

# **New York University—Stern School of Business**

## **The Financial Services Industry**

**Summer 2016 (FINC-GB.2334.70)—M-W 6.00pm-9.00pm**

**Room 2-70**

**Professor Militello**

This course provides an overview of the investment banking (IB) business and financial service (FS) industry. Financial services have become an integrated group of product and service offerings; provided by large financial service firms and smaller boutique-like organizations. This course examines the forces shaping these organizations, the delivery of their product and service offerings and the business landscape of the IB and FS industry—both today and into the future. Three fundamental questions are addressed throughout the course:

- (1) How are things done today in the IB and FS industry?
- (2) Why are they done that way?
- (3) How are they likely to be done in the future?

With these three key questions in mind, the course examines the areas in which investment banks and financial service firms today operate and conduct business, including: advisory services; the business of raising of capital; sales and trading; the business of investing and managing capital—both proprietary and for the account of others; and, risk management. Importantly, as they impact IB and the FS industry, the following considerations are critical to our class discussions:

- The interplay of politics, regulation, globalization, and technology;
- The emergence of alternative business models such as private equity, hedge funds and the rise of newer and more direct sources of both providing and raising capital;
- The challenges of both developing and managing financial products and services over the product life cycle—beginning with high margins to the inevitability of commoditization; and,
- The realities of learning how to more effectively manage both ethical and business dilemmas in the face of constant industry change.

By the end of the course, participants will:

- Be prepared for entering the IB or FS industry;
- Be knowledgeable in working with IB or FS professionals—as a client or service provider;
- Be able to intelligently interpret financial events—both opportunities and threats—as they affect both the broader economy and/or more specifically the IB and FS industry.

Please remember that this is a survey course of the FS industry. The text should be used as a background reference and/or reinforcement tool. Readings—including cases—for each session are suggested throughout the outline. Postings (to NYU Classes) set the stage for our time together focusing on the key questions and practices that are shaping the industry—both today and in the future. It is important to give each of these postings your attention before coming to class. As the discussions are not “routine” lectures—but interactive conversations—it is important to prepare for each session as much as possible. There will be periodic team assignments throughout the course plus a mid-term and final examination.

## Outline<sup>1</sup>—Investment Banking and the Financial Services Industry

### Overview (Session 1)—June 29<sup>th</sup>

This session explores the Investment banking (IB) and financial service (FS) industry landscape—including the important roles and responsibilities of both the providers and consumers of such services. What are the key focus areas and dilemmas facing those attempting to successfully operate in the IB and/or FS industry? In this opening session we address:

- **The businesses**—advisory, capital-raising, risk transformation, asset management, sales and trading
- **The landscape**—investment banks (universal and boutique), private equity, hedge funds and other asset managers (pension funds and insurance companies)
- **The customers**—organizational decision-makers (CEOs, CFOs), high net worth individuals (family offices) and the increasing trend of the “provider-customer”
- **The influencers**—activist investors, central banks and the regulators
- **The dilemmas**—entrepreneurship and stewardship, fragmentation and integration, diversification and specialization, increased sales and product suitability

**Text:** Chapters 1 & 2;

**Text Case**—Investment Banking in 2008—A Brave New World

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<sup>1</sup> Sessions are indicative—not cast in stone. Discussions and class work will guide our time table; however, we will endeavor to cover all topics as scheduled. Each week students receive a Sunday-morning email keeping them apprised of assignments, postings, expectations and a status report of where class activities stand. It is important to keep up with the suggested readings from your text and the postings to NYU Classes.

### **Postings:**

Posting #1: “Banking 2020,” *Accenture*

Posting #2: “Should Commercial and Investment Banking be Separated” *Mckinsey and Company*

### **The Business of Advice (Session 2)—July 6<sup>th</sup> (No Class July 4<sup>th</sup>)**

This session explores the advisory business as it shapes relationships and business opportunities at the client level—both organizational and individual. For both the IB and FS businesses what key practice areas must be mastered for success? The following topics are addressed:

- **The advisory business**—what is it, who does it and what’s in it for them?
- **Value creation**—customer value conversations, organizational and individual perspectives, a climb up Maslow’s pyramid
- **Financial advisors as good doctors**—diagnosing before prescribing; needs before products
- **Cost (return) and flexibility (risk)**—an analytical and behavioral framework for assessing IB and FS needs/opportunities
- **Creating and destroying value**—getting it right/wrong (why capital structure matters in maintaining and growing a business)
- **Getting paid—or not—for value creation**; fees—market share, share of customer wallet
- **The trusted financial advisor**—the upsides (and downsides) of getting “close” to the customer; and the elements and process of building trust

**Text:** Chapter 10

### **Postings:**

Posting #3: “The Financial Services Advisory Workbook,” *Professor Militello*, 2016 edition

Posting #4: “Capital Structure, Cost of Capital and Financial Flexibility,” *TMI Academy*

### **Mergers and Acquisitions—Business Portfolio Management (Sessions 3 & 4)—July 11<sup>th</sup> & 13<sup>th</sup>**

Based on the first two sessions we move forward to one of the key questions of the course; namely, what are the levers of value creation—the management of the portfolio of a business enterprise; whether it is family-run, public or private-equity owned? The dynamics of such ownership alternatives have diverse implications; however, there are certain “commonalities” worth exploring as such. In these sessions we look at:

- **Overview**—the advisory business of M&A:  
What is it, who does it and what’s in it for them?
- **Business portfolio management**—the owner’s and/or CEO’s key lever of value creation/destruction
- **The business life-cycle**— key to business valuation
- **The challenges of ownership**—private and public equity
- **Diversification, core competencies and adjacencies**  
Why good advisors make money
  
- **M&A and value creation**—a true story  
(NYU Classes)  
**The Case of Bruno’s Wholesale Meats**—the acquisition, building and divestiture of a middle-market business
  
- **Equity separations**—spin-offs and the reemergence of tracking stock
- **Risk management in M&A deals**—preserving business objectives with derivative instruments; the case of Rhone Poulenc
- **Alternatives to overinvestment**—the “hidden” secret of risk management
  
- **The M&A merry-go-round**—the anatomy of the deal, e.g., Kraft/Heinz
- **IBs and creative financing**, e.g., Dell/EMC
- **Key challenges facing the advisory business**: SWOT discussion
- **Where are we headed?**

**Text:** Chapter 4;

**Text Case**—Freeport-McMoRan: Financing an Acquisition

**Postings:**

Posting #5: “Growing Beyond the Core Business,” *Mckinsey*, 2015

Posting #6: “The Risks and Rewards of Spin-offs, Equity Carve-Outs and Tracking Stock,” *L.E.K.*, Volume iii, Issue 1

## **The Business of Raising Capital (Sessions 5, 6 and 7)—July 20<sup>th</sup>, July 25<sup>th</sup> & 27<sup>th</sup>**

These sessions take participants on a journey of the capital markets line. Utilizing our advisory cost/flexibility framework we explore the following as to their implications for investment banks, financial service firms; and, both issuers and investors.

Here our three questions strongly come into play; namely, how are things done, why are they done that way and how are they likely to be done in the future? Along this thought process we explore:

- **The Lending Business**
  - Overview—the lending business  
What is it, who does it and what’s in it for them?
  - Evolution of the lending business—where have the “real” bankers gone?  
The “twilight” zone
  - Relationship or transactional banking?
  - Credit Risk—a silo of expertise or an organizational culture?
  - Positioning the lending business—the capital markets line  
Revolving credits, term Loans—an alphabet soup
  - Beyond return-on-assets— the *quid pro quos*
  - Alternatives to bank lending—peer-to-peer, crowdfunding, the “Uberization” of finance
  - Key business challenges facing today’s lenders/borrowers—SWOT discussion
  - Where are we headed?
- **The fixed-income business**
  - Overview—the “fixed-income” business:  
What is it, who does it and what’s in it for them?
  - Where has the innovation gone?
  - Here come those rising interest rates?
  - Positioning the business on the capital markets line;  
Subordinated debt, mezzanine financing (preferred debt and convertibles)
  - Fragmented and global markets—why, where and when to raise capital?
  - Windows of opportunity—another level of advice
  - Visitations of the Samurai, Bull Dogs, Yankees, etc.
  - Negotiated and bought deals—whose running the show?
  - Key challenges facing the fixed-income business—SWOT discussion
  - Where are we headed?
- **The equity business**
  - Overview—the equity business:  
What is it, who does it and what’s in it for them?
  - Politics of equity—knowing the Chancellor doesn’t hurt!
  - Positioning the business on the capital markets line—public and private equity
  - Early stage investing—friends and family no more!
  - Venture and vulture capitalists
  - Business implications and opportunities of equity financing
  - Role of the IB advisor
  - Primary (IPO), follow-on and secondary offerings
  - SEC filing requirements—impact of the “Job’s Act” on the equity issuance process
  - The democratization of equity ownership—Dutch Auction (Google)
  - Key challenges facing the public equity business—SWOT discussion
  - Where are we headed?

**Text:** Chapters 3, 7, 8; and, 9

## **Postings:**

Posting #7: “Decoding Financial—Technology Innovation,” *McKinsey Quarterly*, June 2015

Posting #8: “The Uberization of Money,” *Wall Street Journal*, November 7-8, 2015

## **The Businesses of Investing Capital (Sessions 9 & 10)—August 1<sup>st</sup> & 3<sup>rd</sup>**

Over the years financial service activities have moved into the shadows of the regulated banking system. While regulators have attempted to squeeze entrepreneurship out of the regulated banking system the latter continues to be an integral part of the business models of both hedge funds and private equity firms. What is the interplay of financial service firms both within and across regulatory frontiers? We explore:

- **Private Equity**
  - Overview of the business  
What is it, who does it and what’s in it for them?
  - Business objectives and organizational structure—The LP agreement
  - Key changing business dynamics of what it takes to create value—and, the realization of such (fee and return structure)
  - Role of and relationship with investment banks
  - Advisory (M&A): funding (LBOs), valuations and debt capacity
  - Key challenges facing private equity—SWOT discussion
  - Where are we headed?

**Text:** Chapters 16-20

**Text Case—** Toys “R” Us LBO

## **Postings:**

Posting #9: “Erik Hirsch on Private Equity,” *McKinsey on Investments*, Summer 2015

Posting #10: “The Future of Alternative Investments,” *World Economic Forum*, 2015

Posting #11: “New Horizons for Infrastructure Investment,” *McKinsey on Investments*, Summer 2015

- **Hedge Funds**
  - Overview of the business  
What is it, who does it and what’s in it for them?
  - Business objectives and organizational structure
  - Not all hedge funds are created equal—style matters
  - Role and relationship with investment banks

- Prime brokerage business
- Key challenges facing the industry—SWOT discussion
- Where are we headed?

**Text:** Chapters 11-15; and, Cases 5, 6 and 7

**Text Case**—McDonald's, Wendy's and Hedge Funds: Hedge Fund Activism

**Postings:**

Posting #12: "The Icahn Manifesto," *Journal of Applied Corporate Finance*

Posting #13: "Preparing for Bigger, Bolder Shareholder Activists," *McKinsey & Company*, March 2014

**Asset/Wealth Management (Session 11)—August 8th**

- Overview of the business  
What is it, who does it and what's in it for them?
- The family office
- Entrance strategies—where to meet wealthy individuals
- Exit strategies—families and legacies, strategic buyers and financial sponsors—changing business dynamics
- Why owners die when they sell their businesses—having patience matters
- Business objectives and organizational structures
- Role and relationship with investment banks—cross-selling
- Key challenges facing the wealth management business—SWOT discussion
- Where are we headed?

**Text:** Chapter 6

**Postings:**

Posting #14: "Global Wealth—Winning the Growth Game," *BCG*, 2015

**The Business of Trading (Session 12)—August 10<sup>th</sup> (Last Class)**

- Overview of the business:  
What is it, who does it and what's in it for them?
- The meaning and value of trading—primary and secondary trades
- The brave new world of rising interest rates
- The business dynamics of trading—who's the customer anyway?
- The evolution and role of the sales desk
- Doing a "simple" trade—three ways to make and/or lose money
- The Gnome of Zurich—listening to the radio matters?  
Stacking-up to dark pools, algorithmic trading and the flash boys?

- Key challenges facing the trading business: SWOT discussion
- Where are we headed?

**Text:** Chapter 5

**Postings:**

Posting #15: “The Quarterly Report on Banking Trading and Derivative Activities,” *OCC*, 2015

Posting #16: “An Objective Look at High Frequency Trading and Dark Pools,” *PWC*, 2015

**Take-home final examination (to be discussed)**

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**Course Information**

This course can be taken concurrently, before or after Global Banking and Capital Markets.

**Logistics and Pedagogy**

The course is conducted over twelve classes.

The course is discussion oriented, and accordingly emphasizes classroom participation. As such, readings and preparations should be completed prior to the class for which they are applicable.

Appointments are always possible and encouraged—please contact [fmilitel@stern.nyu.edu](mailto:fmilitel@stern.nyu.edu).

**Text Book**

The text for the course is:

“Investment Banks, Hedge Funds and Private Equity,” by David P. Stowell, Elsevier 2013, Second Edition

Text and case readings are noted in the course syllabus; as well as postings of additional readings to further our class discussions. Class discussions are not routine lectures; but seek to build upon the course readings and reflect on current events and issues. There will be periodic team assignments and class discussions of such.

**Examinations**

Due to the heavy load of class work and topics to be covered examinations will be take-home. We will not use class time for taking examinations.

For the mid-terms participants are allowed to work in teams as large as three—that’s the limit. The mid-term examination will count for 30% of each student’s final grade.



The final examination is also a take-home—but is to be completed by each student on an individual basis. The final examination counts for 40% of each student’s final grade.

### **Class participation/team assignments**

Participation in class discussions and attendance is very important. Completing periodic team assignments, class preparations and attendance are extremely important. They will be noted. Accordingly, attendance, participation, and assignments count for up to 30% of one’s final grade.

### **Semester Grading Guidelines**

The final allocation of course grades follows school and departmental guidelines—with a limit of 35% of final grades being comprised of A or A-.

### **Professor Bio**

**Frederick C. Militello, Jr.**, is an advisor to senior corporate and banking executives on a wide-range of organizational initiatives. He is a former vice president, managing director and division executive at Chase Manhattan Bank (JP Morgan Chase). His responsibilities included corporate relationship banking, non-loan financial products and services, treasury consulting and financial advisory. He has worked as a banker and advisor for many of the world’s leading corporations including Apple Computer, Georgia-Pacific, Mead Corporation, McDonalds, Monsanto, Gillette, Hewlett Packard, Dow Chemical, Pfizer, Estee Lauder, Warner Lambert, Baxter Laboratories, Sandoz Corporation and many others.

He is an adjunct professor of finance at New York University’s Leonard N. Stern School of Business. He teaches courses on both Global Banking and Capital Markets; and, Investment Banking and the Financial Services Industry. He has been teaching at Stern since 1990.

Since the early 1970s Frederick has been a leading practitioner and advisor to bankers and corporate financial executives around the world. Specifically:

#### **Financial and Senior Banking Executive:**

- Frederick has worked his way up Wall-Street holding financial positions for US Steel Corporation, Mobil Oil Corporation, the Bank of Boston International and the American Stock Exchange. Starting at the “bottom”—as a messenger, Federal Reserve clearing-house “runner” and exchange floor clearing clerk—he moved-up through the ranks to senior management positions in international and corporate banking departments. He also was employed by Business International Corporation (acquired by the Economist Intelligence Unit) where he launched one of the first financial publications for senior financial executives; namely, *Business International Money Report*.

He is a former vice president, managing director and division executive at Chase Manhattan Bank (JP Morgan Chase).

**Business and financial Entrepreneur:**

- Frederick has been founder and co-owner of two Wall Street-based financial/educational advisory practices with an emphasis on corporate and investment banking—organizational structure, business and product line development and a wide-range of senior leadership issues and challenges.

In the capacity of a senior thought leader thousands of bankers attended his seminars and workshops on both product skills and behavioral competencies.

**Board Member and Investor:**

- Frederick has been an angel investor and board member for start-up operations ranging from encryption technologies to those seeking to reshape the travel and entertainment industries.

He also has sat on the board of non-profit organizations including the Children’s Media Project and served as Chairperson of the Durham Valley Preservation Commission.

**Author and Financial Commentator:**

- Frederick has written books in the fields of finance and banking including:

. *Leverage Competencies: What Financial Executives Need to Lead;*

. *The Empowered Organization: Redefining the Roles and Practices of Finance;*

. *Integrity-Based Financial Leadership and Ethical Behavior;*

. *Reassessing Corporate Banking Relationships: Issues, Practices and New Directions;*

. *Foreign Exchange Risk Management: A Survey of Corporate Practices*

**Public Speaker and Educator:**

- Besides his more than twenty years of educational service and dedication to improving the banking profession at NYU Stern, Frederick has been a speaker and Chair Person for educational organizations including the Belgian-American Chamber of Commerce, Management Centre Europe, the American Management Association and a guest professor at the Rotterdam School of Management and the Vlerick Gent Leuven School of Management. Frederick was also a teaching fellow and Adjunct Associate Professor of Economics at Pace University.

### **Other Accomplishments:**

As a young scholar Frederick was awarded the Wall Street Journal Student Achievement Award in Economics.

Educated in New York, Frederick studied at Pace and Columbia Universities earning advanced degrees in economics and international economics.

Frederick has a passion for cooking and is a graduate of the Culinary Institute of America—Boot Camp Program. For almost thirty years his family was active in the thoroughbred horse breeding business operating their farm out of Durham, New York. He and his wife recently moved to Albany, New York.