MORGAN STANLEY'S BOARD and GREEK MYTHOLOGY: A CASE STUDY of the FRAGILITY of a GLOBAL INVESTMENT BANK and of CORPORATE GOVERNANCE GONE ASTRAY

"Mack is back!" has a triumphant ring to it, and it was reverberating loudly through the halls of Morgan Stanley on the news of John Mack's return as chairman and CEO. The louder ring, however, was that of an alarm bell warning us once again never to underestimate the fragility of an investment bank. Morgan's board of directors seemed to pay lip service to a characteristic all investment banks share regardless of size, history or reputation.

With $40 billion in revenue; A+ to AA credit ratings; 54,000 employees in 600 offices world-wide; consistent top-five rankings in its industry's annual league tables; and a stock market capitalization of $60 billion, the firm has the outward look of stability and rock solid strength. Add to this picture its rich history - the financial triumphs of the legendary J.P. Morgan and the California roots of Dean Witter - and you have a financial monolith, or so it may seem.

Yet, in four short but turbulent months in 2005, the firm came perilously close to losing its way, its talent and its independence. Under the relentless pressure of the so-called "Group of Eight" and the glare of the financial media, its CEO had to resign, its employees endured a barrage of calls from head hunters (leading to departures of many very talented people) and its stock price performance continued to languish far behind its peer group. How could these events take place under the supposedly watchful eyes of a board of directors whose members have sterling reputations and distinguished business careers in positions of leadership?

Remember Goodbody; DuPont Walston; Bache; Warburg Paribas Becker; E.F. Hutton; Drexel Burnham Lambert; Kidder, Peabody; Salomon Brothers? All once well respected franchises that have disappeared from Wall Street. While the dynamics of each firm's fate may differ somewhat, the end result was always the same: when the ship of state's prow went under the waves, her crew had to scramble to safety and the vessel eventually sank. Why?

Investment bank balance sheets contain cash, securities owned, lots of short-term and long-term debt and a modest amount of equity capital. The most important assets, however, the most critical components - people, ideas and clients (all known in the industry as "elevator assets") - are conspicuously missing from the balance sheet per se. There are no hard assets here; no manufacturing plants, refining facilities or warehouses…just lots of bright, well educated, hard working people.

For whatever the reason(s), Morgan Stanley's board and its departed CEO seemed to overlook a basic rule of management: "ignore your people at your own peril" and thus exposed the firm's fragility, indeed its Achilles heel. Assets that go up and down a firm's elevators every day can just as easily go out the door and across the street. The departure of key employees who take their ideas and clients with them very quickly threatens an investment bank's very existence.

Inside the boardroom, was this oversight due to ignorance? Hubris? Lack of humility? We may never know.

What we do know is that, despite the presence of a textbook example of corporate governance principles on the company's web site, a small group of very intelligent and successful people (apparently comfortable with each other and certainly used to getting their own way) lost their way. As senior talent streamed out the door, the board almost waited too long to act. In the process, did its members not understand or did they simply ignore the fragility of a powerful, valuable and storied franchise that its shareholders expected them to honor and protect?

Lastly, how can this board justify the exit package it bestowed upon the ex-CEO <u>after</u> his departure, let alone the "bequests" to two of his loyal subordinates? And why did it take the new CEO himself to repudiate a giant pay package the board had awarded him only a day earlier?

Bring on the Harvard Business School case study researchers! There is much to learn here.

Bruce S. Foerster
Miami, Florida
August 2005