Lehman Brothers: How one of the oldest banks in history went bankrupt?

Lehman Brothers Holdings Incorporation was a global firm which was responsible for giving various different financial services. At one point in time, it was the fourth largest bank in the US and the services it dealt with were investment banking, investment management, private banking, fixed income sales and trading and private equity. It was founded by three brothers in 1850 and functioned for more than a century and a half when finally in 2008, it filed for bankruptcy and was taken over by Barclays and Nomura Holdings.

How it came into being?

One of the brothers, Henry Lehman, came from Germany and opened a small general store in Alabama in 1844. After some time another brother joined him and then the third one too which is the name of it got changed to Lehman Brothers. They started off by trading their merchandise in return for cotton as payment because cotton had a great value at that time. After some years in 1858, the civil war took place, and the company now played their part in financing the reconstruction of that area; Alabama. The company then soon became part of the New York stock exchange in 1883. In the following two decades a lot of changes took place in terms of seats changing hands between Phillip Lehman and then his son took office, after which some out of the family individuals were employed as well. By 1930 Lehman Brothers had become a reputed firm that was now financing major companies and industries on a massive scale. In 1969, however, Robert Lehman died who was the last person from the

Lehman family to manage the firm, and now there was a lot of confusion as to who was going to take the seat. It was at this time that Pete Peterson, the CEO of Bell and Howell, was called to take the firm out of the turmoil it was getting into. Pete came, and in 1975, Lehman merged with Kuhn and Loeb Co to form the fourth largest bank in the United States of America.

Years of great profits

In the years 2003 and 2004, when the US housing bubble was taking place, Lehman Inc acquired about five mortgage lenders. These acquisitions seemed to be a great success for the company initially because the revenues that were being made from the real estate business were being used to invest in the capital market, and this led to a growth rate of 56 percent which was, at this point, higher than their businesses in investment banking or even asset management. In 2006, there was a 10 percent rise in the mortgages which they secured and the profits which they made in the year 2005 till 2007 were the highest in their history of existence. In 2007, it had a net income of about 4.2 billion dollars which was clearly record breaking for them.

Beginning of the end

In the first quarter of 2007, the Housing market of US was facing many issues as was now becoming apparent, but the chief financial officer of Lehman was positive that such delinquencies would not have any major effect on the company and that their profitability would remain as it was. He also said that the small issues were not expected to affect the US economy and therefore there was nothing to worry about. This, however, was a big miscalculation on the company’s part because what followed next was destructive.

The month of August of the same year was when credit crisis took the market, and at this time the stock price of the company fell sharply. Because of this, it had to shut down some units and eliminate many mortgage related jobs. In the fourth quarter, however, the stock price came back, but Lehman Inc didn’t take full advantage of it as they should have. Lehman had a really big portfolio of mortgage securities which meant that it was vulnerable to all the uncertainties in the housing market. In 2008, Bear Stearns almost collapsed, and this led to a 48 percent fall in the Lehman shares. On June 9, the company reported their loss of about 2.8 billion dollars and therefore started efforts to improve that situation.

The final blow

All those efforts and measures were too late, and things had already gotten out of control. The third quarter financial report showed further loss of 3.9 billion dollars, and this made it clear that now the business had to be restructured. On September 15 in the year 2008, Lehman filed for bankruptcy, which was the largest bankruptcy in the history of US. This led to a lot of financial disturbances worldwide because Lehman was a large firm and one of the major financial firms in the US. Two days later, Barclays agreed to purchase the company’s three divisions while the rest were taken over by Nomura Holdings. And this is how one of the biggest financial firms in the history of US was brought down to failure and definite end.

Why did the firm end up so bad?

There isn’t much detail that goes on to answer this question because things were pretty evident for Lehman. When Lehman was nearing its end and wanted to be taken over by another firm, no other firm was ready to do that for their separate reasons. It is always better to be acquired by another firm than to declare bankruptcy but for Lehman, there was no choice. Also, the financial situation of the company was too wrecked with all the losses, and therefore no firm was ready, not even the government, to step into such a mess which is why Lehman Inc. was left with the only choice of declaring their bankruptcy. It was then after the bankruptcy that Barclays and Nomura Holdings agreed to buy its divisions so that they could run it according to their own will.

Lessons for future bankers and investors

Businessmen and individual from the financial market should certainly take an example from this case and make a personal analysis of where things went wrong and what blunders could have been avoided and how. Lehman Brothers was not a small name and therefore had a long story behind its failure. That story is not for us to just read and flip over but to take a lesson from because the amount of experience and time invested in this case is something we don’t get to learn from anywhere else. The one big lesson from this case was that there is no such thing as stable stock. Some financial gurus may say that it is safe to pull all your eggs in companies that are leading the market and big giants of their industry because somehow dividend payments will be guaranteed in that investment and the resale will always benefit. Lehman Brothers along with CitiGroup and Merrill Lynch are all examples of names that were leading giants of their time and yet they ended up rather worse than the small setups. This proves that investors should always treat all their shares as unpredictable and should take wise decisions in times of crisis rather than blindly relying on the reputed name.