

Morgan Stanley's Return on System Noninvestment CASE STUDY

Morgan Stanley is a global financial services firm with more than 600 offices in 30 countries and over 53,000 employees. It was founded in 1935 and is headquartered in New York City. The firm operates in four segments: Institutional Securities, Asset Management, Retail Brokerage, and Discover (which provides Discover Card services.) The firm acquired the Discover Card business as a result of its merger with retail brokerage Dean Witter Discover and Co. in 1997.

The unification of Morgan Stanley and Dean Witter created a digital, cultural, and philosophical divide, which was extremely difficult to overcome. One of the business sectors to suffer the most under this arrangement has been Retail Brokerage, which manages \$616 billion in client assets. Retail Brokerage provides comprehensive brokerage, investment, and financial services to individual investors globally, with 9,526 worldwide representatives in more than 500 retail locations, including 485 in the United States.

Despite the merger, the Retail Brokerage group was never accepted as an equal partner by the rest of Morgan Stanley. Former Dean Witter employees have claimed they felt like disrespected outsiders after the merger. The feeling persisted and many retail brokers viewed their job security as tenuous at best.

Moreover, Retail Brokerage was not well-integrated with the rest of the company. It ran on a different systems platform than the institutional brokerage side, and its employee systems were not integrated. Retail Brokerage systems were also much more antiquated than those at other parts of the company. Brokers had to visit their offices on weekends to print portfolio summaries in advance of client meetings, because the outdated computer systems could not handle the task during normal business hours. Even on those off-hours, desktop PCs, which hadn't been upgraded in years, would often crash and printers clogged if they were being used by more than two people. Brokers did their work without benefit of an application that provided both real-time stock quotes and transaction histories. Some of the firm's technology problems couldn't be hidden from clients, who routinely complained about the customer Web site and sparsely detailed year-end tax reports they received.

Top brokers started to leave, taking with them the portfolios of numerous important clients. Profits specifically from Retail Brokerage dropped precipitously and margins lagged behind those of comparable brokerage firms. During this time, nearly 1,500 brokers left the company. Bill Doyle, an analyst with Forrester Research Inc., pointed out that the business was ailing partially as a result of a lack of investment in technology.

When the stock market crashed in 2001, CEO Philip Purcell believed that the market's comeback would happen slowly. He therefore focused his business strategy on maximizing profits instead of generating revenue. The implementation of this strategy involved cutting costs. Each of Morgan Stanley's divisions received less funding for their operations, jobs were eliminated, and investing in technology was obviously a low priority. Purcell, of course, had miscalculated. The market rebounded within a few years, and Morgan Stanley was not positioned to compete in retail. While his firm was watching its margins, Merrill Lynch was spending \$1 billion on new systems for its brokers. The turmoil in the inner sanctum of Morgan Stanley's leadership also contributed to the company's woes.

Purcell locked horns with investors, executives, and former executives over a number of issues, one of which was selling the underperforming Discover credit card division. Some investors even wanted Purcell to spin off the entire Dean Witter part of the company. In March 2005, eight former executives appealed to Morgan Stanley's board of directors to remove Purcell as CEO for his mismanagement of Discover and Retail Brokerage. The board determined that the best interest of the firm was served by keeping Purcell and divesting itself of its struggling divisions. The board also approved Purcell's appointments of two executives who were considered loyal to him and to the board.

Protesting Purcell's leadership, two leading executives in the investment banking division resigned. More departures followed. Purcell's critics now had even more ammunition with which to bring him down: in addition to mismanaging the struggling areas of the business, his actions had threatened the performance of the firm's strength, investment banking. Purcell finally resigned in June 2005, unable to shake the claims that his solutions to

problems were lightweight rather than dramatic and far-reaching, and that his decisions were based on protecting his job rather than improving the firm. He was succeeded by John Mack, a former Morgan Stanley president who had left the company in 2001 as a result of a power struggle with Purcell.

With new leadership in place, Morgan Stanley has finally begun to address the issue of technology in its Retail Brokerage division, which has been renamed the Global Wealth Management Group. In October 2005, the firm hired Eileen Murray as its head of Global Operations and Technology. She works directly under Chief Executive John Mack, with whom she has a strong professional history. Murray has committed to boosting Morgan Stanley's investment in technology for retail, saying, "We expect to make substantial improvements" that "will ultimately help our financial advisors better serve our clients, while also helping our clients better manage their relationship with us." As proof, the technology and operations budget for the Global Wealth Management Group for 2006 exceeded \$500 million. Mack also brought in a new boss for the group. It is now under the leadership of James Gorman, who performed a successful parallel makeover at Merrill Lynch's brokerage division.

Mack has been under some pressure to sell the retail division, a choice he has been reluctant to make. He subscribes to the view that ownership of a retail brokerage business is an investment in the firm because, in addition to providing revenue from individual investors, it gives Morgan Stanley a direct channel for selling its own investment banking products. Mack's goal is to increase the profit margin of the Global Wealth Management Group retail brokerage, which ranges from 11 percent to 20 percent, which would make it as profitable as rivals' businesses.

Mack has stated both publicly and privately that some of Morgan Stanley's businesses had not received the technology they needed, and he intends to make the necessary investments. In the firm's 2005 annual report, Mack said, "We are committed to addressing underinvestment," and "We're going to upgrade our technology platforms and provide our financial advisors and investment representatives with a tool kit that is as competitive as that of our leading peers."

Some of the overwhelmed broker desktop workstations have been replaced. The new systems are better integrated with backend systems so that brokers have a better view of client portfolios.

The company plans further improvements in this area so that brokers will have access to all relevant client data at once, including transaction history, contact history, and portfolio performance. Consolidating all of these features will require several years of work. The company also rolled out a new tax-reporting application that automatically reconciles gains and losses and allows users to download information from its client Web site into popular tax programs. Before that time, customers had to wade through a confusing maze of figures to add up gains and losses on their year-end tax reports.

In response to customer demands, Morgan Stanley scheduled an upgrade of its Web site for May 2006, which analyst Doyle described as a particularly weak area for the firm. The services available online to Morgan Stanley customers dated back to pre-2000 technology. Doyle sees the Web presence as a major challenge because Morgan Stanley has been focusing more on its wealthiest clients than on the rank-and-file small investors. The firm had previously assumed that these top clients weren't interested in online services because they get the direct attention of brokers (whereas investors with portfolios under \$100,000 must deal with call centers). Research by Forrester has shown the opposite to be true: wealthy customers actually want more hands-on control of their portfolios, and therefore want more tools and services available online. These customers prefer to approach their brokers with their own ideas. Gorman, as head of retail brokerage, must not lose sight of the significance that online technology holds for his division.

Mack and Gorman must also take measures to repair the schism that developed after the merger with Dean Witter. Mack has been addressing the issue of a "one-firm culture." The firm is trying to stem the loss of productive brokers. Increasing salaries and expense accounts are not enough. The top brokers still feel they can fulfill their earning potential better and hold jobs longer at other firms. It's not just that their print queue gets jammed; it's that they question how much the company values them if it's not willing to support them in such a way that they can best perform their jobs.

By the spring of 2006, signs of progress were evident. In June 2006, Morgan Stanley generated second-quarter net income of \$1.96 billion. The retail brokerage division posted \$157 million in pretax profit, the largest profit since the first quarter of 2005.

Sources: Edward Cone, "Morgan Stanley: Trading Sideways," "Return on Noninvestment," and "Follow the Money," *CIO Insight*, April 4, 2006; "Morgan Stanley's Mack Attack," *Business Week*, June 22, 2006; George Stein and Gregory Cresci, "Morgan Stanley Soars as Mack Delivers in 2nd Quarter (Update2)," *Bloomberg.com*, June 21, 2006; and www.morganstanley.com, accessed June 21, 2006.

CASE STUDY QUESTIONS

1. Why did Morgan Stanley underinvest in information technology?
2. Why was the merger with Dean Witter disruptive for the company?
3. Why was Dean Witter and Retail Brokerage a good place to increase spending on information systems? (Review the six strategic objectives of information systems discussed in section 1.1.)
4. If you were James Gorman, the new head of Global Wealth Management Group, what information systems would you invest in? Why? Do you think Morgan Stanley's plans for an integrated client information system are worthwhile? [Hint: Think of the services you would like to receive from your banker or stock broker.]
5. Aside from new systems, what changes in management and organization are required to restore revenue and profit growth at the Global Wealth Management Group?