Nashville Medical News

DECEMBER 2004 www.medicalnewsinc.com

How to Recognize an Investment Banker

Okay, here's a quiz on investment bankers. See how many you believe are true:

(1) Investment bankers lend or invest money directly into deals.

(2) It is not necessary for investment bankers to be licensed as securities broker/dealers.

(3) Most of the value added by investment bankers occurs prior to the agreement in principle being negotiated. Attorneys and accountants handle the due diligence and closing.

Turney Stevens

(4) The larger the firm, the better the deal capability.

(5) Only investment bankers specializing exclusively in a given industry sector know the space well enough to be effective.

Here are the correct answers: (1) False; (2) False; (3) False; (4) False; (5) False.

How did you do? If you got 'em all right, you're ready to be a very good client for an investment banker.

(1) Do investment bankers invest directly? No, *Merchant Bankers* invest directly. *Private Equity Fund managers* and *Venture Capital Fund managers* invest directly. *Subordinated Debt Fund managers* lend directly. Investment bankers may ALSO be merchant bankers but most are professionals who act as advisors.

Investment bankers, by contrast, are *agents*. They are professional *advisors* to clients, just as attorneys and accountants are professional advisors. In many cases, investment bankers are actually trained as attorneys and accountants prior to becoming bankers.

But investment bankers, while filling a vital role on the transaction team, differ from attorneys and advisors in one very key aspect. They are not compensated by the hour but, by industry custom, receive a *success fee* or *commission* upon, and only upon, successful completion of the assignment.

Many investment bankers, to offset the risk of a transaction not closing after months of labor have been invested, will price their services to include a retainer *plus* a success fee.

The retainer accomplishes three objectives from the banker's perspective: (1) It provides some compensation in the event that a transaction does not ultimately close for reasons beyond the banker's control; (2) It establishes a fiduciary duty to the client and removes any legal doubt as to where loyalties should lie; (3) It enables the banker to determine that a given client is fully committed to what is, at best, a long and grueling process.

(2) Must investment bankers be licensed? One quick and easy way to separate those who have made rock-solid commitments to the profession is to determine if they are licensed at the state and federal levels.

Any agent representing a client in a transaction involving the sale of securities must be licensed by the Securities and Exchange Commission and by each state in which an offer to sell those securities is made. An offer may consist of any conversation about the transaction. Despite these reasonably clear cut rules, there are many firms and representatives of firms that are not licensed. Ask about licensing and you'll have a good first read on professional capability and commitment.

(3) Where is the most value added? Many would say the most important contribution an investment banker makes is in matching a client with a source of funding or a buyer.

There's no doubt that successful marketing of the transaction is a key skill, but the greatest contributions of a very good investment banker can only be appreciated after the deal appears to have been struck. That's when the terms initially offered must be protected against erosion during due diligence with an equally aggressive defensive strategy by the bankers.

We estimate that 60-70 percent of our total professional labor in a transaction is invested *after* the deal has been initially struck. This is counter-intuitive to most clients, especially those like once-in-a-lifetime sellers or infrequent equity and debt solicitors.

Because bankers have that big success fee dangling out there upon completion of the transaction, they have the most incentive of any professionals on the deal team to complete the process as rapidly as possible. Authorizing a banker to lead the process helps to ensure that the issues arising along the way will get dealt with quickly and effectively.

Good bankers, however, must know how to work smoothly and cooperatively with the irreplaceable skills brought by the attorneys and accountants who are also critical members of the team. Once the key business issues are settled in the definitive documents, the rest of the process must depend on the lawyers for closure and the bankers should defer to them at that point.

(4/5) Are larger firms better? Are specialists better? Yes and no. Smaller, boutique firms can offer the advantage of a specialized *process* rather than an industry specialization. They also offer, for the most part, deal teams consisting *only* of senior professionals, versus the larger firms' assigning of more junior bankers to execute the day to day aspects of a given transaction.

The other side of the issue, however, is that larger firms can bring more labor hours to bear more quickly on a given assignment if unusual speed and urgency are vital. The larger firms may also be more likely to have more personnel internally who are experienced in multiple narrow types of transactions, e.g. taking a public company private or executing a PIPE ("Private Investment in a Public Equity"), to name two examples.

There are many types of clients and client needs and there are many types of investment banks to meet those needs.

Turney Stevens is Chairman of Harpeth Capital, LLC, a Nashville-based investment banking firm with MBA's, JD's, and CPA's on its staff. The firm is a licensed NASD broker/dealer in 29 states.