Investment Banking and Brokerages – A Changing Scene

Investment banks have played a pivotal role in our society, playing a key role to help our markets and economies by connecting people, capital and ideas. This however, hasn't always been the case and the future of banking can be quite different with the emergence of brokerages, evolving financial regulations, client sophistication and emerging market opportunities.

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History and Background

Merchant Banking to Present

One way to think of investment banks and brokerages is as a marketplace. Banks support a diverse range of clients, customers and businesses across the world along with the broader financial markets by connecting sellers with investors and in-process - injecting liquidity into the markets. Today, investment banks can also be characterized as intermediaries for businesses and markets. Banks support core corporate functions ranging from mergers and acquisitions, capital raises/access, restructuring - or strategic advisory. It's clear that the role of investment banks today is integral to the growth of our businesses, financial markets and broader economy but it hasn't always been like this.

Present Day Emergence

Early in the 19th century, the emergence of merchant and commercial banking would give rise to the investment banking we see today. Firms like J.P Morgan began their practices through a merchant banking model where the business would deal primarily with loans and investments via the bank's own books. As these banks grew, so did the businesses they serviced and with this growth and emergence - later in the 19th century, firms sought capital raises through securities issuances to outside investors in major global financial hubs (i.e., New York, London.) and at that point, investment banks assumed the role of underwriting. Through engagement in the business of representing issuers to the investing public, firms involved in the emerging practice of underwriting would go on to become the modern investment banks we see today (e.g., JP Morgan, Morgan Stanley, Goldman Sachs).

Value Chain

Today, to understand the value chain of investment banks, looking at the products and services investment banks offer tells us how much banks have evolved. Broadly, banks provide advice and services for transactions for different kinds of customers - ranging from corporations to governments. Some primary activities of banks include underwriting and issuances (e.g., IPOs) and advisory/facilitation of M&A (including leveraged buyouts). Further, some forms or offices focus on specific financial products/services such as restructurings. Looking at things more generally, banks help with facilitating certain processes which can include marketing, sales, funding, investing and financing services or transactions.

Overall, investment banks started out with a merchant banking model but have grown to provide more services and products for a wider range of clients. With the growth of advisory and product/service offerings for a broader set of clients, the roles of investment banks in our current world or global economy are paramount - and indifferent to business cycles. Investment banks and the emergence of stand-alone brokerages are staples in our financial markets, and they continue to grow with time, innovation and sophistication.

Sources: Deloitte Industry Report, Financial Institute, Investopedia, Britannica, Wall Street Prep

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Industry Key Trends

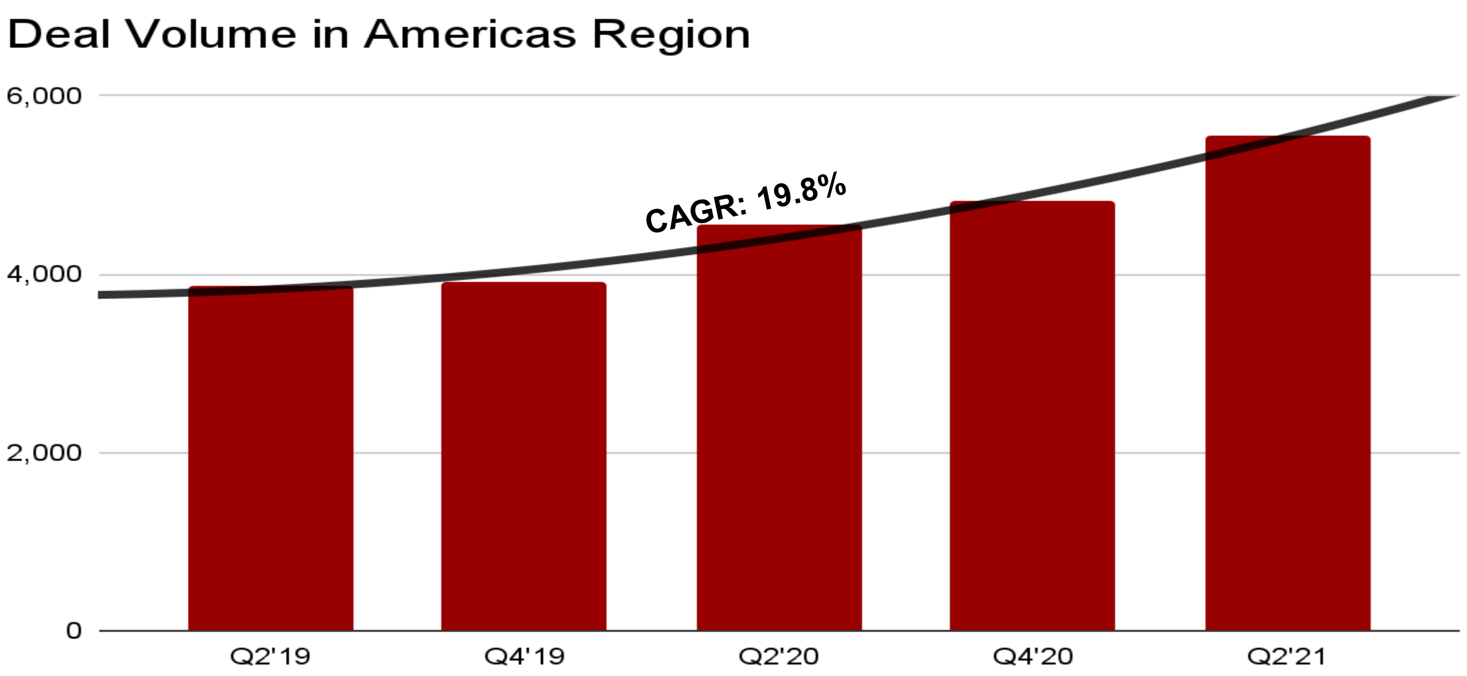
Consolidation of Banking Systems

This trend toward consolidation is driven by firm pressure to meet changing client expectations, invest in new technology and digital innovations, and most importantly, maintain compliance costs. These bank-owned brokerage firms invested significant resources into their wealth advisory services and made key acquisitions, both domestically and internationally, in order to shift the focus to serving the high-net-worth (HNW) market segment, the company plans to add products and services. For example, in 2018, the Bank of Nova Scotia acquired Jarislowsky Fraser Ltd. for $980 million, a Montreal-based asset management firm catering not just to institutions, but also to HNW and ultra-HNW investors.

Increase in M&A Advisory Service

Over the five years to 2021, many of the industry's banks have exceeded expectations in their M&A deal volume. As many investment banks have experienced a declining income in trading, they have shifted their primary focus to advisory services in M&A. In 2016, many boutique investment banks were advising on mergers and acquisitions (M&A) at a rate of 34.0% more than in 2007. M&A advising has a greater focus on relationships than FICC, which relies heavily on scale and huge investments in technology and compliance. It does not require smaller players to compete with their larger rivals on scale.

In 2021, over 62,000 mergers and acquisitions were announced globally, a 24% increase from 2020, breaking a record-breaking number of previous records. M&A activity in 2021 was driven by strong demand for technology and digital assets, as well as the deal-making demand that had been suppressed since 2020. The Americas region still holds the heaviest presence in increasing its deal volume through capturing most of the megadeals across the globe.



Sources: Deloitte Industry Report, McKinsey Industry Report, Bank of Albania

Industry Key Trends

Growing Presence of Smaller Boutique Banks

As a result of the increasing regulatory environment since the financial crisis, revenue growth has been constrained across developed countries and is primarily affecting bulge bracket banks. However, boutique banks are leveraging this opportunity by increasing their focus on advisory services. Over the past five years, smaller players have experienced significant growth in revenue, and this has diluted market share concentration at the global level. Due to automation, investment banks have cut back on staff in back-office functions while investing heavily in technology.

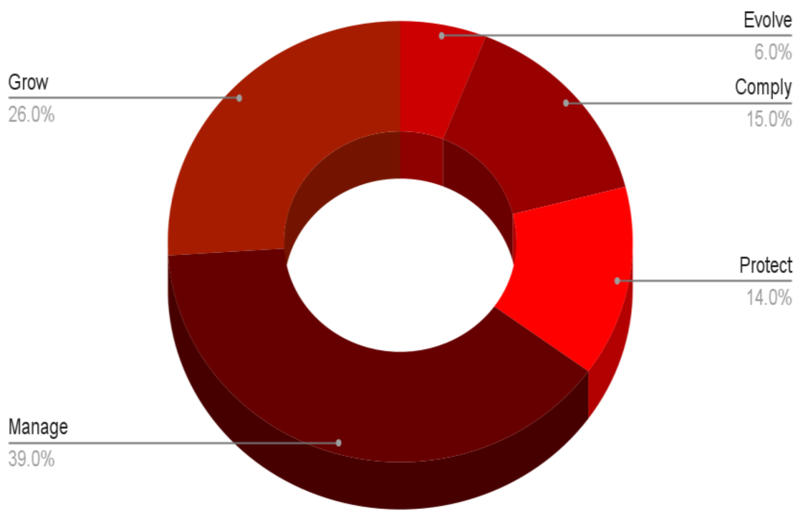
Consequently, over the five-year period ending in 2021, the workforce will grow at an annualized rate of 1.1% to 340,146 workers, underscoring the need for technologists to design and implement new systems in-house. Enterprises rose at an annualized rate of 3.0% to 23,831 companies over the five years to 2021 as boutique banks entered the industry.

Automation of Deals with AI Analytics

Through the advancement of technology over the last decade, investment banks have been able to receive proactive alerts when their professional networks change. Managing Directors and senior executives won't be replaced by robots, but they can accelerate deal-making, making your team's access to information faster and easier. AI and bots offer plenty of value for investment banks when it comes to high-pressure deals, eliminating human errors, automating the signature process, or simply scheduling meetings seamlessly. Over the years, many of the banks have taken advantage of Ai and data analytics to determine bid ranges and spreads, as well as to plan staffing in order to maximize success fees and reduce closing times.

Reasons behind Banks' Investment in AI:

- Evolve: To become better in service delivery
- Grow: To acquire more clients
- Comply: To comply with regulatory purposes
- Protect To secure information about clients
- Manage: To increase efficiency



Sources: Deloitte Industry Report, McKinsey Industry Report

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Case Studies

Key Actors

Investment Banks

- JPMorgan
- Goldman Sachs
- Bank of America

Brokerage Firms

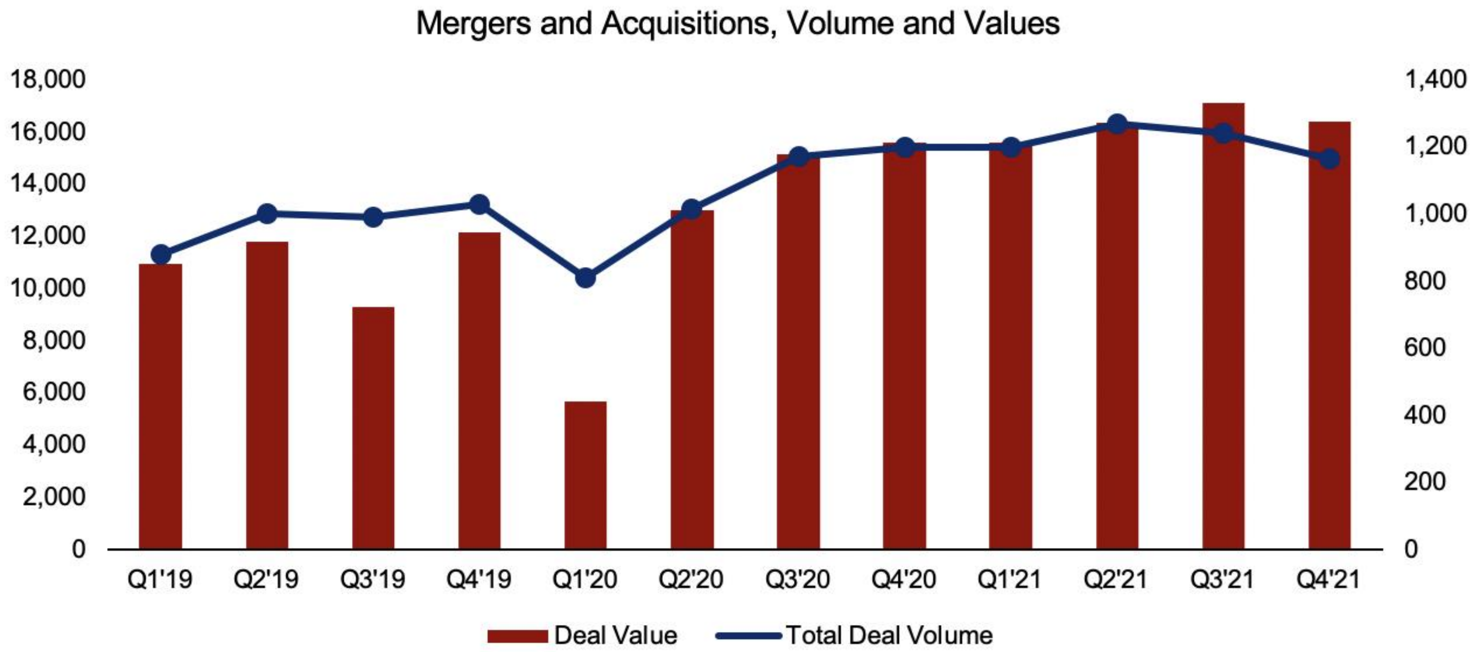
- Fidelity Investments
- Charles Schwab

It's important to identify that most large household names are usually subsidiaries of massive banking firms. It's important to note that although most large banking firms have an Investment banking and Brokerage division, The key areas within both areas differs. In investment banking some of the familiar big names include Goldman Sachs, JPMorgan Chase, and Bank of America. As far as major brokerage firms, this would include Charles Schwab, and Fidelity Investments.

Investment Opportunities: M&A

2021 was a record-breaking year for Mergers and Acquisitions. This past year was an all time high for deal value and smashed the previous record set in 2007. For the first time ever, global Mergers and Acquisitions volume reached $5 trillion. This figure was a massive increase from the previous year which only reported in at $4.2 trillion. To put things into perspective, there were 62,000 deals executed 2021 alone, and of the 62,000, 130 were mega deals. Mega deals are known as deals with companies that exceed a valuation of five billion dollars. Although it may seem like most of the opportunity has already been captured, many professionals note that 2022 can serve as an even larger year for Mergers and Acquisitions. Here are the few reasons as to why it's a massive investment opportunity

- Labour Shortages: Companies are using Mergers and Acquisitions to acquire employees
- Technological Change: More companies are having growing demand for digital and innovative ways of conducting business, because of this, older, more traditional companies are acquiring technology firms



Sources: PricewaterhouseCoopers, ADV Ratings

Case Studies

Recent News Stories: Compensation Increase

The CEOs of many large banks in America are receiving massive pay raises due to bank performance over this past year. As previously mentioned in this report, this is due to the record-breaking year for global Mergers and Acquisitions as well as increased profits. Although these banks conduct services in several different areas, their investment banking arm is a major reason to these compensation increases. Of some of the four largest banks in the world, these CEO received pay increases:

- James Gorman~Morgan Stanley ($30 million 6% pay increase
- Jamie Dimon~JPMorgan ($30 million 6% pay increase)
- David Solomon~Goldman Sachs ($30 million 6% pay increase)
- Brian Moynihan~Bank of America ($30 million 6% pay increase)

Almost all CEO's salaries were raised to approximately 35 million dollars.

It's evident that CEOs of banks received massive compensation increases, but what about analysts and associates? Fortunately for them, junior analyst also received large pay increases.

Some things to note is how almost all of the listed CEO's pay raises were raised to approximately 35 millions dollars. Although everyone's pay was increased, some were compensated more significantly than others, such as David Solomon receiving a 50% pay increase since last year. These massive profits and pay increases are in large due to the investment banking arms of each of the banks. In addition to a major bounce back for net income within the banks, 2021 was a record-breaking year in large due to the investment banking arm of each of the four banks. 2021 was a record-breaking year for Mergers and Acquisition. For the first time in history, it reached volumes of over five trillion dollars.

Sources: Minutehack, Bloomberg

Recent News Stories: Free Trading Apps

Free applications for trading is what's as of late, taking the financial world by storm. Namely, companies such as *Robinhood,* and *Webull* are showing investors and traders that would have traditionally gone to brokerage firms, that they have the facilities to trade in a more convenient and cost-efficient way. The prominence of these apps however are giving more traditional brokerage firms a major hit. Although Charles Schwab is the largest brokerage firm in the world, with a reported 7.6 trillion dollars of assets under management, their online presence is quite weak in comparison to their dominance in the brokerage area. Banks have found that although higher networth individuals are not significantly affected through online free trading apps, smaller, more retail investors are branching off into different alternatives recently. Just to put things into perspective of how quickly the culture of trading is changing, *Robinhood* user account holder in 2014 was 500,000, whereas in 2021, they reported 22 million. Their exponential user growth has also equated to high 2021 revenue growth of 91 million dollars. More traditional brokerage firms are still not completely out of the water, however. It was reported recently that *Robinhood*, like other large technology companies, sell their user data to third parties. This gives more privacy sensitive consumers a reason to stick to companies like Charles Schwab, and Fidelity Investments. In general, free digital trading apps are forcing traditional brokerages to change their business model and prioritize. Whether or not brokerage firms change is under their discretion, but what can't be denied, is the future and prominence of free trading applications.