

A wide-angle photograph of a city skyline viewed from across a body of water. In the foreground, there's a dark, rippling surface of water. A low concrete wall or pier runs along the shore. Behind it, a row of multi-story brick buildings with dark roofs and multiple windows stretches across the frame. In the background, a dense cluster of modern skyscrapers with glass facades rises against a clear blue sky. Some buildings have unique architectural features, like a tall, thin tower on the left and a cylindrical building with a curved facade in the center. A construction crane is visible on the far right side of the skyline.

Andreas Krause

The process of underwriting

# The role of underwriters

- Investment banks advise clients on the issue of securities
- They also engage with potential investors to assess the demand for these securities
- Based on this assessment a price range is determined and formal bids by investors invited
- Investment banks then also administer the offer and the allocation of securities to investors

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## Complex underwriting practices

- ▶ While simple forms of organising the underwriting exist, it is most common to assemble syndicates and apply a book-building mechanism
- ▶ In a syndicate multiple investment banks are working together to underwrite the securities (where one investment bank acts as the lead underwriter)
- ▶ Book-building involves investment banks to ascertain tentative bids by selected investors to gauge interest in the issue before the securities are offered more widely
- ▶ We will look at the reason for such practices and how they allow issuers to maximize the proceeds from their issue



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## Benefitting issuers of securities

- ▶ Investment banks approach selected investors to give an indication of the price they are willing to pay
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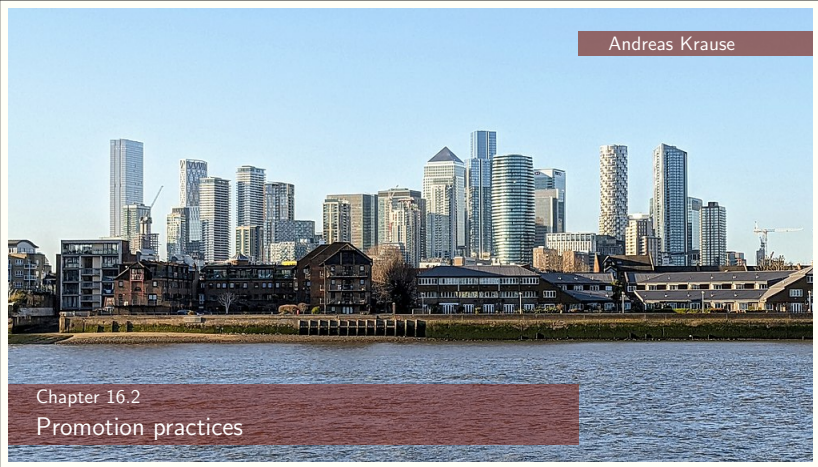
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Chapter 7.1.2  
Book-building

## Discussion of the model results

- ▶ The book-building process is designed such that investors reveal their true information, increasing the offer price
- ▶ It also reduces the uncertainty about the proceeds the issuer will receive
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## Appointing multiple underwriters

- ▶ Investment banks need to be able to identify investors willing to purchase the security
- ▶ If more investment banks are involved, the more investors can be reached
- ▶ This leads to a moral hazard in that incentives for investment banks to exert effort in a large group are low
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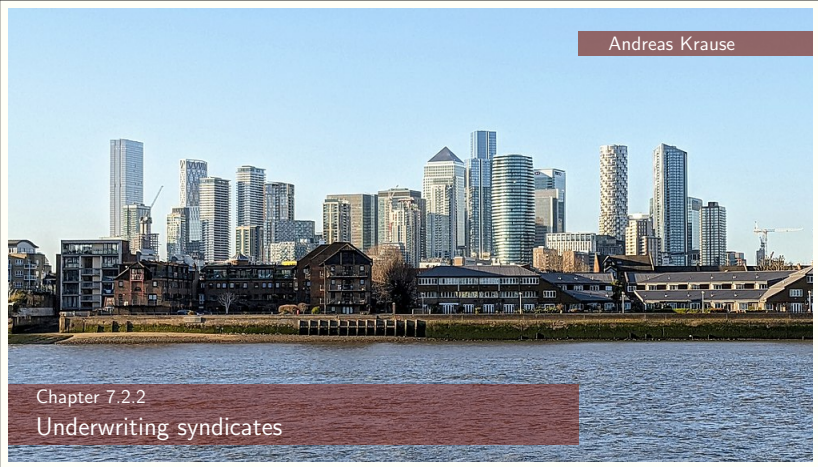
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Chapter 7.2.2  
Underwriting syndicates

## Discussion of the model results

- To limit free-riding among syndicate members, the size of a syndicate will be limited
- Appointing a lead underwriter allows the fee income to be distributed within the syndicate to provide additional incentives for investment banks to exert effort
- How would you select syndicate members?
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## Summary of key results

- Book-building and syndicate formation benefit issuers in that they receive higher proceeds for their securities
- Book-building requires investors to reveal their information truthfully, increasing the price that can be achieved
- Syndicates allow more such investors to be contacted and hence indirectly will increase the offer price
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