

Investment Banking: Institutions, Politics, and Law. *By Alan D. Morrison and William J. Wilhelm Jr.* New York: Oxford University Press, 2007. xiii + 341 pp. Index, notes, bibliography, tables, figures. Cloth, \$45.00. ISBN: 0-199-29657-X.

Reviewed by Ranald Michie

This historical account of the growth and development of investment banks from their origins in the eighteenth century to the present day is largely culled from a reading of the standard works on both individual firms and investment banking generally. Although the authors acknowledge this in the text, they have not attempted to add value by comparing and contrasting practices in different financial centers or by exploring the reasons behind, and the consequences of, the existence of powerful and independent investment banks in some countries and not in others. Instead, they focus almost exclusively on the United States, particularly in their coverage of the nineteenth and twentieth centuries. Thus, it is events in the United States, whether financial crises, public opinion, technological change, economic analysis, or government intervention, that they view as crucial to the way that investment banks evolved. Although the importance of the changing international environment and the contribution made by foreigners, especially European Jews, are acknowledged, these factors are barely explored. The question of why German Jews have played such a major role in the history of investment banking, while operating largely outside their own country, continues to puzzle me, for example.

However, the authors do add value to the subject when they relate investment banking to its wider political, social, and legal environment. Not only are they familiar with recent economic thinking on the subject of investment banking; they have also acquainted themselves with other areas, such as constitutional history and the laws of property. An introductory chapter, in which they discuss the current importance and operation of U.S. investment banks, is followed by two theoretical chapters that identify the fundamental and specific contributions made by investment banks to the working of a capitalist economy. These are described as twofold. First, there was the position that investment banks occupied at the center of an information network, enabling them to link

investors and borrowers. Second, there was an acquired reputation for expertise and honesty, as this created the trust without which sophisticated financial transactions would have been rendered nearly impossible. Neither conclusion is a surprise, but the authors do provide them with a theoretical basis and explicit justification. Thus, the fear that an unsuccessful outcome would damage their reputations helps to explain the established investment banks' reluctance of to move into new areas. Nevertheless, investment banking remained both competitive and responsive, as it was always possible for new entrants to establish themselves by responding to changing demands despite the established firms' advantage of contacts and reputation. The trade-off between taking a risk and preserving a reputation was a fine judgment in many cases, and the successful investment banks were those who got it right, whether by skill or luck.

The next five chapters follow the history of investment banking largely in the United States, both to support the theoretical conclusions drawn and to develop an understanding of the various forces at work. These chapters improve as they become more modern. The earlier chapters tend to be superficial, especially when they are dealing with developments outside the United States. What is lost by this heavy U.S. orientation are the nature and timing of developments elsewhere. Both government borrowing and the finance of international trade were of great importance for investment banking, as were the different relations that existed between various countries and their commercial banks and stock exchanges. It cannot be assumed that investment banks in the United States were unaffected by circumstances in other countries, where major events like the two world wars were much more disruptive of financial systems. Conversely, other countries escaped the legislative consequences of the Wall Street crash in the shape of the Securities and Exchange Commission and the Glass-Steagall Act. A glance at what was happening abroad in those years would have helped to identify the unique aspects in the development of U.S. investment banks that were to make them so powerful today.

The survey culminates in a discussion of U.S. investment banks toward the end of the twentieth century that looks at how their operations have been changed by technology and training. With computing technology, each investment bank can now process much more information, while the application of mathematical techniques to investment

analysis has eliminated the importance of accumulated experience. The consequence for investment banks was that they could become both much bigger in terms of their operations and much more exposed to direct competition as reputation came to matter less. These issues are considered in the final two chapters, presented in lieu of a formal conclusion, that examine how investment banks have coped with their transition from small partnerships to large companies and have tried to determine what the future holds for them. It would appear that the historical component of the book is somewhat secondary to its focus on the current state of U.S. investment banking. There is, for example, no mention of history in the title.

This book does provide a useful introduction to questions of how U.S. investment banks reached the position they occupy today. Its explicit coverage of some elements in that history, notably networking and reputation, emphasizes their importance. This should encourage others to examine reputation and networks, both over time and between countries, so as to test their relative importance in the face of other factors at work, such as the ravages of war, the expulsion of Jews, the nationalization of banks, and the collapse of international trade and investment. Possibly the dominant position of U.S. investment banks today is simply the result of their location in the United States rather than in Europe!

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