

# [Lehman brothers](https://assignbuster.com/lehman-brothers/)

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Research afailurethat occurred at a large organization such as Tyco, Chrysler/Daimler-Benz, Daewoo, WorldCom, or Enron. In an APA formatted paper that is no longer than 1, 050 words, describe how specific organizational behavior theories could have predicted or can explain the failure of the company. Compare and contrast the contributions ofleadership, management, and organizational structures to the organizational failure. Lehman Brothers Holdings Inc, the fourth largest US investment bank, succumbed to the sub prime mortgage crisis in the biggest bankruptcy filing in history.

The 158 year old firm, which survived railroad bankruptcies of the 1800s, thegreat depressionin the 1930s, & the collapse of long term capital management a decade ago, filed a chapter 11 petition with US bankruptcy caught in Manhattan on September, 15. The following day, its investment banking & trading divisions were acquired by Barclays plc along with its New York headquarters building. In the biggest reshaping of the financial industry since the GreatDepression, Wall Street’s most storied firm, Lehman Brothers Holdings Inc. , headed towards extinction.

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What happened that weekend was that the Fed got a bunch of bank presidents together and asked them to invest in Lehman (basically loan Lehmanmoney). The bank CEOs, knowing the risk of such a loan (they could see Lehman's finances), refused to do so without some kind of assistance from the government (whether it be loss-protection, the government paying half of the loan, etc etc). Hank Paulson, the Secretary of Treasury, refused to do this, saying that he didn't want to saddle the taxpayers with paying to save a private company that screwed up.

Breakup process IMIDIATE AFTER EFFECTS- US stocks tumbled, more than $300 billion in market value, pummeled by the developments. Lehman plunged 95%; AIG retreated 42% on funding concerns while Bank of America Corp slumped 14% after agreeing to buy Merrill Lynch & Co. for $50 billion. The bankruptcy filing represents the end of a 158-year-old company that survived world wars, the Asian financial crisis and the collapse of hedge fund Long-Term Capital Management, but not the global credit crunch.

Financial institutions globally have recorded more than $500 billion of write-downs and credit losses as the U. S. subprime mortgage crisis has spread to other markets. {text: bookmark-start} {text: bookmark-end} Bankruptcy also represents a bad end to Chief Executive Dick Fuld's four-decadecareerat Lehman. Fuld, who piloted the investment bank through prior crises with aplomb, was widely seen as too slow to recognize Lehman's need to raise capital and shed bad assets. Lehman Brothers filed for bankruptcy because they failed to raise enough capital to secure their debts.

The next logical question is why did they have so much debt? This is a two-fold answer: second, Lehman had a ton of what is called " leveraged assets". Basically what happened (the non-basic is for another question) is Lehman took their assets and took out loans secured by those assets (for instance, using their on-hand cash as down payments on loans) and then invested those loans in the aforementioned property derivatives. So, not only did those investments lose value, but Lehman had to pay the interest on the money they borrowed (and subsequently lost).

In short, Lehman was a casualty of the credit crunch due to exposure to bad debt. In August 2007, the firm closed its subprime lender, BNC Mortgage, eliminating 1, 200 positions in 23 locations, and took an after-tax charge of $25 million and a $27 million reduction in goodwill). Lehman said that poor market conditions in the mortgage space " necessitated a substantial reduction in its resources and capacity in the subprime space". At the end of August ‘ 07, Lehman had $600 billion of assets financed with just $30 billion of equity.

Having so little capital meant that a 5 percent decline in assets would wipe out the value of the company, which investors saw as a real risk due to the company's billions of dollars of mortgage securities. In 2008, Lehman faced an unprecedented loss to the continuing subprime mortgage crisis. Lehman's loss was apparently a result of having held on to large positions in subprime and other lower-rated mortgage tranches when securitizing the underlying mortgages; whether Lehman did this because it was simply unable to sell the lower-rated bonds, or made a conscious decision to hold them, is unclear.

In any event, huge losses accrued in lower-rated mortgage-backed securities throughout 2008. In the second fiscal quarter, Lehman reported losses of $2. 8 billion and was forced to sell off $6 billion in assets. In the first half of 2008 alone, Lehman stock lost 73% of its value as the credit market continued to tighten. In August 2008, Lehman reported that it intended to release 6% of its work force, 1, 500 people, just ahead of its third-quarter-reporting deadline in September. On August 22, 2008, shares in Lehman closed up 5% (16% for the week) on reports that the state-controlled Korea Development Bank was considering buying the bank.

Most of those gains were quickly eroded as news came in that Korea Development Bank was " facing difficulties pleasing regulators and attracting partners for the deal. " It culminated on September 9, when Lehman's shares plunged 45% to $7. 79, after it was reported that the state-run South Korean firm had put talks on hold. On September 17, 2008 Swiss Re estimates its overall net exposure approximately CHF 50 million to Lehman Brothers. Investor confidence continued to erode as Lehman's stock lost roughly half its value and pushed the S&P 500 down 3. 4% on September 9.

The Dow Jones lost 300 points the same day on investors' concerns about the security of the bank. The U. S. government did not announce any plans to assist with any possible financial crisis that emerged at Lehman. The next day, Lehman announced a loss of $3. 9 billion and their intent to sell off a majority stake in their investment-management business, which includes Neuberger Berman. The stock slid 7 percent that day. Lehman, after earlier rejecting questions on the sale of the company, was reportedly searching for a buyer as its stock price dropped another 40 percent on September 11, 2008.

Just before the collapse of Lehman Brothers, executives at Neuberger Berman sent e-mail memos suggesting, among other things, that the Lehman Brothers' top people forgo multi-million dollar bonuses to " send a strong message to both employees and investors that management is not shirkingaccountabilityfor recent performance. " Lehman Brothers Investment Management Director George Herbert Walker IV, second cousin to U. S. President George Walker Bush, dismissed the proposal, going so far as to actually apologize to other members of the Lehman Brothers executive committee for the idea of bonus reduction having been suggested.

He wrote, " Sorry team. I am not sure what's in the water at Neuberger Berman. I'm embarrassed and I apologize. " In its Chapter 11 filing, Lehman named Citibank and Bank of New York Mellon as trustees for about $138 billion of senior Lehman bonds. It said Citi's Hong Kong affiliate had made a $275 million bank loan to Lehman. Among Lehman's other unsecured creditors are Japanese banks Aozora Bank, Mizuho Financial Group Inc, Shinsei Bank and UFJ Bank. France's BNP Paribas is also on Lehman's list of its 30 largest unsecured creditors.

The firm said that as of May 31, it owed about $110. 5 billion on account of senior unsecured notes, $12. 6 billion on account of subordinated unsecured notes, and $5 billion on account of junior subordinated notes. Lehman also disclosed that it owned stakes of 10 percent or more in a number of companies, including Imperial Sugar Co , Lpath Inc, Derma Services, Flagstone Reinsurance, GLG Partners, Ronco Corp , Pacific Energy Partners, Blount International , Pemstar Inc and Transmontaigne Inc.

The investment bank, once the fourth-largest in the United States, had hoped to raise capital by selling off a stake in its investment unit, and use that capital as well as other funds to spin off some of its toxic assets to shareholders. But that plan did not satisfy investors, who punished Lehman's share price, or rating agencies, who pressed the company to find a stronger partner. Lehman said the uncertainty, particularly among banks through which it clears securities trades, ultimately made it impossible for it to continue to operate its business.

The bankruptcy filing comes after a weekend of heated negotiations among regulators and Wall Street firms about Lehman's fate. The U. S. government refused to backstop Lehman's worst assets the way it backstopped Bear Stearns Cos Inc's sale to JPMorgan Chase. Government officials told banks to support Lehman or else be prepared for more investment banks to lose investor confidence and fail. But prospective bidders refused to buy Lehman without government support, people briefed on the matter said. In the end, Lehman was allowed to fail, and Bank of America Corp agreed to buy what was seen as the next weakest U.

S. investment bank, Merrill Lynch & Co Inc. For many of Lehman's 26, 000 employees the outlook is likely to be gloomy, with job losses expected to be substantial even if significant parts of the business can be sold. At Lehman's headquarters in midtown Manhattan on Sunday afternoon, men dressed in suits came and went, while some employees entered the building with what appeared to be empty duffel bags, then left with them full. Others emerged with accordion files, binders stuffed with papers and full valises.

On Sunday night, hundreds of Lehman employees were still in the office to clear their desks and pack personal belongings, according to an employee. Several money-market funds and institutional cash funds had significant exposure to Lehman with the institutional cash fund run by The Bank of New York Mellon and the Primary Reserve Fund, a money-market fund, both falling below $1 per share, called " breaking the buck", following losses on their holdings of Lehman assets. In a statement The Bank of New York Mellon said its fund had isolated the Lehman assets in a separate structure. It said the assets accounted for 1. 3% of its fund. The drop in the Primary Reserve Fund was the first time since 1994 that a money-market fund had dropped below the $1-per-share level. About 100 hedge funds used Lehman as their prime broker and relied largely on the firm for financing. As administrators) took charge of the London business and the U. S. holding company filed for bankruptcy, positions held by those hedge funds at Lehman were frozen. As a result the hedge funds are being forced to de-lever and sit on large cash balances inhibiting chances at further growth. In Japan, banks and insurers announced a combined 249 billion yen ($2. billion) in potential losses tied to the collapse of Lehman. Mizuho Trust & Banking Co. cut its profit forecast by more than half, citing 11. 8 billion yen in losses on bonds and loans linked to Lehman. The Bank of Japan Governor Masaaki Shirakawa said " Most lending to Lehman Brothers was made by major Japanese banks, and their possible losses seem to be within the levels that can be covered by their profits," adding " There is no concern that the latest events will threaten the stability of Japan's financial system. " During bankruptcy proceedings a lawyer from The Royal Bank of Scotland Group said the company is facing between $1. billion and $1. 8 billion in claims against Lehman partially based on an unsecured guarantee from Lehman and connected to trading losses with Lehman subsidiaries, Martin Bienenstock. After Constellation Energy was reported to have exposure to Lehman, its stock went down 56% in the first day of trading having started at $67. 87. The massive drop in stocks led to the New York Stock Exchange halting trade of Constellation. The next day, as the stock plummeted as low as $13 per share, Constellation announced it was hiring Morgan Stanley and UBS to advise it on " strategic alternatives" suggesting a buyout.

While rumors suggested French power company Electricite de France would buy the company or increase its stake, Constellation ultimately agreed to a buyout by MidAmerican Energy, part of Berkshire Hathaway (headed by billionaire Warren Buffett). The Federal Agricultural Mortgage Corporation or Farmer Mac said it would have to write off $48 million in Lehman debt it owned as a result of the bankruptcy. Farmer Mac said it may not be in compliance with its minimum capital requirements at the end of September. 2008). economies.

Furthermore, such wealth effects tend to play out gradually. The 158 year old Lehman Brothers’ move to file for bankruptcy wiped off more than Rs2000 crore from the market valuation of those Indian companies in which the US financial major made equity investments. Major stocks held through participatory notes issued by Lehman Brothers Investment Management, a SEBI- registered foreign institutional investor, saw their prices nosedive. Participatory notes are derivative instruments through which foreign investors that are not registered in India can trade on the Indian markets.

In addition to its equity holdings in listed companies, Lehman had also invested in various projects of Indian companies, especially in real estate. In India, Lehman also acquired BRICS Institutional Equities business of research analysts and sales and trading professionals and bought a 26% stake in Edelweiss CapitalFinance, a non banking financial company, recently. The investment banking major has also been involved in several Indian initial public offers. IT SECTOR- The meltdown in US had a huge impact on indian IT & IT companies as a large chunk of their revenues is from US.

Thus, the crisis had definitely delayed various new projects. Market sources revealed that the companies affected by the crisis such as Lehman Brothers, Merill Lynch and AIG have been outsourcing work to wipro, Tata Consultancy Services & Infosys. There was a direct impact on the revenues of this companies. As more & more consolidation, acquisition & mergers took place in the US, the number of companies in this space came down & shrunk the addressable market for the Indian IT services companies. Consolidation also led to consolidated IT resources & reduction in IT spending, which had negative effect on the IT companies.

The slowdown also had an jmpact on the hiring practices of Indian IT services companies, who had to now focus on just-in-time hiring, rather than advanced hiring practices like campus recruitment. Thus, w. r. t. Lehman, as much as 60% of the revenue of India’s software firms comes from the global financial sector, so the fallout of Lehman’s bankruptcy on India’s IT sector cn be well imagined. REAL ESTATE- The collapse of Lehman Brothers and the bailout of Merrill Lynch, the global financial behemoths, affected Indian realty companies that were in the process of raising fresh funds.

Many leading realtors, already facing a paucity of funds due to a slowdown or a correction in prices, found it more difficult to raise resources even at the project level. Merrill Lynch & Lehman Brothers had exposure to more than a dozen realty companies, including, Ansal Housing, Anant Raj Industries, Unity Infrastructure, the Puravankara group and J Kumar Infrastructure, among others. The Indian companies are not only unable to raise fresh capital but they are also finding it difficult to sell the inventory of housing stock as demand & prices both have fallen.

BANKING- ICICI Bank said that it might need to make an additional provision of $28 million (Rs. 188 crore) on its exposure to bonds issued by Lehman. It had already made provisions of $12 million on these bonds. Indian IT major Wipro Technologies has expressed interest in bidding for the Indian back office business of Lehman. The bankrupt investment banking firm is expected to close its captive unit in Mumbai by the end of this month. The unit’s 1200 employees, who work on equity research and analytics support for the mergers and acquisitions business, have been asked to quit by September end.

Unlike employees in Lehman’s investment banking business who have been receiving feelers from domestic banks, employees in the captive BPO are unlikely to find alternate jobs quickly because the IT and IT- enabled services industries have already begun downsizing, owing to the global financial crisis. The RBI had moved quickly to improve liquidity. Still there could be some impact on credit availability. That implies more expensive credit (even public sector banks are said to be raising money at 11. 5%, so that lending rates will inch up to 16 % and higher).

For companies looking to raise capital, the alternative of funding through fresh equity is not cheap, either, since stock valuations have suffered in the wake of the FII pull out. Capital has suddenly become more expensive. There is a risk that projects underway will suffer from delays and cost overruns as cost of credit shoots up. Real estate could be most affected sector. Builders may have to resort to dropping prices to find customers for housing projects nearing completion. Another worry is impact on job creation in the country.

There could be downsizing in companies in sectors impacted by high cost of credit and fall in demand. The layoffs in IT sector may be a fair portent of things to come. The crisis does have a silver lining. The falling rupee(against the dollar) will mean that exporters affected by the earlier rise of the currency can breathe easy. However importers would be at the receiving end. Importers of oil and other commodities’ prices will neutralize the impact of the dollar’s decline against the rupee. Prices of stocks and real estate, which had appreciated by too much, will come down to realistic levels.

The Lehman Brothers bankruptcy filing indicate that as of their May 31, 2008financial statementthat the firm has $639 billion of assets and $613 billion of debt. At that time the firm had about $110 billion in ordinary bonds, and about $17. 6 billion in subordinated bonds. The composition of the other debts is hard to determine, in part, because of a bad cross reference in that part of the filing. As of the last financial statement, accounts payable were about $71 billion, short term debt was $163 billion, other current liabilities were about $29 billion, and long term debt was about $350 billion.

As of the filing date, the listing of the top 30 outsider creditors of the firm mentioned $138 billion of ordinary bonds (managed by two bond trustees), $17 billion of subordinated bonds (managed by one of the two ordinary bond trustees), and about 3 billion in bank loans and letters of credit ranging in size from $463 million to $10 million from 23 different institutions (a few of whom appear to be related entities of each other). This leaves about $485 million of debts owed to creditors in amounts less than $10 million and insider debtors.

This would suggest that $71 billion+ is made up of trade credit in small amounts per creditor, while $414 billion is made up of financial creditors in amounts less than $10 million and insider debt, with insider debt probably making up the bulk of the debts, as investment banks don't generally take deposits from millions of households the way that commercial banks do. There don't appear to be any significant (i. e. more than $10 million) secured creditors or trade creditors, although this might not include financial rights of setoff.

There are more details in an Affidavit of the CFO, which is honestly rather dubious and unsatisfying. I find it very hard to believe that Lehman Brothers is incapable of providing much, much more information than it has to date with only modest effort. While it might not be able to provide ever single creditor in a matter of weeks, it ought to be able to publicly account for more than a third of its outstanding debt. These folks are in the financial analysis business and live and die on their own ability to be highly leveraged without becoming insolvent.

Equity The most recent financial statement listed the aggregate value of preferred stock at $7 billion (and did not include it as a debtor in the petition). The aggregate redemption value of the preferred stock based upon the rights of each class of preferred stock, the number of preferred shares identified in the petition (presumably the number of authorized preferred shares in each class), and assuming that preferred stock dividends aren't grossly in arrears, is about $237 billion. This is calculated as follows: 5 million shares, $500 each, $2. 5 billion 4 million shares, $5000 each, $2. billion 12 million shares, $2500 each, $30 billion 5. 2 million shares, $2500 each, $12. 5 billion 66 million shares, $2500 each, $165 billlion 12 million shares, $25 each, $0. 3 billion 12 million shares, $25 each, $0. 3 billion 16 million shares, $25 each, $0. 4 billion 8 million shares, $25 each, $0. 2 billion 4 million shares, $1000 each, $4 billion 2 million shares, $1000 each, $2 billion But, this appears to grossly overstate the amount of preferred stock shares outstanding. There are 694, 401, 926 common shares outstanding according to the petition.

Assets The source balance statement listed the company's assets as $314 billion in cash, $42 billion in net receivables, $4. 3 billion in fixed assets, and $279 billion in non-current assets. Presumably, this number is lower now, due to market losses, particularly in mortgage based securities. Some breakdown on the nature of those assets is available: Sanford Bernstein analyst Brad Hintz estimates that 55% of Lehman's balance sheet can be quickly liquidated, particularly such assets as receivables and short-term loans known as repurchase agreements.

There are about $269 billion in securities that are " another story," Hintz wrote in a report released Monday. He estimates 27% of the $269 billion is in mortgages, 17% in derivatives, and 8% in real estate. Analysis The two primary bond trustees seem likely to be the dominant voice on behalf of creditors in this bankruptcy on the creditor's committee. This could be a 100% payout liquidity failure bankruptcy, and failing that, could be one in which common stock shareholders, preferred stock shareholders, and perhaps subordinated debtors bear the brunt of the impact, while general creditors are held harmless or nearly so.

Indeed, if the company adopts a plan that holds harmless all preferred and general unsecured creditors, and all secured creditors, then only the holders of subordinated debt would have any right to object. Since all of the subordinated debt appears to be represented by a single bond trustee, this might mean that the plan could be confirmed in a one on one negotiation with the representative of that bank. Equity and subordinated debt together are capable of absorbing a $43 billion loss between May 31, 2008 and the bankruptcy filing, and pre-bankruptcy loss estimates had been in the vicinity of $7 billion.

Barclays Bank is discussing buying the brokerage and investment banking operations including the headquarters out of bankruptcy for about $8 billion (presumably the usually highly profitable brick and mortar part of the operation which probably also counts for most accounts payable and accounts receivable), and assuming that this is a market value for that operation by some reasonable measure, the market losses that other creditors would have to bear would remain unchanges, but greater liquidity could speed up the payout.

The bankruptcy filing covers only Lehman’s holding company. Its brokerage and money-management units are not in Chapter 11 '' employees still have their jobs, customers still execute transactions on accounts, and portfolio managers still manage mutual funds. The relative independence of these subsidiaries from the bankruptcy process is what enables Barclays, the U. K. -bank that walked away from a Lehman rescue over the weekend, to consider purchasing part of Lehman.

Another interesting possibility would be a plan that allocated good, short term assets to outsider creditors as payment in full, while allocating securities of uncertain value, like the mortgage backed securities, to the insiders. Outsiders can't object if they get quick cash in exchange of the debts owed to them, so this plan could be imposed on them, leaving insiders with any windfalls resulting from market undervaluation of Lehman Brothers' complex financial assets.

The biggest overall risk is that the derivatives market, and in particular, the credit default market, will be screwed up by the freezing of the positions of a major market player, although recent bankruptcy law reforms are designed to minimize this impact. Financial crises are terrifying when underlying economic fundamentals are out of line with established theory, leading to bursts of unjustified optimism and/or pessimism. It is theresponsibilityof the powers that be to bring sense to the market. Every financial crisis is different, but they do all end.

The Lehman Brothers bankruptcy and Merrill Lynch’s acquisition by Bank of America is yet another stage in the progression of the financial crisis that had its roots in the US sub-prime mortgage market. The initial stage of the crisis took a toll on direct mortgage lenders like Countrywide Financial. In a subsequent stage, guarantors of mortgage-backed securities like Freddie Mac and Fannie Mae came under attack. This culminated in their going into US government ‘ receivership’ (effectively nationalization) a few weeks ago before the bankruptcy was actually filed.

Lehman’s demise marks the stage where banks with indirect but large exposures to the US mortgage market, principally through derivative instruments, bear the brunt. This is not necessarily the final stage and the worst is perhaps not over. A key feature of this crisis that started in the middle of 2007 has been the lack of clarity on both the nature and number of financial institutions that have indirect exposure to subprime assets, as well as, cross-product problems involving movement from subprime to prime mortgages with final spillover into derivatives, structured products and counterparty risks.

We could see another set of intermediaries coming under severe pressure. The decision by the US Treasury and the Fed not to guarantee Lehman’s financial liabilities is a clear signal to the market that they believe that no institution is ‘ too big to fail’. Going forward, a government-funded bailout is likely to be the exception, not the norm. Besides, with Lehman’s bankruptcy, the fate of its counterparties hangs in balance. It is not clear whether a fire-sale of Lehman’s assets will be adequate to pay off its creditors.

Besides, apprehensions of other banks meeting Lehman’s fate will keep inter-bank lenders on edge. This could lead to a huge squeeze on inter-bank liquidity and trigger another bout of turbulence in credit markets. Finally, the Lehman episode has ramped up the level of risk-aversion in the global financial system. These are days of extreme and often irrational pessimism. The way to survive this crisis is to stay focused on the fundamentals. From a fundamental perspective, India’s financial system has a lot going for it. Indian banks have no direct exposure to G-7 mortgage markets and their ndirect exposure is minuscule relative to the size of their balance sheet. This has protected us in the past and will continue to insulate us to a significant degree from the turmoil in global markets. As this phase of extreme pessimism abates a bit, global investors are likely to reward India for the robustness of its system. Thus, at last, the bankruptcy of Lehman Brothers Holdings Inc, was mainly caused by the fall in house prices & the easy finance provided for housing at vary low interest rates which made the Dow Jones Industrial Average to fall 500 points.

The treasury secretary Henry M. Paulson Jr. had been sending warning signals to Lehman Brothers ever since the firm announced its second quarter losses of $2. 8 billion. Experts were also quoted as saying that the 158-year-old bank was just living off the brand name that it had nurtured over the years. The Lehman bankruptcy had a great impact on INDIA. The undercapitalization of financial houses that was at the core of the financial meltdown in the US & developed markets became a problem in Indian Financial System, too.