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Oh Where, Oh Where has the Wall Street Partnership Gone?

Allan D. Grody April 18, 2012

In the 1970s, before financial institutions became public shareholder owned companies, a partnership model prevailed. Following Greg Smith's infamous *New York Times* op-ed on Goldman's alleged money-crazed culture, Allan Grody asks the question, has globalization eviscerated the partnership culture?

Can this be the Goldman Sachs I knew back in the 1970s when the partnership model prevailed and before investment banks were public shareholder owned companies?

> *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….* Matt Taibbi reporting in Rolling Stone magazine

Greg Smith, the author of the now infamous NY Times Op Ed on Goldman's "alleged" money crazed culture brought no understanding of historical context to help in the public's/regulators/industry debate on Goldman or any other of these now "too-big-to fail", perhaps even "too-complex-to-manage" systemically important financial institutions. SIFI's as they are called now to use the new Dodd-Frank term for Goldman and others of their ilk.

My firm both audited them and many others like them. Back then the many Wall Street partnerships allowed one firm to audit so many of the same types of firms. There was competition amongst investment banks, but not of the ferocious kind seen today and memorialized in the book, Barbarians at the Gate. After all there was fixed commissions back then, set high enough so that everyone made out well. The 1% was paid on the total value of 100 share orders of individuals and on 100,000 share orders bought by institutions, no discounting allowed. A lot of my partners became Goldman partners. I did consulting work for them. I lived through private partnerships of Wall Street as an employee. I then helped many of them go public as their advisor. I know lots of folks who know Goldman well. This Goldman as described in Rolling Stone or by Greg Smith is not the same Goldman we knew then or now.

Goldman was founded in 1869 as a family business and became a partnership in 1885 when the founder Marcus Goldman brought his son-in law Samuel Sachs into the business. Partnership risk management worked – it was its own money they risked, day in and day out. BIG mistake to change this culture– risking the "money in my pocket" was all the risk management they needed then. Now stochastic techniques from physics prevail as the best practice risk management technique. Besides being in a black box it is detached from the ownership of the money used in the business. These techniques don't work. We all saw that.

However, Goldman was different in regard to their risk management culture up to and through the financial crisis. Regulators, in reviewing the financial crisis singled our Goldman as having their act together in risk management. Their partners had their finger on the pulse of the company. So what went wrong that precipitated a young recruit of 14 years vintage to quit and make such observations as below?

> *When the history books are written about Goldman Sachs, they may reflect that the current chief executive officer, Lloyd C. Blankfein, and the president, Gary D. Cohn, lost hold of the firm's culture on their watch. I truly believe that this decline in the firm's moral fiber represents the single most serious threat to its long-run survival.*

I lived in my own private partnership for quite some time as it grew and became global. Our partners increasingly became globe-trotting rain makers. They became increasingly detached, ever so slowly from the personal mentoring that was so critical to communicating a culture across decades let alone generations. We kept pace with our clients' globalization aspirations, and spent increasingly more time chasing and competing for new business and increasingly less time in preserving the culture we had inherited. We recognized this change and hired academics and professional educators to teach ethics and culture, but it wasn't the same. We too became enamored with size and money although nowhere near what came to be the excessive incentive compensation systems that drove these financial engineering/investment banks after they went public and took other people's money. One of our own, Arthur Andersen became the poster boy for such excesses and was the seed of its untimely demise.

In 1999 Goldman, one of the last holdouts from an era of public offerings of investment banks, a movement that started in the 1970's by the Donaldson, Lufkin & Jenrette partnership, went public. The growing globalization of the firm, the acquisition of a traditional commodity trading firm, J. Aron & Co. and the public offering of shares in Goldman came together. Detaching the family/partners money and substituting it with other people's money – that was the tipping point in a culture change at Goldman that Greg Smith observed but incorrectly diagnosed. The fact that the Goldman partnership debated the decision to go public for decades and was one of the last of the great investment partnerships to go public says more about its high moral standards then a single employee's disgruntled observations on his way out the door.

In my role as advisor to many of these Wall Street partnerships, I saw the way the partners would caucus at their Monday morning meetings, deciding the market view for the week and who's trading desk would be given the partnership's money for investing and trading. They sat individually in glass windowed offices around the trading room or sat all together in the trading room. They moved back and forth between the two. Back then the moving ticker, an elaborate marvel of electronic switches and lights was the focal point of all the action. It is still today but in more digitized electronic form. The green screens of the Quotron terminals, the early forerunner of the Bloomberg terminal was the prestigious toy each partner acquired to facilitate watching markets … and how they fared in their trading.

There was a feeling of closeness in the firms back then – a sense of intimacy felt both culturally and physically. The personal mentoring was easier in this environment. Culture was transmitted almost effortlessly. In seeing a transgression it could easily be remedied. Then it began to change, slowly at first, then more rapidly through a volatile mix of a partnership pushed by regulation out of its long standing legally permitted monopolistic pricing habits into an increasingly competitive business model. Globalization removed the intimacy in which culture is best transmitted. Partners taking their own capital out of the business through a public sale of its shares removed the tie to their best risk control, putting their own money on the line.

ABOUT ALLAN D. GRODY

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