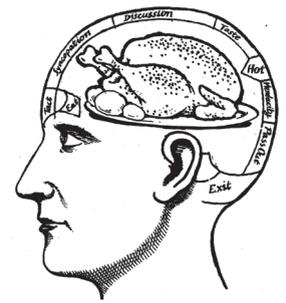


FOOD FOR THOUGHTS

by Andrew Capon

Brown Brothers Harriman

with managing partner Douglas Donahue



The most dangerous four words in investing are: "This time it's different". The most unwelcome words to a dedicated gastronome with licence to enjoy the world's finest eateries while interviewing the great and the good of the investment world are: "In-house dining".

And so it was that the misunderstandings that can result from two diaries divided by a common language, a time difference, tight deadlines and a surfeit of intermediaries (however well-meaning), turned my best-laid plans into sandwiches.

It would be churlish, however, to dwell on the how and why. Seeing Douglas ("Digger") Donahue again after more than a decade is a pleasure that surmounts even the most distressing of culinary circumstances.

As the managing partner of Brown Brothers Harriman & Co (BBH) he can lay claim to being *primus inter pares* at America's oldest and most storied private bank. It has a shared heritage with Alex Brown & Sons, long since subsumed into Deutsche Bank and the UK's Brown Shipley. But despite its considerable vintage, BBH is full of vim and vigour.



Douglas Donahue: 'BBH is too careful to fail'

In 2008, when that 158-year old upstart Lehman Brothers went to the wall, precipitating the worst financial crisis since the Great Depression, BBH posted record results. "The sign was a plus, not a minus," adds Donahue laconically as we chat in a meeting room at the bank's London HQ. As was true throughout the financial world, BBH spent that fraught time carefully weighing up counterparty exposures and where necessary unravelling them. But unlike most of its peers, it was also experiencing a reverse run.

With liquidity in safe haven assets disappearing, this was something of a headache, though Donahue admits it was also flattering.

"We spent a lot of time travelling, explaining the balance sheet, which wasn't hard because there was nothing to hide," he says. "All of the marketable securities we held throughout that period were being marked at a profit.

"My favourite memory was meeting with a large institution and it saying, 'We know you won't be bailed out and aren't too big to fail. What we like about you is that we think you are too careful to fail'."

If the financial crisis demonstrated the distinctive business strengths of BBH, Digger Donahue is the personification of the singular culture of the firm. He joined in 1976 and has never worked anywhere else. The firm's 41 partners and 57 managing directors have an average length of service of 22 years. The general partners of the firm are the owners. They put their capital on the line and share liability.

CEO? No, call me Dean

"When people ask me what it's like to be a CEO, I reply I have no idea," says Donahue. "Dean of faculty would be closer to the truth. There's one P&L. That encourages constant peer review and constant debate." Not that Donahue is a dewy-eyed romantic who believes the clock can be turned back to a time when partnerships were the dominant corporate structure of the financial world. That would result in a capital deficit, fettering the hyper-activity and wealth-creating potential of globalised, 21st century capitalism.

But operating profits of \$308m in 2010, more than half generated outside of the US, suggests the structure works for BBH.

"Our order of priority is clients, employees, owners," he says. When I look at competitors who have to in some cases worry about government first of all, if they have been bailed out, next shareholders and only then clients, it feels like a privilege. We get paid as owners when our employees deliver for our clients."

That is reflected in how the business has been run. While competitors have been slashing headcount, BBH has been hiring. "Reduction in force is one of those phrases that hides the truth," he says. "What it means is having fewer people to serve clients, generally at a time of stress when they need you most. We have a world class return-on-equity. But for me that is a long term measure of success. I don't have the pressure of shareholders or analysts banging on my door and telling me to hit this number or that every quarter."

There are, however, what Donahue calls, "positive constraints" to a general partnership. Traditional commercial banking is now a relatively small part of the business and there is next to zero tolerance for non-performing loans. In capital markets BBH is active in foreign exchange but mostly sticks to agency

trading, research and advisory. Its fund management and investor services businesses, with \$40bn and \$3tr in assets, respectively, similarly require little capital.

Having cruised through the financial crisis under a wet sail, Donahue is optimistic about BBH's future. He is less upbeat about the broader economy. He sees some positive signs in recent US labour and housing reports and thinks rising earnings can support the bounce in stock markets. But he remains concerned that fragile sentiment will continue to prove a drag.

"The capitalist system tends to be pro-cyclical. As economies grow, citizens get wealthier and spend more," he says. "But for that to happen there has to be growth and that is built on the bedrock of confidence. Confidence has been severely knocked by the financial crisis, which in turn has led to solvency problems for individuals and governments, which has hampered growth. That has been compounded by a lack of political leadership both in the US and Europe. We are still in a precarious situation."

Regulation is another concern. Donahue welcomes tighter rules, saying unambiguously that banks took inappropriate risks and deserve to reap what they sowed. But, he notes, the drafting of legislation that works in the complex setting of the financial system is fraught with possible unintended consequences.

Whatever regulators and the economy throw at him, Donahue remains sure of one thing: BBH is not about to change course. "I have had investment bankers queuing up, telling me we should go public. That queue is dwindling because they usually get about five minutes," he says. "It would be a way for the owners to get a big pay day and have new friends slap them on the back and tell them how clever they are. But that is not what motivates people here. We would rather be respected for what we do."

The fourth Earl of Sandwich's love of cribbage gave the world its favourite snack. My view on the merits of the coronation chicken at BBH is neither here nor there. This is not a precedent, rather the exception that proves the rule. Normal service will be resumed next time. But what the lunch lacked in foodie frisson was more than made up for by the conversation. Besides, it was strangely fitting. They do things differently at Brown Brothers Harriman and have done for more than 200 years.

Brown Brothers Harriman & Co:
Park House, 16-18 Finsbury Circus,
London, EC2M 7EB
Lunch: Sandwiches
Drinks: Water; coffee
Total: N/A
Rating: N/A