

The following 'Viewpoint' article appears in Issue Three 2000 of *FS.comment*, a magazine published by IBM and sent to top executives in banking and financial services:

#### No Panacea for Profits

US investment banking isn't proving a cash cow for European banks keen to develop profits and presence, says Ray Soifer<sup>1</sup>

US investment banking is extremely competitive. And if additional capital enters the industry by way of the Gramm/Leach/Bliley Financial Services Modernisation Act of 1999, it will become even more so. As readers will recall, after London's Big Bang in 1986, came an overcapitalised securities industry, flush with large inflows of capital from domestic and foreign clearing banks, which came face-to-face with the impact of a bear market. Does anyone remember Citicorp Scrimgeour Vickers and Security Pacific Hoare Govett? For that matter, how about Citicorp and Security Pacific?

That said, the effect of Gramm/Leach/Bliley will not be as dramatic in the US as the Big Bang was in London, the main reason being most of the banking organisations that would enter the US securities business have already done so through Section 20.

Nonetheless, it must be emphasised that there is substantial overcapacity in most facets of US investment banking, and those banks which would take advantage of Gramm/Leach/Bliley to expand their securities activities would do well to carefully consider the risks involved in increasing their financial commitment to an industry that already has no shortage of effective competitors.

Loan syndication and bond underwriting have many things in common. Indeed, there are real strategic advantages to a bank's being able to offer both types of debt financing to clients, since market conditions may favor each at different times. Equities and strategic advisory work, however, have much less in common with commercial banking than does the fixed-income business, and it is here that the major investment banking firms have established their dominant market positions.

In investment banking generally, a very significant competitive asymmetry has developed. The large US firms -- primarily the Big Three (Goldman Sachs, Merrill Lynch and Morgan Stanley), plus JP Morgan, Salomon Smith Barney and Lehman Brothers -- increasingly dominate European cross-border transactions as well as those involving large multinational companies.

In contrast, in the US, still the world's largest capital market, the only European-owned firms that are in a position to challenge the Big Three without making another major acquisition are Credit Suisse, owner of CSFB and now Donaldson, Lufkin & Jenrette (DLJ), and Deutsche Bank, which acquired Bankers Trust. Combining the capabilities and market position of DLJ with that of CSFB placed Credit Suisse solidly within a 'super-bulge bracket' in the US (alongside the global Big Three and Salomon Smith Barney) but it still lags behind the Big Three outside the US. PaineWebber, while providing UBS with a strategically important addition to its global private banking capabilities, is not a significant factor in most aspects of US investment banking.

As I see it, it is quite conceivable that other European banks will eventually face second-tier status in investment banking, even within Europe, as the top US-based firms extend their global market dominance - unless they acquire major US investment banking firms themselves.

Since an unfriendly acquisition of an investment bank isn't practical - because the people would leave - the ability to make a friendly acquisition will depend upon finding a willing seller. In the present market environment, there simply aren't any among US investment banks large enough to make a difference, strategically speaking; these firms are doing well enough on their own to wish to remain independent. As in the case of Deutsche Bank - Bankers Trust, for that to change may well require a market collapse of some sort.

US investment banking, then, for most European as well as American banks, is unlikely to be the panacea for profits that some have hoped for. Indeed, I've watched many large European banks pay large premiums to buy small US investment banks, too small to make much difference to their strategic position or financial results, and just shook my head.

To some extent, this may be a repetition of the phenomenon we saw in the 1970s and 1980s, when European banks bought up small US retail banks. Most of those have now gone, leaving a handful of serious players with US banking operations large enough to be competitive in their markets, and strategically important enough to their parent companies to continue to attract the capital needed to keep them that way. With US banking consolidation likely to continue, it is likely that even fewer European players will choose to remain over time.

---

<sup>1</sup> Ray Soifer, a former top-ranked Wall Street banking analyst, recently established his own strategic consultancy in banking and financial services. He may be reached via e-mail at [ray@soiferconsulting.com](mailto:ray@soiferconsulting.com).