicing capacity. The overall prospect is for reduced access to commercial lenders and greater recourse to development banks in the short term.

Development banks will have to deal with an economic environment considerably different from the one to which they have been accustomed. Most governments are under severe pressure to reform their public finances. Their debt levels have approached unsustainability necessitating efforts to lower debt levels and reduce debt service burden. Furthermore, because of heavy borrowing in the past, there is less scope for tapping the liquid resources of public financial enterprises like national commercial banks and statutory pension funds and social security funds. Instead, additional debt financing by the governments is more likely to be from multinational commercial banks and multilateral financial institutions.

CHALLENGES FOR DEVELOPMENT BANKS

Development banks are likely to be seriously challenged in this decade. On the lending side of their operations,

one challenge is competition from commercial banks and merchant banks. The growth in size of non-financial enterprises and the associated growth in the average size of their loan demands will bring them into a range which attracts the interest of private financial institutions. Paradoxically too, the success of development banks in demonstrating the feasibility of doing good investment financing business will also encourage the interest of potential competitors.

Another challenge on the lending side is the greater complexity of enterprise risk evaluation when the enterprises are cross border enterprises operating in non-uniform regulatory and legal jurisdictions. On the funding side, development banks may increasingly need to rely on their own financial strength for market access of funds since governments may become reluctant to guarantee their debt and might not have the debt bearing capacity or sufficiently strong credit ratings.

Investment banking :

What is investment banking? Is it investing? Is it banking? Really, it is neither. Investment banking, or I-banking, as it is often called, is the term used to describe the business of raising capital for companies and advising them on financing and merger alternatives. Capital essentially means money. Companies need cash in order to grow and expand their businesses investment banks sell securities (debt and equity) to investors in order to raise this cash. These securities can come in the form of stocks, bonds, or loans. Once issued, these securities trade in the global financial markets.

Corporate finance is the traditional aspect of investment banks which also involves helping customers raise funds in capital markets and giving advice on mergers and acquisitions (M&A). This may involve subscribing investors to a security issuance, coordinating with bidders, or negotiating with a merger target. Another term for the investment banking division is corporate finance, and its advisory group is often termed "mergers and acquisitions". A pitch book of financial information is generated to market the bank to a potential M&A client if the pitch is successful, the bank arranges the deal for the client.

The investment banking division (IBD) is generally divided into **industry coverage and product coverage groups**.

- A. Industry coverage groups focus on a specific industry – such as healthcare, public finance (governments), FIG (financial institutions group), industrials, TMT (technology, media, and telecommunication) – and maintains relationships with corporations within the industry to bring in business for the bank.
 - B. Product coverage groups focus on financial products – such as mergers and acquisitions, leveraged finance, public finance, asset finance and leasing, structured finance, restructuring, equity, and high-grade debt – and generally work and collaborate with industry groups on the more intricate and specialized needs of a client.
- Corporate finance

The bread and butter of a traditional investment bank, corporate finance generally performs two different functions:

- 1) Mergers and acquisitions advisory and
- 2) Underwriting.

(1) Mergers and acquisitions advisory : On the mergers and acquisitions (M&A) advising side of corporate finance, bankers assist in negotiating and structuring mergers between companies. If, for example, a company wants to buy another firm, then an investment bank will help finalize the purchase price, structure the deal, and generally ensure a smooth transaction. In the last few years, the M&A market has been white-hot, as companies have large cash balances with which they can complete strategic transactions.

(2) Underwriting : The underwriting function within corporate finance involves the process of raising capital for a company. In the investment banking world, capital can be raised by selling either equity (stocks) or debt (bonds or loans) (as well as some more exotic securities) to investors. Underwriting is unique, in that it involves the investment bank assuming a large amount of risk. Essentially, in the case of a bond offering, you can think of the process of underwriting as an investment bank writing a check to a company, then raising the funds in the markets from investors. This means that the investment bank assumes the risk of the transaction not selling in the market. Think of this as buying pizza for friends and relying on them to pay you back. If you've ever done this, you've "underwritten" a transaction.

Although performing two functions, corporate finance is often divided into a number of industry-focused groups, called "coverage" groups. Coverage groups are usually aligned by a client's industry and can potentially include aerospace & defense, automotive, consumer goods, diversified industrials, FIG (financial institutions and governments), financial sponsors, healthcare, natural resources (oil & gas, metals &

mining, power), TMT (technology, media, telecom), real estate, and transportation. As these groups focus on industries and relationships, they are able to become very close to the clients and their needs. Therefore, it is not uncommon for M&A advisory work to either be done within these groups, or as a completely separate group, also broken into industry coverage teams.

As those in corporate finance are privy to private company information, such as forward-looking financials, they are considered on the “private side” of the so-called Chinese wall and are unable to sell or trade such privileged information.

COOPERATIVE BANKING:

Cooperative banking is retail and commercial banking organized on a cooperative basis. Cooperative banking institutions take deposits and lend money in most parts of the world. Cooperative banking, as discussed here, includes retail banking carried out by credit unions, mutual savings banks, building societies and cooperatives, as well as commercial banking services provided by mutual organizations (such as cooperative federations) to cooperative businesses.

The co-operative banks are small-sized units which operate both in urban and non-urban centers. They finance small borrowers in industrial and trade sectors besides professional and salary classes. Regulated by the Central Bank, they are governed by the Banking Regulations Act and banking laws (co-operative societies) act. Generally the co-operative banking structure is divided into following 5 categories

1. Primary Co-operative Credit Society: The primary co-operative credit society is an association of borrowers and non-borrowers residing in a particular locality. The funds of the society are derived from the share capital and deposits of members and loans from central co-operative banks. The borrowing powers of the members as well as of the society are fixed. The loans are given to members for the purchase of cattle, fodder, fertilizers, pesticides, etc.

2. Central Co-operative Banks : These are the federations of primary credit societies in a district and are of two types-those having a membership of primary societies only and those having a membership of societies as well as individuals. The funds of the bank consist of share capital, deposits, loans and overdrafts from state co-operative banks and joint stocks. These banks provide finance to member societies within the limits of the borrowing capacity of societies. They also conduct all the business of a joint stock bank.

3. State Co-operative Banks: The state co-operative bank is a federation of central co-operative bank and acts as a watchdog of the co-operative banking structure in the

state. Its funds are obtained from share capital, deposits, loans and overdrafts from the Reserve Bank of India. The state co-operative banks lend money to central co-operative banks and primary societies and not directly to the farmers.

4. Land Development Banks: The Land development banks are organized in 3 tiers namely state, central, and primary level and they meet the long term credit requirements of the farmers for developmental purposes. The state land development banks oversee, the primary land development banks situated in the districts and tehsil areas in the state.

5. Urban Co-operative Banks : The term Urban Co-operative Banks (UCBs), though not formally defined, refers to primary co-operative banks located in urban and semi-urban areas. These banks, till 1996, were allowed to lend money only for non-agricultural purposes. This distinction does not hold today. These banks were traditionally centered on communities, localities, work place groups. They essentially lend to small borrowers and businesses. Today, their scope of operations has widened considerably.

Functions of Co-operative Banking : Functions of Co-operative Banks Co-operative banks also perform the basic banking functions of banking but they differ from commercial banks in the following respects .The major functions of a cooperative bank are

A.Mobilization of funds from their members :

B.Advance loans to the members :