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**Morgan Stanley's Mack Attack**

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Amid the endless applause from hundreds of traders, bankers, and research analysts, one of Wall Street's fiercest warriors was becoming teary-eyed. The day was June 30, 2005. The place was Morgan Stanley's Manhattan headquarters, where John J. Mack had abruptly said goodbye to his colleagues four years earlier. The occasion was Mack's return to become CEO, replacing Philip J. Purcell, who had resigned weeks earlier after mounting criticism that he was mismanaging the famed investment bank, which once rivaled Goldman Sachs & Co. for supremacy on Wall Street.

As the ovation died down and a hush fell over the room, Mack spoke of his dreams for Morgan Stanley, a firm he had worked to build into a Wall Street powerhouse since joining in 1972 as a bond salesman. As president, he helped orchestrate the $10 billion merger in 1997 with Purcell's retail brokerage giant, Dean Witter Discover & Co. Mack was so convinced the deal would reshape Wall Street that he stepped aside to let Purcell run the financial behemoth. When it became clear that he had no shot at taking over, Mack bolted in 2001 and quickly landed a job running rival Credit Suisse First Boston.

The June meeting signified that Mack was home—and in charge. "We want to be the leader and show the Street what we stand for," he told the crowd, including his wife, Christy, who had encouraged him to return. "[Morgan Stanley] is the gold standard."

SHRINKING VIOLET. In that single moment, Mack restored much of the swagger Morgan Stanley had lost since the Dean Witter deal. But there was still plenty of work to be done—more than Mack imagined. In a speech to investors shortly after his arrival, Mack said the firm's main problem wasn't its strategy or its business mix, as was widely believed, but its culture. It had become soft and timid, missing out on growth opportunities in everything from private equity to mortgages, junk bonds to equity derivatives.

As one executive recently put it, the bank had become so risk-averse and mired in second-guessing that every time someone brought up a new idea for a business it was shot down by a "culture of no." While rivals such as Goldman, Merrill Lynch, and Lehman Brothers were making acquisitions and diving into risky but profitable endeavors, senior managers at Morgan Stanley were sending people with bold notions back to the drawing board. The cautiousness cascaded down from the top. Purcell was so worried about potential liability, says someone who worked with him, that he didn't even use e-mail. (Purcell declined to comment for this story.)

Today, Mack, 61, is taking a cudgel to that way of thinking as he embarks on a radical shakeup of Morgan Stanley. Whereas Purcell was a top-down strategist and tended to hole up in his office, rarely socializing with the troops or making calls on clients, Mack is drawing on his skills as a salesman and operator to make Morgan Stanley as nimble and dynamic as possible.

ADDED MUSCLE. He's doing much more than glad-handing, though: He's building out new businesses and putting vast sums of money at risk, both for the bank and on behalf of its clients, in an effort to catch up with Goldman in the ever-more-important trading business. And he's beefing up international operations, regularly traveling to Europe and Asia and beating Goldman to new markets such as Dubai. He's also making symbolic moves, such as returning top brass to the 40th floor, their home before the merger.

Mack's war is taking place on two fronts: internally, against inertia; and externally, against a superior rival that used to be a peer. "If you go back to the mid-'90s, there was no question that we were the No.1 firm," says Mack, who has promised investors that he will double the company's pretax earnings, to at least $14 billion, by 2010. "This is not rocket science."

To win the war, Mack is purging the ranks, replacing most board members and the people running the bank's divisions. He has reassigned staff to expand the asset management business and redrawn the organizational chart for the retail brokerage. "I think what he's trying to do is build a team based not on the John Mack who was there 10 years ago but on the John Mack who's here today," says General Electric (GE) CEO Jeffrey R. Immelt, who considers Mack a friend.

STILL TRAILING. The question is whether Mack's offensive will boost the stock to shareholders' satisfaction. So far the news has been mixed. The stock is up 14% during Mack's tenure but has underperformed the Standard & Poor's Investment Banking & Brokerage index by 14 percentage points and rival Goldman by 32 points. Year to date, however, the gap has narrowed.

And on June 21 there was further evidence of momentum: Morgan Stanley reported second-quarter earnings per share of $1.86, more than double the figure of a year ago and far better than analysts' consensus estimates of $1.45, according to Thomson Financial. More important, the bank improved its results from the first quarter, whereas Goldman and Lehman turned in weaker second quarter performances. Investors sent Morgan Stanley's stock up nearly 5% on the news, and respected analyst Michael Mayo at Prudential Financial Inc. upgraded the company to "overweight" from "neutral."

Even the troubled retail brokerage and asset management businesses appeared to be on the mend, with the retail brokerage business achieving its highest net revenues since the first quarter of 2001. The results stood in stark contrast to the calls from people inside and outside the firm that Mack should dump those businesses and admit the merger was a failed attempt to marry what they consider a Rolls-Royce (Morgan Stanley) with a Chevy (Dean Witter Discover).

DEFECTIONS. Mack insists there could be a big upside for the stock if the retail brokerage business, which now has an 11% profit margin, becomes as profitable as rivals' businesses, which have 20% margins. Asset management, he says, could take off once it starts offering more private-equity and hedge fund investments, as Goldman does.

To be sure, Morgan Stanley still has a long way to go before it can claim it's the top dog on the Street. Senior managers who are paid largely in stock might decide the anticipated boost to the share price isn't worth waiting for. "There are people who are disappointed that it's not happy days yet," says one close observer.

Former Vice-Chairman Joseph R. Perella, now of Perella Weinberg Partners, is capitalizing on the uncertainty. He already has hired three senior bankers known for their close ties to European clients, including Paulo Pereira, the head of European mergers and acquisitions.

SUDDEN SWITCH. Some analysts, meanwhile, wonder whether Morgan Stanley is equipped to ramp up the risky trading business so aggressively. "You can't just throw a switch and make it happen," says Merrill Lynch financial-services analyst Guy Moszkowski. And there are worries that Mack's embrace of risk might drive clients away. His approach "is going to make [Morgan Stanley] a very different kind of firm," says one former executive. The fear: that some clients will turn to boutique investment banks such as Perella Weinberg for objective advice, free from potential conflicts of interest with the trading desk.

INTUITION AND SPEED. Yet for all the consternation, there's no doubt that Mack is making Morgan Stanley gutsier. In the past 12 months it has soared from nowhere to become one of the top investment banks financing private-equity deals, business once avoided as too risky. Morgan Stanley was one of three leading advisers on Kohlberg Kravis Roberts & Co.'s $5 billion public offering on the Euronext exchange in Amsterdam in May. "They're changing," says kkr's Henry Kravis. "They're doing some financings for us that are very innovative." Morgan Stanley will "be able to establish forward momentum on a number of fronts they didn't have before John got there," says Stephen A. Schwarzman, CEO of the Blackstone Group.

Decisions are also being made more speedily. "I can lob a phone call in and say 'this needs board approval,' and three days later we're in place to get something done," says Neal Shear, co-head of institutional sales and trading. That's different from 2004, when Shear proposed to senior managers that Morgan Stanley bid for the petroleum products distributor TransMontaigne Inc. to bulk up its commodities-trading business. Nothing happened.

When Shear brought the idea to Mack in March, he "intuitively understood what we were talking about," says Shear, and in little more than a week, Morgan Stanley made an offer. (On June 19 its $567 million offer was tentatively accepted.) Rair Simonyan, chairman of Morgan Stanley in Moscow, has had a similar experience. "It's just a call or an e-mail, and I can reach whoever I need," he says.

SHRINKING VIOLET. More than anything, there's a new openness at Morgan Stanley. By many accounts, Purcell limited the exposure of his executives to the board. Mack insists his entire management team attend meetings and socialize with members. "John has gone out of his way to make sure the board has exposure to a wide variety of people," says C. Robert Kidder, a principal at private-equity firm Stonehenge Partners Inc., who has been on the board for many years.

Slowly but surely many of last year's critics are being converted. In June one of the firm's top brass in capital markets, Jon Anda, returned to Morgan Stanley five months after leaving for Perella Weinberg. Even Moszkowski, who has a "neutral" rating on the stock, acknowledges that Morgan Stanley is becoming more competitive. "Whenever a top franchise player reenergizes itself, it's going to be felt," Moszkowski says.

A lot is riding on Mack's turnaround strategy. If he fails to boost the stock, Morgan Stanley could end up as one of the hunted instead of being a hunter. Some speculate that JPMorgan Chase & Co. could try to reunite the House of Morgan by buying Morgan Stanley.

For Mack to succeed, he must rekindle bankers' killer instincts. When clients tell him they haven't heard from his bankers, he blows up. "That kind of stuff drives me crazy," he says. Recently he delivered a vivid pep talk, telling bankers to get mad. "It should bother us when we lose business," he said. "We can't lose a piece of business and [then] make excuses. We should be angry about it and think about how we're going to get [it] back."

HEY, SPORTS FANS. But the fiery leader is also warm and engaging. He lavishes attention on employees at events ranging from strategy breakfasts to dinners with their spouses at the Morgan Library & Museum. He introduces himself to anyone he doesn't know when he rides the elevators and walks the floors. During a stroll in January, he overheard a group of traders discussing whether his alma mater, Duke University, could beat the University of Maryland in a basketball game. He bet on Duke; the traders owe him dinner.

Mack's passion has served him well on his unlikely Wall Street odyssey. The sixth son of Lebanese immigrants whose father ran a grocery store in Mooresville, N.C., Mack's first job in finance was as a clerk at a small brokerage during his junior year at Duke, after a cracked vertebra made it impossible for him to continue on his football scholarship. Mack rose through Morgan Stanley's ranks to become president in 1993. He earned the nickname Mack the Knife for his cost-cutting prowess while managing the fixed income division, and he lived up to his billing at CSFB, where he cut 10,000 jobs and returned the bank to profitability. (CSFB's board didn't renew Mack's contract in 2004 after a dispute over the firm's direction.)

Even before coming back to Morgan Stanley, Mack sensed his job might be complicated. For weeks people hoped the board would bring him in to make peace with the senior executives who had fled in what some called Purcell's "Monday Night Massacre". But on the day his new job was announced, Mack told the troops that while he planned to reach out to the people who left, he would rehire them only on his terms.

"We don't want individual agendas," he said, but rather "team players" who believe in "one firm." Those who left still resented Zoe Cruz, then acting president, for backing Purcell and refused to work with her. Mack didn't budge. "I'm not going to let anyone put a gun to my head and tell me they'll come back only if I shoot someone they don't want to work with," Mack says. (Cruz declined to comment.)

ONLY ON HIS TERMS. In some cases, Mack realized, only outsiders could help. Case in point: He badly needed someone to fix the firm's retail brokerage business. On Day Two of his tenure he called James Gorman at Merrill Lynch. Gorman, who had led Merrill's retail brokerage business for years, had just been moved to a more general strategy position. Mack started sweet-talking him. Lure No.1: a chance to return Morgan Stanley to its former glory. Lure No.2: Gorman would have free rein. The only catch was that he couldn't start work until February, when his Merrill contract expired. Mack agreed, and he primed the pump by laying off 10% of the firm's least productive brokers before Gorman got there.

At the same time Mack was wooing Gorman, he was commissioning Chief Financial Officer David H. Sidwell to draw up a list of everything that needed to be decided on. Within two months, Mack had reversed the spin-off of the Discover credit-card unit, announced plans to sell Morgan Stanley's aircraft-leasing business, and persuaded three new directors and some executives he had taken with him to csfb five years earlier to return, while accepting resignations from other top managers and directors.

"BITCH SESSION." After that flurry of decisions, Mack tried to take a break to clear his head but cut it short when bankers said they needed him in Beijing. Mack darted there to have dinner with senior managers working on the initial public offering of China Construction Bank Corp. The following day he met with five clients. It was the first of many trips; in October alone, he traveled to Europe, Asia, and Russia. His message was simple: He was taking the firm "off autopilot," as he told one group of employees in Tokyo.

Back at home, though, Mack was getting frustrated. He had asked all the division heads to size up their performance vs. competitors. He had no idea how many gaps there were, or how big. When he asked about the firm's business with private-equity firms, the Street's biggest-paying clients, he was told that Morgan Stanley didn't cover them much because they required junk-bond financing and commitments of capital from the firm's own balance sheet, things Morgan Stanley simply wouldn't do.

Tensions exploded at a meeting of senior managers in suburban Westchester County, N.Y., in October. Mack wanted to discuss how the firm would achieve its goals. Instead he got a flood of complaints pent up over seven months of upheaval. "It was a bitch session," says one senior executive. Mack let staffers go on and on about all the opportunities they had missed in recent years.

"THINK LIKE OWNERS". It was becoming a familiar theme. A couple of weeks before, in Japan, a client had told him that he had once approached Morgan Stanley about a deal in 2003 and never heard back. Mack called Cruz for an explanation. "She said: 'John, we analyzed it and we analyzed it. We just never made a decision.' She called it 'analysis paralysis,'" Mack recalls. And in December, when he signed off on Discover's purchase of a British credit-card company called Goldfish Financial Services for $1.8 billion, he learned the idea had been in the works for years. Even the firm's stock ticker hadn't been changed to reflect that the bank had switched its name to Morgan Stanley—from Morgan Stanley Dean Witter—years earlier.

Mack realized he needed people to be entrepreneurial, the way they were when the company was a private partnership. "Think like owners" became his mantra. Mack wanted bankers to seize opportunities, not miss them, and for heaven's sake not be afraid to present them to senior executives. He even took top managers to General Electric Co.'s training facility in Crotonville, N.Y., in January for a session on leadership. Afterward they met with Jeff Immelt and team and picked their brains.

Mack also tried to lead by example. Around the same time he told investors that Morgan Stanley was going to pursue acquisitions to boost revenues, he opened talks with the hedge fund FrontPoint Partners and, later, asset manager BlackRock Inc. about combining forces. In both cases, the companies asked for more than Mack was willing to pay. (In February, Merrill Lynch merged its $539 billion asset management business into BlackRock for a 49.8% stake in the company.)

FRESH OFFERINGS. By the spring, Mack was starting to see signs of progress. Gorman was making real strides in overhauling the retail brokerage business. Gorman had set about laying off 700 more people and redesigning everything from customer statements to the way brokers are trained. He created a special team to focus on finding more investment products from inside and outside Morgan Stanley that would attract wealthy investors. He expanded the company's retail banking services and small-business lending programs. And he started devising a way for bankers to easily send clients to the firm's financial advisers, and for advisers to send bankers potential deals.

The asset management business was also showing signs of life. Instead of managing the division for profits and cutting costs, Mack wanted its new head, Owen D. Thomas, to expand it, especially its private equity and hedge-fund offerings. Thomas started encouraging employees to come up with new ideas. He brought over the head of the firm's prime brokerage business catering to hedge funds to help him brainstorm about potential investments in hedge funds and teams he might be able to woo to Morgan Stanley. In the second quarter the division launched nine new funds. Thomas also brought in some teams of hedge-fund managers and purchased a Boston fund.

When asked recently about the most discouraging moment of his first year, Mack said it was the death in April of Peter F. Karches, once the head of institutional securities and one of Mack's closest friends at Morgan Stanley. He held a meeting at which he shared with thousands of staff members Karches' philosophy that making a wrong decision is "unfortunate" but that not making a decision is "unforgivable."

It's a lesson Mack has taken to heart as he races to make a nine-year-old merger work. "I say to Christy that I feel like I'm in my 30s, but I know I'm 61," he says. "I can't do this forever. And she says: ‘John, are you nuts? It's what you love.'" Mack concedes her point. "I like the action. I like the people. I like the business." But, he adds: "It's a lot of work."

Q1. Based on the information in this case study, describe the competencies that seem strongest in John Mack.

Q2. To what extent has John Mack exhibited transformational leadership behaviors to shift Morgan Stanley’s culture and decision making?