



WP/01/90

IMF Working Paper

Investment Banking and Security Market Development: Does Finance Follow Industry?

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IMF Working Paper

IMF Institute

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Authorized for distribution by Reza Vaez-Zadeh

July 2001

Abstract

The views expressed in this Working Paper are those of the author(s) and do not necessarily represent those of the IMF or IMF policy. Working Papers describe research in progress by the author(s) and are published to elicit comments and to further debate.

Long-term relationships between business firms and investment banks are pervasive in developed security markets and there is evidence that better monitoring and information result from these relationships. Therefore, security markets should allocate resources better when an investment banking industry exists. We study the necessary conditions for the emergence of sustainable relationships and explore whether policy can foster them. We show that policy can help alleviate the costs of relationships, but an investment banking industry will not emerge with only a small number of large firms.

JEL Classification Numbers: G20; L22

Keywords: relationships; size distribution of firms

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¹ Harvard Business School and University of Chile, respectively. This paper was written while Alexander Galetovic was a Visiting Scholar at the IMF Institute. The Institute's hospitality is gratefully acknowledged. We thank Stanley Black, Tito Cordella, Leonardo Hernández, and seminar participants at the Institute for comments.

Contents	Page
I. Introduction and Motivation.....	3
II. How are Relationships Produced?.....	5
A. The Importance of Relationships in Investment Banking.....	5
B. The Economics of Investment Banking Relationships	6
C. A Simple Model of Relationships	7
III. Relationships and the Structure of the Investment Banking Industry.....	8
A. The Implicit Cooperation Condition and Industry Structure	8
B. Relationships are for Large Firms.....	11
C. When Will an Investment Banking Industry Emerge?.....	13
IV. Some Policy Implications	14
A. Can Policy Do Anything to Foster Relationships and Investment Banking? ...	14
B. Antitrust Dilemmas in the Investment Banking Industry.....	16
C. What Will the Global Investment Banking Industry Look Like?	17
V. Conclusions.....	17
Figures	
1. Concentration and Volume in Underwriting.....	19
2. Concentration and Volume in Mergers and Acquisitions.....	20
Tables	
1a. Leading U.S. Underwriters: All Debt and Equity, 1999 (Ranked by dollar volume raised in new issues)	21
1b. Leading U.S. Underwriters: All Debt and Equity, 1999 (Ranked by disclosed fees)	21
2. 1977–82 IPOs Categorized by Gross Proceeds and Contract Type.....	22
References.....	23