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### Investment banking in America

## Unburdening

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### Success on Wall Street has come to mean cutting people and problems

NO INVESTMENT bank has actually gone bust of late, and even disappointing results for the third quarter, announced over the past two weeks, show that most of the big firms nevertheless have returns on equity in double digits, or very nearly. Solace, presumably, to those still at their desk as colleagues are turned out on the street.

Still, panicky investors have pushed the shares of every major bank to their lowest level in years as they have watched falling stockmarkets, the thinnest of pickings for both mergers and acquisitions and the underwriting of new shares, and now the growing mass of litigation surrounding investment banks. Even the shares of Goldman Sachs, which likes to think of itself as being in a class above the rest, have dropped below the price on the day of Goldman's initial public offering in 1999.

Over the past year, costs at the eight biggest Wall Street firms have fallen by one-fifth, or \$4.3 billion. In New York, 20,000 jobs in the securities industry have been lost, a tenth of the total. The same number again will need to go in order to match post-bubble reality, says Svilen Ivanov of the Boston Consulting Group. Even the few investment banks that are not cutting their numbers, such as UBS Warburg, are nevertheless getting rid of dull performers, to replace them with those they expect to be more stellar. Meanwhile, out go fancy dinners and even, heavens, business-class flights.

If there was a surprise in the latest batch of results, it was the sharp jump in earnings posted by Goldman, which managed to increase profits by 12%. Yet because the source of these earnings is buried deep within the bank's proprietary-trading operations, the numbers have been viewed more with bewilderment than admiration. The top prize for performance goes to Bear Stearns, a grittier firm which managed to post

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quarterly earnings up 22% while revenues fell by 4%.

Bear Stearns's recipe? A strong market for mortgages, a speciality, helped. So did higher earnings from brokerage operations that cater to hedge funds, another house strength. Such funds have held big short positions as stockmarkets have slumped. Bear Stearns earns money from lending the funds shares to sell.

The firm also benefited simply because it never was a force in mergers and acquisitions or offerings, to which so many others committed huge resources. Yet perhaps the biggest reason for Bear Stearns's success is that it began a determined cost-cutting drive a year ago, when many firms held out hope of a quick recovery. Others have since got the message.

Most investment banks feel that even if they cut staff too far, they can always rehire if business picks up. Weighing more uncertainly is the fear of litigation. Citigroup, for instance, is being scrutinised by the Securities and Exchange Commission, New York's attorney-general, the Justice Department, Congress and Manhattan's district attorney—among others.

Last week, the National Association of Securities Dealers (NASD) announced that it was imposing a \$5m fine on Citigroup's Salomon Smith Barney subsidiary, for publicly hyping Winstar, a telecoms company, at the same time as it was privately urging others to sell. Winstar is now bankrupt. Were the settlement the end of Citigroup's problems, Winstar would not have been such a bad transaction. According to the NASD, Salomon Smith Barney received \$24m for underwriting \$5.6 billion-worth of Winstar securities. Investors might have lost buckets, but Citi still looks \$19m ahead after the fine.

As part of the announcement, however, the NASD helpfully mentioned other, "larger" investigations into the bank's vilified research—by itself and by other regulators. At what point does Citi's reputation begin to crumble? Even if the litigation can be settled, the attention of senior management has shifted from running the business to defending it.