How Goldman Sachs Turned the Great Recession into Competitive Advantage Using Strategic Management

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Abstract

What are the strategic questions confronting Goldman Sachs in the wake of the Great Recession? Goldman Sachs has been considered the most prestigious investment banking firm on Wall Street. Since September 2008, Goldman operates as a bank holding company and financial holding company regulated by the Federal Reserve. It gives advice on how to achieve long-term financial goals in times of both prosperity and crisis. This case reveals how Goldman Sachs became the quintessential global firm for the current period, which combines both growth and weaknesses. It further argues that Goldman Sachs has adopted innovative strategies one step ahead of its competitors, thus surviving the worst of times and redefining the traditional investment banking field.

Background

Founded in 1869, Goldman Sachs has been considered the most prestigious investment banking firm on Wall Street. Its clients include both public and private institutions seeking funding for expansion to meet the needs of their clients and advice on how to achieve long-term financial goals in times of both prosperity and crisis. Indeed, Goldman would be the quintessential firm for the current period, which combines both growth and weakness.

Currently, Goldman Sachs operates as bank holding company and a financial holding company. It is regulated by the Board of Governors of the Federal Reserve System. It has an American depository institution subsidiary, Goldman Sachs Bank USA, which is a "New York State-chartered bank."[1] The business of investment firm includes help in planning corporate mergers, issuing IPO's, serving the needs of wealthy investors through portfolio management and acting as a market maker for a variety of securities, including money market, commodities and foreign exchange instruments.

Goldman Sach's key executives are Lloyd C. Blankfein: Chairman and Chief Executive Officer, David M. Solomon: President and Co-Chief Operating Officer; Harvey M. Schwartz: President and Co-Chief Operating Officer.[2]

Like many Wall Street firms, Goldman Sachs was a private partnership for its first 130 years. In 1999, it broke with tradition and became publicly traded. That being said, the partners continued to hold the preponderant capital value of the new corporate entity. Access to capital drove the decision to go public, a decision that helped the firm to skyrocket to the top of the Wall Street power players. After it went public, Goldman raised nearly $4 billion through sales of its stock on the NY Exchange. This was the second largest stock offering in American history.[3]

Description of Business and Services

In one of investment banking's most prestigious services, Goldman acts as adviser to both public and private clients who are grappling with major strategic decisions. For governments, this might involve questions of how to raise money for major infrastructure projects such as those being proposed by the Trump administration. For corporate clients, the advice might address merger and acquisition activity, defense against takeovers, and the structuring of major capital acquisition steps.[4]

In its market making capacity, Goldman buys into and sells securities from its own inventory. The primary purpose of this activity is to make money for the firm through transaction fees, but it is also important to the proper functioning of the market. In 2010, Goldman Sachs faced criticism for having sold mortgage-backed securities out of its inventory when it perceived that the market for such securities was imploding at the very moment it was promoting them to customers. Of course, the company's goal was to make money—as would be the case for all investment banks—but politicians faulted them for unloading them to customers. Needless to say, the long-run consequence of such behavior would be to make the firm less trustworthy, but taking such a risk might be seen as worth taking by senior management. At least it could be said that banks purchasing mortgage-backed securities in 2007 did not only take Goldman's advice. The financial press was warning about their stability for some time. For example, on September 6, 2006, Vikas Bajaj warned *The New York Times* readers that "Investors are attracted" as "mortgages grow riskier."[5]

Table 1. Company Overview

Business Description	Investment banking, securities and investment management firm
Segments	Investment banking, institutional client services, investing and lending and investment management
Status	Bank holding company and a financial holding company
Regulator	Board of Governors of the Federal Reserve System
Industry	Capital Markets
Sector	Financial Services
Stock Style and Type	Large Value
Stock Price (08/24/2017)	$222.99 (closing)
Market Cap	$86.1 billion
Net Income	$8.5 billion
Sales	$32.3 billion
Direct Investment	No
Dividend Reinvestment	No
Key Executives	Chairman and Chief Executive Officer: Lloyd C. Blankfein President and Co-Chief Operating Officer: David M. Solomon President and Co-Chief Operating Officer: Harvey M. Schwartz

Source: Annual Report 2016;[6] SEC Filings 2016;[7] Morningstar, August 2017.[8] Figures in US$ billions and as of August 27, 2017.

Goldman also advances loans to businesses, a traditional investment banking function going back to the 16th century when Christians, such as the Fuggers in Germany, were allowed to provide similar services charging interest and money management. (The banker, Jakop Fugger, was known as "Fugger the Rich" and "minted his own money and maintained banks in every European capital."[9]) Despite its reputation as serving only the wealthiest clients, Goldman has a thriving small business loan department that is both profitable and makes sense from a public relations standpoint. The small business program began in 2015 and is an important part of Goldman's overall strategy to extend loans of all sorts, including personal loans. As reported in *The Wall Street Journal*, one research analyst compared Goldman to Jimmy Stewart's bank in "It's a Wonderful Life": "It's not quite Bailey Savings & Loan but it's getting closer."[10]

Finally, Goldman is in the asset management buying and selling securities for wealthy clients. Asset management is a key part of the investment banking business since it generates a steady stream of revenue based on predictable fees.

Vision, Mission and Business Values

For many years, Goldman has had a sterling reputation. While the firm was denounced in the aftermath of the 2007 stock market crash, it remains one of the most reputable employers in the US. Up until the mid-80s, Goldman could even be described as paternalistic with many managers remaining with the firm for decades. With handsome bonuses and benefits, as well as a tendency to provide a stable career, it has been one of the most highly sought-after workplaces on Wall Street. For example, *Fortune* magazine ranked Goldman Sachs #62 on its list of "best places to work" in 2017.[11] The average salary for an employee was $622,000 in 2006, and the average total compensation per employee was $135,594 in the first 3 months of 2013. Reflecting the regulations and changes in performance since the Great Recession, it dropped to $72,931 in the first 3 months of 2016.[12,13,14]

The company's mission statement and business principles reads as follows:

> It is only with the determination and dedication of our people that we can serve our clients, generate long-term value for our shareholders and contribute to the broader public. At the crux of our efforts is a focus on cultivating and sustaining a diverse work environment and workforce, which is critical to meeting the unique needs of our diverse client base and the communities in which we operate. At every step of our employees' careers we invest in them, and ensure their interests remain focused on the long term and closely aligned with those of our clients and shareholders. Our goals are to maximize individual potential, increase commercial effectiveness, reinforce the firm's culture, expand our people's professional opportunities, and help them contribute positively to their greater communities.[15]

The reputation was just as gold-plated with the client community, perceiving Goldman as trustworthy and mindful of their best interests. This was a reputation that was built under the founder of Sidney Weinberg who started work in 1907 as a janitor's assistant at the age of sixteen. Twenty years later he was a partner and well on his way to being nicknamed "Mr. Wall Street." Weinberg served on the War Production Board during WWII and developed close ties to corporate executives who were part of the war industry, such as Henry Ford. Those connections benefited the firm when peacetime arrived, helping the firm to become a financial powerhouse in the 1950s and 60s.[16,17]

In a 1969 *New York Times* obituary, Weinberg is quoted as saying: "I never traded. I'm an investment banker. I don't shoot craps. If I had been a speculator and taken advantage of what I knew I could have five times as much as I have today."[18]

The corporate culture at Goldman Sachs is much different today. To satisfy the investor community, there is enormous pressure on firms to engage in high-stakes investments, such as hedge funds, collateralized mortgage securities, foreign exchange speculation, and the like. To Goldman's credit, its executives seem to know how to gauge the risks and learn from mistakes. This helps the firm maintain a solid reputation even if the mainstream media finds it a convenient target.

Business Environment

Economic Environment

Goldman Sachs was impacted by the financial crisis that originated in 2009 due to its involvement in subprime mortgage securitization. However, the company was also one of the key players in the creation of the bubble that led to the financial crisis. The chief executives tolerated the firm selling short during the 2007 subprime mortgage crisis.[19] After going public and being forced to compete in an environment where short-term success was critical, decisions made to sell short were in the firm's interest even if it made for bad publicity.

The financial environment of investment banking facilitated greater risks. The subprime mortgage crisis started with a "steep rise in home foreclosures in 2006" and "spiraled seemingly out of control in 2007, triggering a national financial crisis that went global within the year."[20] The crisis resulted in major cut backs on consumer spending, plummeting of the housing market, dramatic rise in home foreclosures and the stock market crash.

In this environment, pressure was enormous for Goldman to exploit buyer illusions that the mortgage backed securities were still worth purchasing. Found guilty for their losses, the company was forced to pay a $5 billion settlement that cut into its profits for 2016. One financial reporter thought that Goldman got off the mortgage game easy. Writing for *The New York Times,* Nathaniel Popper, concluded that Goldman did not have to pay at least a billion because of loophole in the settlement. For example, Goldman was supposed to pay $240 million on affordable housing, but "the bank will have to pay at most only 30 percent of that money to fulfill the deal."[21]

Competitive Environment: Forces Driving Industry Competition

Using Michael Porter's analysis of forces driving industry competition, Ross argues that Goldman Sachs is "America's dominant investment bank has a very well-protected position with respect to new entrants or substitute services, but it faces a nearly omnipotent supplier in the U.S. government."[22] In terms of product segments, Goldman Sachs' key competitors are JPMorgan Chase, Morgan Stanley and Deutsche Bank AG. While JPMorgan is the only financial institution that has higher revenue and assets than Goldman Sachs, it is commonly believed that Morgan Stanley is the chief rival. Morgan Stanley and Goldman Sachs are the only two "standalone investment banks in the United States."[23]

Despite greater entry barriers, however, Goldman Sachs still faces strong competition. Table 2 compares Goldman's market capitalization and net income to "benchmarks" in the investment banking industry. On August 25, 2017, Goldman's closing price was $222.47, as compared to its peers such as Morgan Stanley ($45.94), Thomson Reuters Group ($45.75), Charles Schwab ($39.76), S&P Global ($151.27).[24] Market capitalization measures "the value of the company traded on the stock market." In August 2017, Goldman's market capitalization ($86,068 million) and net income ($8,527 million) were above industry average ($7,913 million and $6,591 million) and higher than top competitors Morgan Stanley, Charles Schwab, Standard & Poor.

Because of the corporate failures in 2007, investment banking markets are more concentrated. Consolidation is on the rise because destructive competition induces banks to collide or seek government protection. Bank concentration has further increased since 2010 when Congress passed the Dodd-Frank Act and made it difficult any new bank to enter investment banking activities. Remaining investment banks, like Goldman Sachs and Morgan Stanley, "have become bank holding companies to qualify for U.S. government assistance under the Troubled Asset Relief Program, or TARP."[25]

By contrast, Goldman's Price-Earnings (P/E) ratio (11.7) is lowest among its peers. It is also lower than overall industry average (15.7) and its peers like Morgan Stanley (13.1) and Charles Schwab (26.7). Stocks with higher P/E ratio can be over-priced or risky; lower P/E ratio is an indication that Goldman's stock might be less risky than its competitors. Generally, investors expect to see a lower Price-to-Earnings (P/E) ratio when deciding to invest in a company. P/E measures how much investors are paying for $1 worth of earnings—the cheaper ratio, the lower the cost. On the other hand, low P/E ratio may be a sign of problems at the individual company. The price may be "depressed" because of market expectations of problems with company's future value.

Table 2. Peer Comparison

Company	Market Capitalization (Million $)	Net Income (Million $)	P/S	P/B	P/E
Goldman Sachs Group Inc.	$86,068	$8,527	2.9	1.1	11.7
Morgan Stanley	$84,372	$6,950	2.3	1.2	13.1
Charles Schwab Corp.	$53,243	$2,164	6.6	3.6	26.7
S&P Global Inc.	$38,876	$2,249	6.8	38.2	17.7
Thomson Reuters Corp.	$32,604	$2,988	3	2.6	33.6
Industry Average	$7,913	$6,591	2.6	2.0	15.7

Source: Morning Star, August 2017.[26] P/S=Prices/Sales; P/B=Price/Book; P/E=Price/Earnings. Figures in US$ millions. Competitors include benchmarks only. Industry average is the average of all companies in the industry.

In investment banking, market competition is high because investment banking clients have low switching costs. To the contrary, consumer bargaining power is quite limited. For high-net worth customers and businesses in need of investment banking services, Goldman Sachs is one of a small number of established banks qualified to meet their needs. Similarly, threat of substitutes is low due to lack of "few opportunities for additional investment banking services because of how securities, exchanges and capital markets are limited through regulation."[27] Since there is little service differentiation among banks due to standardization of products and greater use of risk management, Goldman Sachs actively relies on customer relationships and past reputation to stand out against the competition.

Political-Legal Environment

Goldman Sachs enjoys special protection by the US government regardless of whichever political party is in power. It is protected by the Securities and Exchange Commission (SEC), which limits product offerings or creation of any potential competitors to Goldman Sachs. Goldman advisers actively reach out to politicians to build up the firm's reputation. For example, the company is noteworthy through the frequent appointment of some of its leading officers in important government roles in both Democratic and Republican administrations. For example, former co-chairman Robert Rubin served as Bill Clinton's economic adviser while Gary Cohn is now serving in a similar role in the Trump administration.

During the 2016 election campaign, Donald Trump criticized Hillary Clinton for taking money from Goldman Sachs. Given the bad press that

Goldman earned over the past decade, it is understandable why President Trump would want to exploit this issue even though after taking office he appointed a number of Goldman's top officers, including Gary Cohn, its former president.[28]

Goldman Sachs varies between two strategies when dealing with the American government. It took advantage of the Federal Reserve's ability to provide loans that helped keep the firm afloat in 2008-2009, but appears to favor weakening Dodd-Frank. This legislation was designed to ensure against future crisis and is a cornerstone of Federal Reserve's policy under both Ben Bernanke and Janice Yellen.

Now that Goldman is a holding bank, it might be worried about Glass-Steagall type restrictions re-imposed as demanded by liberal Democrats, like Elizabeth Warren and Bernie Sanders—and even President Donald Trump. President Trump's agenda involves "breaking up big banks, which could push efforts for revival of the Glass-Steagall Act, a Depression-era law that separated commercial lending from investment banking."[29] Steven Mnuchin, Trump's Treasury Secretary and a former Goldman Sachs executive, is now examining Dodd-Frank to see how the legislation might be overhauled to meet Republican Party free market preferences.

Gary Cohn, another Trump adviser and former Goldman Sachs executive, whose separation from Goldman is much later than Mnuchin's, appears to favor "Wall Street split of lending and investment banks." In fact, there are signs that Cohn is not completely on-board the Trump administration's economic vision, given his declaration that a return to Glass-Steagall makes sense. On April 5th, *Bloomberg* reported that Cohn told legislators in a private meeting that commercial banks should be in the business of making loans while investment banks should be in the business of trading and underwriting securities.[30]

Regulatory Environment

Since the subprime mortgage crisis, investment banking no longer exists as a separate financial group. Goldman's next major structural change took place when it, along with Morgan-Stanley, another major investment bank, became a holding company in 2008. This effectively transformed Goldman into a traditional bank, rather than a securities firm. Perhaps seeing the need to avoid the kind of risks that had made collateralized mortgage securities attractive, Goldman became a traditional bank since that offered a cushion of bank deposits that had protected commercial banks like Bank of America and JPMorgan Chase in periods of financial crisis. Becoming a traditional bank also gave them access to the Federal Reserve's lending facilities that would help it stave off the kind of collapse that Lehman suffered. Of course, the transformation will make Goldman less profitable, but the partners probably understood that it was best for the firm to avoid the kind of fate that had devastated Wall Street in recent years.

As a response to concerns that Wall Street had excessive influence on elections, the Securities and Exchange Commission (SEC) issued regulations in 2010 that limit campaign donations from asset managers and outright ban them from high-level employees entirely.[31] For firms like Goldman that are heavily involved with managing government pension funds and municipal bonds, the measures were designed to create an appearance of transparency.

With the repeal of Glass-Steagall under President Clinton who deregulated banking industry, some analysts predicted that if the lines separating commercial banks and investment banks were dissolved that the culture of the investment bank would dominate. If Goldman has absorbed the lessons of the 2007 crash, it might welcome stability and long-term growth. If Glass-Steagall was the preeminent legislation of the Great Depression, Dodd-Frank can be considered its counterpart for the Great Recession of 2007. Goldman's attitude toward Dodd-Frank is ambivalent to say the least. Lloyd Blankfein, the CEO and Chairman of Goldman Sachs, is on record as opposing a full repeal of Dodd-Frank even though he is bullish on the Trump administration that he views as pro-growth.[32]

Even before Goldman became a bank holding company, it relied upon the Federal Reserve to shore up its financial position, taking advantage of the "Emergency Liquidity Program." The Fed provided overnight loans to stressed investment banks, including Goldman that borrowed a total of nearly $900 billion against collateral such as money market instruments and even the mortgage-backed securities responsible for the crash.[33]

With the new administration, there is some question whether Trump will follow through on his attacks on "too big to fail" policies supported by both the Bush and Obama administrations. *The Financial Times* reported that Trump has ordered a review too big to fail prompted by complaints from conservatives who say they enable government bailouts. His Treasury secretary and former Goldman executive, Steven Mnuchin, was quoted in the article: "Let me make it absolutely clear. President Trump is absolutely committed to make sure taxpayers are not at risk of government bailouts of entities that are too big to fail."[34] Given a calamitous collapse of the American stock market, there will be enormous pressure on the White House to avoid a total meltdown that would not be in American interests.

Financial Statement Analysis

Like most banks, Goldman's bottom line is improving. In the fourth quarter of 2016, it reported earnings that surpassed forecasts. The firm's trading desk helped to boost earnings with a 25% increase in revenues, with fixed income and commodities transactions registering a 78% in activity, which was key to the department's healthy gains. In addition to the trading desk, there were strong results produced through debt underwriting. The bottom line was a 12% increase in quarterly earnings to $8.1 billion and a per-share profit of $5.08.[35]

In addition to increased revenues, a significant reduction in expenses helped to boost the bottom line. *Forbes* reported that expenses, excluding salaries, decreased by 44% in the fourth quarter. Key reductions materialized in legal settlements, as well as lower costs from real estate and professional fees. Overall, these declines made up for a 19% increase in quarterly compensation packages to $2.4 billion and accounted for an overall 23% decline in expenses.[36]

Table 3. Goldman Sachs Income Statement and Balance Sheet

Income Statement	**2014**	**2015**	**2016**
Revenue	$34,528	$33,820	$30,608
Total noninterest expense	$22,171	$25,042	$20,304
Net Income	$8,477	$6,083	$7,398
Balance Sheet	**2014**	**2015**	**2016**
Loans	$28,938	$45,407	$49,672
Total Assets	$856,240	$861,395	$860,165
Deposits	$83,008	$97,519	$124,098
Total Liabilities	$773,443	$774,667	$773,272
Total Stockholders' Equity	$82,797	$86,728	$86,893

Source: Morningstar, August 2017.[37] Figures are "year-end data" information—December. Figures in US$ million.

Overall, company's strength can be seen in multiple indicators. The company has strong revenue growth, stock price performance, steady record of earnings per share growth and greater net income over the years. Table 3 shows that while there has been a decline in annual revenue from 2014 ($34,528 million) to 2016 ($30,608 million), Goldman's stock holder's equity and total assets have increased. As the balance sheet shows, there has been increase from $82,797 million to $86,893 million in stock holders' equity. Total stockholders' equity is an important cushion against a danger of insolvency. It "represents how much a company would have left over in assets if the company went out of business immediately."[38] Also, bank deposits have increased and total liabilities remained relatively stable from 2014 to 2016. This is an overall indication that the company is taking steps to improve firm's solvency and overall capital position.

As shown Table 4, Goldman's overall profitability decreased from 2007 to 2016, as measured by return on equity and return on assets. Return on assets dropped from 1.17% (2007) to 0.82% in 2016. Similarly, return on equity dropped from 31.52% in 2007 to 9.37% in 2016. This decrease is understandable given the impact of the financial crisis and the concomitant decline in company's earnings from investment banking activities. This was a time of major turmoil in the US financial industry. However, looking at the net profit margin, we can see that the company started to catch up around 2012, boosting its net margin from 8.71% in 2011 to 21.34% in 2012.

In the last few years, liquidity and financial health indicators of Goldman Sachs performed better than profitability indicators. For example, the company has reduced its financial leverage and debt/equity ratio, which is important for maintaining solvency if the company suffered a major setback. Table 4 indicates that Goldman has reduced its financial leverage from 28.21% in 2007 to 11.36% in 2016. Lower D/E ratio indicates that the company is using less and less debt to finance its assets relative to the amount of shareholders' equity. This indicates less risk taking and less stock price volatility.

Lower D/E ratio signals a change in strategy towards more conservative portfolio management. As recently noted in *Fortune*, "Goldman typically relies more on trading than its competitors, the bank has been trying to shift its model over the last few years to rely less on the business and more on stable markets such as investment management."[39]

Perhaps the only "dark clouds" on the horizon are the same that face American investors as a whole. Commodity trading is not a very stable stream of income. Oil price bottoming out might be good if consumers are filling up their tanks or companies using oil to fuel or lubricate production line machinery. Yet it is a drain on the overall economy since the oil sector is an important part of the GDP. Furthermore, countries that rely almost exclusively on oil exports have been stagnating as well. With smaller revenues, they are less able to purchase exports from industrialized nations like the USA.

Another worrisome trend is a slowdown in the Chinese economy, which has helped to fuel American growth through its import of both agricultural commodities and manufactured goods. For example, Chinese imports of automobiles dropped by nearly 20% in early 2015. To some extent, this is a function of "on shoring" as well as a slowdown in the Chinese economy. As the country's development moves it closer to Western norms, many goods are now produced domestically. This will certainly impact American manufacturers used to reaping handsome profits in the Chinese marketplace.[40]

Table 4. Goldman Sachs-Key Financial Ratios

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Profitability										
Tax Rate %	34.11	0.6	32.5	35.2	27.99	33.3	31.5	31.4	30.7	28.2
Net Margin %	24.8	9.18	26.99	19.7	8.71	21.34	22.59	23.39	16.46	23.15
Asset Turnover Average	0.05	0.02	0.05	0.04	0.03	0.04	0.03	0.04	0.04	0.04
Return on Assets %	1.17	0.2	1.44	0.88	0.27	0.78	0.84	0.91	0.65	0.82
Financial Leverage Average	28.21	18.47	13.32	12.95	13.72	13.5	12.79	11.63	11.4	11.36
Return on Equity %	31.52	4.66	19.12	11.5	3.65	10.66	10.98	11.15	7.47	9.37
Liquidity & Financial Health										
Financial Leverage	28.21	18.47	13.32	12.95	13.72	13.5	12.79	11.63	11.4	11.36
Debt/Equity	4.14	3.51	2.9	2.48	3.13	2.87	2.61	2.59	2.65	2.78
Growth (Year-over-year)										
Revenue Growth %	22.09	-51.68	92.3	-13.31	-26.43	18.58	0.13	0.94	-2.05	-9.5
Earnings Per Share										
EPS	24.73	4.47	22.13	13.18	4.51	14.13	15.46	17.07	12.14	16.29

Source: Morningstar, August 2017.[41] Figures are "year-end data" information--November for the period 2007-2008 and December for the period 2009-2016.

In 2016 Annual Report, Goldman Sachs admits that it has downsized its balance sheet position significantly to adapt to new financial environment:

> In terms of our capital and liquidity, our balance sheet has never been more conservatively positioned as a result of adjustments we have made

> to adapt to new regulations since the financial crisis. By almost all measures, Goldman Sachs, and the broader financial system, is safer. For example, our Global Core Liquid Assets have increased by almost four times, our common shareholders' equity has nearly doubled and our gross leverage has been cut by more than one-half since the end of 2007.[42]

Finally, Goldman as well as its competitors have to deal with uncertainty in the credit markets as the Federal Reserve tries to strike a balance between growth and stable prices. If interest rates are raised, technology stocks tend to suffer as investors worry about a slowdown of GDP. When the economy slumps, the sector contracts more sharply than others because businesses tend to hold off on capital investments such as new hardware and software until it picks up again.

Despite these countervailing tendencies, Goldman's overall outlook seems bullish. The Street Ratings recommend "buy" its stock.

SWOT Analysis

Internal Strengths

Goldman Sachs is global market leader in investment banking. It is a company with strong brand name, best talents, innovative work culture, lucrative earnings and government support. Goldman's key strength is that it serves a wide range of clients from corporations to government agencies, as well as wealthy individuals. Because of its established name, customers prefer to deal with Goldman Sachs and do not mind paying premium prices. This reputation helps Goldman Sachs have a more stable costumer base than its competitors, acquire other businesses quickly, and raise debt at low cost.

For corporate customers, Goldman's traditional investment banking services help to raise capital through loans, new stock offerings or bonds. It also offers expertise in various forms of restructuring. This might include mergers and acquisitions, spinoffs, going public or restructuring. In the USA, Goldman was ranked number one in M&A for 2016, accounting for 25% market share of all global deals.[43] Political turmoil, however, is slowing down the M&A business as companies shy away from major deals

For well-to-do individuals, Goldman is an investment adviser par excellence. With a wide range of plans based on mutual funds, stocks and bonds, it draws upon a research staff of highly-trained specialists. In keeping with its move toward addressing a broader customer base, it has taken steps to build a "robo-adviser system" that would allow investors with more modest funds to take advantage of the firm's research database that would be at the core of the system. In developing such a capability, the firm would be seeking to compete with Charles Schwab, ETrade and other financial institutions geared to the mass market.[44]

Finally, as a market maker, Goldman serves the needs of large institutional investors such as pension funds who buy and sell massive blocks of securities. In the past, such services required labor-intensive specialists. However, like much of Goldman's business, computers have begun to replace such labor and in this case, it is centered in the Electronic Market-Making Desk. On August 30, 2016, *The Financial Times* reported on just one of the sweeping new changes: "Goldman Sachs has begun quietly pushing a computer program that allows investors to trade in the $8.4tn US corporate bond market without ever having to communicate with a person at the investment bank."[45]

Internal Weaknesses

A diminished concern for social responsibility undermined Goldman Sachs's larger goals of projecting integrity and trustworthiness that were part of the firm's legacy. Despite its image as an enormously powerful financial institution, Goldman faces uncertainties. With a limited number of services offered in the financial marketplace, it is vulnerable to collapse if a major income generator such as M&A suffers a major setback (as mentioned above, M&A activity has declined in the current period of flux.) Also, the loss of a major client might provoke a severe loss of income as well.

While it is hard to put a price-tag on any corporation's reputation, Goldman no longer enjoys the clean image it had until it began to follow the pattern of most Wall Street firms in putting short-term profit over long-term capital appreciation. The most glaring example of this, of course, was its role in the mortgage-backed security meltdown. Charged with fraud and subjected to caustic questioning by both Democratic and Republican legislators, the firm took a public relations setback as well as paying a hefty fine (but one that was less than the stated amount)

In a survey by *Fortune* magazine in 2011, Goldman earned a low rating for social responsibility that covers a broad terrain.[46] While not in the same category of a company like BP that was responsible for the Gulf of Mexico oil spill, Goldman keeps getting caught up in deals that do not quite pass the corporate social responsibility test.

For example, the company has been accused of profiting from the Greek financial crisis by concealing the nation's true debt. Goldman made handsome fees for its part in the transaction but at the loss of its reputation at least among people who have viewed Wall Street critically in recent years. In *The Nation* magazine, Robert Reich, who served in the Ford, Carter and Clinton administrations, writes:

> In 2001, Greece was looking for ways to disguise its mounting financial troubles. The Maastricht Treaty required all Eurozone member states to show improvement in their public finances, but Greece was heading in the wrong direction. Then Goldman Sachs came to the rescue, arranging a secret loan of 2.8 billion euros for Greece, disguised as an off-the-books "cross-currency swap"—a complicated transaction in which Greece's foreign-currency debt was converted into a domestic-currency obligation using a fictitious market exchange rate.[47]

More recently, Goldman Sachs has gotten bad press for concluding a $2.8 billion bond deal with the government of Venezuela that has been criticized for financial mismanagement, corruption, and repression.[48] Goldman defended itself by saying that its asset-management arm purchased the bonds "on the secondary market from a broker and did not interact with the Venezuelan government."[49] While that might be true, it hardly does much to change the way the firm is perceived by the broader public. As is always the case with Goldman, the bottom line was the major influence on its decision. It paid 31 cents on the dollar for the bonds, which mature in October 2022. At that price, the yield would be more than 40 % as compared to the original 6% coupon.

External Opportunities

Since Goldman's top officers have either served in government positions or have close ties to international financial institutions such as the World Bank and the IMF, it is not surprising that the firm has exploited external opportunities involving governments with which it has had financial interests.

Emerging markets present ample opportunities for global expansion of investment banking services. Goldman Sachs currently operates "Goldman Sachs Emerging Markets Equity Fund", which "invests primarily in a diversified portfolio of equity investments in emerging country issuers". Sector allocation of debt portfolio is "external sovereign" (65.8%) and mostly concentrated in Latin America (48.5%), with some allocation in Central & Eastern Europe (19.5%), Asia (16.5%) and the Middle East (10.5%). As much as presenting external opportunities, these markets also present major vulnerabilities such as credit risk, interest rate risk, exchange rate risk, liquidity risk and most recently political risks.[50]

In 2015, Goldman Sachs shut down its BRIC fund, which used to invest in the emerging markets of Brazil, Russia, India and China. While the four countries offered prospects of rapid GDP growth, they "fell short compared to a broader index of all emerging market countries."[51]

External Threats

While Goldman Sachs was not a casualty of the 2007 financial crisis, like Lehman Brothers or Bear Stearns, it was on a tight rope. The firm sustained a fourth-quarter loss of $2.12 billion in 2008 even though it made just about the same income for the entire year. That, however, was a sign of weakness since that was 9 billion dollars less than the year before. Like other major players in the American economy, Goldman survived the 2007 crash, but has not returned to the earnings level that preceded it.[52] This is a function of a tight credit market. When the cost of borrowing is high, this tends to contract investing.

For the past 40 years at least, Wall Street has seen a dramatic concentration of firms that is a product of both failure to compete or being absorbed by larger institutions such as Salomon Brothers becoming part of Citigroup. Today, there are four behemoths that enjoy the lion's share of financial services: JP Morgan Chase, Morgan Stanley, Goldman Sachs and Deutsche Bank. Goldman regards Morgan Stanley as its chief competitor even though Morgan Chase's assets and revenues are greater, as explained in the previous section (financial analysis).

Corporate Strategies

Goldman has already taken several steps to address sluggish earnings and restore its public image in the aftermath of the Great Recession. First, it no longer only operates an investment banker. The bank has been "looking at offering banking services to ordinary Americans, moving beyond its traditional business serving big companies."[53] This includes offering online savings accounts and certificates of deposit. The transitioning was a result of Goldman's acquisition of GE Capital Bank in 2015.

None of the new businesses have generated revenue that can compensate for losses during the financial crisis. The N*ew York Times* reported in 2016 that "the bank reported the lowest first-quarter profit and revenue since 2004, with declines across almost all of the bank's major business lines. The firm earned $1.1 billion, or $2.68 a share, down 55 percent from the same period a year earlier."[54]

Goldman's reliance on trading and underwriting makes it an easy target of new regulations and volatile markets. However, the bank has earned a reputation for using clever strategies one step ahead of its competitors, thus surviving the worst of times. After the financial crisis, it cut back bond trading, anticipating that the bubble would not last very long. It also made significant cuts to its fixed income and securities trading units. Besides its business units, the firm made significant cuts in salaries and bonuses across the company in 2016, including a 40% decrease in compensation packages.

These strategies have helped the bank remain profitable even they came at a loss of revenue. To address “accountability “concerns, Goldman Sachs Chairman and CEO Lloyd Blankfein created in 2010 “Business Standards Committee” (BSC). The BSC was given the task to review and make recommendations to Goldman’s business standards and practices. Upon reviewing every major business, region and operation of the firm, the BSC published a report in January 2011. In this report, the executives explained what changes they made, how they impacted the firm and came up with 39 recommendations.[55]

Concluding Remarks

Goldman Sachs has been considered the most prestigious investment banking firm on Wall Street. Since the Great Recession, Goldman operates as a bank holding company and financial holding company regulated by the Federal Reserve.

This case study reveals how Goldman Sachs became the quintessential firm for the current period, which combines both growth and weaknesses. Its clients include both public and private institutions seeking funding for expansion to meet the needs of their clients. Goldman gives advice on how to achieve long-term financial goals in times of both prosperity and crisis.

This case further shows that Goldman has begun to extend beyond the boundaries of its traditional business lines. Seeking to serve the needs of middle-class Americans, it is considering making its premium banking services to those seeking an alternative to traditional commercial and savings banks. Despite having become a bank holding company, Goldman regards traditional investment banker Morgan Stanley as vying for the same clients. Since the services offered by Morgan and Goldman tend to be similar, especially given the electronic transformation of many of the services offered by such firms, Goldman is forced to rely on its good name and reputation that has obviously suffered some decline since 2007.

Below are few strategic directions we discuss for the company in the foreseeable future. We believe that these strategies can continue to: a) expand customer base, b) sustain competitive advantage, and c) survive the economic downturn.

1. *Continue involvement in Mergers and Acquisitions:* This is an area in which Goldman Sachs excels. They lead to increased market share and total revenue. The main disadvantage of M&A deals is that they may be costly. In the USA, Goldman was ranked number one in M&A for 2016, accounting for 25% market share of all global deals (Turner, 2016). Political turmoil, however, is slowing down the M&A business as companies shy away from major deals.

2. *Align corporate portfolio with more "qualified risks":* Increased global expansion generates higher returns for the company but Goldman Sachs should more carefully evaluate countries on an individual basis. "Goldman Sachs Emerging Markets Equity Fund" invests primarily in emerging country issuers of debt, which are concentrated in Latin America and Eastern Europe. These markets have been red flagged recently. Greece is a glaring example of how these markets can suddenly turn wrong.
3. *Rely on government support but better manage risks to avoid becoming "too big to fail":* Despite being tainted by its dumping of mortgage-backed securities in 2007-2008 to unsuspecting customers, Goldman Sachs might be described as "too big to fail." Rather than using a term with such negative connotations, Goldman is instead categorized as a "systemically important financial institution" (SIFI), which means the same thing. Goldman enjoys the support of the Federal Reserve and the Treasury Department and will continue to do so as long as the government and Goldman Sachs partners have close ties either in Democratic or Republican administrations.

Discussion Questions

- *What are the strategic questions confronting Goldman Sachs in the wake of the Great Recession?*
- *To what extent are the company's trading and investment businesses working?*
- *Are the results so satisfactory as to merit ongoing investments in those businesses?*

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