



Investment Banking 101

Understanding and learning how to use middle-market investment banking services could help your company.

by William S. Hanneman and Mark D. Working

The typical private middle-market company owner or CEO infrequently uses the services of an investment banker. The reason may be a lack of understanding of what a middle-market investment banker can do and when it is appropriate to consult and retain one.

DEFINING INVESTMENT BANKING

The basic services of a middle-market investment banker fall into three categories: (i) obtain capital for the business, (ii) monetize equity value, and (iii) provide advice related to corporate development activities.

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Investment bankers are experts in valuation and capitalization. Each business has unique characteristics as a result of its size, stage of evolution, industry, and market position. Likewise, the markets for capital, valuation issues, and corporate development alternatives are not the same for all companies. Accordingly, investment bankers specialize in knowing certain markets, industries, and types of businesses.

OBTAINING CAPITAL FOR THE BUSINESS

In the middle-market, commercial banks are the dominant capital purveyors. In most situations, borrowing arrangements are expertly handled by corporate CFOs and owners. However, when the need departs from the norm, an investment banker can be a great addition to the corporate finance team. The investment banker must be intimately familiar with an array of business capital sources, as well as the risks that individual providers will accept and the returns that

they demand. The challenge for an investment banker is to maintain a current roster of lenders and investors and the constantly changing appetites of each. Keeping track is a full time job.

Because each business has a unique set of risks, when it comes to corporate finance, one size doesn't fit all. In fact, the range of circumstances is quite broad. It is the banker's role to design a structure that offers the lowest cost of capital, consistent with the need to maintain sufficient liquidity and flexibility to deal with the unexpected.

The investment banker can assist with analysis and communication. Oftentimes, the greatest challenge is to communicate the benefits of a business opportunity in a manner that can be understood and evaluated by capital providers. Because the investment banker understands how these decisions are made, he can help translate the business opportunity into terms that fit a lender's or investor's lexicon.

Market knowledge and financial engineering, together with an ability to articulate the credit risk and/or investment return case to the market, are talents that the banker brings to the table. Companies facing situations where a significant change in the amount of

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MONETIZING EQUITY VALUE

A distinctly separate segment of the investment banking trade involves planning and executing transactions to convert illiquid business equity into cash. The advice of an investment banker is sought to evaluate

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the alternatives, whether a sale, an IPO, or a recapitalization, to monetize illiquid value. The investment banker's job is to advise on the expected valuation, terms, conditions, process and time frame for accomplishing the objective.

If the objective is a sale, the investment banker knows how to position a firm to maximize value. The banker also knows that both the probability and degree of success are directly related to the extent of preparation and the precision by which the process is managed. The goal is to maintain a strong negotiating position throughout the process by eliminating surprises and minimizing delays.

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CORPORATE DEVELOPMENT ADVICE

In most businesses, management is charged with the development of the strategic plan.

Strategic planning is the process by which a direction is established to position the business to achieve a sustainable competitive advantage and create the greatest future value. On occasion, these plans involve the need to combine businesses (whether through acquisition or merger) or to divest businesses that no longer fit the core strategy.

The investment banker can provide insight into the implications of the business strategy on shareholder value, how the business would be viewed in the marketplace, and the alternatives for realizing value at some

future date. The relevancy of these opinions is predicated upon the investment banker's knowledge of the client's business and industry. For precisely this reason, an investment banker often specializes in specific industries.

The addition of an investment banker to the corporate development team of a middle-market business is one way of gaining input on the value impact of a business strategy before actually embarking on it.

THE RIGHT INVESTMENT BANKER

Beyond technical expertise, the best investment banker for a particular assignment

will be the one who clearly understands the client's objectives, risk tolerance, values and objectives. Whether the objective is financing, making an important acquisition, or selling the business, the bankers will work closely with owners and/or managers over an extended time period. Accordingly, the ability to communicate with the banker and trust that the client's interest is the top priority are key to a successful relationship. ❖



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INVESTMENT BANKERS

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ABOUT ZACHARY SCOTT

Zachary Scott is an investment banking and financial advisory firm founded in 1991 to serve the needs of privately held, middle-market companies. The firm offers a unique combination of in-depth knowledge of the capital markets and industry competitive dynamics, sophisticated analytical capabilities, and proven expertise in structuring and negotiating complex transactions. For more information on Zachary Scott, please go to ZacharyScott.com.

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