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Bank strategies

No size fits all

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Don't blame banks' business models for the credit crisis. Blame their management

Illustration by David Simonds

FROM "you and us" to "us and them". UBS, a dishevelled Swiss bank, announced on August 12th that it was stepping away from its integrated model and establishing its investment-banking, wealth-management and asset-management divisions as stand-alone entities. UBS's management scoffs at the idea that this will lead to the sale of the investment bank, but a break-up is precisely what many inside and outside the bank think is needed. The problem, they say, is that big banks like UBS and America's Citigroup have got the wrong model.

It is true that risk-loving investment bankers and stability-prizing private bankers make unlikely bedfellows. The recklessness of UBS's investment bankers has made the bank the credit crunch's biggest total loss-maker to date. Clients of its private bank are spooked: the wealth-management arm suffered an overall loss of deposits in the second quarter. Swiss regulators are also unnerved and want a more robust capital regime for the country's big banks.

And there is a good case for greater simplicity in bank models. The management skills needed to excel at investment banking are different from those in retail or corporate lending. In the industry, they say that the universal-banking model is like putting together a lion and a horse.

Yet, tempting as it is to believe that changing business models would solve UBS's problems, or those of the wider industry, the evidence of the credit crisis suggests otherwise. No single model has emerged from the turmoil either wholly vindicated or entirely discredited. Credit Suisse shares a city square in Zurich and a business strategy with UBS, but has come through the past 12 months in much better shape and continues to attract money into its wealth-management division. Citigroup's version of the universal-banking model is one where it walks into every punch going; Britain's HSBC has been more successful in blunting the impact of its American misadventures through decent earnings in emerging markets. Of the Wall Street investment banks, Goldman Sachs has survived with its reputation enhanced. Bear Stearns did not survive at all. Pure retail banks can blow up too: Northern Rock, which was nationalised by the British government after a humiliating run on it, had a simple enough product line.

A familiar story

What separates the winners from the losers is not models, but management. One aim of the reorganisation at UBS is to stop its investment-banking arm from funding itself with inexpensive capital thrown off by the wealth-management arm. That should not have been happening anyway. The model may have enabled traders to fund themselves too cheaply, but the bank's managers set the internal cost of capital too low. That Credit Suisse's boss, Brady Dougan, has an investment-banking background may help to explain why it has done a better job. And imagine if Jamie Dimon, the fêted boss of JPMorgan Chase, rather than Chuck Prince, a dancing lawyer, had been running Citigroup. The outcome would surely have been quite different.

Regulators, too, should remember that no one bank model offers a clean solution to the problem of systemic risk. Simpler, slimmer institutions may be easier to police, but they are more liable to go under when the environment sours. Even smallish banks can pose systemic dangers: Bear Stearns was not big, but it still warranted a rescue. Bigger, diversified institutions may be more resilient, and they also come in handy when a buyer is needed for an ailing competitor. But they are harder to supervise, impose greater costs if they get into difficulty themselves, and can constrain competition and innovation.

Some businesses will need to change because of the crisis. UBS may well have to get rid of its investment bank to shore up its reputation with its wealthy customers. The frailties of the Wall Street investment banks—in particular, their exposure to wholesale markets for funding—have become shockingly clear. But the structure of an organisation matters less than the quality of the people who lead it. For bank regulators and shareholders, the question is less "what?", more "who?".