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The Investment Banking Industry

Walking the Tightrope

Economy Business And Markets

Long caffeine fueled working hours, Armani suits, and fat bonuses. Investment banking is one of the more lucrative branches of financial services. In Iran, however, the business is just at its beginnings, meaning under current economic conditions, investment banks are struggling to survive.

In an exclusive interview with the Financial Tribune, Ali Khosroshahi, Amin Investment Bank's Senior Asset Management & Investment analyst, gave a closer view of Iran's investment banks.

With a bearish stock market hovering near 21-month lows, even investment banks, which are the best capitalized companies in the financial services industry, have been struggling to make a profit. They suffer from what Khosroshahi calls an "unsafe margin" for their business, a byproduct of the high cost of money. "Most of investment banks' earnings come from issuing and market making for debt securities," said Khosroshahi. "Handling debt securities roughly accounts for 80 percent of their earnings." When investment banks fall short on cash, they have to borrow from banks to carry on offering a market for these securities. "Now imagine having to borrow at a higher rate than those they receive for market making," he said.

An investment banks makes between five to six percent commission on its best market making contracts. The market maker is also getting a 20 percent interest on the sukuk – Islamic bonds. If in need of money it has to borrow at around 27 to 29 percent. That means it will be making a two to three percent loss on the borrowed money. "So if an investment bank is handling five trillion rials of sukuk, a two percent loss would amount to a 100 billion rial loss for it in that year, more than what it can handle," the analyst said.

“This is threatening the entire investment banking industry,” said Khosroshahi. It is already hurting some investment banks, but losses can be easily hidden in books and it takes years for the situation to be seen from the outside.

Furthermore, investment banks have to offer some added interest on the sukuk, so that they can sell them. “This is why you see sukuk on which the issuer is paying a 20 percent interest is traded with 23 to 25 percent interest in market,” he said. “Because no one will buy securities with 20 percent interest from investment banks,” he added. This added cost further raises risks for the investment banks.

As for underwriting stocks, the market for it has stalled because companies had a hard time last year. “A company raises capital when it is making a profit, has projects and an expansion plan, when you don’t have that, you have no underwriting, no research report.”

The market for stock issuance has all but evaporated in the past year. Coupled with other activities like merger and acquisition services, these activities “can barely cover the company’s operational costs and are not lucrative,” according to the analyst. This has concentrated investment bank activities on bonds, increasing their operational risk.

Will this situation change? Not until a final nuclear deal between Iran and the P5+1 – US, Britain, France, Germany, China and Russia – is signed and implemented. “The equity market is based on future expectations,” said Khosroshahi. “And right now expectations of Iran’s economic outlook are bleak.”

“The market has exhausted its optimistic expectations twice, as talks failed to culminate in a deal back in November, and furthermore politicians belittled the framework agreement reached on April 2,” he opined. So now everyone wants to be sure the deal is reached.

Yet, it will take a year for the economy to start moving forward after a deal normalizes transactions with the world. It will take another year or two afterwards for companies to recuperate the losses they have sustained in the past few years, he explained.

But the investment industry needs to move faster and Amin – Iran’s first investment bank – has an expansion plan. Firstly it wants to increase its market share in sukuk trading. It was third with a 16 percent market share last year, behind Parsian Lotus and Omid. Secondly it is diversifying into financial engineering and M&A. Last but not least, it is on the lookout for foreign investors. Last week 25 foreign investors from Europe and Asia visited Amin’s offices to explore avenues of investment in Iran, Khosroshahi concluded.

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