

The End of Lehman Brothers

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Background

Lehman Brothers started their journey of business back in 1844. Henry Lehman started a general store and he was an immigrant of Germany. The general store was created in Montgomery, Alabama. Later on, until 1850, Henry Lehman and his brothers Emanuel and Mayer started their joint business venture named as Lehman Brothers. The firm had faced several prosperous years in the United States and became the reason to boost up the US economy over many years. Lehman Brother became a huge investment banking system in the country. Lehman Brothers also faced several challenges in the 19th and 20th century and successfully handle these challenges. The challenges include railroad bankruptcy in 1800, the era of the Great Depression in 1930, the time of two massive world wars, the collapse of long-term capital management, and the Russian collapse in 1998. These were all huge disasters, but the firm Lehman Brothers survived all of them. But 21st century started with many unpredictable crises of markets and the US housing market crisis impacted negatively on the firm of Lehman Brothers and brought it onto the knees. The major reason of the failure was the interest and huge spending of Lehman Brothers in the subprime mortgage market that became a huge disastrous step and ended the prosperous era of Lehman Brothers.

The Major Guilty Party

In the start of the 21st century, United States housing boom spread all over the country. In 2003 and 2004, Lehman Brothers chose to acquire five mortgage lenders, which initially provided the firm with a huge rate of profit. These lenders include subprime lender, BNC mortgage lender, and the Aurora loan services. All these service providers based on the specialties of Alt-A loans. These types of loans were designed to provide borrowers the opportunity to take loans without a complete set of documentation processes. These purchases sound psychic in the first place, but Lehman Brothers achieved a huge rate of profit due to their investment procedures. The real estate business of Lehman Brothers generated a revenue flow of 56% from 2004 to 2006. These real estate business revenues were far more than the other Lehman Brothers businesses including the investment banking business and the asset management business. Lehman Brothers observed a \$146 billion business in the area of mortgages in 2006, which led to a 10 percent increase from 2005. The every year profit of Lehman Brothers were recorded and it was better than before, such as from 2005 to 2007, the reported profit rate net income crossed the \$4.2 billion over the Lehman Brothers revenues of \$19.3 billion.

A Gigantic Mistake Or Miscalculation

In 2007, the circumstances started to change as the stock reached \$86.18. Lehman Brothers got the edge in the market with the market capitalization nearly too more than \$50 billion. But this was the start of the problem that started to arise in the US housing market. In the first quarter of 2007, cracks started to emerge in the US housing markets, and they are visible in all the markets in the country. On the other side, defaults linked with subprime mortgages started to increase. In March 2007, the stock faced the biggest one-day drop in the last five years, and one day later, it was predicted that it would impact the Lehman Brothers profit rates. However, the Lehman Brothers reported record revenues and profit for the first quarter of the year. The predictions were made that the changing pattern of US housing market with impact the profitability of Lehman Brothers, but the Chief Financial Officer of Lehman Brothers stated some different views. According to his views, the risks that are arising in the markets will not impact or may have little impact on the profit and earning rate of the Lehman Brothers firm. In his opinion, there were no risks linked with the subprime markets and the rest of the US housing markets that could hurt the United States economy.

The Problems Arise And Lead To Failure Of Lehman Brothers

The year 2007 was not a good one for the US markets as in August 2007, markets faced a huge credit crisis. It was the result of the crisis of two Bear Stearns Hedge Funds. This leads to the starting cracks in the foundation of Lehman Brothers. The stock of the firm started to decrease and fell quickly. This negatively impacted its reputation, and the firm had to take serious steps to survive. The company had no other option rather to eliminate the mortgage related jobs, and it eliminate more than 23, 00 jobs. The company had to face several problems and due to these problems the company shut down its BNC unit. The problems were not resolved as they kept increasing, and the firm closed its offices of the ALT-A loans association in three states of the country. The US housing market stocks rate were unpredictable and the problems seems to increase, this does not impacted the mortgage reputation of Lehman Brothers and it was still the major player in the market. However, the insecurities towards the future led the Lehman Brothers to sign different liabilities in the mortgage-backed securities. It was based on a portfolio of more than \$80 billion, and it was far higher than the shareholders' equity level. The fourth quarter of the year 2007 brought back the profit rate for Lehman Brothers, and its stock rebounded. The global trending markets faced new high-profit rates and increases in the prices for the fixed income assets. These all scenarios created a temporary return to Lehman Brothers in the market. The Lehman Brothers started to take initiative to settle in the market again, but the firm did not accept the opportunity to spend on the mortgage portfolio. It leads to the huge disastrous situation for the firm as it was the last opportunity to stable for the company.

Lehman Move Towards The End

The conditions of the US housing market and the mortgage system negatively impacted the reputation of Lehman Brothers. The ratio of the firm in the total assets and its comparison with the shareholder's equity level was 31 in the year 2007. The huge rate of spending in the mortgage portfolio and its required securities level increased the firm vulnerability in the markets. Its condition started to decline, and the mortgage value of securities started to weaken its foundations in the markets. Later on, at the start of 2008, the company's reputation and condition did not improve, and the collapse of Bear Stearns impacted its profit rate more negatively. It was the collapse of the second-largest institution of mortgage securities that led to the start of cracks in the foundation of Lehman Brothers. Due to the collapse of Bear Stearns, the share of Lehman Brothers fell instantly, and it was predicted that it would lead to a huge disaster and the huge failure of the successful Wall Street firm Lehman Brothers. The shares of Lehman Brothers fall till 48 % in the markets. In June 2008, Lehman Brothers announced their second quarter loss in the markets which was more than \$2 billion. Several measures were taken, but all of them were considered late measures that did not contribute positively to the reputé of the company. In September 2008, the firm reported a huge loss of \$3.9 billion. In the end of that week, Lehman Brothers only had \$1 billion cash left. The Bank of America and Barclays PLC started their measures to take over the Lehman Brothers, but it was too late, and their efforts remained unsuccessful. The end of Lehman Brothers was considered the worst and most dangerous fall of markets in 2008, and it negatively impacted the world financial markets for many weeks.

Reasons Of Fall And Failure

The ethical lapse existed in the fall and failure of the Lehman Brothers firm. The most wrong and inappropriate measure was the manipulation of assets done by the administration of the company. It includes the approval of assets that were taken away from the accounts of Lehman Brothers. The approval was made by Chief Financial Officer Erin Callan of the company. This huge misinterpretation impacted negatively to the financial scenario of the company. This manipulation technique was used twice in two quarters before the fall of the company. The movement of assets from the company's balance sheet was an intentional measure taken to create an imaginable stance that everything was alright and under security. The executive team of the company had taken several wrong turns and decisions to balance the reputé of the company in the international markets. The management was unable to determine the right steps to take and failed to handle the issues properly. The banking leverage was high from six consistent months, and they do not have any choice to mislead the shareholders, but they needed a better solution and a better step. They should have applied strategic measures and serve with accurate information to the details of finances to their shareholders. They could receive then better option and more time from the market to stabilize in the market and the situation was not leaded towards this disastrous end.

The story and the failure of Lehman Brothers include not only the crash and fall of the markets but also wrong decisions in their investment processes. It also includes the lack of ethical behavior and lack of professionalism that showed by its administrative staff and its professional advisors. They did not hold the fact of failure and consistently take miss leaded decisions and manipulate the financial information of the company. The consequences were severe and led to the end of the world's famous investment banking system, the Lehman Brothers. The major and profound messages that could be gained from the huge failure of the company are that the ethical behavior is required and was required at the time of its fall. The transparency and accountability measures were important and paramount in the case of Lehman Brothers. The unethical decisions and spending in the wrong ways led them to collapse, and their unethical business practices ended their journey of business. A global crisis occurs in the business world, and these are not preventable enough not to impact any business venture negatively. The responsibilities lies with the firms that needs to take transparent measures, ethical decisions, and accountability measures for their firm strength and long term ways. (Financial Crisis Inquiry Commission, 2011) (U.S. Government Publishing Office, 2010) (Valukas, A. R., 2010)

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