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Investment banking**Rank injustice**

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Are league tables to blame for the industry's ills?

EVEN Cluedo does not have this many suspects. The list of culprits for the woes afflicting banks includes bankers' pay, credit ratings, ill-prepared boards, sleepy supervisors, accounting regimes, flawed risk models and Alan Greenspan. Should league tables, which rank investment banks on their market share in businesses such as share underwriting, debt issuance and mergers and acquisitions (M&A), also be fingerprinted?

That league-table positions matter to the banks is not in doubt. Many have specialist teams devoted to supplying data to the firms that compile the rankings, and to challenging the positions of rivals. According to Nick Studer of Oliver Wyman, a consultancy, some have a dedicated sales team with the job of pushing banks up the table at the end of each quarter, often by agreeing to reduce fees. High league-table positions feature prominently in marketing pitches, to good effect: according to a study by Jack Bao at the Massachusetts Institute of Technology and Alex Edmans at the Wharton School, corporate clients rely principally on past market-share data to select their M&A advisers.

Did this emphasis on league tables have a distorting effect on bank behaviour before the credit crisis? The results of an internal investigation into the calamity at UBS showed that its investment-banking unit was hell-bent on closing gaps with its rivals in fixed income. Merrill Lynch set great store on coming top of the league tables for structuring collateralised-debt obligations during the boom years.

Yet to blame league tables for their mishaps feels a bit like accusing the candlestick, not Colonel Mustard. Revenue is a greater incentive for banks to hustle for business than rankings. And some investment banks manage to resist the urge to be on every podium: Goldman Sachs occupies a relatively lowly position in debt-issuance tables but is still widely seen as the industry's overall leader.

It is not as easy as you might think to game the system. True, in their marketing material, banks can manipulate the data to suit their own ends—by being selective about which deals they include, for example. But even if they lower their fees to obtain league-table credit, there is little evidence that clients award mandates based solely on price. Data providers see few signs of egregious discounting.

The bigger question is how useful league tables really are to clients. Defenders say clients routinely dig into the underlying data to identify banks with specific expertise. But the tables shed less light on the quality of the service being offered. Mr Edmans says that some M&A advisers are persistently associated with higher bounces in an acquirer's share price when deals are announced—but that these firms tend not to be the ones with the biggest chunk of the market (see table). In this analysis, Goldman looks less stellar than its share of deals suggests. Worse, the research found that previous market share (the measure that clients do use) was negatively correlated with later performance. If league tables did a better job of capturing quality as well as quantity, they would be less suspected.

Bigger is not better

Top M&A advisers to acquirers listed in America
1980-2007

| | Market share by value, % | Excess returns*, % |
|---------------------------|-----------------------------|-----------------------|
| Bear Stearns | 3.04 | 0.98 |
| DLJ | 3.60 | 0.70 |
| Salomon | 2.51 | 0.66 |
| Lehman Brothers | 5.66 | 0.53 |
| CSFB | 6.05 | 0.49 |
| (Salomon) Smith Barney | 5.09 | 0.40 |
| JPMorgan | 5.69 | 0.23 |
| Merrill Lynch | 9.45 | 0.20 |
| Morgan Stanley | 11.03 | 0.11 |
| Goldman Sachs | 10.71 | 0.09 |

Source: Jack Bao and Alex Edmans

*Performance of bidder's share price compared with market expectations before announcement of deal

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