Research on the Role of Investment Banks in the China's IPO Market

Chenhao Wang

Sino-German Institute of Design and Communication, Zhejiang Wanli University, Ningbo, 315100, China

2021016986@zwu.edu.cn

Abstract. Investment banks are essential players in today's dynamic capital market, serving as intermediaries that facilitate a wide range of financial activities crucial for economic growth and development. These activities encompass venture capital, project financing, mergers and acquisitions, corporate restructuring, securities issuance, and investment analysis. Investment banks must establish robust developmental frameworks and adapt to changing industry dynamics to remain effective and resilient in the face of evolving economic and financial landscapes. This research explores the role played by investment banks in the Chinese Initial Public Offering (IPO) market while considering the nation's historical context. China's financial evolution has been marked by unique historical events and economic reforms, which have significantly influenced its IPO market and the involvement of investment banks. Examining the interplay between these factors is vital for understanding the broader dynamics of the global financial system. It provides valuable insights into the strategies and adaptations required for investment banks to thrive in this complex environment. This study aims to contribute to the existing body of knowledge and inform industry stakeholders, policymakers, and investors about the intricacies of investment banking in China's IPO market.

Keywords: Investment Banks, Initial Public Offering, Risk Management.

1. Introduction

In the Chinese environment, investment banks and securities enterprises are acknowledged as financial entities that exhibit certain characteristics associated with investment banking. Nevertheless, it is crucial to acknowledge that these two things must be distinct and distinct. The financial institution in question sets itself apart from comprehensive commercial banks by virtue of the disparity in their primary business activity, with a focus on capital market operations. The supplementary activities of investment banks arise from their core role, and firms are obligated to enlist the assistance of investment banks throughout the initial public offering (IPO) process, as indicated by the IPO protocol [1].

The diversification of business growth for China Investment Bank may be achieved via developing novel financial products and strategic service models, such as company restructuring and mergers and acquisitions. In addition to the act of self-operation and securities underwriting, there is potential for expansion into the realms of financial derivatives and asset management. Employing a diverse range of distinct enterprises has the potential to enhance financial returns and foster expansion. Investment banks have the capacity to provide financial advice. Chinese firms are experiencing a notable growth trajectory, necessitating enhanced financial management practices and improved access to capital markets. This is particularly crucial given the country's rapid pace and commendable quality of economic progress. Investment banks use corporate growth strategies to effectively align consumer and market demands while concurrently offering specialized guidance to enterprises. This approach facilitates the establishment of robust relationships between investment banks and enterprises, enabling a comprehensive comprehension of their financial management practices. The primary objective of this study is to examine corporate growth strategies and manufacturing optimization techniques to effectively manage credit risks inside firms. Investment firms have the potential to cultivate client loyalty via the provision of exceptional service [1]. China Investment Bank should also adopt a comprehensive growth strategy that ensures modern enterprises meet collectivization and large-scale expansion needs throughout their development. The growth potential of investment banks is limited by expansion size. Investment banks must reduce operating expenditures and increase value by considering their specific operational conditions and market dynamics. China Investment Bank must also focus on talent development in strategic development to improve its business skills. To adapt to changing external conditions and national financial policy, banks should develop internal talent and create a comprehensive training course structure and ongoing education program. This would increase bank employees' understanding of financial risk reduction, risk avoidance skills, and teamwork. Investment banks must deliberately improve welfare benefits and give various professional development opportunities to attract flexible talent and high-caliber, seasoned experts [2].

2. Market Research

The market research conducted for an IPO company encompasses various surveys that provide essential information. These surveys include an examination of the company's historical evolution, an assessment of the industry and competition, an analysis of supply and marketing, an evaluation of industry-related transactions with other parties, an examination of executive compensation and personnel changes, an assessment of the organizational structure and internal control mechanisms, a review of financial accounting practices, and an exploration of business development strategies and objectives, the utilization of raised funds, and identification of potential risk factors. Conducting market research is a crucial preliminary measure for a firm before the issuance of stocks. This approach assesses the extent to which different facets of the organization have achieved the criteria for inclusion. While accounting companies and legal firms are involved in this process, it is essential to acknowledge that investment banks' macro direction and summary analysis are integral and inseparable components. Ultimately, investment banks will thoroughly investigate using financial data provided by accountants, legal views offered by attorneys, and pertinent documentation. Therefore, an accurate assessment of the firm may be conducted. Furthermore, the examination of procurement, production, sales, related parties, related transactions, risk factors, and other significant aspects pertaining to the financial condition within the issuer's business and technical investigation is typically carried out by business personnel entrusted with the responsibility of conducting financial market investigations. This process also forms a crucial component of financial market investigation [3].

2.1. The Role of Market Research

In accordance with the stipulations outlined in the Chinese Securities Law, it is mandatory for every business to seek counsel from a securities firm with lead underwriting credentials for a duration of one year prior to initiating the submission of an issue review to the China Securities Regulatory Commission. The primary objective of advice is to enable investment banks to acquire an initial comprehension of the comprehensive financial and business circumstances pertaining to the target unit during the market study phase. This includes aspects such as the company performance, principal products, and equity structure. Acquire a comprehensive comprehension of significant knowledge pertaining to fundamental business processes, including sales models, manufacturing models, procurement models, and other related aspects. This task involves formulating a detailed implementation strategy for doing market research. The plan should include precise arrangements pertaining to time allocation, staff deployment, work content, and other relevant considerations. It also requires analyzing the target unit's circumstances and generating a comprehensive business list for market research [3].

2.2. A Case Study of Investment Banks Successfully Assisting Companies in Market Research Prior to IPO Listing

This study examines the effective approaches investment banks use to do market research on L Company, facilitating its initial public offering (IPO). The project undertaken by The L Guarantee

Company faced many challenges related to market research throughout its development phase. The first phase pertains to the early phases of organizational formation. During its inception, the firm needed more public recognition, an underdeveloped infrastructure, and operated inside restricted commercial channels. Moreover, it is evident that the individuals employed inside the organization need to improve their levels of expertise. Furthermore, the examination of user enterprises is characterized by a very wide range, hence posing challenges in accurately assessing the financial condition of these user corporations. The individuals being evaluated exhibit a need for more comprehending of the fundamental components of the investigation, and there is a notable occurrence of neglecting one's responsibilities in examining corporate entities. The subsequent section pertains to the developmental phase of the organization, wherein a notable issue occurs about the inadequate recognition of talent acquisition, constrained expansion of business channels, and an inefficient identification of crucial corporate components. Based on the findings of market research, the investment bank recommends that L business place utmost importance on enhancing its due diligence procedure as the primary course of action. In order to enhance the efficacy of the due diligence framework, it is important to comprehensively evaluate several aspects, such as firm data, operational methods, and financial necessities. The primary aim of this strategy is to provide a comprehensive understanding of the relevant information on the target company. It also seeks to tackle the problem of information asymmetry and use proficient strategies to mitigate risks effectively [4].

3. Valuation

Investment banks do thorough investigations to determine a suitable value for the firm, relying on financial data supplied by accountants, legal perspectives offered by lawyers, and any pertinent documents.

The proposed valuation model is an analogical approach that relies on assessing income and assets. Begin by conducting an analysis of the company's past performance in order to make projections about its future performance under the current management. Next, examine the factors that influence the potential increase or decrease in the company's future revenue costs. Lastly, gather pertinent financial indicators from publicly listed companies that share similar characteristics regarding enterprise size, business model, technology, and products. The data obtained for analogical analysis should include representative P/E ratios, prices, sales ratios, and price-to-equity ratios. It is important to adjust these ratios for variables that may impact their comparability, such as non-listed firm characteristics and national pricing disparities [5].

The analogy is used to ascertain the value-to-sales ratio for a firm as seen by investors. The valuation of a publicly traded company, as determined by the market, may be obtained by dividing its total sales over a four-quarter period. In order to ascertain accurate worth, it is necessary to meticulously choose organizations that possess comparable sales sizes and development characteristics for the purpose of comparison. It is suggested to do so to avoid underestimating or overestimating value [5].

The absolute valuation approach is often seen in the form of the income method. The income approach is a valuation technique used to ascertain an assessed asset's worth by predicting the evaluated firm's anticipated future earnings and translating them into their current value. The income approach is used to assess the worth of a business entity, with the resulting value being the aggregate sum of money spent to acquire the anticipated rights to income. Hence, from the standpoint of investors and businesses, the revenue approach emerges as the most straightforward and efficient technique for assessing the worth of organizations. In the realm of industrial and commercial companies, it is common practice to use the discounted cash flow approach to approximate their inherent worth. The Dividend Discount Model (DDM) is well-suited for firms characterized by substantial dividend payouts and a consistent outlook for growth and expansion [6].

4. Risk Management

Systemic risk, often referred to as macro risk, and non-systemic risk, also known as micro risk, are two prevalent approaches for categorizing the comprehensive notion of risk. Systemic risk refers to non-diversifiable risk arising due to changes in policies, regulations, laws, market conditions, or the external environment. Credit risk, liquidity risk, capital risk, settlement risk, operational risk, and other analogous concerns include many manifestations of non-systematic risk that arise from the behaviors of persons or operational procedures inside an organization. Managers may use risk management approaches, such as modifying asset allocation and establishing a diversified investment portfolio, in order to mitigate risk and enhance returns [7]. In addition, risk management is an ongoing process that aims to improve operational efficiency, allocate resources effectively, assure compliance with set standards, meet performance objectives, increase financial stability, and mitigate potential harm to the organization [8].

4.1. Research on the Current Situation and Countermeasures of Risk Management in Investment Banks

The prioritization of business operations is a key focus of the China Investment Bank. The organization specifically focuses on primary and secondary underwriting and agency services. The absence of new enterprises has resulted in a need for more risk exposure management. The financial viability of a corporation is contingent upon its commercial scope, although introducing new business risks might enhance operational performance [9]. Operating rules provide Chinese investment banks with minimal capital. According to relevant data, Chinese investment banks have many times the average Western investment bank registered capital. Independent operations are widespread in Chinese investment banking. Unlike other commercial banks, Chinese investment banks cannot take depositors' deposits, which would provide more steady financing. For operational efficiency, investment banks must constantly expand. Thus, corporations must raise capital via mortgages or purchases from the credit market throughout operations. Investment banks incur higher operational expenses due to variable money collection strategies. This severely impacts investment banks' usual development. Enterprises' low free assets and increased development borrowings will increase indebtedness. Thus, borrowing more raises leverage. Leverage raises income and debt in good and bad times. That propensity increases with the leverage ratio. Liquidity requirements rise with leverage. When market conditions worsen, and company finances fall, investment banks may need help to provide operating capital. Short-term borrowing and minor financing are standard practices for Chinese investment banks. They struggle to handle various hazards. Investment banks need help raising operating cash. Short-term borrowing and minor financing are standard practices for Chinese investment banks. They struggle to handle various hazards [9]. The China Investment Banking Law is pending, while the Securities Law has been passed. The Chinese securities firms need modern investment bank features. China violates international investment banking standards. Legally, Chinese investment bank business units cannot perform investment banking. The law prohibits investment banks from charging merger and acquisition fees or financing interests. They can't address asset securitization and financial derivatives with financial technology. Investment banks cannot advise on risk management or finance decisions or charge for them [9].

4.2. Risk Management Measures

In order to effectively manage risk, investment banks require a robust external regulatory framework and enhanced risk management procedures. Investment banks are required to effectively oversee their debt, conduct statistical analysis of company performance, and implement enhanced risk management strategies [10]. In addition, it is important for them to establish robust procedures to achieve success in risk management effectively. The possibility exists that the China Investment Bank may use a countercyclical loss reserve strategy. In order to safeguard buffer reserves and mitigate speculative activities, investment banks may choose to augment the asset loss reserve ratio.

In order to effectively manage risk, it is essential for China Investment Bank to enhance the skill set of its workforce. In order to mitigate the danger of excessive consolidation within China's investment banking business, it is imperative for China Investment Bank to enhance its human capital development and use in key sectors such as firm mergers and acquisitions, bond issuance, and bond underwriting. Examining well-established global investment banking firms and local securities companies may provide valuable insights into the process of implementing mechanism and system changes—the implementation of a performance-based income plan aimed at optimizing individual potential [11].

5. Early Stage of Listing

What investment banks need to do in the early stages of listing Roadshow. Roadshows play a crucial role in marketing a company's initial public offering (IPO). Underwriters play a crucial role in elucidating the issuer's circumstances to a broader range of investors and comprehending their investment objectives. The roadshow team comprises individuals from underwriting firms and issuing companies that use various communication methods such as meetings, presentations, and internet live broadcasts. Investment banks are required to engage in cross-regional communication with prospective investors, facilitate the promotion of issuers' interests, and foster investor trust throughout the whole of this undertaking.

Private equity-affiliated enterprises refer to companies that are associated with or have a connection to private equity. These organizations often operate under the ownership or control of private equity firms, which are investment entities that pool capital from various sources to acquire ownership stakes in businesses. This enterprise encompasses the activities of fundraising, project selection, and money generation. The process necessitates the development and execution of an investment strategy. Efficiently managing projects and generating revenue are key objectives in project management. Four distinct operational steps are involved in allocating financial resources inside a corporation. One key benefit of commercial banks is the presence of extensive distribution networks and access to client resources. Banks use their talents in a four-stage process to provide comprehensive advice and support to firms with financial concerns. The organization engages in proactive marketing strategies to promote its commercial banking services, with the aim of attracting firms in need of capital investments. This endeavor serves to enhance both the value and reputation of the company [3].

6. Conclusion

There is a potential for collaboration between commercial and investment banks to provide linking services. This would facilitate the integration of financial advisory services offered by investment banks into the lending operations of commercial banks. Implementing this novel service can substantially enhance the company's managerial structure, augment the overall managerial effectiveness, foster a favorable reputation in the market, facilitate the attainment of financial objectives, and expedite the process of successfully listing the company.

Investment banks are a necessary component of the modern monetary system since they play a crucial role in managing capital and listing and financing firms. This makes investment banks an important component of the modern monetary system. When investment banks are not participating in the process of an initial public offering (IPO), it may be challenging for firms to finish the procedure effectively. Investment banks are playing a major role in China as a direct consequence of the recent modifications that have been made to the process by which equities are issued in the nation. Even though the investment banking industry in China did not get started until much later than it did in other countries, there are still significant disparities in the size of the institutions that are engaged, the sorts of companies they concentrate on, and the degree of risk management. This is the most important domain in which investment banks have space for development and advancement opportunities. In order to expand its reach and increase its influence, the China Investment Bank will need to hone its skills in the area of risk management and become an expert in the field. On the other hand, the investment industry has been rapidly developing and is playing a role that is becoming an increasingly crucial role in the initial public offering market in China. When it comes to China's investment banks, the larger their strength, the greater their responsibility, and the better the development of the country's laws and regulations that regulate investment banking will be overall.

References

[1] Wu, W. L. (2016). An Exploration of the Responsibilities of Investment Banks in Corporate IPOs. Modern Finance, 17, 89.

[2] Chen, M. Z. (2022). Development Strategies of Chinese Investment Banks under the Financial Strategy of a Major Nation. Small and Medium Enterprise Management and Technology, 06, 109-111.

[3] Xiao, J. W. (2020). A Brief Analysis of Financial Due Diligence in IPOs by Securities Company Investment Banks. Entrepreneur, 34 (7), 249-250.

[4] Yin, X. (2022). Practical Research on the Due Diligence Model of Guarantee Company Projects. Brand Research, 13, 271-273.

[5] Li, J. (2003). Comparative Analysis of Valuation Methods for Growing Enterprises. Management Science, 16 (5), 27-30.

[6] Yuan, Q. L. (2014). Investment Value Analysis of Bank of Communications Based on Financial Modeling Experimental Platform. Journal of Xinyang Agricultural College, 3, 46-50.

[7] Chakabva, O., & Tengeh, R. K. (2023). The Relationship between SME Owner-Manager Characteristics and Risk Management Strategies. Journal of Open Innovation: Technology, Market, and Complexity, 9 (3), 100112.

[8] Wang, Z. G. (2008). Research on Risk Management of IPO Projects of Chinese Investment Banks. Shandong University.

[9] Wen, Z. P., & Liang, S. D. (2006). Portfolio Methods and Comprehensive Risk Management in Banks. Journal of Southwest Jiaotong University (Social Sciences), 7 (3), 134-138.

[10] Li, Y. (2016). A Discussion on the Issues and Countermeasures of Risk Management in Investment Banks. Modern Market, 16, 80-81.

[11] Bai, W., & Shi, J. X. (2014). Analysis of Issues and Countermeasures in Risk Management of Chinese Investment Banks. Chinese Information, 8, 36.