When acting as either underwriter in the primary market or dealer in the secondary market, the investment banker contemplates making a profit by marking up his merchandise in much the same manner as a wholesale or retail merchant in commodities. He invests his own capital—or borrowed funds—in bonds, assumes all of the risks inherent in ownership thereof, and if in the judgment of the market provides a valuable product, is able to pay his overhead and carrying costs, compensate his salesmen, and make a profit.

As a dealer in the secondary market where the "float," or inventory, of bonds will at any particular time measure several hundred million dollars, the dealer provides a means for the orderly exchange of seasoned bonds among investors. Since the municipal market is almost exclusively an over-the-counter market, the services of the hundreds of dealers operating on a nationwide basis assure the marketability of bonds—the ready conversion of bonds to cash and vice versa—which is so vitally important to all investors.

As a broker the investment banker provides a further service to his clients by undertaking to seek out the best market for a particular bond and to enable an investor to purchase or sell bonds at a reasonable commission.

Operating in the primary market as an underwriter, the investment banker provides a necessary service to municipalities. He stands ready to risk his capital in bidding for bonds offered in blocks by the issuer and distributes the bonds to his clients who are seeking profitable investments. It is thus through his efforts that the hundreds and thousands of investors of all sizes and types funnel their resources to municipalities which need funds for schools, civic improvements, public utility enterprises, roads, etc.

SOURCES OF FINANCING

The inventory required in order to effectively conduct business is an important consideration for the investment banker. Because of the almost infinite variety of bonds available for sale (rating, maturity, coupon rate, type security, and issuer are all important considerations for the investor), municipal bond inventories are large relative to inventories of other securities.[3] The method of financing of these inventories is thus an important aspect of the business.

Inventories of municipal bonds are financed basically in the following three ways: (1) by use of the investment bankers' own capital, (2) by commercial bank loans, and (3) through repurchase agreements.

The most common form of financing is through use of the investment bankers' own capital. This is true whether the firm is a dealer bank or a dealer, or whether the firm is a partnership or a corporation. Additionally, the size of the firm is not of great significance.

[3] As evidenced by a survey conducted by the Wharton School of Finance and Commerce of broker-dealer inventory practices for the first quarter of 1962. Although the variability among individual firms was great, inventory-sales ratios for new issues "averaged 4 percent for common stock, 9 percent for corporate bonds, and 29 percent for municipal bonds; for outstanding issues, the figures were 8 percent for common stock, 11 percent for U.S. Governments, 24 percent for corporate bonds, and 30 percent for municipals." Irwin Friend, "Investment Banking and the New Issues Market—Summary Volume," University of Pennsylvania, 1965.