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Another Slap at Democracy on Wall St.

By GRETCHEN MORGENSON

Millions of investors rushed into the stock market in the 1990's, believing that Wall Street was at least a fairly level playing field. Although they have since learned how illusory that notion was, the myth of democracy on Wall Street took a real beating last week.

One look at the Salomon Smith Barney documents detailing its allocation of initial public offerings, subpoenaed and just released by Congress, showed individual investors why they couldn't get the hot stocks that raced skyward during the mania. Ahead of them in line at most big firms were grasping executives who had a far greater chance of bagging hot stocks because their companies were paying investment banking fees to the firms doing the doling.

What the firms were really dispensing was free money. That is because the firms bringing shares public routinely and excessively underpriced them. An analysis by Sanford C. Bernstein & Company in 1999 showed that the median underpricing of initial offerings, which had been less than 5 percent in the early 1990's, rocketed to 30 percent that year.

That represented a heap of money left on the table by companies selling stock. It now appears that brokerage firms used this pile to reward already wealthy executives whose companies were, or might become, their customers.

How big was the honey pot? Figures from Thomson Financial put the first-day gains in new telecom shares issued from January 1999 to January 2001 at $9.6 billion. In telecom stocks alone, brokerage firms had almost $10 billion to divvy up among their "best customers."

Were you one of those lucky ducks? Didn't think so.

But Bernard J. Ebbers, former chief executive of WorldCom, was. He received 869,000 shares in hot stock offerings from 1996 to 2000. Other WorldCom executives received thousands of shares as well. And if Congress follows through on its threat of investigating the allocation practices of all Wall Street firms, investors will learn who else benefited.

Salomon said Mr. Ebbers's assets under management at the firm put him in the top 1 percent of its retail clients. That entitled him to receive large allocations of I.P.O. shares. But Peter Tanous, president of Lynx Investment Advisoryin Washington, wonders if Mr. Ebbers was a big client because of the fees his assets generated to the firm or the investment banking fees generated to Salomon by WorldCom and paid by its shareholders.

"Wall Street will say, `In what business don't you favor your best clients?' " Mr. Tanous said. "But maybe they're favoing the corporate executive, not the client," which in this case was WorldCom. If so, the gains on the offerings, Mr. Tanous said, should have gone to WorldCom shareholders. There's a novel thought.

Only an analysis of Mr. Ebbers's records with Salomon will show whether his personal account was one of the firm's largest fee generators. If so, then the profits are his. But if the fees generated by Mr. Ebbers in his personal account were dwarfed by investment banking fees generated by WorldCom, then the answer of whom the profits belonged to becomes muddier.

That there was a gross misallocation of capital into telecom during the mania is painfully clear. Too many companies were funded and too many failed. The human cost of this misallocation is also large. Challenger, Gray & Christmas, the job outplacement company, reports that 504,000 telecom jobs were eliminated in the 19 months through July. This year, telecom companies account for 23 percent of all jobs eliminated in the United States.

It's worth wondering if that pain would have been smaller had these companies taken into their coffers some of the money they left in Wall Street's trough. Perhaps more of them would have made it and fewer jobs would have been lost. Instead, the bulk of that $10 billion honey pot went into the pockets of the "best customers" of Wall Street.

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