A wide-angle photograph of a city skyline viewed from across a body of water. In the foreground, there's a calm body of water with some ripples. Behind it, a row of older, multi-story brick buildings with dark roofs sits along the waterfront. In the background, a dense cluster of modern skyscrapers of various architectural styles, including glass facades and unique shapes, rises against a clear blue sky. A construction crane is visible on the 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

# 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 banks 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

# Benefitting issuers of securities

- ▶ Investment banks approach selected investors to give an indication of the price they are willing to pay
- ▶ These bids are then expected to be honoured when the securities are offered to the general public
- ▶ This process is referred to as book-building
- ▶ We will see how such a process increases the price at which securities are sold



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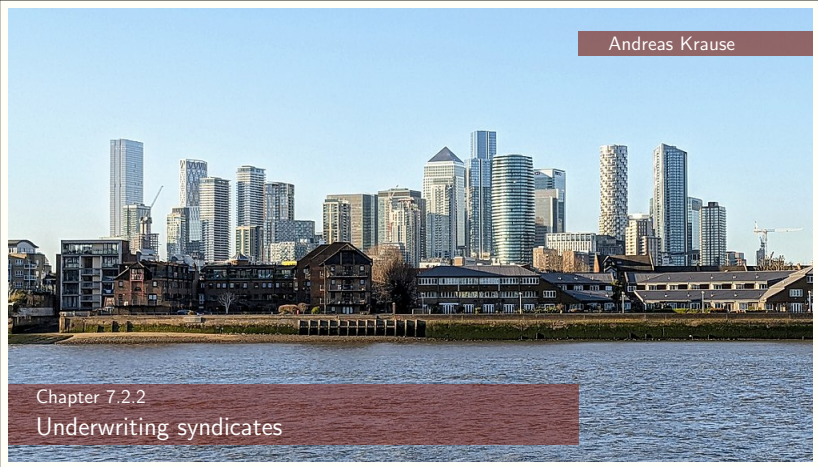
Chapter 7.1.2  
Book-building

## 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
- ? Does book-building benefit only selected investors?
- ! Issuers also benefit as overall the offer price obtained will be higher compared to other mechanisms, despite any discounts applied

# 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
- ▶ We will discuss how these two aspects can be balanced by appointing a syndicate



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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?
- ! You need group of investment banks with contacts reaching different types of investors and different geographical foci

## 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
- ▶ These underwriting practices have been developed to maximize the proceeds the issuer obtains



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