# Book The Partnership

## The Making of Goldman Sachs

Charles D. Ellis
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## Recommendation

Every great company invariably encounters crises that can cripple its growth or propel it to greatness. Goldman Sachs, the biggest name in investment banking, has survived, though other titans, such as Bear Stearns, have fallen. However, Goldman Sachs became a traditional bank holding company amid 2008's tumult on Wall Street and is no longer an investment bank. Charles D. Ellis, a strategic consultant to Goldman Sachs and other financial firms for more than 30 years, has written an exhaustive company history. He analyzes the firm's numerous triumphs and notable missteps. He shines a spotlight on the powerful personalities who shaped the firm's development over 140 years, including several men who went on to play major roles in the U.S. government. This detailed portrayal of pivotal individuals includes revealing anecdotes, and provides insight into the formation of Goldman Sachs's unique culture and philosophy. At more than 700 pages, including extensive notes, the book requires a serious commitment, but *BooksInShort* believes this absorbing history will reward you amply for your time.

## Take-Aways

- Marcus Goldman started out in 1870 selling promissory notes. In 1882, he brought his son-in-law, Samuel Sachs, into his business, and named it M. Goldman and Sachs.
- Marcus's son Henry severed ties with the firm over his pro-German stance in WWI.
- Few members of the Goldman and Sachs families are on speaking terms today.
- The ill-fated Goldman Sachs Trading Corporation cost the firm $12 million when it collapsed during the Depression.
- Penn Central Railroad's bankruptcy in 1970 could have destroyed Goldman Sachs.
- Goldman Sachs is known for its history of strong leaders, including Sidney Weinberg, Gus Levy, John Whitehead and John Weinberg.
- Recent leaders have included Robert Rubin, Henry Paulson and Lloyd Blankfein.
- The firm places a premium on recruiting and retaining top talent. It conducts extensive interviews, pays well, trains well and fosters a workaholic culture.
- The firm's strict ethics are governed by the "Principles," a code of its core values.
- Making money has always been the primary objective at Goldman Sachs.

## Summary

### The Founder

Marcus Goldman came to the U.S. from Bavaria at 27 years old in 1848 "as part of the first major Jewish immigration to America." He purchased "paper" (mercantile promissory notes) from stores and sold it to commercial banks. In 1882, with annual profits around $50,000, Goldman made his son-in-law, Samuel Sachs, a junior partner, and renamed the firm M. Goldman and Sachs. Marcus's son, Henry, and Samuel's son, Walter, succeeded the firm's leaders.

> "The financial colossus got its start as the inconspicuous business of a single immigrant with no staff and almost no capital."

"By the 1890s, Goldman Sachs was already the nation's largest dealer in commercial paper, with $67 million in sales in 1894." The firm entered the investment banking business, and underwrote both United Cigar and the fledgling Sears Roebuck. Goldman Sachs developed a mutually beneficial relationship with Lehman Brothers, which had money to invest and benefited from Goldman Sachs's ability to provide clients.

> "Redefining a business and reinventing the firm – often very substantially changing itself and its way of doing business – are themes in the extraordinary growth and expansion of Goldman Sachs."

World War I marked the end of the relationship between Walter Sachs's son, Samuel, and Henry Goldman, who shockingly supported Germany despite his family's efforts to convince him to tone down his public pronouncements. America entered the war in 1917, and Goldman abruptly ended his 35-year tenure "the day the firm began selling Liberty Bonds for the U.S. government." Goldman's resignation hurt the firm because he withdrew his capital and created a rift that still exists. "To this day, there are hardly any Goldmans who are on speaking terms with any Sachses." Goldman's departure also ended the firm's lucrative partnership with Lehman Brothers.

> "Goldman Sachs was fighting for its life all through the Depression and World War II."

In 1927, Sidney Weinberg was named partner, though he came from outside the two founding families. Goldman Sachs also brought in a new senior partner in charge of underwriting, Waddill Catchings, a good-looking, charismatic Wall Street attorney. Hungry and overconfident, he engineered meteoric growth for the firm by creating the Goldman Sachs Trading Corporation, an investment trust that purchased major interests in other companies. At its peak, it "controlled $500 million in investments," but it leveraged the funds heavily. In the summer of 1929, the American Trust Company of San Francisco – Goldman Sachs's largest holding – failed to pay dividends, setting the stage for one of the century's biggest financial disasters. When the market crashed that October, Goldman Sachs Trading shares plummeted from $326 to $1.75. In the end, the failed trust cost Goldman Sachs about $12 million, leaving Sidney Weinberg with the formidable task of restoring the firm's financial stability and good name.

## Sidney Weinberg Makes His Mark

Born and raised in Brooklyn, Weinberg was street-smart, bright, instinctive and playful. Small in stature, but a giant in business acumen, he had a head for numbers and an ability to read people quickly. He insisted on integrity, honesty and ethical behavior. He emphasized customer service and tried to ensure that every employee understood the firm's philosophy. Weinberg had a legendary ability to get along with others. He made friends in high places and laid the foundation for Goldman Sachs's growth from the 1930s through the 1950s. His determination and shrewd business sense paid off in 1956. After he led months of secret negotiations with the Ford Motor Company, Weinberg engineered the then-largest IPO in history – 10.2 million shares worth some $700 million. Although Weinberg was vastly underpaid, getting only $250,000 for his efforts, the Ford deal moved the firm into the upper echelons of underwriters (later in his career, Weinberg billed Wall Street's first $1million merger-and-acquisition fee). Ford remained Goldman Sachs's highest profile client for 50 years and helped keep it prominent. On the heels of his Ford deal, Weinberg completed a record $350 million bond issue for Sears Roebuck and a $300 million bond issue for General Electric.

> "By the 1960s, Goldman Sachs was already well along in developing one of its decisive competitive strengths – selling securities more effectively than the rest."

A strong, powerful leader with a quick wit and a charming sense of humor, Weinberg excelled at cultivating relationships. He interacted with many influential people, particularly CEOs of Goldman Sachs's client corporations. Though Weinberg had little interest in the firm's daily operational structure, he insisted on recruiting only top-notch talent. Looking for a worthy successor, Weinberg eventually brought in Gus Levy, who would oversee three decades of impressive growth. Weinberg liked to hire M.B.A.s right out of Harvard. In 1947, John Whitehead, who admittedly knew little about Goldman Sachs, joined the investment banking division.

## Gus Levy: Tireless Worker

Levy, who joined the firm in 1933, became chairman of the New York Stock Exchange and an influential member of the Republican Party. A notoriously hard worker with a brilliant mathematical mind, he spearheaded Goldman Sachs's entry into the "block-trading business." Under Weinberg, the firm had built its reputation on investment banking. But Levy, a gambler at heart, recognized its potential to orchestrate large stock trades and widen its client base. Weinberg eventually made Levy managing partner, but he also created a management committee that would prevent Levy from turning Goldman Sachs into a "trading firm."

> "When new recruits get to Goldman Sachs, their indoctrination into the firm's culture and principles begins immediately and is seen by everyone as a high priority."

Levy was tough. He had little tolerance for meetings and small talk. He particularly disliked long discussions, preferring to render quick, on-the-spot decisions. He was all business. Levy rarely complimented employees, and he put a lot of pressure on himself and his workforce. Despite his gruff nature, Levy was loyal to his employees and never refused to help anyone in trouble. He was the consummate multitasker. His workday began at 7 a.m. and he returned phone calls until midnight. Levy's work ethic became the model for staffers. Everyone began arriving at 7 a.m. Employees took pride in being different from their colleagues in other firms. Like Levy, they were driven to succeed. Levy's thirst for activity was unquenchable. He served as an outside director at many corporations and committed countless hours to nonprofits. He gave millions to charity.

## Levy Averts Total Disaster

Perhaps the most challenging event in Levy's career occurred in 1970 when Penn Central, the nation's largest railroad and a key Goldman Sachs client, declared bankruptcy. The firm faced astronomical losses as the value of Penn Central's commercial paper plummeted, spurring some 40 investors to sue the firm for about $87 million – many millions more than it could repay. Goldman Sachs was facing disaster. Several clients rejected its offer to settle for 50 cents on the dollar, paving the way for legal battles. Plaintiffs claimed that Goldman Sachs did not perform due diligence in assessing Penn Central's real value. A Securities and Exchange Commission (SEC) report claimed that Goldman Sachs failed to inform investors of Penn Central's worsening finances. The firm agreed to a SEC consent decree that regulated its future dealings in commercial paper. Goldman Sachs lost around $30 million in this debacle and endured mounds of negative publicity. But it regrouped and restored its reputation.

## Clients Always Come First

Goldman Sachs has always prided itself on client service, a tradition that took root in the '50s under sales manager Ray Young, whom everyone admired and respected. Young, a straight shooter, was loyal to his people and received loyalty in return. They rarely challenged his decisions. Goldman Sachs paid its salespeople exceptionally well and fostered teamwork by creating a system in which everyone shared commissions. Prospective hires had to endure multiple interviews and demonstrate their ambition.

> "Great and enduring organizational change at a firm like Goldman Sachs does not always come in the form of dramatic events, but rather in the steady no-waves and no-nonsense pursuit of central beliefs."

In the '70s, Goldman Sachs instituted an intensive, Friday evening training program for securities salespeople. The sessions typically ran late – another way to test employee commitment. The trainers required the salespeople to make mock presentations to bosses who were playing the roles of customers. They would then sharply criticize the trainees' sales pitches. Such a commitment to excellence enabled Goldman Sachs to emerge as the top broker for many large corporations that prospered under its skilled guidance.

## A Change in Strategy

Change never comes easily, particularly in the ultraconservative banking industry. Until Goldman Sachs revolutionized the business, investment banking firms rarely pursued business. The strong relationship between an investment firm and its clients would continue for years as both parties prospered. In the mid-'50s, with Weinberg's blessing, John Whitehead conducted a study that recommended that Goldman Sachs alter its strategy and structure. Whitehead believed the firm should divide its workforce into those who solicit business and "manage relationships," and those who focus on transactions. Powerful individuals, including Weinberg, found the idea repellant. Weinberg personally attended to his customers' every need. Although the partners never formally voted on the proposal, Whitehead proceeded. He created the firm's new Investment Banking Services unit, gave his salespeople more products to offer and expanded his sales force.

> "The firm's strategic objective is to be recognized widely as the world's best solutions provider."

The company's leaders refined the plan over the years. Between 1979 and 1984, Goldman Sachs added 500 new clients, forcing its competitors to acknowledge this new way of doing business. Whitehead's ability to organize and execute while rewarding his employees' achievements made Goldman Sachs virtually untouchable. Whitehead and John Weinberg (Sidney's son) ran the firm after Levy died of a stroke in 1976 at age 66. Whitehead's distinguished 38-year career with Goldman Sachs ended in 1985 when he became U.S. deputy secretary of state under George Shultz during the Reagan administration.

### Follow Your Principles

One of Whitehead's most significant contributions to Goldman Sachs included his compilation of the "Principles" in the late-'70s. This list of ethics underscored the firm's philosophy and practices. Whitehead wanted to codify the firm's "core values" so it could pass them along to its rapidly expanding workforce and preserve them for the future. The code is still highlighted in every annual report. It says the firm should:

- Emphasize customer service and satisfy every client. No effort is too great.
- Commit to professional excellence, hard work and maximum effort.
- Prioritize teamwork in achieving objectives.
- Employ only the most talented people. To be the best, recruit and hire the best.
- Adhere to the highest ethical and moral standards, personally and professionally.
- Strive to increase business while respecting the competition and treating everyone fairly.

> "Despite major changes in the firm's size, organizational structure and business, the 'Principles,' with minor changes for political correctness over the years, have endured."

Whitehead didn't write down every principle. For instance, every employee knew that Goldman Sachs's first objective was to make money, that everyone was supposed to keep costs to a minimum and that open communication was vital to success. Most significantly, every employee recognized the importance of personal responsibility.

### A Potent Combination

Instead of fighting about who would succeed Levy as senior partner, Whitehead and Weinberg refused to engage in a power struggle. Although the "two Johns" had different personalities, they ran Goldman Sachs together. They shared similar ideas and strategies for the firm. One of their best calls was deciding not to lease space on the top floors of the World Trade Center, which was destroyed on September 11, 2001.

> "Making money – always and no exceptions – was a principle of Goldman Sachs. Nothing was ever done for prestige. In fact, the prestige clients were often charged the most."

Whitehead was largely responsible for establishing the firm's tradition of hiring only the best people, a practice that elevates Goldman Sachs. It recruits top M.B.A.s and subjects each one to many intensive interviews in a quest for potential leaders with ambition, commitment and a willingness to be part of a team. Retention is a priority.

### Goldman Sachs Generates U.S. Leaders

Former CEOs Henry Paulson and Robert Rubin, who both served as U.S. Treasury Secretary, are among the Goldman Sachs alumni who have occupied influential government positions elsewhere. Paulson – bright, disciplined, serious – oversaw the firm's IPO in 1999. He also stubbornly opposed consensus opinion when he rejected a proposal to merge with J.P. Morgan.

> "Philanthropy and public service are more important to Goldman Sachs people – particularly its alumni – than to any comparable group."

Under current CEO Lloyd Blankfein, Goldman Sachs avoided the crippling losses suffered by its competitors during the 2007 subprime mortgage meltdown. In making the transition from an investment bank to a bank holding company in September 2008, Goldman Sachs maintained its profitability while positioning itself for the diverse challenges ahead.

## About the Author

**Charles D. Ellis**, a longtime Goldman Sachs strategy consultant, is the author of 14 books.