

Research paper on lehman brothers bankruptcy

[Business](#), [Company](#)



Lehman Brothers Bankruptcy

One of the most talked about signs, and for some experts the root cause, of the global recession that plagued in 2008 is the September 2008 bankruptcy petition of known financial giant Lehman Brothers. The known global firm had ended up succumbing to tantamount debt due to the ongoing subprime mortgage transpiring in the period which resulted to severe mortgage complications and foreclosures, especially in the real estate sector. The bankruptcy petition was considered a crucial blow to the financial industry given the Dow Jones drop to the all time low and subsequent depreciation prevailed throughout the globe. Many experts have been curious with the sudden bankruptcy of the group considering the Lehman Brothers' financial capability and history. How did Lehman fall behind in its responsibilities and why did it end up filing for bankruptcy? The reason for the decline and eventual bankruptcy of Lehman is due to its financial scheme and strategy that fostered their high debt and disabled them from managing such debts and retain control despite the financial crisis transpiring in the period.

According to the retelling of the Essvle Corporation (2011) upon the establishment of the Wall Street in the 1800s and the first investments after the Revolutionary War, investment banking became prominent especially in the dawn of the American Civil War. Investors bought millions worth of government bonds to help finance the growing war and eventually create institutions that would sustain finance throughout the country. Some of the most prominent investment firms in the period such as JP Morgan (1907), Goldman Sachs (1869) and Lazard (1848) became the first few investment banks available in the market to also offer financial services to their clients.

There was also the bank known as Lehman Brothers founded in 1844 by German immigrant Henry Lehman, which then became a partnership with Lazard brothers Emanuel and Mayer Lazard in 1848 thus the name of the firm. The group opened their first office in New York in 1858 and the business evolved into taking cotton from farmers and settle the money for merchandise. It is also said that Lehman had also become influential as a member of the New York Cotton Exchange in the 1860s and a member of the new York Stock Exchange in 1887 .

Despite the company being hailed as one of the most influential financial firms in the globe, many did not expect a news that would shock the nature of the financial market throughout the globe. Wearden, Teather, and Treanor (2008) wrote that the morning of September 15, Lehman Brothers had filed for bankruptcy protection after a long negotiations in saving the company. The petition filed by the company was Chapter 11 protection, making the Lehman Brothers the biggest victim of the sub-prime crisis happening in the region. According to the company, it had filed for bankruptcy for the very reason it wishes to protect its assets and retain its value. Many immediately announced that the collapse of one of the most influential players in Wall Street is one of the biggest financial crisis that left many industries at risk, for both business owners and its employees. The resulting backlash of the announcement had also shook up the financial market, which may impact the entire globe for the years to come .

Experts had varied as to explaining the reasons as to why a powerful company such as Lehman had filed for bankruptcy. Latifi (2013) had listed three major reasons as to why the company had filed for bankruptcy. The

first reason for the bankruptcy of Lehman is due to poor assets and risk management frameworks which disabled the company to the possible consequences of its decisions in case of emergency. In the case of real estate, Lehman had borrowed excessively and invest mostly in the mortgage market. As a result, Lehman became a leader in subprime mortgage backed securities, continuing a series of aggressive strategies of expanding its real-estate business. In 2007, the company had been reported to accumulate \$85 billion portfolio worth in the mortgage industry. However, with Lehman concentrating on the mortgage market, it had created vulnerabilities that can break the housing and mortgage markets. In addition to this, the protection of the CDOs and the CDSs for investment had been a bad combo considering that both a CDO and a CDS comprises a myriad of mortgage backed securities. As a result, Lehman had been overwhelmed by the borrowers in which they asked for money, disabling them from returning the money they had loaned. In terms of risk management, the company had heavily relied on the VaR model which measures fluctuations of risks under usual market settings at 99% confidence. Experts believe that the VaR model hindered the Lehman Brothers in managing its assets considering that they have a poor strategy on risk prevention and management. They had blindly followed on a mathematical model of risks, which could have been interpreted falsely or inaccurately.

The second reason as to why the company had succumbed to bankruptcy is due to poor managerial capacities. In a passage written about the Lehman Brothers by a worker, the company is said to never sleep.

‘ When the trading bell sounded on the New York Stock Exchange at four

o'clock in the afternoon, a lot of equity guys packed up because there was nothing more for them to do. Bank debt and high-yield debt often went till seven o'clock or later. Most days the traders had normal-looking balance sheets, not too drastic one way or the other. But, losses were never loved at Lehman. And if you turned in a sheet with a drop of \$500, 000 on the day, that was a trouble. In a way, Lehman was run by a junta of platoon officers.- they would all learn the basics, but they would also spend a lot of time in combat'

In this passage, it shows that the company had an unorganized organization and working scheme that caused some workers to snap. In a further assessment, experts believe that the country's CEO Richard Fuld had a part in the bankruptcy announcement as his managerial capacity was ruthless and aggressive. He was also overconfident and greedy as he did not take into account the signs of losses in the company and continued to borrow money, invest in the mortgage industry and sell shares. A journalist even stated that the CEO may have not been ready to accept the crisis at hand. In addition, while the company had a similar structure like other financial firms, its board of directors only comprise of ten individuals, working on company issues alongside the overconfident CEO. Sadly, the board of directors were seen to be accepting of Fuld's preference to money as he fired all directors that would contradict his orders. In this end, the board did not have the capacity to influence the CEO with regards to the signs of an imminent crisis and loss. Finally, it also had a poor and ineffective corporate structure that had left the company violating the COSO requirements in organizing one's corporate system and business strategies. Fuld had ordered the company to

adhere to his desires of risk management objectives, making the corporate board helpless with the issues.

The third reason for Lehman's bankruptcy is due to the recorded cases of fraud. Since 2007, there were already records of losses for the Lehman Brothers, forcing them to write billions worth of bad debt that affected its position. It also did not have a financial leverage due to its incapable managerial team. To hide from investors, borrowers and the government their situation, Lehman had used REPO 105 transactions to prevent itself from getting negative ratings. It would also falsify its records, removing \$50 billion worth of commitments in its records, reducing its actually net debt. With the newly freshened accounts and records, the company continued to seek funding from institutions and just remove the troubled assets from their records to prevent further discussions over its liabilities. The repo statement had also enabled the company to look well-capitalized despite its losses and increasing debt. Once the company announced the bankruptcy, it revealed hidden transactions and removed records of debt. It was also discovered that accountants and auditors of the company would report positive ratios, neglecting the importance of ethics. It can also be argued that the government had also made the bankruptcy of Lehman possible given the fact that the Federal Reserve and the Treasury had allowed the bankruptcy to happen. Some even see Lehman as a sacrificial lamb to prevent other financial troubles from occurring, especially the protests of banks regarding the bailout requests .

Upon the announcement of the bankruptcy request, the international community had found itself on a standstill given the effects of the request

throughout the globe. In the report of AFP (2008) the global stock markets had recovered severe losses once the announcement has been made formal by the company. In Japan, the NIKKEI share prices had dropped to 5.06% after the morning trade. Banking shares soon followed the collapse, making it one of the lowest recorded points the NIKKEI had ever experienced. In the case of the Hong Kong stock market, shares had dropped to 6.1% upon the opening of the stock market, while China had recorded a drop of up to 3.36%. Even the famous Shanghai Composite Index, which covers A and B shares, was recorded to be at 2,009.77 points. The A-Share had fell 73.32 points, while the Shenzhen A-share fell down 6.62 points. Singapore had also recorded a lower share price of over 57.54 points. South Korea had also experienced a low stock market point system and they had stressed that once the US reacts to the issue, it is possible the stock market would return back to normal. The Philippines and Taiwan had also recorded market drops from 3.88-4.3% upon the morning bell prior to the announcement.

In the case of the Western countries, the Dow Jones Average had dropped below 11,000 prior to the announcement. Experts and analysts had cited it is the largest point loss the Dow Jones had recorded since the September 2001 terror attacks. In the case of the Nasdaq, it had fell down 3.60% while Standard & Poor's 500 index had fell down 4.71% or 1,192.70 points. The London FTSE 100 index had also dropped 3.92% to 5,204.20. The French CAC 40 had also experienced the same drop as it was recorded to be at 4,168.97 points. In Frankfurt, the DAX had experienced a 2.74% loss, landing at 6,064.16 points. The huge drop in the respective stock markets had caused investors to panic as to how the effect of the Lehman announcement

would befall on other financial firms. The various financial institutions such as the Bank of Japan and the US Federal Reserve had immediately injected billions of dollars to re-divert the losses experienced in the stock market and to put temporary stocks in shares that had been sold or taken by investors in light of the issue. Nonetheless, the losses had immediately called in for an emergency sale of stocks and still the caused a hard hit on the banks throughout the globe .

According to Wachman (2009) Iceland, Latvia and Pakistan are just some of the economies that suffered the most with the announcement of Lehman's bankruptcy. In the case of Latvia, the nation now is trying to see financial aid from the International Monetary Fund and from the EU considering that their budget has already cut to the brim and the increasing unemployment in the region has severely affected their budget. In Iceland, the region is now in a state of chaos as the government fell within six months after the closure of Iceland's major banks. Iceland had also experienced a fallout with international investment and financial companies given the protests that these institutions had gotten heavy loans from the bank, which caused them to bankruptcy. Finally, in Pakistan, the nation had experienced a financial meltdown due to the dwindling foreign reserves of the country, which dropped by \$1bn per month as the government had tried to regulate the economy. In an analysis, it is plausible that Pakistan would default to foreign loans to pay its debts and sustain its economy in the next three years .

As of today, the issue on the Lehman Brothers bankruptcy is still discussed in court as far as to how it would pay its creditors and lenders. As of recent, the Associated Press (2013) reported that the Lehman Brothers, especially its

European arm, that they would be paying their creditors in full. According to the lead administrator of the European arm of the company, Tony Lomas stated that the settlements to retrieve several of Lehman's brokerage deals and client assets, allowing settlements and claims to be done. The assessment done to the company's settlements and records could be considered a milestone as it would finally enable the company to pay their debts. Almost £23 billion worth of client assets are held by the European sector since the day its US counterpart had filed for bankruptcy in September 15, 2008 . Regardless, the bankruptcy of what is considered one of the strongest financial institutions in the world is now regarded as one of the major reasons as to why the global economic recession became plausible and affects the globe even at the present.

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