UBS Investment Banking - A Value Creating History?

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Executive Summary

The investment bank of UBS AG has constantly developed since it was founded at the Swiss Bank Corporation (SBC) in the year 1980. It became one of the leading institutes throughout Europe and the United States by acquiring several smaller and larger competitors. Since 2007, however, the Subprime Crisis completely redrew the (investment) banking business. In the course of the last two years, UBS's investment bank had to report write-downs and losses of over US$ 40 billion within this crisis; only three institutes in the United States reported a higher loss.
Due to this negative performance, the question arose, whether the history of the investment bank of UBS (and SBC respectively) was guided by value creation at the stock exchange. The focus of interest lied upon the events in which the active management announced expansions, as well as contractions of its business. Analysing the daily abnormal stock returns over the last 18 years, using an event study methodology, quantified the influences of the different announcements on the stock price. The goal of this analysis was to find whether there were any recurrent patterns among the reactions from the shareholders concerning expansions on the one hand and contractions on the other.

In order to find the relevant news announced by the investment bank, the first part of the research was a thorough search through various databases such as LexisNexis, which holds articles of the most important newspapers all over the world. For this thesis I concentrated on the articles provided by "The Times", "The Independent (London)" and "The New York Times", because the investment bank of UBS AG is based in London and furthermore has large operations in the United States. For this reason the chosen newspapers are close to the source. With the articles, a broad history of the development of the investment bank over a period starting on the 1st of January 1992 until the 30th of April 2009 was the result. In total 202 announcements were included in the dataset. In order to distinguish between the different types of statements, the events were classified as good (expansions), bad (contractions) and neutral (change of management).
In a second step of the preparatory work, the historical stock prices of SBC and UBS had to be downloaded from Thomson Datastream. In order to compare the stock returns to the market, a representative stock index had to be chosen. For my research I decided to use the World Datastream Banking Index, which represents the economic environment of SBC's and UBS's investment bank, by focusing on the international financial centres, very well.

The analysis itself was conducted using an event study methodology, which measured the effects of economic announcements on the value of firms. Based on the market model, prior to the event date one compares how the shares of the firm under observation react in comparison to the

chosen market index. In the course of an Ordinary Least Squares regression, the α (intersection) and the β (slope) are calculated for each event. With these market model parameters one then quantifies the abnormal return of every event. In order to verify, that the information content of the announcements is included in the abnormal returns, three different event windows were analysed. The largest event window included 21 trading days surrounding the event and the smallest one included three trading days. If efficient markets are assumed, the 3-day event window should already include all the information that was provided, in the stock price.
In a concluding step the abnormal returns of every event have to be cumulated over time, resulting in the Cumulative Abnormal Return (CAR). This was done for all the events, and on the other hand for every event category (good, bad and neutral). Finally, the results have to be compared to the standard normal distribution in order to verify if they are significantly different from zero.

Since the CARs in my analysis showed various patterns over the whole period under consideration, I looked at four sub-periods in order to conclude whether there was any observable difference in the results. The first sub-period ranged from 1992 to 1996 and thereby denoted the development prior to the merger between SBC and UBS. The other three sub-periods were divided into the phase after the merger, the years following the TMT-bubble and finally, the Subprime Crisis.

In the descriptive statistics part I found small evidence that in the years where the SBC/UBS stock prices outperformed the index, the count of the good news was higher as the one of the bad news. This observation was strongly bound to the general economic environment. When the markets were in an upswing, the majority of the news was in general classified as good. This makes sense in economical terms, because when the markets are going up, an investment bank is likely to get good revenues. Thereby, the generated profits can be used in order to expand the business. On the other hand, when the economy is a downturn, the investment bank is more likely to contract its business by making a part of its workforce redundant and by selling some of its niches which turned out to be non-profitable.

Prior to the merger with UBS, the investment bank under management of SBC expanded throughout the world by taking over several of its competitors in order to become one of the world's leading institutions by the end of the decade. Overall, these measures were followed by significantly positive CARs, concluding that the investors of the bank approved to these diversifying measures.
In the first development stage of the newly established UBS AG, however, the bank was drawn by the losses of their investment into the hedge fund Long Term Capital Management (LTCM) in 1998. Succeeding to this, rumours spread that Marcel Ospel reviewed the options of the

investment bank and that he wanted to sell it. In the year 2000, by acquiring Paine Webber, the management of UBS finally denied its intention to sell UBS Warburg. A bad economic environment, drawn by the TMT-bubble, however, influenced the outlook of this deal and thereby the reactions of the shareholders. The CAR for bad news within this sub-period was higher as the one for good news and thereby suggested that the shareholders of UBS were not in favour of an expanding investment bank, but rather for a sale of the business.

Prior to the Subprime Crisis the economy was in its greatest constant upswing of the whole period under consideration. In the course of this new environment UBS started to vigorously expand its investment banking business, by acquiring several niches from their competitors. An expansion into Brazil marked the peak of this development. To me, these expansions, however, were very much at random and did not seem to have any clear pattern. This was reflected in the CARs for good news, which were highly insignificant and thereby likely to be zero.

During the subprime crisis, consequences of the enormous losses had to be taken. Thousands of employees had to be made redundant and the investment bank was drastically restructured. These measures were followed by significantly positive CARs. From this one can conclude, that the investors were in favour of a contracting investment bank. Rather than announcing the intention of having one of the world's top investment banks, the active management of UBS talked of a right-sized institution which would be perfectly positioned along with the premier Wealth and Asset Management subsidiaries. This marked a development towards quality, rather than quantity as it was initiated between 2003 and 2006.

Overall, the development of the investment bank can be divided into two clear periods. With SBC, the investors seemed to be in favour of the goal of reaching a major position within investment banking on Wall Street. After the merger with UBS, however, this clear plan was hindered by losses and the following rumours of a sale. Therefore the development under management of the newly established UBS AG, never reached an equal acceptance as it did with SBC.

My analysis definitely clarifies the development of UBS's investment bank and its value creation. The discussed patterns show how the shareholders exactly reacted to the announcements during different phases.

The outcome, however, has to be put into perspective, since there are other, more precise methodologies of conducting event studies, such as the three-factor model developed by Fama and French.

Also, the assumption of efficient markets is in serious discussions at the moment. A future correction of the data according to the newly developed hypotheses could shed new light on my conclusions.