SHEFFIELD HAWORTH'S 2023 IBCM COMPENSATION OUTLOOK TURNS BEARISH AFTER SLUGGISH Q1

Although investment banking compensation will likely be down again this year as revenues continue to drag, this is good news for banks looking to hire.

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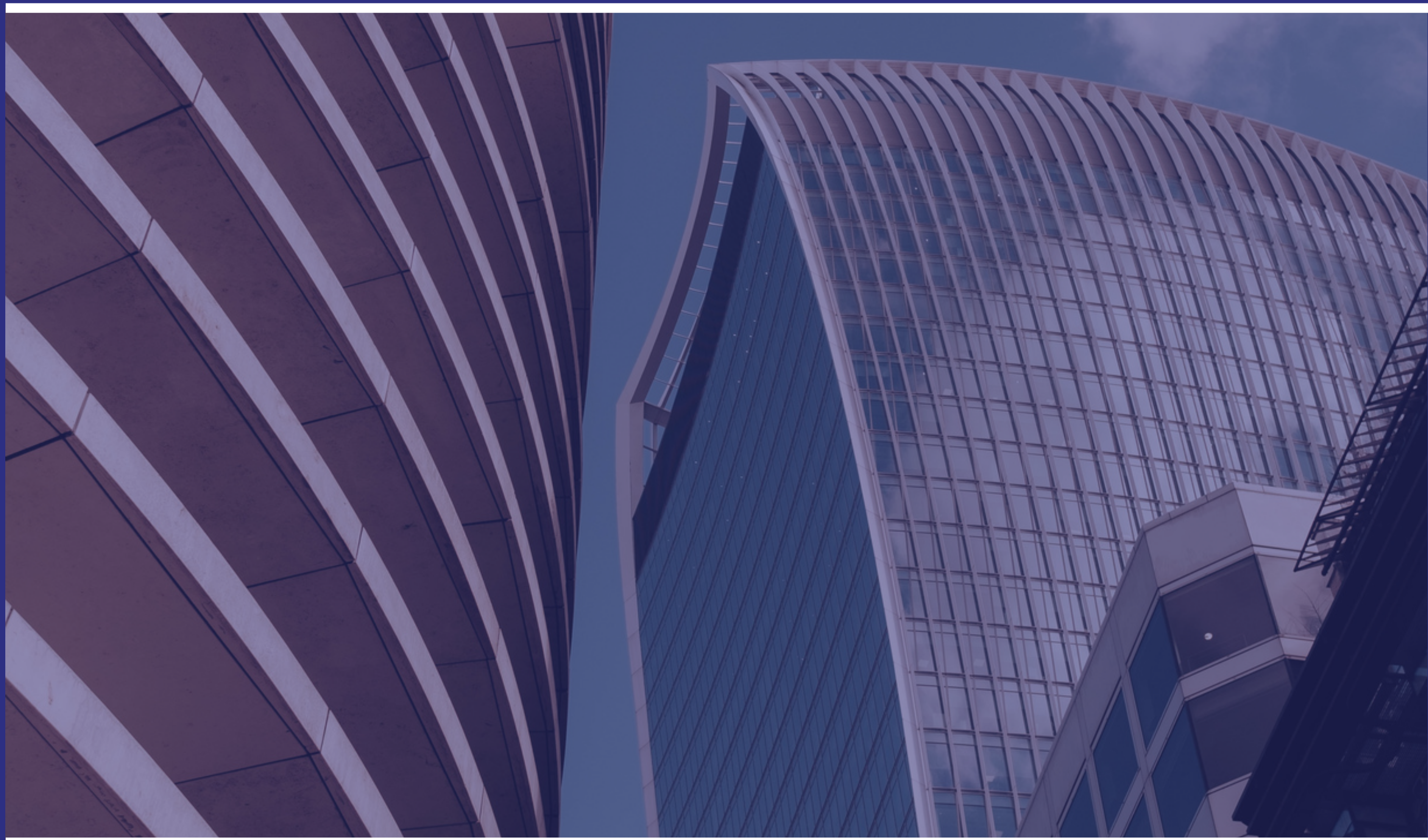

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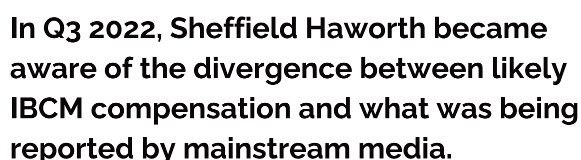


In Q3 2022, Sheffield Haworth became aware of the divergence between likely IBCM compensation and what was being reported by mainstream media.

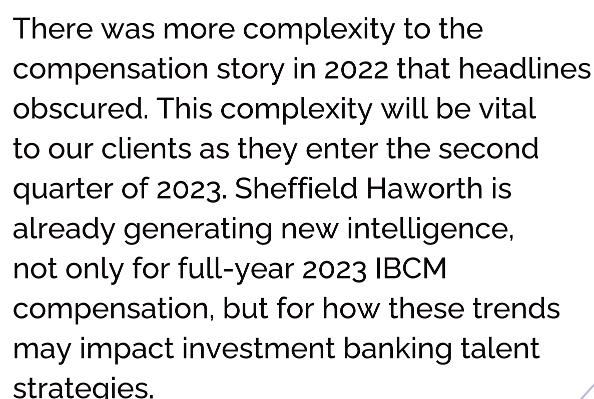
The public discussion on the subject was relatively optimistic about pay rates for the full year, signaling compensation being down only 10-15%. With investment-banking revenue already down so sharply for 2022, how could this be true? Sheffield Haworth's conversations with well-placed business leaders in Q3/Q4 alluded to the fact that average MD-level compensation could be down big which ended up being the case.

After a promising start, revenues fell precipitously from Q2 onwards. US investment banking ended the year reporting a 45 percent decline in revenues. Leading lenders were also suffering mark-to-market losses in Leveraged Finance. Meanwhile, there was widespread confusion between compensation as reported for investment banking, global markets, the front- and back-offices, and the differences between junior, as opposed to senior compensation.

In order for compensation to be flat or even up in Equities and FICC, which were both having a good year, compensation had to be down in IBCM. In order for junior IBCM compensation to stay relatively flat, or even up year-on-year in the case of Analysts, MD-level compensation had to come down sharply. This is exactly what occurred.

On March 30th, 2023, the New York State Comptroller announced the average bonus for a securities employee fell 26 percent from the previous year. This percentage reflected average senior FICC compensation being up 1-10%, Equities compensation remaining relatively flat, IBCM compensation being down 45%, and modest declines for middle and back-office professionals. The only reason average senior IBCM compensation did not decline more sharply was because M&A deals close after they are announced and bolstered the rate of decline in M&A activity.

History tells us investment banking compensation typically declines less than the percentage decline in revenue in difficult years just as it typically rises less with revenue gains in good years. However, with junior IBCM compensation more or less flat as bankers progressed up the grid, we knew senior investment banking compensation would have to take a bigger hit than what the media was reporting. There would also need to be layoffs. Sharp cuts in compensation have prevented further redundancies, at least for now. Relatively 'typical' annual reductions in force in the realm of 2-5% followed in January and February 2023 versus possible staff cuts of 10-20%. We suspect layoffs will continue in May and June unless revenues recover.



There was more complexity to the compensation story in 2022 that headlines obscured. This complexity will be vital to our clients as they enter the second quarter of 2023. Sheffield Haworth is already generating new intelligence, not only for full-year 2023 IBCM compensation, but for how these trends may impact investment banking talent strategies.

A Perfect Storm

Last year was a nearly perfect storm for the US investment banking market with M&A, Equity Capital Markets, Debt Capital Markets, Leveraged Finance and High Yield declining at the same time, as equity markets stumbled, valuations fell, and credit was under pressure.

The most dramatic decline in revenue was in Equity Capital Markets, down 80 percent from 2021. In some years, investment banking revenue can prop up declines in trading revenue, and, in other years, the reverse is true. In 2022, neither was strong enough to keep compensation levels aloft.

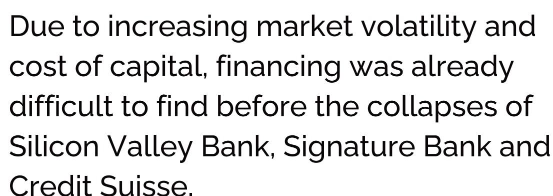
Now, not even midway through 2023, we see a shift taking place. We are looking beyond the current headlines. We suspect compensation levels will be down again this year, but for reasons that at once resemble and depart from the environment that made 2022 such a difficult year.

Changing market dynamics

In Q1/Q2 2023, the broad themes of the investment banking environment seem similar to 2022. The war in Ukraine continues. Volatility continues to unsettle the equity markets. Financial conditions are tightening with higher interest rates and inflation concerns. Some IPOs are getting done but it is hardly a crowded calendar. While Investment Grade DCM has been recovering, the Leveraged Finance market is essentially flat. While some large M&A deals are being announced, M&A volumes still need to find their level.

These similarities obscure how the dynamics of the operating environment are already changing. Distracted as we are by headlines about a banking "crisis" we may be missing changing market and geopolitical dynamics which point to improving conditions in the second half of 2023.

Using the United States as a bellwether frame of reference, we see the Federal Reserve ending its quantitative easing program in 2023, but also reaching the higher levels that interest rates need to move in order to curb inflation. The shock waves that higher interest rates produced in US regional banks will, perversely, accelerate lower inflation. Nevertheless, higher interest rates benefit the full-service banks as they fuel higher interest rate margins and provide a cushion for mainstream IBCM revenues. The largest full-service US banks have seen an inflow of deposits from rivals under a cloud.



Due to increasing market volatility and cost of capital, financing was already difficult to find before the collapses of Silicon Valley Bank, Signature Bank and Credit Suisse.

Alternative lenders have more leverage with borrowers when capital is scarce and when banks are not lending. Considering the growing number of companies and asset holders in need of financing, we will see a pickup in activity from credit investors selectively taking advantage of these opportunities.

Meanwhile, the largest US full-service banks are more powerful than before. A macro theme in the investment banking operating environment is the ongoing shift of power from London to New York. Brexit has done no favors to the City in this regard. As we enter the second half of 2023, New York will be the clear winner over London. We will see it first in the IPO markets and then in the increased rate of investment by private equity firms which have enough dry powder to drive a new wave of activity once markets reprice.

Superior senior talent will, as ever, be in short supply. The banking disruptions of early 2023 were indicative of weak leadership, poor risk management and their impact on morale and the trust of markets. Employee engagement and the perception of employees and target employees of different types of banking platforms have become a central factor in the conversation on both employee retention and hiring.

What does this mean for IBCM compensation in 2023?

What can we expect for compensation in 2023?

Sheffield Haworth expects 2023 compensation levels to be down. They could be flat at best if there is a major uptick in financing and M&A activity during the second half of the year. However, given the overflow of M&A business from 2021 which propped up M&A revenues in 2022, it is unlikely that compensation can stay flat without such a pickup. 'Flat' will not be enough, rather it will probably lead to a second round of redundancies and compensation being down 10% YOY. For added perspective, if 2023 Managing Director compensation is flat with 2022, it will be flat with pre-pandemic 2019 compensation according to Sheffield Haworth data.

Analyst and Associate investment banking talent may be proportionately less affected, but even this might be hard to pull off. Even though banks are aware that we are in the era of "the great resignation" and want to retain junior staff, the numbers will not support this unless volumes recover. If banks need to cut into their execution engines with additional layoffs, it may put them in a serious bind, as the indirect result will be involuntary losses on top of planned RIFs, which will prove very costly.

Looking beyond compensation, investment banking firms need to take a two-pronged approach to talent: looking internally to find staffing efficiencies (which will likely include layoffs) and upgrading talent opportunistically with talent they may not have access to outside of the recent disruptions. The opportunity for taking advantage of competitors' mistakes is massive but remains highly competitive as strong talent entertains multiple offers.

For Sheffield Haworth, our mission goes beyond executive search. More and more of our work is helping clients improve their governance structures. An area that cries out for reinvention is board membership. The past year has indicated that investment banking boards are wanting in their understanding of risk management and quantitative finance. Those are skills that cannot be learned retroactively, and certainly not on the job.

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Natalie joined Sheffield Haworth in 2019 and focuses on executing senior-level corporate finance advisory assignments including M&A, Sector Coverage, Equity & Debt Capital Markets.

She has led senior search mandates, including individual target hires and team build outs and has successfully led and executed several consulting projects focused on competitor intelligence and market analysis.

In addition to search, Natalie also provides competitive intelligence management scans, management and cultural assessments with the Sheffield Haworth assessment team, benchmarking and succession planning, market sentiment analysis, and compensation analytics and advisory. She also functions as Head of Research within the Americas Banking team and leads the commentary and analysis behind Sheffield Haworth's Americas IBD Moves Reports.

Previously, Natalie specialized in Investment Banking, Private Capital and CFO searches at Korn Ferry. She graduated from Denison University with a B.A. in Political Science and English.