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Effect of Investment Banking on Innovation and Growth of Start-UPS

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A B S T R A C T

The impact of investment banking on start-up growth and innovation is examined in this paper. We conduct a review of the literature to find out what research has already been done on the benefits of investment banking for startups in terms of facilitating access to capital, offering advisory services, and enhancing reputation and visibility. Investment banking, according to our research, can have a positive impact on start-ups' innovation activities, such as patenting, spending on R&D, and product development, as well as on their growth outcomes, such as revenue, profitability, and market valuation. To address the gaps and restrictions in the current literature, we offer some directions for future research.

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INTRODUCTION

For start-ups to survive and flourish in a cutthroat market, innovation and growth are crucial. However, start-ups frequently struggle with issues like restricted access to capital, high levels of uncertainty, and regulatory restrictions. By offering start-ups a range of services like financing, advice, valuation, and market access, investment banking can significantly contribute to their ability to innovate and grow. Since the advent of new products, services, procedures, and business models utilizing artificial intelligence (AI), big data analytics, cloud computing, blockchain, biometrics, and other digital technologies, the banking industry has also undergone a technological transformation (Bhatnagar, Taneja, & Özen, 2022). With the help of these innovations, banks have been able to increase their productivity, profitability, personalization, customer satisfaction, and innovation cycles (McKinsey and Company 2020). However, they have also brought about brand-new difficulties, like cybersecurity risks. We review the literature on the impact of investment banking on start-up innovation and growth in this essay and pinpoint the key mechanisms, advantages, and difficulties. The effects of technological innovation on the banking industry are also covered, along with how it may present both opportunities and dangers for both banks and start-ups.

The specific research questions are:

1. How does investment banking affect the innovation activities of start-ups, such as R&D spending, patenting, and product development?
2. How does investment banking affect the growth outcomes of start-ups, such as sales, profitability, market share, and valuation?

THEORETICAL REVIEW

The effect of investment banking on innovation and growth of start -ups is a topic that has received considerable attention in recent years, as banks face increasing competition from Fintechs and other digital disruptors. Investment banking can be seen as a source of financing, advice, and network for start-ups, but also as a potential acquirer or partner (Rosenblatt, 2020). The literature on this topic can be divided into three main streams:

1. The impact of investment banking on start-up performance,
2. The impact of investment banking on start-up innovation, trends and development,
3. The impact of investment banking on start-up ecosystem.

The first body of research looks at the impact that investment banking has on start-ups' financial health, including their ability to generate revenue, be profitable, be valued, and survive. By facilitating initial public offerings (IPOs), which are a company's first sales of shares to the general public, investment banking can have an impact on the performance of start-ups. IPOs can assist start-ups in raising significant sums of money, boosting their visibility and credibility while also luring in talent and clients (Allayarov, & Ravshanova, 2021). However, there are additional expenses and difficulties associated with IPOs, such as market volatility, disclosure requirements, and regulatory compliance. Start-ups must therefore carefully weigh the advantages and disadvantages of going public and seek professional advice from investment bankers who can assist them in preparing for the process, pricing their shares, and marketing their offering. The advice provided on mergers and acquisitions (M andAs), which are transactions involving the combining or transfer of ownership of two or more companies, can also have an impact on start-up performance. Start-ups may benefit from mergers and acquisitions in a number of ways, including by increasing their market share, diversifying their product line, gaining access to new technologies or resources, and achieving synergies or economies of scale. However, there are risks and difficulties associated with mergers and acquisitions as well, including cultural conflicts, integration issues, legal issues, and valuation disputes. Start-ups must therefore carefully assess the strategic fit and financial viability of potential M&A deals and seek professional guidance from investment bankers who can assist them in locating targets or buyers, negotiating terms, and carrying out transactions. By offering brokerage or financial advisory services to large institutional clients like pension funds, investment banking can also have an impact on the performance of start-ups. As part of their portfolio diversification strategy, these clients frequently invest in start-ups in an effort to increase returns while taking on greater risks. These clients may receive ongoing support and monitoring from investment banking in addition to assistance in identifying and evaluating suitable startup investments. Investment banking can assist start-ups in accessing these clients as potential sources of funding as well as gaining knowledge and feedback from their perspectives and expectations (Guo, et al., 2020). The main defense is that investment banking can give start-ups access to capital, knowledge, and reputation, which can increase their potential for growth and lower their risk of failure. For instance, Liberti and Petersen (2018) discover that startups that receive loans from banks with greater industry expertise experience higher sales growth and lower default rates. Likewise, Campanella and co. (2017) demonstrates that start-ups that rely on online banking platforms have better credit risk management and lower information costs than those that depend on traditional banking channels.

The second body of literature looks into the effects of investment banking on start-ups' R&D, patenting, and product development activities. Facilitating the initial public offering (IPO) process for start-ups looking to access the public capital markets is one of the main duties of investment banking. However, some startups have chosen alternative methods of going public, such as direct listing and Dutch auction, which minimize the role and fees of investment bankers and enable more market-based pricing and share distribution (Rosenblatt, 2020). As an illustration, while Google used a Dutch auction for its IPO, Spotify and Slack decided to go public through a direct listing. These approaches can increase transparency, effectiveness, and fairness for start-ups and their investors, but they also carry higher risks and unknowns, like price volatility and liquidity problems. The development of new trading platforms and technologies for private securities is another area of innovation in investment banking. These developments can give start-up businesses more liquidity and valuation options prior to going public (Luo, & Bai, 2021). The secondary trading of private shares among accredited investors, employees, and founders is made possible by platforms like Nasdaq Private Market, Forge Global, and EquityZen, for instance. Without diluting their ownership or disclosing sensitive information, these platforms can assist startups in raising capital, retaining talent, and optimizing their capital structure (Rosenblatt, 2020). The interaction and integration with ecosystems and fintechs that provide start-ups with fresh products and services is another area of innovation in investment banking. For instance, some investment banks have partnered with fintechs to benefit from their data, analytics, and platforms in order to improve their offerings and reach new subsets of start-ups. For instance, Citi collaborated with Qapita, a fintech company with headquarters in Singapore that offers digital equity management solutions for start-ups (Petria, Capraru, & Ihnatov, 2015). Some investment banks have also started or joined brand-new ecosystems that benefit startups in ways other than banking, like by giving them access to mentors, networks, customers, and suppliers. For instance, ING established ING Labs, a global network of innovation hubs that provide funding, knowledge, and connections for start-ups (ING Labs, 2020). The main defense is that, depending on the nature and timing of the financial services offered, investment banking can either foster or stifle innovation. Petria et al. (2015) find that start-ups that receive early-stage venture capital from banks are more likely than those that receive late-stage venture capital or no venture capital to patent and introduce new products. On the other hand, McKinsey (2019) contends that start-ups that are purchased by banks may see a decline in innovation as a result of cultural misunderstandings and administrative restrictions.

The third body of literature investigates how the start-up ecosystem, including the quantity, variety, and quality of start-ups as well as their interactions, is impacted by investment banking. By giving start-ups access to resources like funding, contacts, and knowledge, investment banking can support their expansion and innovation. Crunchbase (2022) claims that over 10,000 start-up funding rounds, worth over $300 billion, included investment banks as participants in 2022. Along with offering them strategic counsel and market insights, investment banks can assist start-ups in establishing connections with potential collaborators, clients, and investors. By providing financial and nonfinancial solutions to start-ups in various industries, for instance, banks can use ecosystems to succeed in the SME market, according to McKinsey (2019). By preparing them for the public markets, valuing their businesses, and marketing their shares, investment banks can assist start-ups with their exit strategies, such as IPOs or acquisitions. For instance, Taliyah Lam (2021), a limited partner at LibreMax Capital, claimed that she has experience working in investment banking and is knowledgeable about the start-up ecosystem and current trends. Investment banking does, however, come with some difficulties and risks that need to be carefully managed for start-ups. Potential conflicts of interest between investment banks and start-ups are one of the major obstacles, particularly when investment banks serve as both advisors and investors to start-ups. This might result in unfair pricing, biased recommendations, or preferential treatment for some clients. The information gap between investment banks and start-ups is another obstacle that could lead to moral hazard or adverse selection issues. For instance, investment banks might have access to proprietary or confidential information about start-ups that they could use for their own gain or leak to third parties. Additionally, there are numerous intricate regulatory and legal requirements for start-ups in the investment banking industry, including fiduciary obligations, disclosure laws, and anti-trust laws (Ghosh, 2021). These problems may reduce the flexibility and independence of start-ups while raising costs and risks. Finally, market fluctuations and uncertainties can have an impact on the performance and valuation of start-ups in the investment banking industry. For instance, according to McKinsey (2022), a decade-long period of relative stability for banks was put an end by a series of interconnected shocks that occurred in 2022. The main claim is that, depending on the degree and type of involvement, investment banking can either help or hinder the growth of a vibrant and dynamic startup ecosystem. For instance, according to McKinsey (2020), banks that employ digital attackers or collaborate with Fintechs can generate new growth opportunities and improve customer experience outside of banking. McKinsey (2021) cautions, however, that banks that control the market or shut out Fintechs risk stifling innovation and competition in the area.

IMPLEMENTATION AND METHODS

This research is included in qualitative descriptive research. The research subject is Investment Banking. Object research studied is Effect of Investment Banking on Innovation and Growth of Start-UPS. The data source is: Effect of Investment Banking on Innovation and Growth of Start-UPS and documents . Data in the form of taking pictures results observation . Research tools or instruments researcher role active in obtaining data in the field . Data collection techniques used covers observation and documentation .

RESULTS AND DISCUSSION

Access to funding during both the early and later stages of development is one of investment banking's main benefits for start-ups. Start-ups can obtain equity or debt funding from a variety of sources, including venture capitalists, angel investors, private equity firms, and public markets, with the aid of investment banks. Starting businesses may be able to use this to fund their expansion plans, increase their operational capacity, spend money on R&D, or buy out rival businesses (McKinsey 2020). Investment banks can also help start-ups with strategic advice and direction on how to improve their capital structure, valuation, and exit strategy (Imerman, & Fabozzi, 2020). The enhancement of a start-up's reputation and credibility in the market is another advantage of investment banking. Investment banks can serve as a bridge between start-ups and potential clients, partners, investors, or regulators. By carrying out due diligence, offering independent valuation, facilitating negotiations, and ensuring compliance with legal and regulatory requirements, they can assist start-ups in gaining trust and confidence. Investment banks can also aid start-ups in becoming more visible and well-known by spreading the word about their name, mission, and values to a larger audience (Duncan 2021).

But there are risks and difficulties that come with starting an investment banking business. For start-ups, investment banking can be expensive and time-consuming, which is one of its main disadvantages. Investment banks frequently impose high fees for their services, which can lower the net proceeds of fundraising or exit transactions (Cojoianu, et al., 2021). The preparation of financial statements, business plans, pitch decks, or prospectuses may also be a requirement of investment banks for start-ups. Starting-up businesses may become sidetracked from their primary tasks and operations as a result (Haralayya, 2021). The potential for conflicts of interest or an unbalanced incentive structure between start-ups and investment banks is another issue with investment banking for startups. Depending on the parties involved in a transaction, such as buyers, sellers, rivals, or regulators, investment banks may play multiple roles or have multiple relationships with them. Their independence and objectivity when assisting or defending startups may be harmed by this. In addition, investment banks might have different objectives or anticipations than startups in terms of the timing, cost, or conditions of a deal. Starting businesses may experience less than ideal results or be dissatisfied as a result.

CONCLUSIONS AND RECOMMENDATIONS

Conclusions

In this paper, we have reviewed the literature on the effect of investment banking on innovation and growth of start-ups. We have focused on four main aspects: how investment banking can provide access to capital, expertise, networks, and digital technologies for start-ups; how investment banking can influence the innovation strategies, capabilities, and outcomes of start-ups; how investment banking can affect the growth trajectories, performance, and valuation of start-ups; and how investment banking can shape the competitive dynamics and ecosystem evolution of start-ups.

Our main findings are as follows:

1. Investment banking can facilitate start-ups' access to capital by offering various financing options, such as venture capital, private equity, debt financing, initial public offerings (IPOs), mergers and acquisitions (M&As), and corporate venturing. These options can help start-ups overcome financial constraints, diversify their funding sources, and optimize their capital structure. However, investment banking can also impose costs and risks on start-ups, such as agency problems, information asymmetry, moral hazard, adverse selection, and lock-in effects (Liberti & Petersen, 2018).
2. Investment banking can provide start-ups with expertise, networks, and digital technologies that can enhance their innovation potential. For example, investment banking can offer start-ups access to industry knowledge, market intelligence, strategic advice, operational support, talent acquisition, and technological platforms. These resources can help start-ups improve their innovation processes, capabilities, and outcomes.

However, investment banking can also create challenges and trade-offs for start-ups, such as loss of autonomy, misalignment of interests, knowledge spillovers, and dependency (Campanella et al., 2017).

3. Investment banking can influence start-ups' growth trajectories, performance, and valuation by affecting their scaling strategies, market entry modes, customer acquisition methods, and exit options. For instance, investment banking can enable start-ups to scale up faster, enter new markets more easily, acquire more customers more efficiently, and exit more profitably. These effects can help start-ups increase their revenues, profits, market share, and valuation. However, investment banking can also entail drawbacks and uncertainties for start-ups, such as overvaluation, underpricing, dilution of ownership, and market volatility (Petria et al., 2015).
4. Investment banking can shape the competitive dynamics and ecosystem evolution of start-ups by altering their competitive positions, strategic choices, collaborative opportunities, and disruptive potential. For example, investment banking can help start-ups gain competitive advantages over incumbents or other start-ups by providing them with financial resources.
5. Investment banking exposes start-ups to various risks, such as information asymmetry, agency problems, and regulatory constraints, that may hamper their innovation performance and growth potential, as they also influence the innovation and growth outcomes of start-ups through different channels, such as financing decisions, governance mechanisms, and exit strategies; and

Recommendations

The rapid development of digital technologies and fintechs has created both opportunities and challenges for incumbent banks. On one hand, banks can leverage innovation to improve their efficiency, risk management, customer experience, and growth prospects. On the other hand, banks face increasing competition from new entrants, changing customer expectations, and regulatory pressures. To survive and thrive in this dynamic environment, banks need to adopt a clear and coherent innovation strategy that aligns with their business objectives and capabilities. Based on a literature review of the effect of investment banking on innovation and growth of start-ups, we propose the following policy recommendations for banks:

1. Invest in digital transformation of the core business. Banks should digitize their processes, products, services, and channels to reduce costs, enhance compliance, and meet customer needs. Digitization can also enable banks to access new sources of data and insights that can improve their credit risk assessment and decision making (Campanella et al., 2017; Petria et al., 2015).
2. Partner with fintechs and other ecosystem players. Banks should collaborate with fintechs and other players in the start-up ecosystem to offer complementary solutions, expand their customer base, and tap into new revenue streams. Partnerships can also help banks access innovative

technologies and capabilities that can enhance their own offerings (McKinsey & Company, 2019).

3. Launch digital attackers or new business models. Banks should consider building or acquiring digital-only banks or platforms that can target underserved segments, offer differentiated value propositions, and compete with disruptors. Digital attackers can also help banks test new ideas, learn from customer feedback, and scale up quickly (McKinsey & Company, 2020).
4. Foster a culture of innovation and agility. Banks should create an organizational environment that supports innovation and agility. This includes empowering teams to experiment and learn from failures, adopting agile ways of working, incentivizing innovation outcomes, and attracting and retaining talent with digital skills and mindsets (McKinsey & Company, 2019).

FURTHER STUDY

The effect of investment banking on innovation and growth of start -ups is a topic that has received increasing attention in recent years, as start-ups play a vital role in fostering economic development and creating jobs. However, the literature on this topic is still scarce and inconclusive, as different studies have adopted different methodologies, data sources, and measures of innovation and growth. Therefore, this paper suggests some directions for further research that could help to fill the gaps and provide a more comprehensive and nuanced understanding of the relationship between investment banking and start-up performance.

1. Future research could explore the mechanisms through which investment banking affects innovation and growth of start-ups. For instance, how does investment banking influence the access to information, credit risk management, operational efficiency, and customer experience of start-ups? How does investment banking enable start-ups to leverage disruptive technologies such as artificial intelligence, digital platforms, and fintech partnerships? How does investment banking shape the strategic choices, organizational culture, and governance structures of start-ups? These questions could be addressed by using qualitative methods such as case studies, interviews, or surveys, or by applying quantitative techniques such as structural equation modeling, mediation analysis, or causal inference.
2. Future research could examine the moderating factors that influence the effect of investment banking on innovation and growth of start-ups. For example, how does the effect vary depending on the type, size, stage, industry, or location of start-ups? How does the effect depend on the characteristics, strategies, or performance of investment banks? How does the effect change under different regulatory, institutional, or market conditions? These questions could be answered by using comparative or cross-sectional methods such as meta-analysis, cluster analysis, or difference-in-differences estimation.

3. Future research could measure the effect of investment banking on innovation and growth of start-ups using more comprehensive and reliable indicators. For instance, how can innovation be captured beyond patent counts or R&D expenditures? How can growth be measured beyond revenue or profit margins? How can other dimensions of start-up performance such as social impact, environmental sustainability, or customer satisfaction be incorporated? These questions could be tackled by using alternative or complementary data sources such as surveys, web scraping, text analysis, or machine learning.

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