Analysis of the Impact of Investment Banks on US Economic Growth

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ABSTRACT

Investment banks are an important part of the capital market. They have more funds than retail investors and are more experienced in long-term investment than traditional commercial banks. However, the improper operation of investment banks in the capital market also makes the whole market difficult to operate stably, and even brings destructive harm. Therefore, this paper will be combined with the history of the economic development of the United States, detailed description of the role of investment banks, and its improper operation will cause great harm. It is found that investment banks play a unique role in resource allocation, especially in supporting the development of high and new technologies whose prospects are not yet clear enough. The means of resource allocation is mainly through the securities market and the fund market. But investment banks may also lead to unmanageable financial innovation, weaken the national economy and spread to global markets.

Keywords: *investment bank, America, economic development,resource allocation.*

1. INTRODUCTION

Investment banks have more funds than retail investors and are more daring and professional when it comes to long-term investments than traditional commercial banks[1]. The investment behavior of banks has been carried out since the first bank appeared in the world, so the investment department in the mixed operations of banks can be regarded as the predecessor of investment banks. Since the emergence of such behavior, scholars have been studying the role of investment banks and looking into their relationship with the capital market. Investment banks have been instrumental in capital operations for many years, but their growth has also promoted the development of capital markets, and enterprises have also benefited[2].

As the largest economy in the world, the capital market of the United States is more developed than those of other countries. Whether it is stable or not affects the stability of the entire world economic development. As early as the end of the 19th century and the beginning of the 20th century, American banks in the stage of mixed operations began to engage in investment business, and various investment banks have been playing a role in the course of American economic development. When studying the impact of investment banks on economic growth, previous researchers mostly described the role of generality and lacked the connection with specific cases.

In view of the events in the history of American economic development, this paper discusses the positive or negative role played by investment banks, and analyzes the causes of the events. This paper summarizes the experience and lessons, and explains the responsibilities that investment banks should bear in the national economic growth and the red line that cannot be crossed in the future, which is conducive to providing some enlightenment for the development of the national economy.

2. ACCELERATING CAPITAL FLOWS

2.1. Driving mechanism of securities market

The main body of the securities market can be divided into four parts: fund-raisers, investors, intermediaries, regulatory agencies, and self-regulatory organizations. Investment banks play an important role in different market entities, and play a special role as an intermediary and one of the main participants.

Investment banks, as intermediaries, act as a bridge between fund-raisers and investors, processing financial market information and providing it to the public. The

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securities market presents a social model in which information flows between different levels, which improves market liquidity and pricing efficiency [3]. This will improve the efficiency of stock market's operations. As an underwriter, it issues bonds and raises funds for governments and corporations. At the same time, as investors, they have strong financial strength to activate the secondary market, adjust the movement of monetary funds, and constantly carry out financial innovation to make the financial market continue to develop.

2.2. American Securities Market

The securities market of the United States was born in the period of the War of Independence. After several periods of reform, it kept advancing and developing, and finally became the international securities market today. Its every move affects the securities markets of the world, among which the most important is the continuous financial innovation. Leaving aside the small-scale options trading that took place in Europe during tulip mania (which never took off), familiar financial innovations such as options futures matured in America.

Now, asset securitization has a profound impact. Asset securitization appeared in the American housing loan mortgage market in the early 1970s, which kicked off the prelude. Today, a large number of government, agency, and private mortgages, credit card loans and receivables in the United States have been securitized. In the US, the securitization market is the second largest after the federal government bond market, and its securities issuance business accounts for a quarter of the total securities issuance market. This activity is driven by American investment banks. A large number of assets with low liquidity and the future cash flow of enterprises are securitized. In this way, fund-raisers quickly obtain a large sum of funds and invest in reproduction, which drives economic vitality and capital turnover in this way[4].

As a capital intermediary, the investment bank advocates financial innovation in the securities market and lobbies enterprises and the government constantly, which makes the activity of accelerating capital flow vigorously carried out in the whole United States. Although its original purpose was to expand the business and diversify it to increase profits, it did did so by accelerating capital flows throughout the financial markets of the United States. Moreover, because the American financial market has a strong influence on the world financial market, international capital keeps flowing in the global market and makes a great contribution to the economic growth of all countries in the world[5]. Therefore, in the process of continuous development and business expansion, investment banks in the United States also activate the capital of the market, improve the turnover speed, and make the American market more open and international.

3. PROMOTING INDUSTRIAL UPGRADING AND IMPROVING RESOURCE ALLOCATION EFFICIENCY

3.1. Investment banks act as overseers

There are three main ways for investment banks to realize the effective allocation of funds: securities, funds and enterprise mergers and acquisitions, and flow resources to high-efficiency and high-quality enterprises, that is, to form a survival mechanism for the fittest. Through securities issuance and fund management, investment banks have formed a large pool of capital resources and allocated funds to various departments and industries through security issuance and venture investment [6]. In this process, the marginal output of funds for investors to purchase a securities issuer is determined, and the reason why the issuer can issue securities also depends on the use efficiency of its funds. Enterprises with good development prospects and high efficiency are more likely to obtain financing and venture capital through securities. On the contrary, enterprises or industries with poor development prospects and inefficient use of funds are difficult to finance through securities. This promotes the flow and concentration of capital to industries or enterprises with high marginal output, and then promotes the allocation of human resources, materials and other resources to realize the optimal allocation of resources.

Table 1. Summary of new listings and delistings in US stock markets from 1975 to 2012

US Stock Markets	Listing and Delisting		Delisting Reasons		
Period	The Number of Listed	The Number of Delisted	Mergers and Acquisitions	Compulsory Delisting	Voluntary Delisting
1975-2012.	15922	17303	9749	7120	434
1975-1996.	11287	8976	4792	4021	163
1997-2012.	4535	8327	4957	3099	271

Period	The Rate of Listed	The Rate of Delisted	M&A Delisting Rate	Compulsory Delisting Rate	Voluntary Delisting Rate
1975-2012.	7.47%	8.22%	4.64%	3.35%	0.22%
1975-1996.	9.22%	7.29%	3.92%	9.25%	0.13%
1997-2012.	5.06%	9.49%	5.64%	3.50%	0.35%

According to the data of delisting and listing in the United States from 1975 to 2012[7][8][9], in the past 38 years, there has been a big wave and a big inflow and outflow. Not only were thousands of junk stocks forced out of the market, but also a number of great companies such as Microsoft, Apple, Google and Amazon emerged. Hundreds of companies have gone public or are otherwise listed in the U.S. This reflects the high degree of inclusiveness and openness of the U.S. stock market, and the fierce competition in the market.

During the 38 years, a total of 17,303 stocks were delisted, of which 9,749 were delisted by mergers and acquisitions, accounting for about 56%. Forced delisting totaled 7,120, or 41%. Other voluntary delistings total 434, accounting for less than 3%. From the above expansion path of the U.S. stock market, although in the 1980s and 1990s, during the peak period of U.S. stock IPO, there were as many as 800 or 900 IPO listings every year, there were also as many as 800 or 900 delisting of U.S. stocks every year.

Investment banks help companies go public, but they are also post IPO regulators. Their massive investment of capital resources has a guiding effect on the market [10]. If the business and financial situation deteriorates and cannot bring high returns to investors, investors will vote with their feet, that is, sell the shares of the company, causing the price of the company to fall, and the company may be acquired or delisted. As professional investors, the behavior of American investment banks has a great impact on the public investors and will affect their investment direction and investment enterprises. After an enterprise is listed, if its operations and financial condition are good and it can bring high returns, investors will be willing to pay a higher price to buy its shares, so that the enterprise can raise more funds at a lower cost. Therefore, in the long run, the survival of the fittest mechanism is very effective and obvious in the securities market.

3.2. Investment banks act as facilitators of mergers and acquisitions

From the data in table 1, it can be found that MERGERS and acquisitions also have a great impact on the American capital market. Mergers and acquisitions delisting accounted for the majority of delisting reasons in the American stock market, more than the combined forced delisting and voluntary delisting. M&A is the core business of modern investment banks. Investment banks are active in all aspects of M&A, mainly providing information services and financing arrangements.

In the late 1970s and early 1980s, the emergence of leveraged buy-outs made the scale of buy-outs unprecedented. Junk bond financing developed by investment banks had the effect of "small fish eating big fish", allowing smaller companies to successfully acquire traditional corporate empires. They participate in the activities of selling bonds and financing mergers, and assist emerging small companies by separating parts of some huge monopolies and establishing smaller, more flexible, and strategically focused companies after mergers and acquisitions [11]. This fully shows that investment banks play an important role in enterprise annexation and industrial adjustment. After merger and acquisition, enterprises play a role in optimizing resource allocation, whether it is to give full play to the scale benefits of large groups or to engage in professional production after restructuring.

Since the beginning of the 21st century, there have been many well-known mergers and acquisitions. In 2005, Google quietly acquired Android for a mere $50 million. The number of Android apps reached 480,000 in September 2011. With 1 billion devices installed in 2013, Android accounted for 78.1 percent of the global market[12]. With 2.5 billion devices installed by the end of 2019, Android accounted for 83 percent of the global market[13]. With Android, Google has also become one of the most important players in the mobile Internet era. All of this, of course, has been facilitated by investment banks. Therefore, investment banks play an extremely important role in optimizing resource allocation, both as participants and as supervisors.

4. PROMOTING THE DEVELOPMENT OF NEW AND HIGH TECHNOLOGY

Silicon Valley has become a cluster of high-tech industries in an area with no industrial history. The take-off of Silicon Valley can be attributed to the following reasons. Firstly, convenient and cheap transportation, excellent geographical location. Secondly, it is just in time to catch up with the technological revolution since the 1970s. The third, least to be ignored, is the continuous

infusion of venture capital [14]. Silicon Valley is not only a cluster of high-tech industry, but also a concentration of venture capital raising and venture capital investment. By developing venture investment business here, investment banks have become important participants in financing high-tech enterprises and promoting the development of high-tech industrialization[15].

Investment banks get most of their funding from self-issued stocks and bonds, which means they don't face the risk of a run on their bank if their short-term investments go bad and the bank's reputation suffers[16]. This allows investment banks to invest in businesses that are risky, with uncertain short-term prospects, but assessed to be likely to yield high returns over a decade or two. Often, such high-risk projects are innovative science and technology projects, and investment banks bring hope for the development of these small and medium-sized technology enterprises. Due to the lack of capital incubation, leading to the abortion of technological innovation and technology, due to the development of the investment banking industry, the number of technology companies with good and advanced technologies is decreasing. Because they can be solved by turning to investment banks for help, facilitating the financing of enterprises, and helping to bring in and out of venture capital.

Silicon Valley is just the tip of the iceberg in the role of investment banks in American technology companies. The vast majority of American technology companies have received investment bank capital injections or financial services. The development of high and new technology effectively drives the increase in total factor productivity. The same capital will create more benefits, and the conversion rate of capital and output will be improved, and the GDP will be correspondingly improved.

5. ABUSE OF HIGH-RISK FINANCIAL DERIVATIVES

When the subprime mortgage crisis broke out in 2008, the top five investment banks on Wall Street fell into unprecedented difficulties.

The main reason is investment banks' excessive credit expansion and abuse of high risk financial derivatives to seek high returns. When the subprime crisis broke out, large losses were generated due to insufficient liquidity[17]. At the same time, because of their operating leverage of about 30 times, their failure was devastating to American financial markets.And because the American market is a global market, most countries in the world are affected by it. It dragged the world economy into a long slump, and America's own economy was hit hard.

Wall Street investment banks designed complex and overly advanced financial instruments that made regulation very difficult. Wall Street investment banks in the United States treat designing circumvention of regulatory procedures, and circumvention of the law of financial products as the main ways to generate revenue growth. Such financial innovation often takes many years before the regulatory authorities list regulations to regulate and conduct regulatory actions. In the absence of supervision, it may be detonated by any event at any time.

6. CONCLUSION

This paper takes the American financial market as an example, takes the market, enterprises and pooling resources as three entry points, explores and confirms the significant role that investment banks play in the capital market and national economic development combined with data and facts. The conclusion is drawn that investment banks play an irreplaceable role in promoting the securities market, and can help the development of excellent emerging enterprises when they play their role of resource allocation through the securities market. Many of these enterprises are mainly engaged in science and technology, so they indirectly promote the development of national high and new technologies, improve total factor productivity, and thus drive economic development.

The past experience and lessons warn all countries in the world, even if the financial innovation of investment banks can lead to rapid economic growth in the short term, the government should also be vigilant about whether it is an economic bubble, which is to exchange short-term bright surface growth at the cost of high risk. Government departments should also implement a corresponding risk isolation mechanism to prevent the spread of risks in the same industry or other industries. At the same time, they should increase the introduction of talent, improve the timeliness of regulation, reduce the lag, because the complexity of financial products is not an excuse not to regulate. Regulators can reduce risk by raising the threshold for approval of derivatives, in keeping with the principle of safety and stability first.

This paper mainly discusses the utility of investment banks through past facts and data, so it does not go into the development direction of investment banks in the future and break through industrial difficulties. Moreover, taking the financial market of the United States as an example, it lacks guidance for some countries with imperfect financial markets in the world. The author's future research will focus on the similarities and differences between the roles played by investment banks in developing countries and developed countries, and continue to explore the roles played by investment banks in different markets.

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