MODULE

Investment Banks & IPOs

Explore how companies get onto stock exchanges and how Shake Shack gained popularity.

This module explains the role of investment banks, the purpose of capital markets and how companies get bigger by deciding to go on the stock market or by uniting with another company.

POWERED BY

Key Takeaways From This Module

Guiding Questions

- What does an investment bank do?
- What is the difference between an investment & commercial bank?
- What are capital markets?
- How does a company IPO?
- How do large companies merge and buy each other?

Enduring Understandings

- The funding process of a company from startup through an initial public offering.
- The skills and requirements for successful investment bankers.
- How to prepare a SWOT analysis for a mergers and acquisitions deal.
- The benefits of an IPO & access to capital markets which investment banks provide.

Investment Banker's Glossary (Part 1/2)

Equity: Partial ownership of a company, such as stocks.

Debt: A loan to a company, to be paid back later with interest.

IPO: Initial public offering; the process where a private company goes public, meaning shares are sold to investors, after which it can be publicly traded on the stock market.

Offering Price: The price of a stock of a company in its IPO.

Capital Market: Where investors can trade securities of a company, whether between the company or between other investors. Stock markets are capital markets!

Underwriting: Where an investment bank agrees to raises capital for a company from investors in exchange for a fee.

Investment Banker's Glossary (Part 2/2)

Merger: When two companies unite to form one, usually ending up under the name of one of them. These two companies are usually equal in size.

Acquisition: When one company buys another company, usually by buying all of the assets of the target company.

SWOT Analysis: A method to gain a perspective into how competitive a company is by looking at its strengths, weaknesses, opportunities, and threats.

Aftermarket: A period after a stock's IPO.

Overvalued: A stock that has a higher price than its true value.

Undervalued: A stock that has a lower price than its true value.

The Basic Breakdown of an Investment Bank

An Investment Bank takes two groups, one that wants to invest their money and make a return, and the other that needs money and is offering those investment opportunities.

When two companies want to unite to form one, or one company buys another, the Mergers & Acquisitions division of the bank advises both companies and acts as the middleman.

If a company needs to get financial capital to grow, the Underwriting division of the bank can introduce them to investors to sell securities, such as with an Initial Public Offering (IPO).

Two Sides of the Same Coin?

Commercial Bank

Offers saving accounts, loans, and checking & debit account services.

Makes money through the interest of loans given to individuals and businesses.

Strict regulation by government, but are more secure and less risky.

Investment Bank

Offers financial services, such as advising on mergers & acquisitions or IPOs.

Makes money through commissions, fees, and the profit of buying and selling shares from IPOs.

More relaxed regulation, meaning less security, but more freedom to operate.

Why are Capital Markets Useful?

Capital Market: A market where investors can trade securities. A security holds financial value, such as equity or debt, a type of loan to companies.

- **Primary Market:** A capital market where securities are first sold to the public. This is where companies come to raise capital with an IPO. The better the access the investment bank has to the primary market, the better chance the company can get more investors.
- **Secondary Market:** A capital market where securities can be traded, such as the stock market.

What's in it for the economy?

By allowing buyers and sellers to interact with each other efficiently, companies are able to get funding for research and spend more on their products and employees.

In addition, capital markets allow for the government to sell bonds, so that they can have money to build infrastructure and fund different types of economic policies.

HOW DO LARGE COMPANIES MERGE AND BUY EACH OTHER?

Again, companies want to increase their profits, but in the case of mergers and acquisitions, large companies want to not only increase their own market share by joining or buying the competition, they also want to extend their reach into others.

Investment banks act as advisories during the deal, analysing strategies based on the aspects of each company in the deal.

But how can investment bankers gain an insight?

The Good, The Bad, and The Ugly: SWOT

Internal: A look within

Strengths
- What is the company good at?
- What's going well right now?

Weaknesses
- What is the company bad at?
- What's hurting the company right now?

External: A look around

Opportunities
- What factors outside of the company can increase growth?
- What's another way to use resources?

Threats
- What's going to reduce success?
- What is the competition doing?

How an Investment Banker Sees Coca-Cola

Strengths

Recognisable Branding

Global reach and production

Loyal fan base and large market share

Weaknesses

Bad Health Reputation

Strong rivalry with Pepsi

Low product diversification

Opportunities

Use world-wide bottling facilities, developed supply-chains, and loyal fan base to quickly produce and sell healthy beverages.

Threats

Decreasing popularity of sodas

Increasing soda tax

Competition, such as new teas and waters.

Historic Mergers and Acquisitions

In 1999, Exxon and Mobil merged to combine the experience of Exxon in water exploration and Mobil's area of high potential for good oil and gas developments. The merger increased the average growth rate of income by 7%, showing its success from increasing ExxonMobil market share.

Pros

By uniting, the reduction of redundancy in production allows for an increase in efficiency and allows for an instant increase in market share, increasing the value of the company and expanding its opportunities.

Cons

A merger or acquisition causes worry within the workforce, as layoffs are not uncommon to reduce redundancies and the cultures of the companies may be problematic. If there are difficulties, the merger or acquisition could be extended, causing additional stress on both companies.

Key Takeaways From This Module

CORE & FUNDAMENTALS

- Investment banks advise mergers and acquisitions, and underwrite comapnies for IPO's
- Investors trade securities on Capital Markets,
- An IPO occurs when a company offers publicly traded shares, which helps them raise capital.

APPLIED KNOWLEDGE

- Conduct thorough research on upcoming IPO's to decide if they're worth investing in.
- Use SWOT analysis to see how well two companies will merge.
- Track and understand the behaviour of a stock in the aftermarket.

RELEVANCE FOR YOU

- You can help companies raise capital as a shareholder.
- SWOT analysis can help you analyze the internal and external factors that make a company competitive(or not)
- Keep up with m&a headlines for companies you want to invest in.