

# [Importance of marketing for investment banking](https://assignbuster.com/importance-of-marketing-for-investment-banking/)

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This paper sets out to explain how the concepts underlying marketing strategy, which Is may be seen as applicable only to Industries that provide tangible goods, such as pads or pharmaceutical drugs, are nevertheless relevant to a service-based industry like investment banking. First, I will define marketing strategy and briefly describe its various elements. Next, I will define investment banking and give a brief description of the various services provided.

Finally, I will explain how understanding marketing treated provides additional rigor and insight to an investment bankers decision making process. II. Marketing Strategy Overview Marketing strategy is a firm’s long-term strategy for establishing and maintaining a competitive advantage In the market, It involves decisions about what products to bring to market, how the product should be priced, how It should be distributed, and how it should be promoted – the “ marketing mix”.

Marketing strategy recognizes that decisions about the marketing mix are interrelated and that they must change over the lifetime of the product. One fundamental concept to marketing strategy is the product life cycle (the “ PL”). This embodies the Idea that a product’s sales volume will change over time and in a predictable pattern. Every product will go through four stages: introduction, growth, maturation, and decline. The goal of marketing strategy is to anticipate each product’s life cycle and to modify the marketing mix in anticipation of the product’s progression through that cycle.

A. Stages of the Product Life Cycle 1. Pre-illumination and Introduction Prior to Introduction, the goal of marketing strategy Is to Identify what kind of product market demands, to then determine the diffusion rate of that product, and finally to make decisions as to pricing, promotion, and distribution of the product. Marketing strategist have many tools available to anticipate what features to put into a new product prior to production of even the first unit, These strategies Include surveys, conjoint analysis, internet experiments, and information accelerators.

Marketing strategist must then predict the anticipated diffusion rate of a product in order to identify its projected sales and the related marketing expenditures in the Introductory phase of the PL (I. E. Penetration versus skimming strategies). Rather than using the “ napkin model,” which projects sales volume for a new product by looking to industry potential market size and penetration rate, marketing strategist rely on the qualitative factors of the ACCORD model and the ATA diffusion model to predict sales. 2 Once the Initial diffusion model Is identified the Bass model can be used to determine the remaining product life cycle-3 2.

Growth and Maturity Stages The introductory period Is followed by a period of growth where competitors begin to enter the market. Marketing strategy tells us that after this growth period return on del attempts to anticipate the timing of both the growth and maturity stages. As a product enters the mature phase, firms can expect increased competition for market share as market penetration reaches saturation. Industry participants can expect to struggle with centralization from a proliferation of product lines, increased operational complexity, and increased advertising spend, among other things, in an effort to maintain the sales volumes.

Firms that understand the PL are expected to anticipate its products’ movement along the PL and re-position their marketing mix n order to maximize revenues in the maturity stage of the market (e. G. , move into the economy or premium sector). Moreover, attentive firms understand that margins will decrease in the mature phase and will redefine the product’s standard of innovation, moving from spending on product innovation to spending on process and strategic innovation in order to retain a competitive advantage in the industry.

Strategic innovation focuses on finding ways to attractive new customers to existing products, 4 leveraging brands to create new customer segments, 5 finding new uses for existing reduces, and increasing the usage of existing products. 3. Decline Phase Finally, marketing strategy aims to predict the timing and nature of the decline phase and identify the appropriate strategy from entering into decline. Generally, a firm can go in one of four directions: leadership, harvesting, niche, or divestiture.

Their strategy will depend on the intensity of the anticipated surviving competition and the competitive strengths of the firm. Ill. Investment Banking Overview Investigated defines an investment bank as “ a financial intermediary that performs a variety of services. Investment banks specialize in large and complex financial transactions such as underwriting, acting as an intermediary between a securities issuer and the investing public, facilitating mergers and other corporate reorganizations, and acting as a broker and/or financial adviser for institutional clients. 6 Most investment banks are generally separated into three distinct functions, only one of which is actual investment banking. The trading division provides investing, intermediating, and risk-management services to investors. The asset management division is responsible for managing money for individual and institutional investors. And the investment banking division principally focuses on (1) raising financing in the capital markets for corporations and governments (debt, equity, hybrid instruments), and (2) advising on merger and acquisition (“ M&A”) transactions.

This paper only focuses on the relevance of marketing strategy for the investment banking division. 7 A Capital Markets Financing Capital market financing is long-term funding obtained through the issuance of a security in a regulated market. The security can be debt (bonds, debentures, or notes), equity (common stock), or hybrid securities. Capital markets financing are typically underwritten by investment banks. Meaning, banks take on risk by purchasing securities from their client (the “ issuer”) then reselling those securities to investors.

Investment banks must determine the marketing method and pricing for these securities. Once financing has been granted to an issuer, investment bankers will typically go on a “ road show’ with the issue to raise excitement for the upcoming When considering the pricing of an equity or a debt offering the investment bankers must undertake a thorough valuation of the company in order to determine whether he company will be able to make expected payments and the rate of return investors will require to hold the debt or equity of the issuer.

Investment bankers use many different valuation techniques to determine the price for a security offering but bankers almost always include an intrinsic analysis of the company using a discounted cash flow method. A discounted cash flow model (a “ DC model”) projects values a company by determining the present value of future cash flows. The investment banker projects future cash flows based on a firm’s historical cash flows ND anticipated changes over the next 5 to 10 years, then projects cash flow growth into perpetuity.

These cash flows are then discounted back using a rate that reflects the rockiness of the firm’s cash flows over time. B. Merger & Acquisition Advisory Investment bankers that focus on M advisory provide valuation and strategic advice to firms that are looking to acquire or sell an asset or a company. Before entering into an acquisition firms must compare the costs, risk, and benefits of an acquisition with the alternative of organic growth. Firms that are looking to sell assets just consider whether the benefits of continuing to operate the asset are a better risk-adjusted option that monitoring the asset.

These decisions are never static and will depend on internal firm dynamics, changes to the firm’s competitive landscape, and macroeconomic forces. For investment bankers, the foundational component in guiding a firm’s decision to buy or sell begins with a thorough understanding of the asset. Bankers will first review past management forecasts to gain a sense of management’s predictive ability and then work with them to create an accurate assessment of the asset’s value. Again, there are several ways investment bankers value an asset but these metrics almost always include a DC model.

In their role as strategic advisers, investment bankers advise a firm on whether they should be looking to buy or sell an asset and the potential targets or buyers for the asset. Beyond an understanding of the valuation of the client’s asset, investment bankers must have a deep understanding of the firms industry, competitors, complements, suppliers, and customers. This allows investment bankers to understand general valuation trends in the market, to identify potential targets or buyers for the client, ND to anticipate the effect of an acquisition or sale on the competitive landscape.

If a firm decides to buy or sell an asset, a key component in identifying the most beneficial target or buyer is identifying firms that provide the greatest synergies upon a combination. The two primary forms of synergies are cost and revenue synergies. Cost synergies arise through efficiencies created from eliminating redundant activities, economies of scale, and improved operating practices. Revenue synergies arise from a firm’s ability to create greater revenue from the combined unit Han as stand-alone entities.

Forecasting synergies can be very difficult. IV. Investment Banking and Marketing Strategy Understanding marketing strategy is important for investment bankers when selling financial products to investors as well as when advising clients on M transactions. A Selling Financial Products The benefit of understanding market strategy is most obvious with respect to an When investment banks raise equity, debt, or hybrid financing for their clients often times they agree to purchase the financial products for resale to third parties.

In this Edgar, investment bankers must make strategic decisions about the marketing mix like any other producer of a tangible product. Marketing strategy provides key insights into the identifying the appropriate marketing mix for financial products, which like any other good, has a PL. However, unlike traditional firms, an investment banks profitability does not rely on realizing profit over the lifetime of a particular financial product. The financial product market is a fast changing market where products can easily fall in or out of favor as investor demand changes.

Investment inks can easily adapt their offerings to match investor demand so they are not particularly worried about a change in demand for a particular financial product that is currently in the market. The major risk that investment banks have in creating a financial product is misjudging the type of product investors are demanding in the market at the time they are preparing a financing package for an issuer. Meaning, while the PL of a financial product is not important in designing financial products, many of the related concepts of marketing strategy, such as customer research and analytics, are still very valuable.

Investment banks have more to gain from understanding (or at least more to lose from not understanding) the value of predictive analytics than most other industries because investor’s appetites for risk and certain financial products change very rapidly. When banks open up their balance sheet to provide hundreds of millions to billions of dollars in financing for an issuer, understanding the real time demand for financial products can be the difference between a profitable transaction and financial turmoil.

While conjoint analysis is generally a good method for testing the market for different product theatres the fast changing nature of the financial markets does not make this a viable alternative for testing the market before introducing a new financial product. While conjoint analysis may not be an option, using customer analytics to determine real time information on product, price, promotion, and distribution can certainly be a huge advantage for an investment banker who understands marketing strategy.

The financial banking industry possess some of the largest reservoirs of data of any industry (particularly those that are also commercial banks) and has the genealogical capabilities to employ that information to their benefit. This data can be analyzed to both predict customer risk and product appetite, allowing investment bankers to work with their clients to tailor the financial product for real time demand.

Customer analytics will also make marketing tactics more efficient and effective because investment bankers can focus their marketing efforts on investors that predict, using customer analytics, are most likely to invest in the financial product based on factors such as the needs of their current portfolio and their ability to pay. Additionally, looking to the financial products market as a whole, it is arguable that it is in a mature phase. Many of the financial products used in the market (e. G. , common stock, leveraged loans, high-yield bonds, preferred stock) have been in existence for a while.

Many of the new products being introduced are variations of these products that try to extract value by appealing to particular segments of the market. Marketing strategy suggests that in a mature market like this, customer advantage if they are able to use customer data to tailor their financial products award particular segments of the market and thus extract additional value. C. Merger & Acquisitions The benefits of marketing strategy for an investment banker providing M&A advice is best illustrated using a case analysis. This paper focuses on Compact Inc. s (“ Compact”) recent acquisition of Time Warner Cable Inc. (“ Time Warner”) and how understanding marketing strategy helps properly frame any valuation or strategic advice that an investment banker could give to Compact. 8 1. Background on Compact and Time Warner Compact is a U. S. Cable operator whose primary source of revenue are from cable elevation (“ Cable TV’), telecommunications services/broadband internet, and content provision service. Compact is the largest Cable TV service provider with nearly 21% market-share, which is projected to remain around that level for the next few years (Exhibit 1).

Compact is also one of the largest broadband services providers and has been gaining market share in this industry (Exhibit 2). Time Warner cable is also a U. S. Cable operator whose primary source of revenue are Cable TV and broadband internet. Time Warner is the second largest cable provider in the U. S. Behind Compact with around 10. % market share (Exhibit 3) and is the second largest broadband service providers in the U. S. This paper focusing only on the relevance of marketing strategy in analyzing Compact’s and Time Warder’s Cable TV and broadband product lines. . Pay Television The Cable TV market is part of the larger pay television (“ Pay TV’) market which also includes satellite television. Market research suggests that this market is in the maturity phase of the PL, if not already in decline. U. S. Pay TV penetration is over 90% of all US TV households (households owning a TV) and the number of US TV households is at 98%. (See Exhibit 5). Growth from new subscribers will be limited to growth in US households, indicating that the market is saturated.

Marketing strategy indicates that in the mature phase, competition can be expected to become fierce as firms aim for growth by attempting to increase customer lifetime value (“ CLC) and steal market share from each other. Profitability is also expected to stabilize and eventually decrease as firms must spend more on advertising for each dollar of revenue. This certainly holds true in the Pay TV industry as margins have decreased for players such as Compact, Time Warner, and Dish Network (Exhibit 6). The loss in margins in the Pay TV industry is also a result of the entrance of online videos (e. . , Nettling), which have proven to be a viable and growing substitute to Pay TV (this is also an indicator of a market close to decline). An investment banker who understands marketing strategy could better evaluate Compact’s strategic position in the Pay TV market and advise Compact on its optimal strategy for entering the decline phase. Within the Pay TV space, Compact and Time Warner have chosen to push their products into both the premium and economy sectors; offering low price base cages as well cars premium packages but at increasing costs (Exhibit 7).

Marketing strategy suggest that this may not be sustainable in the long-run because the online streaming video market is a substitute for this premium product and has a lower price point. An investment banker who understood marketing strategy would strictly flows from the Cable TV sector given the vulnerability of the margins in the premium Cable TV space to the cheaper online video alternative. As a result, any DC valuation for Compact or Time Warner should reflect downward pressure on revenues from this sector. Additionally, going into the decline stage of a product you expect to see spend concentrated more on advertising.

A banker who understands marketing strategy would be able to accurately value the significance of the cost synergies from reduced advertising spend that a merger between Compact and Time Warner could generate. Conversely, in the mature stage of the PL, you do not expect to see projections for increased capital expenditure but rather for strategic and process based innovations. Compact’s projected increased capital expenditure, especially when its competitors re expected to decrease expenditures (Exhibit 8) may indicate that management is not optimally allocating resources.

This puts management’s investment decisions into question and be a basis for increasing the risk profile of the company. Marketing strategy should also affect the strategic advice an investment banker would give to Compact regarding its strategy leading into the declining phase of the Pay TV industry. Because Compact has built a competitive advantage in the industry, an investment banker who understands marketing strategy would not likely recommend a divestiture or harvesting strategy. The only options would be to either act as a leader in the industry or a niche player depending on the level of remaining competition.

From a marketing strategy perspective, Compact’s acquisition of Time Warner was a smart move in shoring up its position as a leader in the declining Pay TV industry by reducing the intensity of the surviving competition. 3. Telecommunications Services and Broadband Compact and Time Warner also compete in providing broadband services. Broadband services are not Just limited to the provision of internet but describe a mode for consumers to access data. This larger industry is the telecommunications service industry. Compact and Time Warner compete for wired broadband services through use of fiber optic cables.

However, both compete with wireless broadband service provides. Some of the major players in the U. S. Wired data platform are Compact, Time Warner, and recently Google. Major competitors in the U. S. Wireless services include AT Inc. , Verizon, and Dish Network. From a valuation perspective understanding the PL of new technology in the telecommunications industry is key because investment in new technology is extremely capital intensive and the PL of ACH new product becomes shorter as new technologies proliferate.

It would be impossible for an investment banker to anticipate the future cash flows of any company in this space without being able to estimate PL of a company’s existing products. Moreover, investment bankers cannot predict future cash flows of those investments in new product lines without understanding concepts such as diffusion rates and competitive lead time. Investment bankers risk losing money by raising financing for negative net present value products or incorrectly advising clients on strategy if they do not understand marketing strategy.

More importantly, understanding marketing strategy enables investment bankers to understand the importance of the growing demand for data analytics on the telecommunications services industry which in turn enables them to give better advice and more accurate telecommunications industry has shifted from charging consumers to access internet and TV content to gathering data on consumers for the purposes of gaining revenue from customer analytics.

Thus, when valuing a combination between Compact and Time Warner, the value should not be limited to the cash flows from fees charged to consumers for broadband internet and TV packages but also the value of Time Warder’s network for data analytics as well as the synergies for the analytics business that can be recognized by merging Compact’s and Time Warder’s customer base. As the demand for customer analytics appears to be a growth industry, bankers should employ market research tools in order to size the market and project the potential future cash flows.

Additionally, from a strategic standpoint, understanding the importance of customer analytics would allow Compact’s investment bankers to recognize the nature of the threat from Google fiber as well as identify key suppliers, implementers, and competitors that may be ideal acquisition targets. V. Conclusion Although investment banking may not be the traditional business that someone would consider when thinking about marketing strategy and the product life cycle, it is clear that is imperative for investment bankers to be thinking about marketing strategy when advising clients on M&A transactions and marketing financial products to investors.

Understanding marketing strategy will help them more accurately price companies and financial products and give them more valuable insight into their client’s competitive landscape. It is not only producers of tangible products who should be thinking about marketing strategy. Marketing strategy applies to all firms that provide a service or good because as technology advances many of the services that are provided can be replaced by software.