

Enlightenment from Digital Transformation of International Investment banks Evidence from Morgan Stanley's acquisition of E*TRADE

Renhao Zhao *

School of Business, Macau University of science and technology, Macau, China

* Corresponding Author Email: 1220017916@student.must.edu.mo

Abstract. After the subprime mortgage crisis in 2008, under the circumstances of great competition pressure in the industry and slowing growth of customer assets, international investment banks gradually shifted their strategic focus to wealth management and actively sought new ways to acquire customers. Thus, digital transformation is the transformation trend at this stage. Therefore, this study provides suggestions and inspiration for the digital transformation of international investment banks through the analysis of Morgan Stanley's strategic acquisition of E*TRADE. The study evaluates whether the acquisition is successful by analyzing financial data, strategic positioning and stock price. The results show that driven by the integration of E*TRADE's digital platform and customer base, Morgan Stanley's revenue and operating efficiency have improved after the acquisition, and its overall performance has also improved. The acquisition can be regarded as a success. However, through the analysis of this acquisition, it is also found that when conducting mergers and acquisitions, attention should be paid to business integration and corporate culture integration. Besides, clear corporate development goals and directions should be set to expand business boundaries and provide more comprehensive and diversified financial services, so that the acquisition activities can play their maximum benefits and better achieve corporate goals.

Keywords: International investment bank; Morgan Stanley; E*TRADE; strategic acquisition; digital transformation.

1. Introduction

Nowadays, the market economy of various countries is developing rapidly, and the demand for financing by enterprises has also increased, which provides a huge market space for investment banks. Especially in the case of strong demand for equity and bond underwriting, the advantages of leading investment banks have become increasingly obvious. In addition, with the continuous adjustment of regulatory systems and the gradual change of market demand, international investment banks have generally begun to reduce traditional "heavy asset" businesses and focus on developing "lightweight" businesses. At the same time, with the development of financial technology, international investment banks are gradually integrating technology with traditional financial services in order to provide customers with a more convenient experience through multiple channels [1]. In this case, international investment banks have gradually shifted their strategic focus to wealth management. The reason why it has become the common direction of the lightweight transformation of international investment banks' investment banking business is that it has broad development space, outstanding financial value, and large synergy value [2]. Among them, Morgan Stanley, a traditional investment banking giant, began to strategically focus on the online brokerage market and acquired the Internet broker E*TRADE in 2020, seeking to use its high-quality online trading platform to improve its digital level, increase the penetration rate of general customers, and explore the second curve of wealth management growth.

Before the acquisition, Morgan Stanley had already begun to actively expand its wealth management scale: in 2009, it merged with Smith Barney under Citigroup to form the scale effect of wealth management business, acquired Mesa West Capital in 2018 to enhance its alternative investment capabilities, and acquired Solium in 2019 to enhance its employee channel supply capabilities. The



acquisition of E*TRADE in 2020 can be seen as an extension of this strategy, aiming to combine E*TRADE's online brokerage services with Morgan Stanley's wealth management expertise to create a more diversified financial services ecosystem [3]. However, this merger is not without its financial risks and challenges, including the integration of different corporate cultures and the alignment of operational processes. Moreover, at almost the same time, the sudden emergence of the COVID-19 epidemic greatly affected the world's economic environment, causing the global economy to decline, and Morgan Stanley was also greatly affected. Therefore, it accelerated the process of light assetization. Although digital platforms have the advantages of easy use and lower operating costs, there are also challenges such as mergers and upgrades, which require investment banks to fully consider in the process of transformation and upgrading.

The public news media and most researchers have focused on the strategic and stock price aspects of this acquisition, and found that this acquisition has expanded Morgan Stanley's assets and asset management business, which is conducive to the stable growth of investment banking revenue. On this basis, this study attempts to use a more comprehensive analysis, through the exploration of Morgan Stanley's motivation for acquiring E*TRADE, the acquisition process, and the analysis from four perspectives: financial data, market share, strategic positioning, and stock price, to determine whether the acquisition is successful. As well as the exploration of the broader impact on investment banking business, it provides useful insights into the strategic considerations of similar acquisitions in the financial industry, and provides useful references and inspirations for the future development of the industry.

2. Motivation

Morgan Stanley is a leading global financial services firm, providing a broad range of investment banking, securities, wealth management and investment management services. The company's solid financial performance and good reputation within the industry have been important drivers of its growth. However, the rapid development of the financial industry and the intensification of competition require companies to make strategic changes. The acquisition of E*TRADE is a strategic move aimed at diversifying Morgan Stanley's business model, enhancing its digital capabilities and expanding its client base. This move will enable it to reach previously underserved mass wealth markets and strengthen Morgan Stanley's wealth management business.

The merger will significantly expand the scale and breadth of Morgan Stanley's wealth management business and position Morgan Stanley as a leader in the wealth management industry across all channels and wealth segments. E*TRADE has more than 5.2 million client accounts with more than \$360 billion in retail client assets, plus Morgan Stanley's existing 3 million client relationships and \$2.7 trillion in client assets. Additionally, Morgan Stanley's full-service, advisor-driven model coupled with E*TRADE's direct-to-consumer and digital capabilities will enable the combined business to have best-in-class products and services to support the full spectrum of wealth and deliver Significantly enhanced customer experience [4].

The acquisition is important because it is a continuation of Morgan Stanley's efforts over the past decade to rebalance the firm's business mix, with the goal of deriving a greater portion of the firm's revenue and earnings from more durable revenue streams that are lighter on the balance sheet. The combined wealth and investment management businesses are expected to contribute about 57% of the firm's pre-tax profits (excluding potential synergies), compared with about 26% in 2010. The acquisition will bring significant growth potential to Morgan Stanley and E*TRADE shareholders. It is expected to achieve approximately \$400 million in potential cost savings by improving the efficiency of technology infrastructure, optimizing shared corporate services and combining banking entities. In addition, it is expected to achieve approximately \$150 million in potential financing synergies by optimizing E*TRADE's approximately \$56 billion in deposits. Morgan Stanley will also enhance its technology and service capabilities, which can bring significant revenue opportunities to shareholders. From E*TRADE's perspective, the company has significant growth potential. Despite

operating in a highly competitive market, E*TRADE has successfully carved a niche for itself with its innovative digital platform and customer-centric approach. Its strong financial performance, growing customer base and sound digital capabilities make it an attractive acquisition target. E*TRADE's growth prospects have also been further promoted by the digitalization trend in the financial industry, and after joining Morgan Stanley, E*TRADE will also have a broader customer base. In short, Morgan Stanley's acquisition of E*TRADE is out of the strategic intention of diversifying its business, acquiring customer resources and leveraging synergies. Morgan Stanley will also hope to gain a competitive advantage in the digital brokerage and wealth management fields, while E*TRADE has received the necessary resources and support to further enhance its digital capabilities and expand market share.

3. Process

Morgan Stanley's acquisition of E*TRADE is a complex transaction involving strategic planning, compliance investigations, regulatory approvals and post-acquisition integration. E*TRADE's powerful digital platform complements Morgan Stanley's existing services and provides the company with enhanced capabilities in the areas of online brokerage and investment services. The merger accelerates Morgan Stanley's transformation to a lighter balance sheet business portfolio and more durable revenue sources. Morgan Stanley expects to achieve cost savings by integrating technology systems and combining overlapping businesses. In addition, the acquisition is expected to generate revenue synergies through the sale of products and services to the combined customer base.

The acquisition began in February 2020, when Morgan Stanley, a leading global financial services company, announced its intention to horizontally acquire E*TRADE, hoping to strengthen Morgan Stanley's position in the retail brokerage and digital banking sectors. The proposed transaction is valued at \$13 billion, making it the largest acquisition of a Wall Street bank since the 2008 financial crisis. The acquisition was made in an all-stock transaction, with Morgan Stanley agreeing to acquire E*TRADE for approximately \$13 billion. Under the agreement, E*TRADE shareholders will receive 1.0432 shares of Morgan Stanley for each share of the company. The acquisition was financed entirely by issuing new Morgan Stanley shares to E*TRADE shareholders, freeing Morgan Stanley from having to use cash reserves or incur significant debt.

Following the announcement, the two companies began a compliance investigation process, which involved a thorough review of E*TRADE's financial records, business model, and regulatory compliance. This process was critical to ensuring that Morgan Stanley understood all potential risks associated with the acquisition. At the same time, Morgan Stanley sought approval from its shareholders and relevant regulators, including the Federal Reserve System and the Office of the Comptroller of the Currency. The acquisition proposal was subject to intense scrutiny due to its size and potential impact on the financial industry. In the third quarter of 2020, after several months of compliance investigations and regulatory reviews, the acquisition was approved by Morgan Stanley's shareholders and regulators.

In October 2020, the transaction was finally completed, and E*TRADE became a wholly owned subsidiary of Morgan Stanley. Morgan Stanley's wealth management platform will add \$382 billion in client assets, 5.3 million retail client accounts, and 1.9 million stock plan participants, representing growth of 14%, 177%, and 71%, respectively. In addition to growth in scale, E*TRADE's technology and brand support have helped Morgan Stanley improve its reach and appeal to the next generation of wealth holders and enhance the company's digital capabilities. At the same time, its product capabilities in fixed income, financial derivatives, and digital banking have also filled in Morgan Stanley's gaps in related fields, helping the company advance into omni-channel and segmented wealth management businesses [5-7].

4. Process Analysis

4.1. Analysis from a Financial Perspective

This paper will analyze and evaluate the financial data of Morgan Stanley before and after the acquisition from December 31, 2019 to December 31, 2020 in terms of profitability, operational efficiency, cost control ability and growth potential. As can be seen from Fig. 1, Morgan Stanley's overall revenue increased between 2019 and 2020. A larger increase occurred in the fourth quarter of 2020. It shows that the company's profitability has increased, with revenue increasing by about 17%. This is a positive signal for the company's overall profitability.

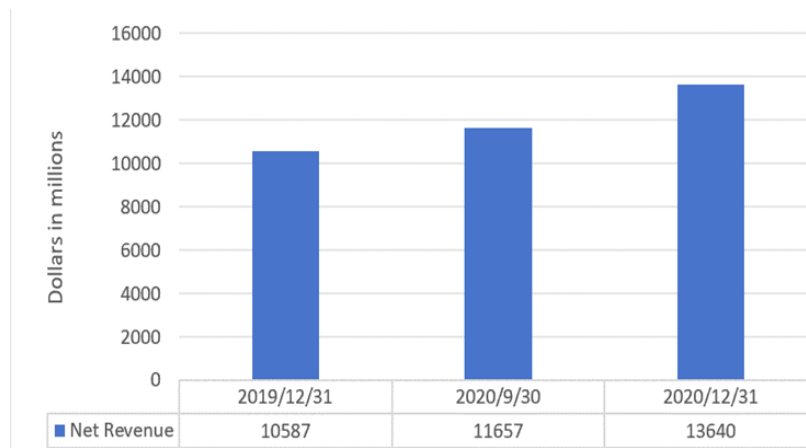


Fig 1. Summary for the net revenue during M&A.

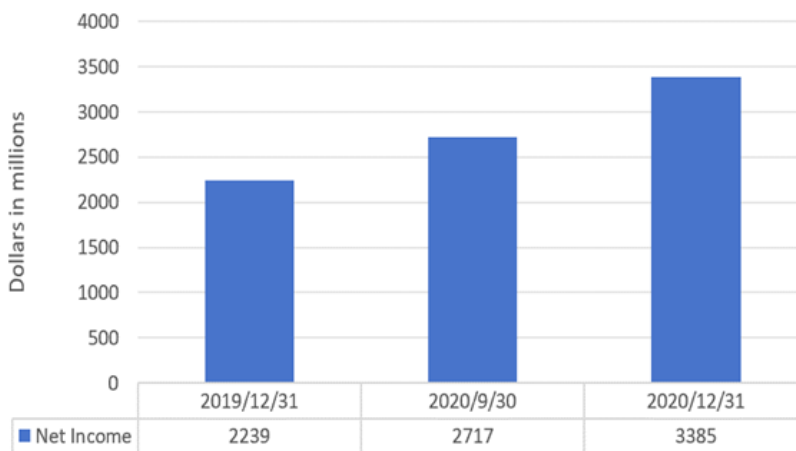


Fig 2. Summary for the net income during M&A.

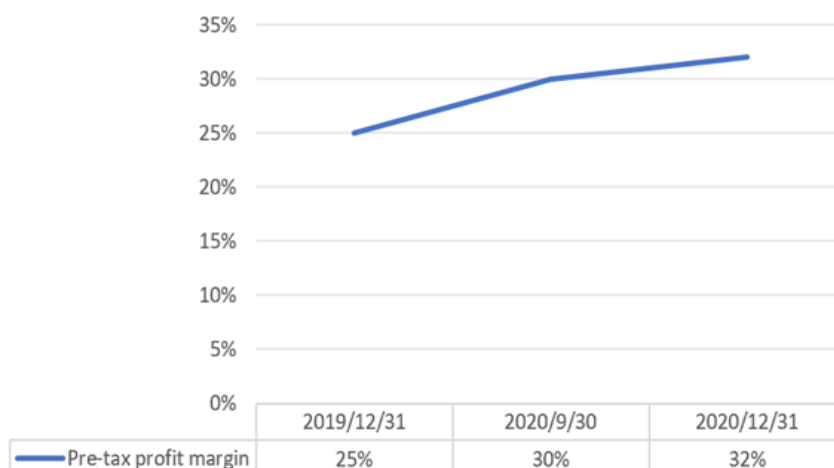


Fig 3. Summary for the pre-tax profit margin during M&A.

Table 1. Pre-tax profit margin.

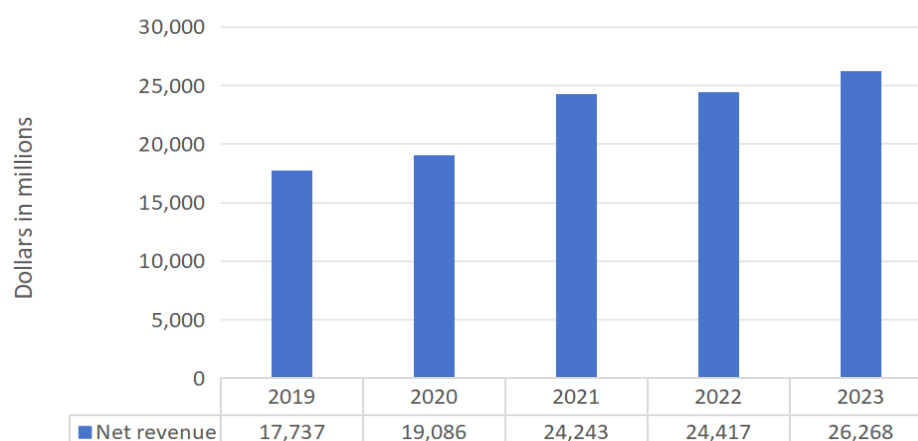
2020 Q4	Income before tax	Net revenue	Pre-tax profit margin
Morgan Stanley (USD in millions)	4,430	13,640	32.48%
Goldman (USD in millions)	5,541	11,741	47.19%
UBS (USD in millions)	2,057	8117	25.34%
Deutsche Bank (EUR in millions)	175	5453	3.21%

Operational efficiency can be measured by a company's operating profit and operating margin. As can be seen from the charts shown in Fig. 2 and Fig. 3, compared with the third quarter of 2020 and the fourth quarter of 2019, operating profit increased by 24.6% in the quarter after the acquisition and by approximately 51.2% in one year, indicating that the company has improved its operating efficiency. A significant improvement. While COVID-19 is causing an economic downturn around the world, Morgan Stanley's corporate profit margins are steadily improving, which can indicate that the company has a certain degree of competitive advantage. Moreover, from Table 1, which indicate that Morgan Stanley still has a leading advantage in the comparison of pre-tax profit margins of other multinational investment banking groups. Seen from Table 2, after the merger and acquisition, the annual average savings rate of the asset management department dropped from 0.38% before the acquisition to 0.24%, and dropped by 73.4% compared with 0.91% in the same period in 2019. This reflects Out of the reduction of asset management costs. At the same time, the scale of wealth managed by the wealth management department has increased significantly, and the number of net assets and savings has also increased significantly. Furthermore, the growth trend in the asset management segment's revenue suggests that this segment has good growth potential in the future.

Seen from Fig. 4 and Fig. 5, after the acquisition, the long-term benefits of the asset management department have continued to grow, indicating that the acquisition has brought continuous long-term positive benefits. From the perspective of the company's overall revenue, the company's overall earnings have been greatly affected by the economic downturn. Morgan Stanley as a whole and its asset management department have performed well after the acquisition, demonstrating strong profitability, high operating efficiency and gradually increasing cost control capabilities. In addition, the healthy growth of revenue and operating profit indicates that the company and its asset management department have good growth potential in the future.

Table 2. Wealth Management Metrics.

Wealth Management Metrics (dollars in billions)	Dec 31, 2020	Sep 30, 2020	Dec 31, 2019
1.Total client assets	\$3,999.00	\$2,852.00	\$2,700.00
2.Net new assets	\$66.10	\$51.80	\$27.10
3.Deposits	\$306.00	\$234.00	\$187.00

**Fig 4.** Net revenue for E*TRADE from 2019-2023.

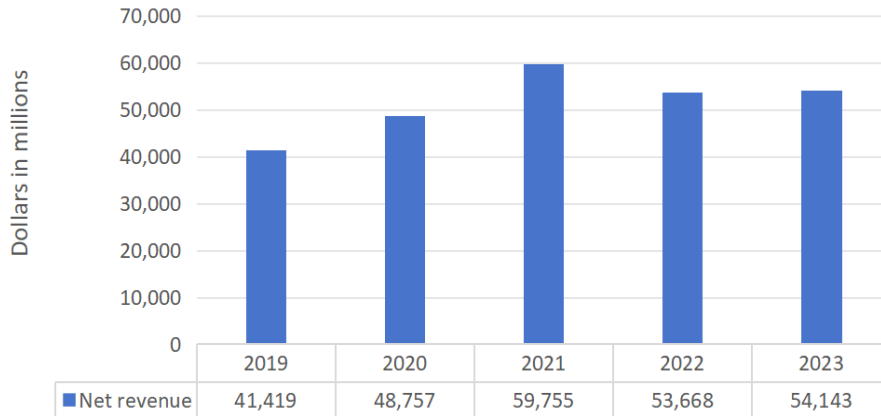


Fig 5. Net revenue for Morgan Stanley from 2019-2023.

4.2. Analysis from a Strategic Perspective

The acquisition of E*TRADE enables Morgan Stanley to enter the direct-to-public wealth management business, which is an important step in the company's business expansion strategy. Over the past few years, Morgan Stanley has been trying to shift its business model away from reliance on investment banking and trading operations toward more stable asset management and retail operations. Through the acquisition of E*TRADE, Morgan Stanley's customer base and asset management scale will be significantly improved.

At the same time, the acquisition of E*TRADE will help Morgan Stanley enter the online brokerage business. Through E*TRADE, Morgan Stanley will be able to enhance its ability to provide one-stop financial services, including investing, lending and cash management, which will increase its competitiveness with competitors.

In addition, the acquisition of E*TRADE will also help Morgan Stanley improve its technological capabilities. E*TRADE is one of the pioneers of online brokerage, with an advanced digital platform and mobile application. This will help Morgan Stanley improve its digital level to meet customers' needs for convenient and efficient financial services.

4.3. Analysis from the Perspective of Stock Price

On the day the acquisition announcement was released, Morgan Stanley's stock price fell by 4.5% (from 56.31 to 53.75), which may reflect investors' doubts about the deal. However, in the following months, Morgan Stanley's stock price gradually stabilized and began to rise after a period of decline. And it rose by 85% in one year (from 53.75 to 99.5). This may reflect investors' recognition of Morgan Stanley's strategic transformation to expand its retail business and enter the online brokerage business and may also reflect Morgan Stanley's confidence in its ability to successfully integrate E*TRADE's business and achieve its strategic goals. At the same time, on the day the acquisition announcement was released, E*TRADE's stock price rose by 22% (from 44.93 to 54.73), which reflects investors' positive reaction to the deal. In addition, since the acquisition agreement stipulates that E*TRADE shareholders will receive Morgan Stanley shares, E*TRADE's stock price is also affected by Morgan Stanley's stock price. As Morgan Stanley's stock price rose, E*TRADE's stock price also rose accordingly.

Therefore, judging by the stock prices of Morgan Stanley and E*TRADE, the acquisition can also be considered a success. However, it is important to note that stock prices are affected by many factors, including the company's financial situation, market environment, investor sentiment, etc. Although changes in stock prices can reflect the market's reaction to the acquisition, this method cannot be completely determined whether it's successful or not.

4.4. Acquisition Risks

From a financial perspective, because this transaction is an all-stock transaction, and an all-stock transaction means that Morgan Stanley will issue additional shares, which may dilute the equity of existing shareholders. If too many new shares are issued, it may have a negative impact on Morgan Stanley's stock price. In addition, the success of the acquisition depends largely on whether Morgan Stanley can successfully integrate E*TRADE's business and achieve the expected strategic goals. If there are problems in the integration process or the strategic goals are not achieved as expected the return on investment of the acquisition may be lower than expected [8-10].

From a market perspective, entering a new market requires facing unknown competition and risks. This transaction will allow Morgan Stanley to get deeper into the retail market, which is a highly competitive market. Large banks, brokerages and fintech companies are competing for this market, and many companies have launched strategies such as zero-commission trading to attract customers. If Morgan Stanley cannot provide better products and services, it may lose market share. At the same time, the online brokerage business is affected by stock market fluctuations. If there are large market fluctuations or an economic recession, it may lead to a decline in trading volume, thereby affecting Morgan Stanley's revenue. In addition, changes in interest rates may also affect the profitability of the online brokerage business.

From a legal perspective, the deal will significantly increase Morgan Stanley's share of the retail investment market, which could trigger antitrust scrutiny, which could affect the acquisition process. If it is found to be monopolistic behavior, Morgan Stanley may face huge fines or even be forced to sell some assets.

5. Suggestions and inspirations

According to the analysis, following suggestions are proposed. First, it is necessary to set clear corporate development goals and directions. The integration and merger of the financial services industry requires clear planning for the future development of the enterprise, and on this basis, select more suitable target companies. In the acquisition process, it is necessary to strengthen risk control and prepare for response in advance. After the acquisition, make internal policy adjustments to better serve the acquired company. Whether it is the integration of upstream and downstream industries or digital upgrades to launch new wealth management models, enterprises should formulate reasonable development strategies based on development goals and market positioning. Secondly, it is necessary to improve business efficiency and customer experience through technological innovation and enhance market competitiveness. At the same time, it is also necessary to actively respond to the security threats of new technologies and improve the security protection capabilities of the system to ensure the quality experience of customers, so as to better enhance customer stickiness and enhance market competitiveness. In this case, Morgan Stanley successfully extended its business tentacles to the field of online trading by acquiring E*TRADE. International investment banks can learn from this strategy to build their own financial ecosystems and expand their business boundaries to provide more comprehensive and diversified financial services.

In general, Morgan Stanley's acquisition of E*TRADE provides some important inspirations and suggestions for the digital transformation of the investment banking industry. In the past, investment banks mainly relied on investment banking and trading businesses, whose revenue fluctuated greatly and was greatly affected by the market environment. Therefore, investment banks need to find new sources of revenue to reduce the impact of market fluctuations. In this case, digital transformation has become a good choice.

6. Conclusion

To sum up, this merger not only demonstrates the deep integration of traditional financial institutions and Internet financial platforms, but also promotes the digital transformation and upgrading of wealth

management services through the application of digital technology. Meanwhile, the risks of mergers and acquisitions cannot be ignored. After the completion of the merger and acquisition, enterprises need to further strengthen financial management and risk monitoring, pay close attention to market trends, clarify the development direction, and formulate scientific and reasonable development strategies to lay a solid foundation for future integration and development. However, this study also has some shortcomings. For example, the financial report analysis of Morgan Stanley and E*TRADE is not in-depth enough, and the stock price is affected by many factors, which cannot fully explain whether the acquisition is successful. Overall, this study provides suggestions and guidance for the digital transformation of the financial industry. In this case, Morgan Stanley's digital transformation has achieved certain results, providing enterprises with a stronger and more efficient revenue growth point, and digital transformation is also a hot spot for transformation in the financial industry today.

References

- [1] China Construction Bank Securities Research Group. Comparison of International Investment Bank Wealth Management Development Models and Its Implications. *Securities Market Herald*, 12-21.
- [2] Dong M. Analysis of Investment Bank M&A Motivations and Performance - Based on Morgan Stanley's Acquisition of Yi Chuang Wealth Management. *Academic Discussion*, 2021, 80-82.
- [3] CICC. Morgan Stanley: Comprehensive financial capabilities to meet the needs of wealth customers, the world's leading wealth management institution, 2021. Retrieved from: <https://research.cicc.com/frontend/recommend/detail?id=2126>
- [4] Morgan Stanley. Morgan Stanley acquires E*TRADE to create a leader in all major wealth management channels, 2020. Retrieved from: <https://www.morganstanley.com/press-releases/morgan-stanley-to-acquire-e-trade>
- [5] Lehman R H. *The Elusive Trade: How Exchange-Traded Funds Conquered Wall Street*. BrownBooks. ORM, 2024.
- [6] Sha C. Method selection and empirical research on the performance evaluation of mergers and acquisitions of Chinese companies - taking the medical device industry as an example. School of Economics, Zhejiang University, 2019.
- [7] Telford T, Merle R. Morgan Stanley buys E-Trade in \$13 billion shake-up to brokerage market. *The Washington Post*, 2020.
- [8] Lees S. *Global acquisitions: Strategic integration and the human factor*. Springer, 2002.
- [9] Chadam J, Pastuszak Z. Acquisitions: how should a project be successfully executed. *Industrial Management & Data Systems*, 2013, 113(9): 1270-1285.
- [10] Ray K G. *Mergers and acquisitions: Strategy, valuation and integration*. PHI Learning Pvt. Ltd., 2022.