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Case Study: Private Banking – A Viable Diversification Strategy for Investment Banks?

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## **Abstract**

The following business case outlines the recent strategic shift of investment bank Goldman Sachs towards more private banking. It is just one example of an established investment bank entering a field of business which is largely different to its traditional core business. The business case illustrates the development of the bank's strategy since its foundation, with a detailed account given of the developments under the bank's last three CEOs. It is shown that diversification towards private banking is a sensible, albeit difficult to implement way for the bank to reduce risk, expand business size and possibly to create long-term value.

**Keywords:** Private Banking, Banking Strategy, Diversification

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## **A Rare Occurrence for Goldman Sachs**

“Goldman Sachs’ third-quarter 2019 results posted a negative earnings surprise of 4.8%. The company reported earnings per share of \$4.79, missing the Zacks Consensus Estimate of \$5.03. Further, the bottom-line figure compares unfavourably with earnings of \$6.28 per share recorded in the year-earlier quarter. The stock declined more than 1.5% in pre-market trading, reflecting investors’ disappointment with the results.” [1]

This is just one of the many headlines David Solomon, current CEO of American investment bank Goldman Sachs, must have read when overlooking the Hudson River from his 200 West Street New York office. The weak performance during Q3 2019, which disappointed analysts and investors alike, is an exceptionally rare occurrence for Goldman Sachs. What is even worse for Solomon is the fact that ever since he became CEO in late 2018, the company’s stock performance has been underperforming the overall market. The stock’s performance under Solomon has been significantly worse than under his two predecessors during their respective tenure (see Exhibit 4). So far in 2019, Solomon’s track record as CEO has rebounded slightly, but the rather tumultuous transition period in 2018 casts a long shadow over Solomon’s performance as CEO.

Goldman Sachs has historically been praised, envied and even feared for its market dominance in the investment banking sector. It came out of the financial crisis in 2008 ahead of its competitors and has been in operation continuously for over 150 years [2]. The American investment bank had been immensely profitable throughout most of its history. Despite this impressive legacy, the company’s stock has declined in value under CEO Solomon. The imminent question one has to ask is: what has led the iconic Wall Street bank to lose its steam in recent years?

Solomon has been in a rather difficult position ever since he became the CEO of Goldman Sachs. He has been chosen as the likeliest candidate to undertake a difficult managerial task. As outlined by the CEO himself, the bank has a pressing need to restructure its business model [3].

In 2019 the company generates most of its revenue in the trading business (see Exhibit 1 and Exhibit 5). Trading has always been an exceptionally profitable business for Goldman Sachs. It is therefore no surprise that the trading culture has markedly influenced Goldman Sachs’ company culture. The trading business is said to be more short-term oriented than other businesses in finance, since it depends less on recurring human interactions and more on competitive pricing [4]. Recent adverse developments in the trading business, however, have negatively affected the bank’s profitability. The decreasing margins, a new wave of legal reregulation, as well as the inherent risk of the trading business have led Goldman Sachs to adopt a new strategy of business diversification. For a detailed account of adverse developments in the trading business see Exhibit 6.

In a first step towards diversification, the bank is expanding heavily into the private banking sector. Goldman Sachs has invested considerably into the wealth management business and, for the first time ever, the retail banking business. Although the private banking sector boasts several advantages over the risky trading business, the implementation of this strategy is not an easy task for Solomon. Private banking is radically different to the institutional client business traditionally pursued by the bank. Because of the inherent differences, there is a need for an immense cultural shift at Goldman Sachs.

To make matters worse for Solomon, the adverse developments in the trading business occur at a time when the bank's reputation among the public is rather low. This is a problem for the bank since the general public constitutes the target demographic for retail banking. The bank's low reputation stems from the handling of the financial crisis of 2007. Goldman Sachs was accused of selling risky assets to its clients while simultaneously short selling the very same assets itself. This led government prosecutors in the US to investigate the bank and then CEO Lloyd Blankfein was asked to testify in court. The ensuing events resulted in considerable negative publicity for Goldman Sachs [5]. In a now famous quote from *Rolling Stone Magazine*, author Matt Taibbi described the company as follows:

*"The first thing you need to know about Goldman Sachs is that it's everywhere. The world's most powerful investment bank is a great vampire squid wrapped around the face of humanity, relentlessly jamming its blood funnel into anything that smells like money. [6] "*

Over the subsequent years, critics have continued to accuse Goldman Sachs' of fostering a business culture of low ethical standards [7]. This hostile market environment towards the bank further limits Solomon's manoeuvring power as CEO. David Solomon must overcome many hurdles if he wants to successfully implement the new strategy of business diversification at Goldman Sachs.

### **The Modest Beginnings of Goldman Sachs**

Goldman Sachs was founded by Marcus Goldman as *Marcus Goldman & Co* in 1869. Marcus Goldman, who emigrated from Bavaria (Germany) in 1848, established the company as broker of IOUs in New York. In 1882 the firm became "Goldman Sachs" after Marcus Goldman's son-in-law, Samuel Sachs, joined the company. It quickly grew and became the largest dealer in commercial paper in the United States by the end of the century [8].

During the beginning of the 20<sup>th</sup> century Goldman Sachs began a collaboration together with Lehman Brothers. They started to co-underwrite all their equity issues in order to increase market share. Their biggest competitor at the time, J.P. Morgan, used to have a monopoly on higher denoted issues in the utilities and the industrial sector. Goldman Sachs and Lehman Brothers hence specialised on issues in retail, a less competitive but also less lucrative market sector. Their first joint underwriting was American retailer Sears Roebuck in 1906. Goldman Sachs and Lehman Brothers acted as co-underwriters for a total of 140 offerings for fifty-six different issuers over the next 30 years. [8]

The economic expansion during the beginning of the 20<sup>th</sup> century ended abruptly with the outbreak of the Great Depression in 1929. The Great Depression led to a nationwide commercial banking failure. Then President Franklin D. Roosevelt introduced a series of legislation and programmes collectively titled the *New Deal*. Part of the New Deal programme was the US Banking Act of 1933, which itself contained four specific provisions referred to as the Glass-Steagall Act. [9]

The purpose of the Glass-Steagall Act was to limit the scope of speculative investments undertaken by commercial banks. In particular, the Glass-Steagall Act prohibited commercial banks, which took in deposits and made loans, to underwrite or deal in securities. Only ten percent of commercial banks' total income could originate from securities. The underwriting of government-issued bonds by commercial banks were the sole exception to this rule. Investment

banks which underwrote and dealt in securities, could no longer maintain close ties to commercial banks. This prevented overlapping directorships or common ownership between the two forms of banking from occurring [9]. The Glass-Steagall Act forced banks to decide which business they wanted to pursue for the future: commercial banking (including private banking) or investment banking. Since the involvement in the private banking sector was all but non-existent for Goldman Sachs at the time, the company opted for the latter.

By 1932 Goldman Sachs' share price had lost nearly 90 percent of its value compared to its previous high. The Great Depression was particularly devastating to the company since very few firms issued long-term debt during the crisis [10]. The bank was on the verge of bankruptcy during the years of the Great Recession.

### **Restructuring of the Business**

In 1930, Sidney J. Weinberg became the new CEO of the company. He started to work at Goldman Sachs as the assistant to the janitor and quickly rose up the ranks to become the company's CEO, a position he held for almost four decades. Weinberg restructured and rescued the company from default in the 1930s. He also increased the company's political influence considerably. At the outbreak of World War II, US President Franklin D. Roosevelt selected Weinberg to serve as the assistant director of the War Production Board. Weinberg hence began a long-standing tradition of Goldman Sachs executives taking on leading roles in public service. He continued in his advisory role under Presidents Harry S. Truman, Dwight D. Eisenhower and Lyndon B. Johnson during the subsequent decades [11].

Weinberg's ambitions to expand the bank's investment banking business were countered by Gus Levy who oversaw the bank's trading department in the 1950s and 1960s. Levy is credited with introducing the strategy of being "long-term greedy" to the company, i.e. emphasising long-term profits over temporary downturns [12]. He eventually became CEO after the death of Weinberg in 1969.

Levy's role as CEO began with a shock to the company. When the Penn Central Transportation Company went bankrupt in 1970, it defaulted on more than US\$ 80 million of commercial paper. Most of this debt was issued by Goldman Sachs. A subsequent SEC lawsuit threatened yet again the survival of the company [13]. The company managed to overcome this incidence with the SEC but opted for a new business strategy in order to prevent a similar existential crisis in the future: business diversification.

Goldman Sachs started to operate a wealth management department for private UHNW individuals shortly after the SEC incidence in 1972 [2]. It marked the first time for Goldman Sachs to engage in private banking. The opening of the wealth management department coincided with the opening of the London office, the first office outside of the United States. The Glass-Steagall Act remained in effect throughout the US, although it had been weakened by prior legislation. In the UK there was no similar legislation in place. This legal difference, as well as cultural similarities between the two countries, provided ideal grounds for Goldman Sachs to expand into the British private wealth market during the 1970s [8].

## **The Dual Culture in Investment Banking**

Although the wealth management department was a key aspect of the new diversification strategy, it contributed only a miniscule part to total revenue during the 1970s. The market penetration even among the small UHNWI segment remained rather low. The bulk of the business was still generated in the deal-based investment banking and trading department [14]. The bull markets of the 1980s and early 1990s only cemented this company internal dominance of the institutional client business.

Following the expansion onto the European continent, the bank expanded into Asia with the opening of its Hong Kong office in 1983 [10]. Goldman Sachs benefitted from its newly established international setup and serviced institutional clients and governments in most of the world's financial centres. The bank secured the underwriting of several former state businesses in Great Britain under Thatcher, as well as the privatization of businesses in Eastern Europe after the dissolution of the Soviet Union [15].

The company's reputation at the time was undoubtedly high. Because of this favourable development, the bank established itself as a prestigious *White Shoe* firm. The term is analogous to the white shoe law firms on the American East Coast. These firms used to recruit only the top graduates of prestigious Ivy League universities. The company's culture at the time was that of a pure meritocracy [16]. It was in direct opposition to banks like Lehman Brothers and Bear Stearns, which rather sought to hire so-called PSD's (poor, smart and desperate to make money). The intense hiring requirements at Goldman Sachs resulted in a relative overrepresentation of rich East Coast WASPs (White Anglo-Saxon Protestants) among employees [17]. By the 1990s the bank's employee profile was radically different than it used to be during the times of CEO Weinberg four decades earlier. Nevertheless, in pursuing this recruitment strategy the company could establish itself as the market leader in equity and debt capital markets during the 1980s and 1990s [8].

## **The Repeal of Glass-Steagall and IPO of Goldman Sachs**

The Glass-Steagall Act had been subject to much criticism throughout its existence by scholars and industry professionals alike. The main point for criticism was the limitation of competition in the financial sector and the creation of an inefficient banking industry [18]. Banks from most of Western Europe and East Asia had not been subject to similar legislation and could therefore better capitalise on synergies. Because of this industry pressure, the act had been subject to numerous changes and amendments, weakening the initial legislative intent. For instance, the changes throughout time made it possible for Goldman Sachs to register its wealth management department with the US Security and Exchange Commission as a corporate(!) investment advisor in 1981 [14] [18].

Bowing under increasing industry pressure, the US Congress decided upon and then President Bill Clinton signed the Gramm-Leach-Bliley Act on November 12, 1999. The act repealed major parts of the Glass-Steagall Act [19] and the operation of a fully-fledged universal bank in the United States has been made possible ever since. The preceding lobbying effort supposedly cost Wall Street banks more than US\$ 300 million to undertake [20].

The reaction among banks was fast and comprehensive. Many commercial banks in the US utilised their client's capital deposits and bought out small to medium sized investment firms

in America. European competitors tried to follow suit, albeit with less economic success than their American counterparts [8]. Larger banks like Goldman Sachs were not among the investment firms to be bought out by commercial banks. Quite contrary to that, the impending repeal of the Glass-Steagall Act was a defining reason for the bank to go public. Goldman Sachs was the last major Wall Street bank to be governed in a private partnership model in 1999. The idea of going public, however, was a hotly debated issue inside the company for decades.

Among the aspects in favour of the IPO were:

- Partners could sell their share in the company freely on the market and increase the level of diversification of their personal assets. This was advantageous because company shares comprised a major part of pensions for the partners and other senior employees.
- Large losses could potentially bankrupt the company under a partnership model. A diverse ownership base provided a greater possibility of receiving external financing and improved the firm's resilience to economic downturns.
- Since ownership in the company was not easily transferable, the total value of such ownership was decreased. This is called the illiquidity premium [21].

Among the aspects arguing against the IPO were:

- Management's loss of agility in decision taking in a fast-paced market environment.
- Loss of control over the company to external investors and more short-term thinking due to continuous posting of quarterly results.
- Greater independence of the bank's employees due to easier transfer of ownership and decoupling of their private fortunes.
- Increase in cost due to regulatory reporting requirements whilst simultaneously losing transparency [21].

The impending repeal of Glass-Steagall eventually persuaded most partners at the time to vote in favour of an IPO. The newly pursued long-term strategy after the IPO was to invest the proceeds from the sale and to grow the business [21].

### **Hank Paulson becomes CEO – A New Culture for Goldman Sachs**

The IPO ended the bank's private partnership model which had persisted for over a century. The presence of external investors required for a massive cultural shift to take place inside the company. As a first tribute to this new reality, the board of directors called for fresh leadership in the bank. Henry "Hank" Paulson became the new CEO of Goldman Sachs to lead the company post-IPO. Paulson was an investment banker with over 25 years of prior experience at Goldman Sachs. During his time as an investment banking employee he was entrusted with servicing large industrial companies in the American Midwest [22].

Paulson is often cited to be a rather conservative type of leader. He is credited with introducing the concept of long-term customer retention in investment banking. His approach was to study clients meticulously, to identify their needs and to provide high quality service and advice specifically tailored to them. According to Paulson's philosophy, satisfied clients can be expected to return to the company in the future and to share their positive experience among their business acquaintances. This means that recurring business in the future would translate to higher profits for the firm than if it were to take advantage of clients in the short run [22].

His idea of establishing long-term business relationship was similar to Gus Levy's mantra of being "long-term greedy" during the 1960s.

Nevertheless, when Paulson assumed office in 1999 the company had a significantly different risk setup than it used to have pre-IPO. Before the IPO most senior employees were partners and therefore had a personal stake invested in the company. The partners were only allowed to liquidate their stake in the bank once they retired from it. This partnership structure inherently led to more long-term strategic thinking and a predisposition to avoid taking on excessive risks.

After the IPO the partners' ownership stake in the company was converted into company stock. Many of the partners at the time quickly divested from the company and thereby decoupled their personal wealth from the bank's financial well-being. Consequently, the financial performance of the partners remaining stake in the company became highly dependent on the evolution of the bank's quarterly earnings reports. Given this new reality, there was a much a higher focus on quarterly results and also considerably higher volatility of the stock. This volatility was primarily driven by the unstable earnings in the institutional client business. The effect was compounded by pressure exerted from the new external investors. Although CEO Paulson personally believed in a conservative leadership style (he refused to take bonus compensation in the form of cash and insisted on being paid in company stock), he was forced to respond to the changes in ownership structure at Goldman Sachs by planning more short-term than before.

The beginning of the millennium marked a time of increased securitization of assets. This was especially true for the FICC business (fixed income, currencies, and commodities), which is a rather volatile business to participate in [23]. Despite its risky nature, Paulson saw the opportunity and expanded heavily on the bank's brokerage business. The IPO made it possible for Goldman Sachs to access global capital markets. The company raised capital by issuing stock and eventually used the proceeds to fund principal transactions, trading not only on behalf of its clients, but also for itself. This further increased the bank's risk profile.

To somehow counter the increased dependence on volatile trading, Paulson sought to diversify the bank's revenue mix. This was partially accomplished through investments into the private banking sector. One of the most important acquisitions under Paulson was that of AYCO Company, L.P. in 2003. AYCO was founded in 1971 by Bill Aydelotte and Jim Conway and is a provider of fee-based financial counselling [24]. While the significant investments into the private banking department indeed reduced volatility of the bank's earnings, it created problems in its own rights. Since the bank relied heavily on income from the trading business, there was an incentive to write off and sell assets from unprofitable trades to private consumers. Although rather unlikely, should all internal barriers fail to safeguard, there would have been a significant conflict of interest at play. This issue was one of the reasons why Glass-Steagall was put into place in 1932 and private clients, of course, were aware of this fact when doing business with the bank.

By the end of the year 2006 (the last year that Paulson was CEO of the company) Goldman Sachs generated 72.6% of its pre-tax earnings in the trading and principal investment business. Just 10.7% of the pre-tax earnings were generated in the investment banking division. This proportion is even less than the private banking business which accounted for a remarkable 16.7% of pre-tax earnings in 2006 [25]. Paulson eventually left the company in 2006 when he was nominated by then President George W. Bush to serve as United States Secretary of the Treasury [26].

## **Lloyd Blankfein becomes CEO – Goldman Sachs and the Financial Crisis**

Lloyd Craig Blankfein became CEO of Goldman Sachs shortly before the outbreak of the financial crisis. He joined the company when J. Aron & Co was acquired by Goldman Sachs in 1981. J. Aron & Co was a commodity and currency trading firm Blankfein used to work for as a salesman. Once Blankfein joined Goldman Sachs, he quickly worked his way up and soon oversaw the bank's commodity trading department. Blankfein positioned the bank under CEO Paulson in such a manner that it could hugely benefit from the rising commodity prices during the early 2000s [23]. His actions during the commodity boom greatly enhanced his personal profile and reputation inside the company. The eventual choice by the board to appoint Blankfein as CEO of Goldman Sachs illustrates the sheer magnitude of the cultural shift that had taken place by 2006. It illustrates the boards newly found focus on short-term proprietary trading over long-term and relationship-based investment banking. In stark contrast to Hank Paulson, Blankfein was not a banker by profession but rather a trader. His leadership style is often described as more pragmatic and founder-centric than that of Hank Paulson [27].

Blankfein's handling of the financial crisis in 2007 is the major reason why Goldman Sachs has been subject to extensive criticism for over a decade. As testified by Blankfein in a court in 2010, the role of Goldman Sachs during the financial crisis was the following:

Goldman Sachs did not issue (sub-prime) mortgage-backed securities itself, it functioned merely as a marked maker. This means that the company bought securities from a seller, hold onto the security in its inventory until a buyer was found, and subsequently sold the security to the buyer. The bid-ask spread constituted the fee for the bank. Any capital depreciation or appreciation incurred during the inventory holding period had to be borne by the bank. Market making is a common practice among Wall Street banks and mortgage-backed securities were by no means the only asset class which were traded in this fashion by Goldman Sachs at the time [28].

Criticism towards the bank involved the following points:

- The firm did not advise buyers on the inherent risk of mortgage-backed securities. Blankfein, however, encountered that the bank had no fiduciary responsibility to its clients while acting as a market maker [29].
- The firm profited by short selling ("betting against") these very securities before the outbreak of the crisis [30].
- CEO Blankfein testified in court voluntarily, but later hired Reid Weingarten as his personal defence lawyer. Blankfein attested that this was only a precautionary measure [31]. Weingarten, however, had previously defended rather infamous businesses executives like Enron's former chief accountant Richard Causey [5]. The company's share price dropped considerably after the news about Blankfein's new lawyer had been revealed to the public.
- Goldman Sachs' involvement in US politics. Former CEO Paulson was entrusted with overseeing the financial crisis as the acting U.S. Treasury Secretary [26]. Although Paulson sold his share in Goldman Sachs prior to assuming office, many observers felt that there was a conflict of interest at play. In his function as Treasury Secretary, Paulson granted Goldman Sachs (and Morgan Stanley) Bank Holding Company status. This enabled the bank to access FED funds for liquidity shortages [32].
- Goldman Sachs used this access to FED funds and eventually received US\$ 10 billion of TARP government money (Troubled Asset Relief Program).

The bank was further rescued from its worsening condition by a significant cash injection provided by investor Warren Buffett. Buffett provided timely cash to the firm on September 23<sup>rd</sup>, 2008, shortly after the collapse of Lehman Brothers. Goldman Sachs' share price was falling sharply at the time and it was not impossible that the bank would have shared the same fate as ex-competitor Lehman Brothers. Buffett's investment of US\$ 5 billion in Goldman Sachs' preferred stock signalled to investors a vote of confidence. It therefore enabled the firm to raise a further US\$ 2.5 billion on capital markets and hence avert a dooming liquidity shortage [33].

Goldman Sachs quickly re-established itself over the course of the ensuing months, took advantage of the dovish response from the US Fed (low interest rates) and became the second largest American investment bank at the end of the crisis. Almost all of Goldman Sachs' competitors were either merged with other banks or bankrupted at this stage [34]. Goldman Sachs repaid the TARP funds as one of the first banks to do so only a year later. The American taxpayer made a net profit from the loan amounting to not less than US\$ 1.4 billion [35]. Warren Buffett is said to have made a profit on his Goldman Sachs investment amounting to US\$ 3.1 billion by the end of the year 2013 [33].

Despite the eventual profitable outcome for the US taxpayer, Goldman Sachs' reputation after the financial crisis was undoubtedly damaged. Criticism against Goldman Sachs and Wall Street banks in general was so extensive that a grass root movement established itself named "Occupy Wall Street" [36]. The loss in reputation in 2008 had ramifications for the company that have lasted for well over a decade.

### **The Aftermath of the Crisis – Further Investments into Private Banking**

Although Blankfein overcame the financial crisis of 2008 with relative success, the recession proved once again that Goldman Sachs' business model was highly vulnerable to economic downturns. This vulnerability was caused in large parts by the bank's risky setup and high reliance on proprietary trading, a business with ever decreasing margins (See Exhibit 6). The case of Lehman Brothers illustrated that even the most traditional investment banks can face bankruptcy within a relatively short amount of time.

Blankfein acknowledged this new reality and further diversified the business. In a first step, he focused on Goldman Sachs' already existing wealth management department. The decision was not uncontroversial. Other banks had in fact divested from wealth management as it proved to be unprofitable to them. Regardless of the criticism, Blankfein ensured a further expansion of the department. The company rebranded its offer to clients under the umbrella brand name "One Goldman Sachs", a marketing slogan signalling a holistic approach Goldman Sachs takes on when dealing with its clients [37]. It is a testament to the continued integration of the bank's various departments.

The strategic move to decrease the bank's risk profile was in line with most of its competitors. Almost all banks downsized their respective FICC units and proprietary trading after the end of the great recession (the major exception being Deutsche Bank) [38] [39]. This was the case because the increased risk of the business, the large amounts of capital required, and the decreasing margins did not justify the existence of these departments to the same extent as before. The imminent implementation of the Volker rule cemented this decision for banks

further. The Volcker rule went into effect on April 1, 2014, and severely limits bank's ability to conduct investment activities with their own accounts [40].

One of Blankfein's last actions as CEO was to pave the way for a radically different offering: an online retail banking platform named *Marcus*. Blankfein could justify the move to shareholders by citing a high growth potential for Goldman Sachs, a favourable time to enter the market due to an ongoing technological overhaul of the industry, the predictable and stable earnings of retail banking, and a cheap source of capital for the bank. The Marcus platform was eventually rolled out in America on October 3<sup>rd</sup>, 2016. It is an online-only offer and comprises an account with one of the highest savings interest rates on the market. It offers a modern technological infrastructure to its clients, does neither charge a maintenance nor account opening fee and includes a loaning facility for private consumers. Consumers in the US may apply for loans at the bank ranging from US\$ 3.500 up until US\$ 40.000 in value [41] [42]. The consumer market response to this offer has been overwhelmingly positive.

By the end of Blankfein's tenure as CEO in 2018, the Marcus platform had amassed deposits amounting to US\$ 48 billion and granted credits worth US\$ 5 billion [43]. The rapid growth prompted Blankfein to expand into the UK market in 2018. In addition to the successful expansion into the retail banking business, Goldman Sachs had established itself as number eight on the exclusive list of the world's largest wealth managers in 2018 (See Exhibit 8). It managed a total of US\$ 394,3 billion for its clients, a figure comparable to the 2018 nominal GDP of a country like Israel or Norway [44].

At a first glance, the company was in a good state when Lloyd Blankfein left office as CEO in October 2018. Blankfein had managed to partially diversify the business and to quickly grow the assets under management from the private banking department. These numbers, however, curtail a much less favourable reality. Goldman Sachs' chief financial officer Stephen Scherr recounted in the beginning of 2019 that the combined investments into the Marcus platform since 2016 had resulted in a loss for the firm amounting to US\$ 1.3 billion [43]. The losses were in part incurred due to the high default rate among Marcus loans. The bank wrote off US\$ 156 million in bad loans in 2018 alone whilst write-offs amounted to 5.5% of the bank's loan book in Q2 2019 [45]. This percentage is significantly higher at Goldman Sachs' than at other banks. The explanation for this poor performance can be found among the bank's damaged reputation. CEO Blankfein feared a strengthening of the bank's vampire squid image while rolling out the Marcus platform in 2016. Because of this concern, the bank did not deploy a specific bad debt collection team, and this lacking feature eventually resulted in a high percentage of uncollected debt among Marcus customers [46].

In addition to the high losses, the differing approaches and working cultures of private banking and trading have caused the firm to have a higher than usual employee turnover ratio [47]. Finally, there is still an immense pressure exerted from external shareholders to seek the most profitable investment opportunities and to produce positive results every single quarter. This short-term thinking may inherently favour Goldman Sachs' well established trading department over an uncertain and long-term oriented private banking department. A continuation of the diversification plan would be met with considerable resistance from shareholders.

## **David Solomon becomes CEO - The New Culture for Goldman Sachs**

This was the state of the company when Blankfein retired as CEO and David Michael Solomon followed in his steps on October 1<sup>st</sup>, 2018. Prior to assuming office, Solomon was heavily endorsed by Blankfein to become the bank's new chief executive officer [48].

David Solomon is often characterized as being a rather unconventional banker. While working as a senior manager at Goldman Sachs he asked his employees to leave work after what he deemed to be excessive working hours. During the bidding for the IPO of Lululemon in 2007 his team of investment bankers won the deal while wearing athleisure brand's clothes instead of traditional suits [49]. Solomon is a part-time DJ in New York and performs under the stage name "DJ D-Sol" [50]. Upon becoming CEO, he loosened the company's dress code, modernized computer systems, introduced video interviews for hiring, and advocated for a reduction of total working hours among employees [51]. Solomon has strongly advocated for a cultural shift at Goldman Sachs.

The new CEO is a supporter of the business diversification strategy started by Blankfein [52]. Goldman Sachs under Solomon announced in 2019 that it plans to hire roughly 200 additional wealth advisors over the course of the following three years. In addition to that, the company agreed to acquire the wealth manager United Capital for US\$ 750 million in early 2019 [53]. Solomon pursues a similar expansionary strategy for the bank's retail banking unit. Key executives under Solomon have unofficially announced a target market penetration of US\$ 250 billion in total deposits with further international expansion into markets like Germany. If this target were to be reached, it would resemble more than a quarter of Goldman Sachs' total assets on the balance sheet. [54].

Apart from the continuation of projects started under his predecessors, his stand-alone projects as CEO have produced somewhat more ambiguous results. His most significant project in 2019 was a collaboration with Apple, resulting in the "Apple Card" released on August 20<sup>th</sup>, 2019. The Apple Card is a laser-etched titanium credit card featuring Apple's logo on the front and Goldman Sachs' logo on the back. The project's aim was to obtain access to the personal data and transaction details of Apple's millions of customers. This data could eventually be used for Goldman Sachs' own retail banking platform [55]. Possible side benefits of the venture might have been to positively influence brand awareness among Apple's customers and demonstrating to consumers Goldman Sachs' ability to engineer a well-functioning credit card.

Although Solomon publicly praised the Apple Card on many occasions, some journalists and external observers remain more wary of the collaboration. Apple openly advertises the credit card using the slogan "*A new kind of credit card. Created by Apple, not a bank.*" [56]. This marketing campaign was put into place, even though Goldman Sachs had reportedly invested more than US\$ 300 million into the card's development. Key executives of Goldman Sachs were allegedly denied entry to Apple Card office premises after the card's rollout. The move has led some journalists to believe that Goldman Sachs has taken on a junior partner role in the project, something deemed unimaginable just a few years prior [46].

The case of the Apple card illustrates that restoring a reputation is not an easy task for a CEO. What is even more difficult for Solomon is to ensure the continued prosperity of his company. As Microsoft founder Bill Gates famously remarked in an interview in 1994:

"Banking is necessary, banks are not. [57]"

## Exhibit 1 – Goldman Sachs Consolidated Statements of Earnings

<b>Consolidated Statements of Earnings</b> <i>in millions, except per share amounts</i>	Year Ended December				
	2018	2017	2016	2015	2014
<b>Revenues</b>					
Investment banking	7.862	7.371	6.273	7.027	6.464
Investment management	6.514	5.803	5.407	5.868	5.748
Commissions and fees	3.199	3.051	3.208	3.320	3.316
Market making	9.451	7.660	9.933	9.523	8.365
Other principal transactions	5.823	5.913	3.382	5.018	6.588
<b>Total non-interest revenues</b>	<b>32.849</b>	<b>29.798</b>	<b>28.203</b>	<b>30.756</b>	<b>30.481</b>
Interest income	19.679	13.113	9.691	8.452	9.604
Interest expense	15.912	10.181	7.104	5.388	5.557
Net interest income	3.767	2.932	2.587	3.064	4.047
<b>Total net revenues</b>	<b>36.616</b>	<b>32.730</b>	<b>30.790</b>	<b>33.820</b>	<b>34.528</b>
<b>Operating expenses</b>					
Compensation and benefits	12.328	11.653	11.448	12.678	12.691
Brokerage, clearing, exchange and distribution fees	3.200	2.876	2.823	2.576	2.501
Market development	740	588	457	557	549
Communications and technology	1.023	897	809	806	779
Depreciation and amortization	1.328	1.152	998	991	1.337
Occupancy	809	733	788	772	827
Professional fees	1.214	1.165	1.081	963	902
Other expenses	2.819	1.877	1.900	5.699	2.585
<b>Total operating expenses</b>	<b>23.461</b>	<b>20.941</b>	<b>20.304</b>	<b>25.042</b>	<b>22.171</b>
Pre-tax earnings	12.481	11.132	10.304	8.778	12.357
Provision for taxes	2.022	6.846	2.906	2.695	3.880
Net earnings	10.459	4.286	7.398	6.083	8.477
Preferred stock dividends	599	601	311	515	400
<b>Net earnings applicable to common shareholders</b>	<b>9.860</b>	<b>3.685</b>	<b>7.087</b>	<b>5.568</b>	<b>8.077</b>
<b>Earnings per common share</b>					
Basic	26	9	17	12	18
Diluted	25	9	16	12	17
<b>Average common shares</b>					
Basic	385	402	427	449	459
Diluted	390	409	435	459	473

Source: Goldman Sachs Annual Reports 2018, 2017, 2016, 2015

## Exhibit 2 – Goldman Sachs Consolidated Statements of Financial Condition

Consolidated Statements of Financial Condition <i>in millions, except per share amounts</i>	Year Ended December				
	2018	2017	2016	2015	2014
<b>Assets</b>					
Cash and cash equivalents	130.547	110.051	121.711	93.439	75.025
Collateralized agreements:					
Securities purchased under agreements to resell	139.258	120.822	116.925	134.308	127.938
Securities borrowed	135.285	190.848	184.600	177.638	160.722
Receivables:					
Loans receivable	80.590	65.933	49.672	45.407	28.938
Customer and other receivables	79.315	84.788	65.824	71.883	63.808
Financial instruments owned	336.161	315.988	295.952	313.502	312.248
Other assets	30.640	28.346	25.481	25.218	22.201
<b>Total assets</b>	<b>931.796</b>	<b>916.776</b>	<b>860.165</b>	<b>861.395</b>	<b>855.842</b>
<b>Liabilities and shareholders' equity</b>					
Deposits	158.257	138.604	124.098	97.519	82.880
Collateralized financings:					
Securities sold under agreements to repurchase	78.723	84.718	71.816	86.069	88.215
Securities loaned	11.808	14.793	7.524	3.614	5.570
Other secured financings	21.433	24.788	21.523	24.753	22.809
Customer and other payables	180.235	178.169	184.069	204.956	206.936
Financial instruments sold, but not yet purchased	108.897	111.930	117.143	115.248	132.083
Unsecured short-term borrowings	40.502	46.922	39.265	42.787	44.539
Unsecured long-term borrowings	224.149	217.687	189.086	175.422	167.302
Other liabilities	17.607	16.922	14.362	18.893	16.075
<b>Total liabilities</b>	<b>841.611</b>	<b>834.533</b>	<b>773.272</b>	<b>774.667</b>	<b>773.045</b>
<b>Commitments, contingencies and guarantees</b>					
<b>Shareholders' equity</b>					
Preferred stock	11.203	11.853	11.203	11.200	9.200
Common stock	9	9	9	9	9
Share-based awards	2.845	2.777	3.914	4.151	3.766
Nonvoting common stock; no shares issued and outstanding	-	-	-	-	-
Additional paid-in capital	54.005	53.357	52.638	51.340	50.049
Retained earnings	100.100	91.519	89.039	83.386	78.984
Accumulated other comprehensive income/(loss)	693	(1.880)	(1.216)	(718)	743
Stock held in treasury, at cost	(78.670)	(75.392)	(68.694)	(62.640)	(58.468)
<b>Total shareholders' equity</b>	<b>90.185</b>	<b>82.243</b>	<b>86.893</b>	<b>86.728</b>	<b>82.797</b>
<b>Total liabilities and shareholders' equity</b>	<b>931.796</b>	<b>916.776</b>	<b>860.165</b>	<b>861.395</b>	<b>855.842</b>

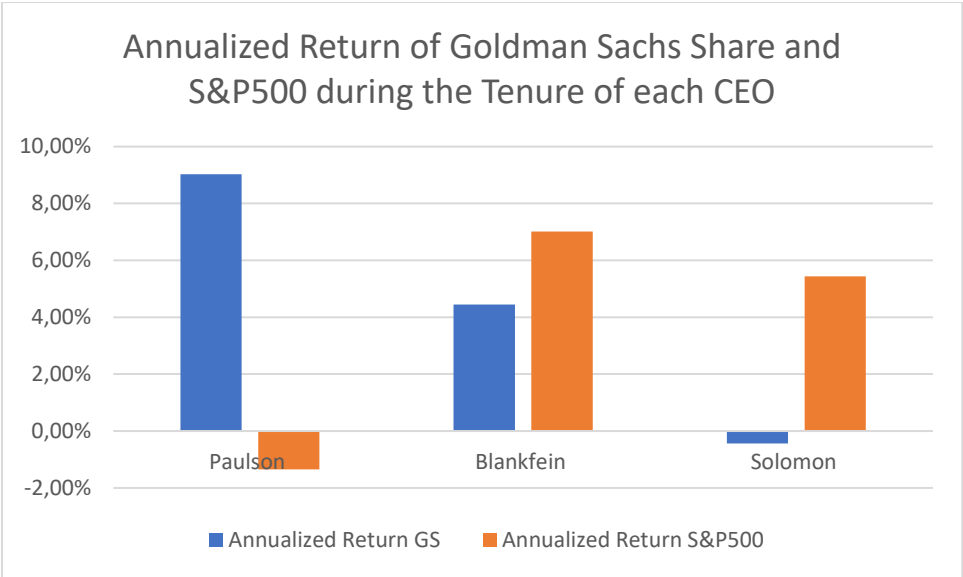
Source: Goldman Sachs Annual Reports 2018, 2017, 2016, 2015

### Exhibit 3 – Goldman Sachs Consolidated Statements of Cash Flows

<b>Consolidated Statements of Cash Flows</b>	Year Ended December				
<i>\$ in millions</i>	2018	2017	2016	2015	2014
<b>Cash flows from operating activities</b>					
Net earnings	10.459	4.286	7.398	6.083	8.477
Adjustments to reconcile net earnings to net cash provided by/(used for):					
Depreciation and amortization	1.328	1.152	998	991	1.337
Deferred income taxes	(2.645)	5.458	551	425	495
Share-based compensation	1.831	1.769	2.111	2.272	2.085
Loss/(gain) related to extinguishment of unsecured borrowings	(160)	(114)	3	(34)	(289)
Changes in operating assets and liabilities:					
Customer and other receivables and payables, net	7.186	(30.136)	(14.723)	19.132	12.328
Collateralized transactions (excluding other secured financings), net	28.147	10.025	78	(14.825)	(52.793)
Financial instruments owned (excluding available-for-sale securities)	(23.381)	(11.843)	13.662	16.078	25.881
Financial instruments sold, but not yet purchased	(3.670)	(5.296)	1.960	(16.835)	4.642
Other, net	652	5.815	(5.726)	(5.417)	(10.095)
<b>Net cash provided by/(used for) operating activities</b>	<b>20.421</b>	<b>(18.227)</b>	<b>6.494</b>	<b>7.870</b>	<b>(7.932)</b>
<b>Cash flows from investing activities</b>					
Purchase of property, leasehold improvements and equipment	(7.982)	(3.184)	(2.865)	(1.833)	(678)
Proceeds from sales of property, leasehold improvements and equipment	3.711	574	381	228	30
Net cash acquired in/(used for) business acquisitions	(162)	(2.383)	14.922	(1.808)	(1.732)
Proceeds from sales and paydowns of investments	411	2.900	1.517	1.019	1.514
Loans receivable, net	(14.865)	(16.693)	(4.280)	(16.180)	(14.043)
<b>Net cash provided by/(used for) investing activities</b>	<b>(22.677)</b>	<b>(28.639)</b>	<b>9.675</b>	<b>(18.574)</b>	<b>(14.909)</b>
<b>Cash flows from financing activities</b>					
Unsecured short-term borrowings, net	2.337	(501)	1.506	(369)	1.659
Other secured financings (short-term), net	586	(405)	(808)	(867)	(837)
Proceeds from issuance of other secured financings (long-term)	4.996	7.401	4.186	10.349	6.900
Repayment of other secured financings (long-term)	(9.482)	(4.726)	(7.375)	(6.502)	(7.636)
Purchase of APEX, senior guaranteed securities and trust preferred securities	(35)	(237)	(1.171)	(1)	(1.611)
Proceeds from issuance of unsecured long-term borrowings	45.927	58.347	50.763	44.595	39.857
Repayment of unsecured long-term borrowings	(37.243)	(30.748)	(36.556)	(29.520)	(28.138)
Derivative contracts with a financing element, net	2.294	1.684	2.115	(47)	643
Deposits, net	20.206	14.506	10.058	14.639	12.201
Preferred stock redemption	(650)	(850)	-		
Common stock repurchased	(3.294)	(6.772)	(6.078)	(4.135)	(5.469)
Settlement of share-based awards	(1.118)	(2.223)	(1.128)		
Dividends and dividend equivalents paid	(1.810)	(1.769)	(1.706)	(1.681)	(1.454)
Proceeds from issuance of preferred stock, net of issuance costs	-	1.495	1.303	1.993	1.980
Proceeds from issuance of common stock	38	7	6	259	123
Cash settlement of share-based awards	-	(3)	-	(2)	(1)
<b>Net cash provided by financing activities</b>	<b>22.752</b>	<b>35.206</b>	<b>12.103</b>	<b>29.118</b>	<b>18.999</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>20.496</b>	<b>(11.660)</b>	<b>28.272</b>	<b>18.414</b>	<b>(3.842)</b>
<b>Cash and cash equivalents, beginning balance</b>	<b>110.051</b>	<b>121.711</b>	<b>93.439</b>	<b>75.025</b>	<b>78.867</b>
<b>Cash and cash equivalents, ending balance</b>	<b>130.547</b>	<b>110.051</b>	<b>121.711</b>	<b>93.439</b>	<b>75.025</b>

Source: Goldman Sachs Annual Reports 2018, 2017, 2016, 2015

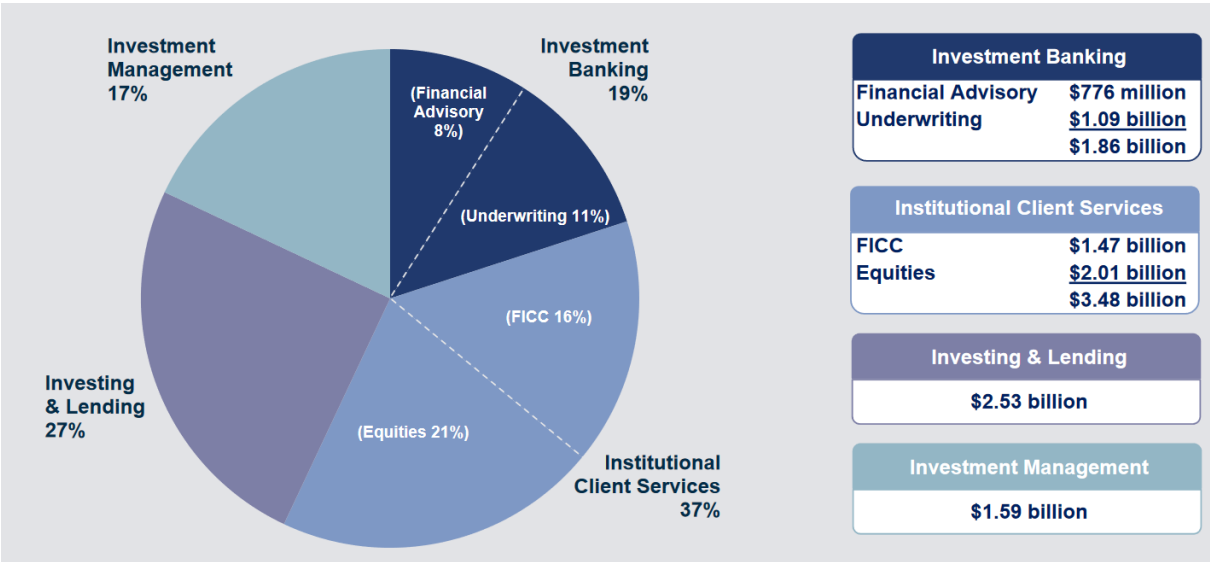
**Exhibit 4 – Annualized Returns of Goldman Sachs and S&P500 By CEO Tenure**



Source: Yahoo Finance Historical Data Goldman Sachs, collated in Excel

Note: Terms as CEO for the three men are assumed to be the following (Paulson: 01/2000-07/2006; Blankfein: 07/2006-09/2018, Solomon: 09/2018-12/2019).

**Exhibit 5 – Goldman Sachs Total Revenue Mix 2Q2019**



Source: Quarterly statement Goldman Sachs 2Q2019

Note: *Investment Management* comprises retail banking and wealth management activities

**Exhibit 6 – Adverse Developments in the Trading Business**

Among the six largest banks in America, Goldman Sachs is the one bank still most reliant on traditional investment banking activities. [43]. Especially the trading business, however, has been subject to fundamental changes over the past decades. These were largely induced by the

introduction of new technology. Since the mid-1990s the trading business has seen an unprecedented wave of computerization. Deals nowadays are largely done automatically, globally, and at the speed of light. It is estimated that in 2016 high-frequency trading initiated between 10%-40% of global trading volume in equities. However, intraday the volume may be up to 100% [58]. This trend is likely to continue in the future.

Automated deals are often criticised to be of little transparency, hard to regulate, and for bearing considerable risk. On May 6, 2010, the so-called *Flash Crash* wiped out billions of dollars on several stock exchanges. Most of the indices, however, rebounded surprisingly quickly. Markets reversed almost all their losses within 36 minutes. Automated trading algorithms produced exceptional gains on the one side, and catastrophic losses on the other [59]. Events such as these can cost a financial cooperation billions of dollars, if not fully bankrupt them in the process. The speed at which massive devaluations may occur leave little room for human oversight and reaction. Its consequences, however, are very real. Several governments in the world have called for further regulation in order to prevent flash crashes from happening in the future. This increases cost for companies, as well as financial liability towards clients [60].

In addition to the inherent risk in trading, enormous investments are needed in order to remain competitive in the industry. In 2014 and earlier, 200 companies paid a combined US\$ 2.8 billion in order to use a new fibre-optic connection between Chicago and New Jersey. The cable was infamously called the “straightest fibre-optic connection in the world”. Since data in a fibre-optic cable travels at the speed of light, the only way to increase the speed even further was to straighten out the cable’s route as much as possible. The new cable facilitates a faster connection between the two cities in the realm of milliseconds. This “improvement” may seem absurd, but it is a necessary investment in order to remain competitive in the trading business. Nevertheless, undertaking these costly investments does not guarantee success in the long run. Disruptive technologies may completely alter the trading business within a relatively short amount of time, thereby potentially producing large write-offs at investment firms [61]. Furthermore, a lot fewer people are employed in the trading business as they used to be. Layoffs due to automation are rather common in the trading business [62].

Lastly, trading is a risky and cyclical business. In times of economic expansion, it may produce exceptional results. In times of economic downturn, however, the losses may be extraordinarily large. Investors anticipate high cyclicalities in a stock and respond with lower prices. Devastating losses at a firm may even incur when the overall market environment is favourable. The case of Barings Bank is an illustrative example. It took but one trader (Nick Leeson) and two major trades to bankrupt a centuries old investment bank within days of occurring [8].

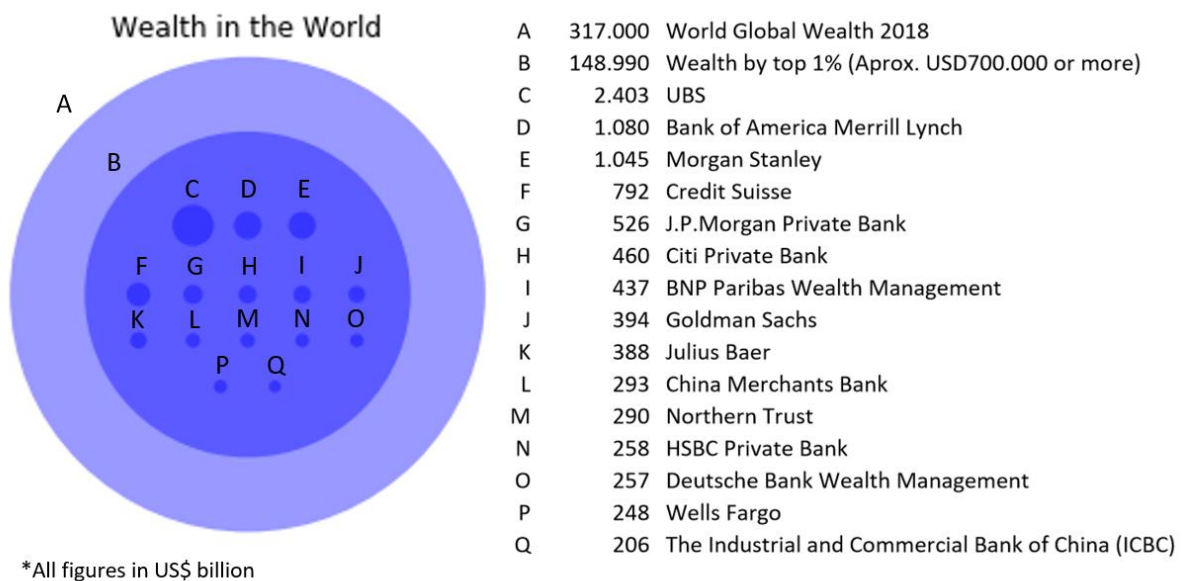
### Exhibit 7 – Development of Market Cap for Select Banks since 1999

Date	Goldman Sachs	JPM Chase	Citigroup	Deutsche Bank	UBS AG	Credit Suisse	Morgan Stanley	Wells Fargo
31/12/1999	42.28B	64.26B	200.66B				66.27B	65.79B
02/01/2001	45.00B	84.85B	253.62B	48.44B			66.29B	92.48B
31/12/2001	44.17B	71.73B	259.91B	41.62B			50.76B	73.70B
31/12/2002	32.21B	47.97B	180.90B	25.68B			36.11B	79.02B
31/12/2003	46.70B	75.03B	250.32B	44.85B			52.13B	100.00B
31/12/2004	50.04B	138.73B	250.28B	44.45B			50.12B	105.32B

03/01/2006	56.34B	140.13B	254.19B	48.55B		50.99B	107.03B
03/01/2007	82.83B	166.40B	271.39B	65.16B		71.07B	120.70B
31/12/2007	84.02B	146.99B	161.26B	62.36B		56.10B	99.54B
31/12/2008	33.37B	117.68B	38.06B	22.43B		33.99B	17.23B
31/12/2009	86.97B	164.26B	94.28B	42.46B		61.47B	40.27B
31/12/2010	85.35B	165.87B	137.45B	46.16B		50.06B	41.14B
03/01/2012	46.29B	131.97B	82.83B	34.77B		31.79B	30.99B
31/12/2012	59.33B	167.26B	119.82B	39.71B		35.04B	37.74B
31/12/2013	79.12B	219.66B	157.85B	47.45B		50.35B	60.99B
31/12/2014	83.40B	232.47B	163.62B	40.05B	61.88B	41.21B	75.70B
31/12/2015	75.60B	241.90B	152.83B	32.22B	72.66B	43.89B	61.08B
03/01/2017	94.85B	310.64B	167.98B	41.53B	60.66B	32.92B	79.75B
02/01/2018	95.83B	369.76B	191.10B	39.94B	68.83B	45.32B	93.32B
31/12/2018	61.43B	319.78B	123.30B	16.83B	45.68B	27.44B	67.40B
02/10/2019	71.28B	362.12B	149.69B	14.85B	39.27B	29.21B	66.49B

Source: Y Charts Goldman Sachs, collated in Excel

### Exhibit 8 – Total World Global Wealth in 2018, Share controlled by the Global 1%, and Assets managed by Top Wealth Managers



Source: Graph created with Python Matplotlib & Python Venn, data extracted from Credit Suisse Global Wealth Report 2018 and Selby Green [63]

Note: Being part of the 1% in global wealth (Net assets above approx. US\$ 700.000) does not necessarily imply owning enough liquid assets to have a bank account at a wealth manager. Conversely, an individual outside the 1% may still own sufficient assets to open a wealth management bank account. The graph serves for scale illustration purposes only and does not attempt to reflect all possible overlaps of clients.

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