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Investment Banking: Global perspective with regulatory framework & financial Crunch

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Abstract: Banking sector is one of the most promising and biggest contributors towards the economic growth of a nation when supplemented by innovative banking information technology, robust marketing strategies and supported with a professional environment. The global meltdown has shaken the banking industry to a larger extent during the course of which, many Investment banks have accepted the fact of losing the market share. The primary objective of bringing regulations in the system was to protect the investors, financial system and ensure transparency by implementing various acts like Glass-Steagall Act, Gramm-Leach-Bliley Act, Dodd-Frank Act and Volcker Rule in the United States. Reserve Bank of India (RBI) had built a robust vault around the banking system by prohibiting local banks from taking excessive risks, conducting the stress test of the bank's investment portfolios in a rising interest rate scenario. The study has resulted in substantiating with predominant influential factors hampering the operations of foreign investment banks in Bangalore are integrated and innovative business strategy, anti-money laundering, operational challenges, and legal policies framed by the regulatory bodies in India.

Key Words: Investment Banking, Global meltdown, Investment Advisory Services (IAS) and Regulatory framework.

I. INTRODUCTION

Banking sector is one of the most promising and biggest contributors towards the economic growth of a nation when supplemented by innovative banking information technology, robust marketing strategies and supported with a professional environment. Banking systems can be defined as the mechanism through which supply of money is created, circulated and controlled by the standard regulatory framework. Banking operations can be classified into three categories namely commercial banking, retail banking and investment banking.

Investment banking is a special segment in banking operation that facilitates high net worth individuals, Corporate houses, and Governments in raising capital, offering financial consultancy services, investments and rendering ancillary services in the form of mergers and acquisitions (M&A), corporate actions, trading of securities (Equity and Fixed Income Instruments, Currencies, Commodities), derivatives, marking market, and advisory services for commission. It is one of the most complex mechanisms in the world of banking industry and rapidly blooming segment under the umbrella of the banking sector. It is a special financial intermediary which performs various financial and advisory services in exchange for service fees.

II. GLOBAL INVESTMENT BANKING

United States (US) is one the pioneer nations to bring the concept of Investment banking into implementation on the basis of merchant banking rooted from the medieval period and dominates the global investment banking. United Kingdom (UK) now separated from European Union is the second largest most sought destination and robust competitor for US in the investment banking Industry. The strategies adopted in the UK is different from the US. The European Investment Bank (EIB) comprises of six member nations namely France, Germany, Italy, Belgium, Netherlands and Luxembourg serving as their common financial market [10].

The investment banking firms' offering exclusive services to its clients in the South Asian countries are confined only with respect to middle end and back-end operations unlike their western counterparts for the reason being central bank regulations towards investment banking functionality, extremely volatile capital markets and to prevent economic downfall. The role of investment banking plays a pivotal role in economic development of the country accelerating various employment opportunities, foreign exchange reserves, FDI, foreign exchange earnings and Gross Domestic Product (GDP). It facilitates in bridging the gap between economic development and robust financial markets.

Largest full-service investment banks across the world which offer both advisory and financial banking services like sales, market marking, research on financial products, currency and commodity trading, hedging, and derivatives are JP Morgan Chase, Goldman Sachs, Bank of America Merrill Lynch, Morgan Stanley, Citigroup, Deutsche Bank, Credit Suisse, Barclays Capital, UBS, Wells Fargo, RBC

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Capital Markets, HSBC, Jefferies Group, BNP Paribas, Nomura Holdings, Mizuho, Lazard, Sumitomo Mitsui, Mitsubishi UFJ, and Societe Generale. United States is the biggest market, followed by Europe, Middle East, Africa and Asia for these banks to operate. Some of their global hubs which are economically and financially sound for operating business involves London, New York, Tokyo, and Australia.

The global meltdown has shaken the banking industry to a larger extent during the course of which, many Investment banks have accepted the fact of losing the market share where rest of the industry is moving towards more specialized, optimized and focusing on serving their core client's needs rather than holding onto different lines of business. Foreign investment banks are creating an edge over others by being biggest changing trend among the local Investment banks for the reason that they can nudge their global peers with internal thresholds on minimum fees by mastering the art of cornering the deals through undercutting as the Indian clients are generally price sensitive and prefer lower bidders.

REGULATORY FRAMEWORK IN UNITED STATES

Regulatory framework was very stringent in the western nations as the concept of Investment banking originated through the roots of merchant banking. The primary objective of bringing regulations in the system was to protect the investors, financial system and ensure transparency. Glass-Steagall Act which separated commercial banking with investment banking, prohibiting underwriting and securities transactions. Gramm-Leach-Bliley Act was introduced to overcome the prohibitions of Glass-Steagall Act in allowing banks to operate in wide range of financial services with an objective was to protect customer's personal and financial information from being shared by the banks.

Dodd-Frank Act is a United States Federal law enforced with an objective of eliminating the need for taxpayer-funded bailouts ensuring co-operation by the financial insiders and fight corruption in the financial industry. Volcker Rule prohibits banks from short-term proprietary trading of securities, derivatives etc. where banks cannot use their own funds to invest in these asset classes in the financial markets to increase their profits.

INDIAN INVESTMENT BANKING

Merchant banking is the original form of investment banking activities which can be performed only after obtaining a license from the Securities Exchange Board of India (SEBI). Merchant bankers are not authorized to carry any other business other than merchant banking. Equity research activity must be carried out independently as part of the merchant banking activities by the merchant banks to avoid conflict of interest. Stockbroking business has to be separated into a different company that is obliged to operate within the framework of SEBI with respect to securities exchange.

Reserve Bank of India (RBI) has regulated the functioning of these Investment banks to ensure there is sufficient liquidity in the financial markets, averse risk and to protect the interests of the investors. India is still blue-eyed emerging market from the investment banking segment despite global financial crunch post - 2007 due to the fact that cost of labour, favourable economic and financial conditions with the strict regulatory framework. Indian Financial System largely escaped the global financial crunch as RBI had built a robust vault around the banking system by requesting all the banks to furnish their risk exposure levels. It also prohibited local banks from taking excessive risks, conducting stress test of the banks investment portfolios in a rising interest rate scenario, and advising banks to meet the adverse impact of interest risk by creating investment fluctuation reserves so that banks could absorb the impact of rising interest rates when there was reversal of rate movement in early 2004[8].

RBI has directed the banks offering Investment Advisory Services (IAS) through a separate subsidiary to avoid any conflict of interest. IAS is defined and regulated by Securities Exchange Board of India (SEBI) regulations 2013 which compels the entities offering these services to be registered under SEBI. Sponsor bank must obtain special approval from Department of Banking Regulation prior offering IAS through an existing subsidiary confined to approved products and services [9].

The areas of improvement that ensures 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 [13].

III. LITERATURE REVIEW

Significant contributions towards this area of descriptive study have been conducted by many authors from United States of America (USA), United Kingdom (UK), European countries, China, Pakistan, Japan and India who have emphasised the evolution of Investment Banking business, history, failures of investment banks, fraudulence and its curbing measures, banking reformation to match the globalisation, modern investment banking techniques, emerging trends in this sector, application of technology in banking sector, impact of business on economy, capital formation, various sources of income generation to investment banks, support of Federal Reserve board, reasons for recession due to financial crunch during 2006-2009, advisory and financial services offered to financial institutions and High Net Worth Individuals (HNI) primarily focusing on the theoretical and conceptual analysis rather than empirical study.

Daniel Dunaief (1995) [1], Jonathan R. Macey (2000)[3],Victoria Geyfman and Timothy J. Yeager (2009) [6] and Lawrence J. White (2010)[7] have emphasized on Federal Reserve Board legally permitted few banks to underwrite and deal in debt and equity securities to few selected investment banking powers under the section 20 of the Glass- Steagall Act. Banks focused on expanding their corporate businesses by venturing into investment banking subsidiaries as per the Section 20 of Glass-Steagall Law. Gramm-Leach-Bliley Act proved to be a taboo on various banking operations and technological innovations were making traditional commercial banking obsolete. It was signed into a law on November 12, 1999, assuming to be an

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important step towards the removal of legal barriers between commercial banking and investment banking in the United States. Glass –Steagall Act of 1933 prohibited US commercial banks from expanding their operations into Securities activities like underwriting, sale or distribution of stocks, bonds, debentures etc.

John Reosti (2002)[4],Anthony Hilton (2008)[5],James Kraus (1985)[8], Dara Khambata (1996)[9], Ross Cranston (1997)[10], John MacCarthy (2016)[11], Andy Peters (2017)[12] have focused on few Investment banks venturing into insurance and securities business in 1999 before the Gramm-Leach-Bliley Act was passed where insurance thrived and securities business failed to churn profits. The Industry was forced to follow the application of Glass-Steagall Act that imposed a separation between commercial and investment banking business during 19030-1990.

STATEMENT OF THE PROBLEM

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 by foreign investment banks in India, especially Bangalore as it is the one of the most promising city and also the research gap being no earlier empirical study conducted in this area.

OBJECTIVES

To analysis the factors influencing the operations of foreign investment banks in Bangalore.

IV. RESEARCH METHODOLOGY

The study is exploratory in nature.

DATA AND SOURCE

The study is mainly based on primary data only. The primary data is collected from structured questionnaire based on investment banking in India on the basis of Linkert scale.

SAMPLING TECHNIQUES

The respondents belongs to employees of foreign investment banks operating in Bangalore urban, who are selected for the study. The snowball sampling technique has been applied to collect the sample size of 50 respondents.

VARIABLES AND TOOLS USED

Investment Banking (IB) services, Segment roles, Professional skills, Operational challenges, Revenue, Data management, Investment paradigm, Legal impact, Customer Relationship Management (CRM), Corporate Social Responsibility (CSR), Business model, Strategy, Anti Money Laundering (AML), Economic policy and Customer database to assess the above said variables. The statistical tools used are Reliability test, Factor and Cluster analysis.

SCOPE OF THE STUDY

The purpose of this research is to identify the challenges, areas of operational improvement, regulatory framework with respect to the foreign Investment banks operating in Bangalore. Promote smooth banking functions in the area of investment to identify the gap between the regulatory framework and its impact on the global financial crunch as most of these foreign banks are head quartered in western countries.

LIMITATIONS OF THE STUDY

The focus is only on the foreign investment banks operating in Bangalore urban.

Table 1.1: Reliability Test Analysis

Cronbach's Alpha	No of Items	F	Sig
.807	21	13.320	.000

Source: Computed from primary data

Table 1.1 shows that the reliability analysis on the factor stimulating, reliability analysis scale ranges between 0.00 and 1.0 (where 0.0 = no reliability & 1.0= perfect analysis). It is observed that the reliability of coefficient alpha (α) of 21 items is 0.807 (scale ranging 0.0 to 1.0) which shows the reliability of the given factors.

Table 1.2: Kaiser-Meyer-Olkin and Bartlett's Test of Sphericity

Kaiser-Meyer-Olkin	Measure of Sampling Adequacy	.618
	Approx. Chi-Square	501.858
Bartlett's Test of Sphericity	Sig	.000

Source: Computed from primary data

Table 1.2 reveals Kaiser-Meyer-Olkin Measure of Sampling Adequacy (KMO) and Bartlett's test of Sphericity have been applied, to the resultant correlation matrix to test whether the relationship among the variables has been significant or not as shown in the table 1.2. The result of the test shows that with the significant value of 0.000 there is significant relationship among the variables chosen for the study. KMO test yields a result of 0.618 which states that factor analysis can be carried out appropriately for these ten variables that are taken for the study. The KMO test explains the proportion of variance in the variable which is common variance that might be caused by the underlying factors may be determined.

Table 1.3: Factors influencing the operations of foreign investment banks

Rotated Component Matrix[a]				
Influencing Factors	**1**	**2**	**3**	**4**
Investment banking services		**.452**		
Operational roles			**.635**	
Professional skills		**.725**		
Operational challenges			**.817**	
Revenue	**.724**			
Data management			**.781**	
Investment paradigm			**.490**	
Legal impact				**.864**
CRM			**.492**	
CSR		**.566**		
Business model	**.654**			
Strategy	**.857**			
AML		**.835**		
Economic policy	**.530**			
Customer database	**.715**			
Total	6.616	1.802	1.344	1.034
Per cent of variance	44.110	12.016	8.963	6.895
Cumulative per cent	44.110	56.126	65.089	71.983
Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization. a. Rotation converged in 13 iterations				

Source: computed results based on primary data

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Table 1.3 illustrates the principal component analysis and rotated factor loading method that has been used for stimulating factors. It is observed that out of fifteen factors, four factors are identified by the rotation method. The total per cent of variation in the factors reflects 71.983 per cent and total Eigen value of the factors is 6.616. The analysis also shows that 71.9 percent variables can be explained during the study.

Table 1.4: Clustering of influencing key components into factors.

Key Components	Factors	Rotated Factor Loadings
I Asset Management (6.616) per cent	Revenue	.724
	Business model	.654
	Strategy	.857
	Economic policy	.530
	Customer database	.715
II Core Banking Solutions (1.802) per cent	Services	.452
	Professional skills	.725
	CSR	.566
	AML	.835
III Operations (1.344) per cent	Segment Roles	.635
	Challenges	.817
	Data management	.781
	Investment paradigm	.490
	CRM	.492
IV Regulatory Framework (1.034) per cent	Legal impact	.864

Source: computed results based on primary data

The factor loadings given in the above table 1.4 projects the correlation between factors and the variables. Large values indicate that a variable and a factor are closely related. Based on the loadings, all the items are identified and segregated into the related factors. The above table 1.4 represents the clustering of influencing key components with respect to the foreign banks operating in Bangalore into different factor groups.

Revenue, business model, strategy, economic policy, and customer database are grouped as I and reflects the level of expertise and experience in asset management by these Investment banks to ensure efficiency and better managerial skills. Services, Professional skills, Corporate social responsibility (CSR), Anti money laundering (AML) are grouped as II which emphasis on the core banking solutions offered by these banks which are customised and create an edge over competitors, both foreign as well Indian banks, that facilitates in remaining robust in the industry. Roles, Customer relationship management (CRM), Investment paradigm, Challenges, Data management are grouped as III that depicts the operational strategies adopted by these banks in the changing business environment which calls for empowering themselves to cater to the customised needs of the clients. Legal impact is grouped as IV that describes the regulatory framework within which these banks are expected to operate which can be in terms of stringent rules to protect the banks from being bankrupt and prevent facing financial crunch.

V. CONCLUSION

Regulatory framework with stringent regulations enables an economy to overcome the financial crunch with timely adoption of preventive measures and also creates a robust financial system. Hence the study has resulted in learning the various factors that influence the foreign investment banks to operate in more rigid Indian environment that has prevented many banks from being bankrupt and still are good at generating revenue. The study also reflects that due to the conservative strategy adopted by Indian regulatory body has prevented the front office and middle office segments from flourishing in the Indian economy.

The results of the analysis shows that innovative business strategy adopted plays a pivotal role in managing the assets of the clients when services are offered by the foreign investment banks operating in Bangalore as the rotated factor loading is .857, which is the highest influencing factor under the key component asset management.

Anti-money laundering has been one of the most significant compliance aspect in the investment banking sector that can either make or break the bank. The highest influencing factor is AML with rotated factor loading being .835 under the key component core banking solutions, emphasizing the importance of designing robust regulatory framework to facilitate better core banking solutions to the trusted clients and investors of investment banks.

Operational challenges describe the regulatory framework that don't encourage front office and middle office segments to operate in Bangalore based on the services rendered by foreign investment banks due to the policies framed by the SEBI and RBI, whose primary focus is protecting the Indian economy from the impact of global financial crunch and such future disasters. Hence, this is the highest influencing factor being .817 under the key component operations.

Though legal impact has been the only influencing factor under the key component of regulatory framework, has an robust factor loading value of .864 that proves that legal policies in Indian economy are indeed conservative to prevent any global meltdown by taking preventive measures.

The study has resulted in substantiating with predominant influential factors hampering the operations of foreign investment banks in Bangalore are integrated and innovative business strategy, anti-money laundering, operational challenges, and legal policies framed by the regulatory bodies in India. India has been very conservative in framing the policies of regulatory framework for the banks permit operating in India.

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