



Schroder Salomon Smith Barney*

“Investment banking in the City of London has often been compared to Wimbledon—an excellent British-hosted tournament that overseas players always win. If that is so, yesterday was quarter finals day, the moment when the last British seeded players finally exit.”

--Financial Times, January 19, 2000

At the time of the announcement of the sale of the Schroders investment banking business to Salomon Smith Barney -- a division of U.S.-based Citigroup -- such were the comments being made about the loss of yet another British-owned merchant bank. But in addition to such wry observations about the deal, many substantive questions arose as well. Why couldn't Schroders survive on its own? What could tiny Schroders possibly offer to Salomon Smith Barney, which dwarfed all but three or four of the largest investment banks in the world? How would a 183-year old British firm, steeped in British history and culture, fit inside a behemoth of a financial institution (itself only two years old in 2000) joining a peculiar combination of the once middling Smith Barney, the brawny but wounded bond house of Salomon Brothers, the retail and commercial insurance player Travelers, and the heavily commercial global and retail banking oriented Citicorp? What competitive forces were driving an acquisition in Europe, a region that at best represented 3% of Citigroup's worldwide earnings a year after the deal's announcement? Did this deal make sense for Citigroup?

The Investment Banking Industry

Investment banking is a segment of the financial services industry that is best characterized as a multi-line integration of capital markets products and services aimed at governments, institutional and retail investors, supranational organizations, and corporations across all industries and sectors of the global economy. The product range is highly diverse, and ranges from the straightforward to the outermost theoretical reaches of quantitative financial economics. Investment banking businesses are generally separated into three broad divisions: (a) Debt capital markets—including but not limited to sales, trading, and research of government and municipal debt, high yield bonds, money markets, foreign and emerging market debt, mortgage-backed and asset-backed securities, foreign exchange, and credit derivatives; (b) Equity capital markets—including sales, trading, brokerage and research in stock issues, trading in various markets, securities lending, risk arbitrage, convertible securities, and equity derivatives products such as options and futures (c) Investment Banking—including corporate finance, private and public new offerings of stocks and bonds, corporate and tax advisory work, and merger and acquisition advisory services. Equity Capital Markets (ECM) and Debt Capital Markets (DCM) are usually separately -- managed departments that straddle the division between investment banking and each of the specific product desks.

* Teaching case written by Michael Fidance under the direction of Prof. Ingo Walter, Stern School of Business, New York University. For teaching purposes only. Copyright 2001 New York University Salomon Center.

According to the Securities Industry Association, in the U.S. alone, \$1,792 billion of corporate underwritings were executed in 1999, nearly 89% of that total being new debt issues. Moreover, nearly 701,000 people were employed in the securities industry in 1999, a 64% increase over 1989 employment figures. Total revenues for U.S. securities firms reached \$183,370 million in 1999 with pre-tax profits growing to a record \$16,270 million, implying an 8.9% pre-tax profit margin for the industry as a whole. Shareholder capital of the top ten largest securities firms in 1999 totaled \$68.8 billion, or 56.6% of the industry total.¹

While certainly there were numerous securities firms which could claim to be market leaders in only some of the product areas noted above—Lazard Frères in M&A and corporate advisory work and Charles Schwab & Co. in retail brokerage, for example -- the fastest-growing and most profitable end of the business was dominated by *bulge-bracket* investment banks that were best characterized by the high level of activity and market share across all of the client segments above, plus product expertise and strong market position in all areas of sales, trading, research, corporate finance, and advisory services. Stand-alone investment banks and investment banking units of broad-gauge financial firms that met this definition included such players as Goldman Sachs, JP Morgan-Chase, Merrill Lynch, Citigroup/Salomon Smith Barney, Morgan Stanley, and Credit Suisse First Boston. Bulge-bracket contenders included UBS Warburg, Deutsche Bank, and Lehman Brothers.

Between 1994 and the end of 2000, no less than 35 transactions involving investment banks occurred, including the 1994 acquisition of Kidder, Peabody by Paine Webber, the April 1997 purchase of Alex. Brown & Sons by Bankers Trust and BT's subsequent acquisition by Deutsche Bank, and the nearly \$10 billion merger of Morgan Stanley and Dean Witter Discover in May of 1997. The latter was perhaps the most defining M&A transaction in the industry, setting the stage for a string of similar multi-billion dollar acquisitions involving the biggest investment banking and financial services firms in the world. The consolidation of the industry was quite dramatic, facilitated in the US by the 1999 repeal of the Glass-Steagall Act of 1933, which had limited the combination of capital raising and investment banking businesses with commercial banking functions. Other deals included the acquisition of Robert Fleming by Chase Manhattan, Paine Webber by UBS, Wasserstein Perella by Dresdner Bank (and its subsequent acquisition by Allianz AG, and Donaldson Lufkin & Jenrette by CSFB, all in 2000 and 2001.

The 1998 announced merger of Citibank and Travelers Group to form Citigroup was among the first transactions to take advantage of pending changes in U.S. securities law. Much of the investment banking consolidation appeared to be driven by gaining market share to service the massively growing needs of investors and securities issuers around the world. Consolidation was also forced by rising costs, changing customer needs, and shifting industry dynamics:

- **Globalization.** The cross-border activities of corporates across all sectors of the economy underscored the globalization of industries ranging from airlines to pharmaceuticals to insurance. When Merrill Lynch bought the British firm Smith New Court in 1995, it did so largely in order to be able to compete for investment banking mandates in markets where Merrill had little or no presence. That watershed purchase permanently widened its investment banking playing field and set the stage for still more worldwide consolidation.

¹ Sources: Thompson Financial Securities Data, U.S. Department of Labor, Securities Industry Fact Book, 2000. All data is for year-end 1999 and for the U.S. securities industry only.

- **Margin compression.** For bulge-bracket firms, finding ways to combat declining commission rates was central to maintaining profitability in investments banking. If commission rates could not be increased in the competitive environment, then volume mattered even more. Such a rationale necessarily placed a focus on economies of scale and size that allowed firms to maintain profitability by boosting the volume of transactions they executed and seemed to be a significant factor in the Morgan Stanley-Dean Witter merger, the UBS acquisition of Paine Webber, and the more recent purchases of Spear, Leeds, Kellogg by Goldman Sachs and of Herzog, Heine, Geduld by Merrill Lynch, among others.
- **Horizontal integration.** Some financial services firms had long and deep experience in particular capital markets product areas but not in others. The ability to provide a complete mix of services was the hallmark of only a handful of firms; others without the ability to offer any number of different financing alternatives to clients found themselves to be uncompetitive. Such economies of scope underscored the need to move horizontally across products, building on expertise in other areas, or buying complementary businesses that completed the circle of product offerings. Industry consolidation was heavily influenced by firms looking to expand their reach in investment banking and was exemplified by other such acquisitions as Chase's 1998 purchase of technology banking firm Hambrecht & Quist, Swiss Bank Corp's (now UBS) acquisition of the American derivatives firm O'Connor, Partners, and Cr dit Suisse First Boston's 1998 purchase of the equity businesses of Barclays de Zoete Wedd.

The consolidation of the industry in 2000 was such that a "super league" of firms appeared in the process of being created, fueled by financial industry CEOs who were determined to do whatever it took to be among the top five or six securities firms in the world. Indeed, the threat of not being in that grouping of investment banks was quite real. In particular product areas and geographic markets, 50-60% of underwriting mandates were dominated by the top five or six firms (see Exhibit 1). The same was true in commission revenues paid by institutional investors, where 60-70% of all commissions and sales-related proceeds flowed to the largest five or six brokers.²

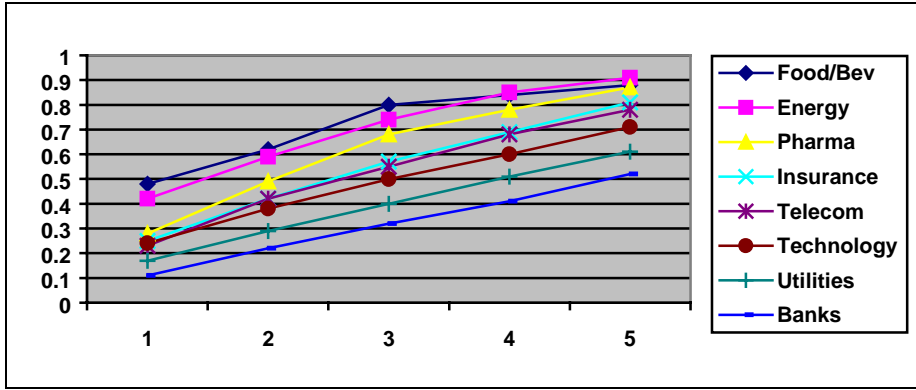
Investment Banking and European Markets

Pan-European equity and fixed income markets -- and, by association, the financial intermediaries servicing them -- in 2000 were characterized as highly regionally compartmentalized, with dominance of a particular market or product varying widely country by country. Indeed, even with the implementation of the Maastricht Treaty in January 2000 that formalized the euro as the single currency of the 12 member states, a single European financial market had been difficult to envision, let alone put into practice. This was especially true for capital markets businesses, since a movement to an EU-wide regulatory system, consolidation of EU stock exchanges, or massive inter-member, cross-border investment flows were slower to develop in financial services than in other industries in the Euro zone. As a proxy for the weak level of concentration in financial services companies throughout the EU, cumulative Euro-zone

² Data on commission revenues from institutional customers is considered highly proprietary. While the data is indeed collected by a handful of consulting firms, it is unavailable to the public. The estimate here is thus anecdotal, based on comments made by various industry executives.

sector capitalizations by number of stocks underscore the fragmented nature of the banking sector on a pan-European (ex-UK) basis (see Figure 1).

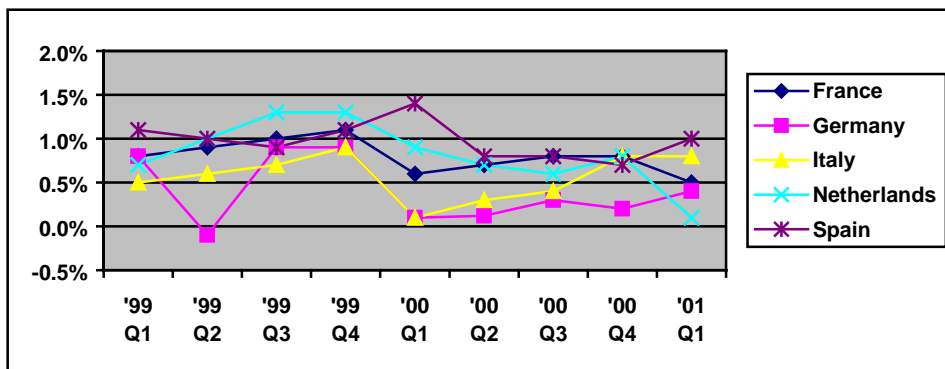
Figure 1: Selected Industry Concentration: Cumulative Eurozone Sector Capitalization by Number of Stocks



Source: DataStream and Salomon Smith Barney

At issue was the fact that, despite broad coordination of monetary policy, trade and industrial regulation and various other aspects of the political economy across the continent, the convergence of economic performance across the 12 Euro zone countries had been less than transparent (see Figure 2).³ Similarly, capital markets across the Euro-enabled countries, not to mention across a pan-European perspective, were all in various stages of development (see Exhibit 2). Moreover, as late as 1986 only two European countries, the United Kingdom and Germany, had market capitalizations greater than five percent of total global market cap, with the entire continent (ex-UK) garnering a mere 8.1% of world capitalization⁴.

Figure 2: Quarterly GDP Percent Change, 1999-2001 for Select Euro zone Countries



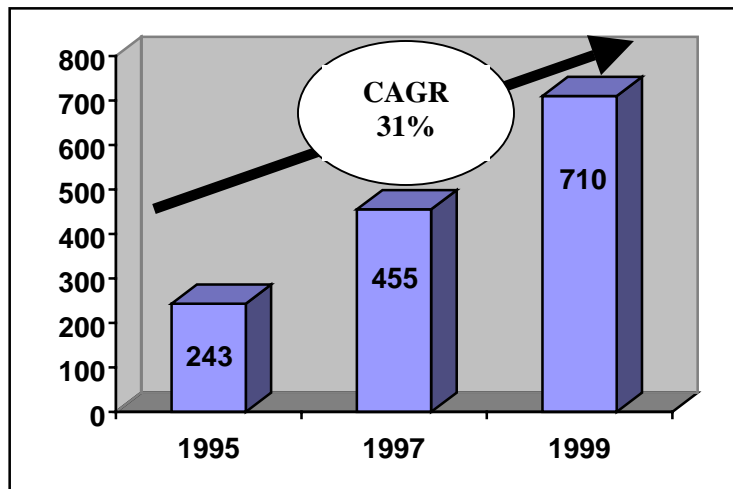
Source: OECD

³ There are 15 members of the European Union; 11 members (plus Greece for 2002) are also party to the Maastricht agreement. Denmark, Sweden, and the United Kingdom are not signatories to the single currency implementation scheduled for January 2002.

⁴ Source: Datastream, Schroder Salomon Smith Barney

Nonetheless, the growth prospects for European capital markets seemed strong. Traditionally, fixed income products (notably government bonds), both in terms of investments and in terms of financing, dominated capital market finance in the Euro zone. Privatizations of state run enterprises from oil companies to banks to airlines that began in earnest under the Thatcher government in the UK in the 1980s spread to the continent in the 1980's and 1990's, providing an impetus for new equity issuance that has been a driver of growing European market caps throughout the 1990s (see Figure 3).

Figure 3: Number of IPOs in Europe



Source: Thomson Financial, Deutsche Börse

The process continued in 2000, and has become a cornerstone of an EU political economy that ensured the state's exit from the private sector to meet Euro-zone economic convergence criteria. More immediately, a number of structural and developmental changes propelled the development of Europe's equity markets and, among other things, created the beginnings of an equity culture that swept through the United States some 20 years earlier:

- Bankassurance.** A uniquely European concept, bankassurance was the term given to a handful of financial conglomerates combining retail and commercial banking, asset management, brokerage, and insurance businesses. Unencumbered by the regulatory barriers in place in the United States until 1999, bankassurance companies became a hallmark of a consolidating financial services industry on the continent. Europeans were long accustomed to one-stop shopping for financial products where bank accounts, credit cards, mortgages, property and casualty insurance, and retirement planning services were all linked. For suppliers, the joint operations of all of these businesses were supposed to create synergies for the cross-selling of products, the key to which was the massive account information insurance companies maintained about their policy holders, providing broad leverage for the brokerage and asset management arms in targeting new clients. The advantage of such a synergy was a powerful driver in competitive advantage and seemed to be pushing consolidation of financial services companies even further. In April 2001, Munich-based insurance giant, Allianz, agreed to pay \$21bn to acquire Dresdner Bank, Germany's second

largest bank, itself the parent company of the securities firm, Dresdner Kleinwort Wasserstein and one of the world's largest asset management groups, that included Deutscher Investment-Trust (DIT), Dresdner RCM, and PIMCO.

- **German deregulation.** The Allianz-Dresdner deal would not have been possible without a massive change in German tax law that was scheduled to eliminate a prohibitive capital gain tax policy in 2002 on the sale of the corporate equity cross-holdings that were the hallmark of the German post-war economy. The Allianz acquisition was struck in such a way that the deal would not close until 2002 in order to take advantage of the tax change. More importantly, the new regulatory environment could unleash the potential sale of more than €220bn of equity cross-holding stakes by German financial and industrial conglomerates that could lead to unprecedented revenue potential for financial intermediaries. Illustrating this potential, in May 2001 Lehman Brothers opened new offices in Germany, further building its presence in a country where 10% of the firm's 3,200 European-based employees were already based.
- **Pension reform.** Underfunded state pension systems and the inordinate budget constraints such government-administered programs confronted in the face of an aging European population generated the prospect of sweeping pension reform. Limiting major state budget deficits, in accordance with the strict Maastricht treaty guidelines for economic convergence that were a prerequisite for joining the single currency, accelerated the privatization of government pension programs. As asset managers vied for pension fund administration across Europe, the competitive environment was likely to spur further consolidation and drive up the quality of services that only the biggest firms could offer. The competitive environment was also a major promoter of performance -- the differentiating quality of various combinations of fixed income and/or equity products that could sustain index-beating returns. Indeed, equity participation by pension funds appeared to be the route that would propel the demand for equities in a way that would keep pace with the potential increase supply indicated from privatizations, secondary new issues by established companies, and IPOs.

In all, the convergence of supply and demand drivers for equities seemed to be the base factor that would see the Europe continental market capitalization grow at a compounded rate of perhaps 30%, from less than \$7 trillion to almost \$25 trillion over the first decade of the new millennium.

The Schroder Salomon Smith Barney Deal

Within this broad context of change in global financial markets, in deregulation, and in the European political economy, Citigroup faced a number of challenges. In the words of one senior Salomon Smith Barney executive, "it is just not possible to be a firm like Citigroup and not be strong in Europe."

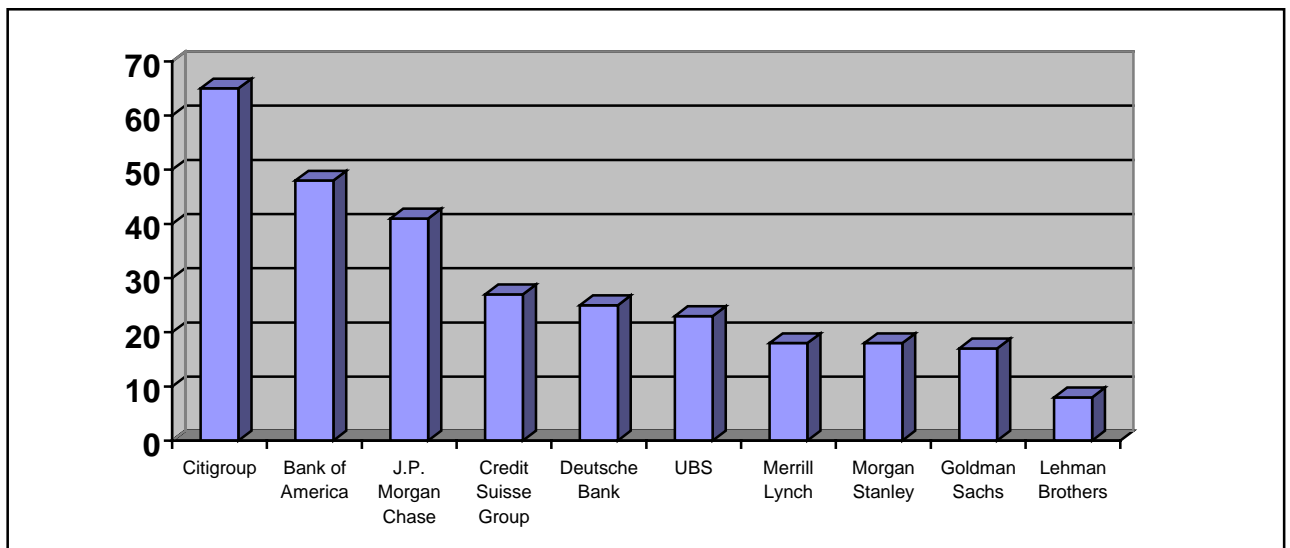
Citigroup

With net revenue of more than \$77 billion in 2000, 230,000 employees, and operations in more than 100 countries, Citigroup was the world's largest diversified financial services

company. Two years after Citicorp reported income of \$3.5 billion and Travelers reported \$2.9 billion, the combined company had more than quadrupled each of these figures—reporting more than \$14 billion in core income.⁵ Cross-selling has been the cornerstone of the Citigroup model, leveraging in a very different way multi-financial product offerings that were not new to the industry. Indeed, the ‘financial supermarket’ concept originated years earlier and is most closely associated with American Express’s interest in diversifying across the realm of financial products in the 1980s. Combining its credit card business with travel services, the Shearson retail brokerage (later part of Smith Barney), and the investment bank Lehman Brothers, among other subsidiaries, American Express was ultimately unable to leverage the businesses off each other, and watched as its businesses took on divergent growth patterns. The conglomerate discount imbedded in the American Express stock price pressured management to eventually abandon the financial supermarket model.

The 1999 Gramm-Leach-Bliley Act fundamentally altered the environment in which Citigroup could operate. It hardly went unnoticed in the financial services industry that the combination of retail and corporate banking, insurance, and brokerage held the potential of redefining the industry as a whole. The size and breadth of new firms such as Citigroup, Bank of America, and J.P. Morgan Chase was blurring the traditional lines demarking the industry and was altering the balance of power across sectors of the market. ‘Bigger is better’ has become a catch-phrase for the securities industry, and adjectives that describe particular investment banks such as ‘independent’ and ‘closely held’ became synonymous with limited capital, a major impediment to solid credit ratings and a barrier to key types of investment-related services that can be offered to clients. Equity capital among leaders in the securities industry became so large that additional consolidation and restructuring of the industry seemed inevitable (see Figure 4).

Figure 4: Equity Capital Among Global Banking Firms; in billions of dollars



Source: The Wall Street Journal Europe, June 18, 2001

Citigroup’s vision of the shift ongoing in the balance of power in financial services was hardly limited to the U.S. Its vision focused on three dominant themes affecting the financial

⁵ Citigroup 2000 Annual Report

sector in the Euro zone -- continuing globalization, on-going consolidation, and the emergence of combined investment bank/commercial bank powerhouses. While Citicorp had long had a presence in commercial and retail banking on the continent, its presence was fragmented along national market lines. Salomon Brothers had maintained a mediocre franchise in European markets with the exception of fixed income, and Smith Barney has long been associated with retail brokerage almost exclusively in the United States, with only a small presence on the continent of selling U.S. equities into wealthy Europeans.

Ironically, both Citicorp and Salomon Brothers had their share of problems in building franchises in Europe. Following the deregulation of the UK securities industry in the mid-1980s, Citicorp purchased two UK securities firms, Vickers da Costa and Scrimgeour Kemp Gee, only to face huge losses and ultimately shutter the business in 1990. Salomon Brothers, seeking to capitalize on the opening of the British brokerage industry to vigorous competition after 1986, never fully committed itself to the European equities market, alternatively building and slowing its presence with mass hirings and firings that followed the volatility of the markets. This cost the firm hugely in terms of credibility with UK issuers and investors, not to mention its recruiting effort. Under the Citigroup name, the different divisions saw the consequences of past actions that had left the firm with one big gap in its mega-bank wholesale businesses -- Europe.

Schroders

With its origins going back to the mid 19th century, Schroders long had an enviable position in the UK securities industry. But by the end of 1999, it remained -- along with three other merchant banks -- Robert Fleming, Rothschilds and Cazenoves -- one of the only investment banks of size still in British hands (in 2000 Fleming was acquired by Chase and Rothschilds had earlier established a joint venture with ABN-AMRO). Having survived the broad shakeout of the UK securities business that surrounded Big Bang in 1986, Schroders had diversified enough to withstand the consolidation of the industry that brought many of its British competitors to their knees. To be sure, Schroders was one of the original merchant banks that focused mainly on corporate finance and advisory work and securities placement that now form the core of modern investment banking. The firm thrived in the pre-Big Bang environment that separated merchant banking, broking (the sales and trading of securities to clients), and jobbing (a particularly British descriptor for market-making).

When the British government abandoned a fixed commission scheme common to all members of the London Stock Exchange and tore down the barrier that separated brokers from jobbers in October 1986, alliances were already forming among the three types of securities firms, ultimately resulting in a first wave of consolidation. In addition to its strong asset management division, Schroders soon managed to build a sizeable presence in brokerage and market-making. By leveraging its strong corporate client relationships across British industry, the firm had succeeded in corporate broking, another UK-specific relationship function that served as the main conduit of market information and activity in a company's stock among investors, the issuer, and the London Stock Exchange. But competition in the new de-regulated environment was intensified by the arrival of non-British players, particularly American ones, seeking to capitalize on the changes affecting the UK market. These were firms whose expertise at running unified businesses across corporate finance, sales, and trading was unparalleled in the world of wholesale finance.

In 1986, Schroders bought Wertheim, a reputable broker and M&A advisory firm in the United States. The Wertheim deal was problematic from the start and the two geographic

divisions operated almost independently. Schroders proved unable to leverage its credibility and reputation in the UK into its American operation. By the late 1980s, investment banking had become a very capital-intensive business, both in serving issuers and investors, and the middling equity of the Schroders franchise kept the firm in the second tier. Schroders was too big to be a niche player, but found it difficult to compete in the ‘bulge bracket’ investment banks as well. Its U.S. business focused mainly on rust-belt industries and had only marginal capacity in fixed income products.

Schroders’ weak presence in the U.S. proved to be a persistently thorny management issue all the way until its sale to Citigroup. In 1999 a failed last-ditch attempt to buy the Beacon Group, another highly reputable advisory firm in the U.S. (later acquired by Chase) sealed the fate of its U.S. business. By 2000, then, Schroders had built a strong UK product franchise, leveraged its European focus to include respected equity-related operations in a handful of continental European markets, and had grown its asset management division to one of the largest in the United Kingdom. To outsiders on the prowl for ways to build wholesale banking capabilities in Europe, such a business certainly looked attractive.

Schroder Salomon Smith Barney

“It is harder to see what magic there is in the deal for Salomon. It is paying top whack for an arguably wasting UK franchise rather than a growing European one. Culturally, the two sides look light years apart. Salomon has a good record in integrating banking acquisitions. This will put it to the test.”

--Financial Times, January 19th, 2000

Citigroup had a tried and tested internal financial model for evaluating acquisitions and, according to one senior executive, “this one fit in well.” Apart from valuing the business, the Citigroup model implicitly demanded a strategic fit in order to be considered – mainly (a) that the acquisition would not be dilutive to shareholder value (over a specific time period, depending on the size of the deal), (b) that it would be complementary to existing businesses, and (c) that the target firm was indeed a business that wanted to be acquired by a firm like Citigroup.⁶

Almost two years before the Schroder acquisition, Citigroup executives focused on the European gap in their wholesale banking capabilities, especially in the investment banking and equity product areas. Management realized early on that there was a compelling need to build or buy, and probably a combination of both. Hiring began in earnest in 1998, and the firm tripled its personnel in European equities over the next two years. However, the Salomon Smith Barney division ran into significant competition in its strategic initiative, confronting other U.S. and European firms who had similar ideas. Salomon Smith Barney’s more established American competitors in Europe—Goldman Sachs, Merrill Lynch, and Morgan Stanley—and its biggest European adversaries—Deutsche Bank, Credit Suisse First Boston, and UBS Warburg—all were hunting for hundreds of bankers, traders, sales people, and analysts. Management faced the predicament of not being able to build fast enough and took this as a signal that an acquisition was imperative.

⁶ In the case of the Schroder deal, Citigroup made a commitment to shareholders that the acquisition would be *accretive* to earnings in the first year of joint operations.

Following Schroders' failed bid for Beacon in the U.S., the firm had begun to look at alternatives. Its acquisition history was unimpressive, and staying the course would almost certainly have meant a continuing erosion of its market share at the hands much bigger full-service firms. For some within Schroders, such a strategy was not necessarily a doomed one. The firm could survive as a second tier player, catering to certain niches in the market such as pan-European small cap equities, where it already had an enviable franchise.

Citigroup was looking at only a handful of firms, Schroders among them. Management knew that there were other suitors waiting to make a move.⁷ Citigroup acted swiftly, focusing on the strength of Schroders' U.K. investment banking business, strong corporate finance and relationship focus, and well-entrenched, (if smallish) brokerage operations in Madrid and Milan, and to a lesser extent Paris. Combined with Salomon Smith Barney's strength in global fixed income, its more transaction-oriented approach to building brokerage market share, and equally middling on-the-ground European presence outside of the U.K., the benefits seemed straightforward. Realizing the critical requirement of being able to serve U.S. client needs in Europe and vice-versa, the deal was complementary to Salomon Smith Barney's existing platform elsewhere -- especially in equities, where five critical distribution channels would then exist: (1) the U.S. investor base, (2) the U.K. investor base, (3) continental European investors, (4) Asian investors, and (5) global private client/high-net-worth retail network.

On January 18, 2000, Citigroup announced that it would pay \$2.2 billion, (1.7 times book value) for Schroders' investment banking business and would absorb its 3000 employees, making unspecified layoffs where there were redundancies. The asset management arm of Schroders would remain publicly traded and Schroders' chairman, Win Bischoff, would fill the newly created position of chairman of Citigroup Europe. In a press release, John Reed, then Citigroup's co-chairman and co-chief executive with Sanford Weill, said, "[the deal] doubles our investment banking platform in Europe and gets us to where we want to be in that important region several years ahead of schedule." On the day of the acquisition, Schroders shares closed up 134 pence, or over 11%. Citigroup shares closed at \$57 ³/₄, down ¹/₄.

The Price

At the time of the acquisition, two-thirds of Schroders PLC market capitalization was seen to be attributable to the firm's asset management business. Institutional asset management was itself a consolidating industry but one in which Schroders held a commanding presence in the U.K. Based on the terms of the deal, Citigroup's price of £1.35 billion for the investment banking arm was almost exactly 1/3 of Schroders' £3.9 billion market cap at the close of the deal.

Within Schroders' securities division, revenues were said to be split unevenly -- 80% from corporate finance and M&A advisory, and 20% from sales and trading. Such weak revenue diversification would help explain Schroders' difficulty in operating in the rapidly changing European marketplace, but raised additional questions of what Citigroup was paying for. Why did it value so highly the investment banking capacity within Schroders, whose corporate financiers were predominately UK-focused? Could it in fact leverage Schroders' brokerage operations with its own mid-ranking equity sales, trading, and research effort in Europe?

⁷ Following the announcement of the deal, rumors circulated that Lehman Brothers and Donaldson, Lufkin Jenrette had held extensive negotiations with Schroders.

Executives at Citigroup claimed that the numbers were conservative and that synergies would assure that “one plus one is greater than two.” While specific revenues and earnings results for Citigroup business units were not made public, management indicated that the price reflected what Citigroup hoped to achieve -- credibility and critical mass in Europe which would allow revenues to grow substantially and help move the combined firm into the top tier of global banking firms. A senior Citigroup executive in early 2001 suggested that revenues had already grown four-fold in Europe since the merger, supporting the hypothesis that the combination of the Citigroup balance sheet, the Salomon Smith Barney distribution platform, and the Schroders product mix provided access to clients that could not otherwise have been achieved.

In the spring of 2001, Schroder Salomon Smith Barney was a co-lead manager of the initial public offering of Inditex, the Spanish retailing group and the largest European IPO up to that time. According to a senior executive, “Schroders gave us access to corporate clients and continental European investors that we didn’t have, and Salomon Smith Barney provided the distribution capability [on a global scale]. The combination gave us a platform that could be leveraged for selling European equities on the continent, in the UK, and in the United States. In all, the biggest gains were sufficient strength and a selectively strong product range.”

Merger Integration

“We looked at this deal as what they would bring to us, and what we could do for them. We wanted this to be a partnership. It had to be a merger of equals—neither side continental Europe was strong. There were pockets of excellence in Europe at both firms, but neither was a dominant firm in European equities. . We did not look at this as if we were taking over Schroders. On the equity side, we worked out a management structure prior to the announcement of the deal. Both sides got a certain amount of management control in various areas.”

-- A senior Citigroup executive.

Integration of the two firms’ personnel would have to be key to the ultimate success of the acquisition. Horror stories abounded about cultural differences and mass defections of key employees in domestic U.S. investment bank mergers, not to mention cross-border ones. The difficulty in the Schroder Salomon Smith Barney deal was twofold.

First, the Schroder culture was very specialist - oriented and research – oriented, focused on specific investment banking services to a limited roster of customers, while the Salomon Smith Barney side was much more transaction focused on a global platform with a board range of both clients and products. Integrating the two would involve convincing both sides from the very beginning that each firm would benefit. Schroders would have the opportunity to rise to the top-tier of securities firms in Europe, something that it would not be able to do alone. Salomon Smith Barney would gain critical mass immediately, something that it had been trying to do in Europe unsuccessfully for at least two years.

Secondly, the new hierarchy of management of the combined firm would be an issue for both sides. From the beginning there was no doubt what the new management structure would be -- according to senior management -- and everything was communicated honestly, clearly, and openly to employees of both firms. Every issue, every problem, every concern, and every key employee thought to be at risk of defection was addressed in daily integration meetings. There was a persistent focus on employees to promote teamwork and to encourage the resources to

grow together. Management of the new firm took no chances, arranging weekly cocktail parties for different product areas to allow employees to get to know each other, holding numerous “off-sites” to take people away from the office to get them acquainted, and even going as far as to put a name plate on every desk on the trading floor so that employees would learn the names of people sitting next to them.

Both firms benefited by moving into new offices in the firm’s London-based headquarters, creating a fresh start for two corporate cultures. Management claimed that neither firm had yet achieved a strong pan-European culture that would be key to growing a business across borders and languages. Undoubtedly, the focus would have to be on keeping people from leaving in the first few months without giving the merger a chance to work. The risk to the business of mass defections was undeniable. With an attrition rate of 30% common in investment bank mergers, the equities division Schroder Salomon Smith Barney managed to retain 95% of targeted employees despite internal projections that the new entity would lose at least 15% of key staff.

Eighteen Months Later (mid-2001)

Credibility and critical mass had been the objectives of the Citigroup acquisition, with a leap of faith required by both sides that meeting those two goals as a combined firm would unleash an array of drivers to allow revenues to grow exponentially. Gaining market share in Europe would be the key measure of success of the deal going forward (see Exhibits 3-6), and initial results suggested that the new firm was making headway despite difficult market conditions: a massive slowdown in IPOs and merger and acquisition activity, the collapse of the technology and internet stock market bubble, and signs of recessionary trends both in Europe and in the United States. In the words of a senior Schroder Salomon Smith Barney manager, “this is not really a slowdown for a firm that was nowhere a year and a half ago in Europe.”

Case Questions

1. What was Schrodgers unable to survive as an independent, Europe-based investment banking firm? Or was it?
2. Why did the previous shareholders choose to sell only the investment banking business to Citigroup, retaining the asset management business?
3. How does the Schrodgers acquisition fir into Citigroup’s overall strategy? How would you measure “success” or “failure” in this regard?
4. What about the price?
5. What are the key integration challenges that face Citigroup, to make sure it gets the most out of the Schrodgers acquisition?

1. Exhibit 1: Selected Securities Underwriting League Table Data

Top Equity New Issue Managers

Managers	First Quarter 2001		Full Year 2000	
	Proceeds (US\$mm)	Market Share	Proceeds (US\$mm)	Market Share
Salomon SB	15,858.9	16.3	41,750.0	15.8
Merrill Lynch	12,042.4	12.4	31,004.3	11.8
Morgan Stanley	11,593.9	11.9	39,429.5	15.0
JP Morgan Chase	10,336.3	10.7	14,677.3	5.6
Goldman Sachs	8,598.5	8.9	44,275.4	16.8
Top 5 Total		60.2		65.0

Source: Thomson Financial

Top M&A Advisors—Any Buyer, European Target

Managers	May 2000-May 2001	
	Number of Deals	Market Share (%)
JP Morgan	127	10.2
Lazard	111	8.6
UBS Warburg	124	8.6
Goldman Sachs	81	8.5
Merrill Lynch	83	8.2
Schroder Salomon Smith Barney	136	7.9
Top 5 Total		52

Source: Thomson Financial

Global Disclosed Fees—All Products

Bookrunners	First Quarter 2001		First Quarter 2000	
	Number of Issues	Market Share (%)	Rank	Market Share (%)
Morgan Stanley	163	14.5	1	14.5
Schroder Salomon Smith Barney	259	12.3	4	7.9
Merrill Lynch	245	11.7	5	6.9
Goldman Sachs	130	10.0	2	14.0
CSFB	250	7.7	3	13.4
Top 5 Total		56.2		56.7

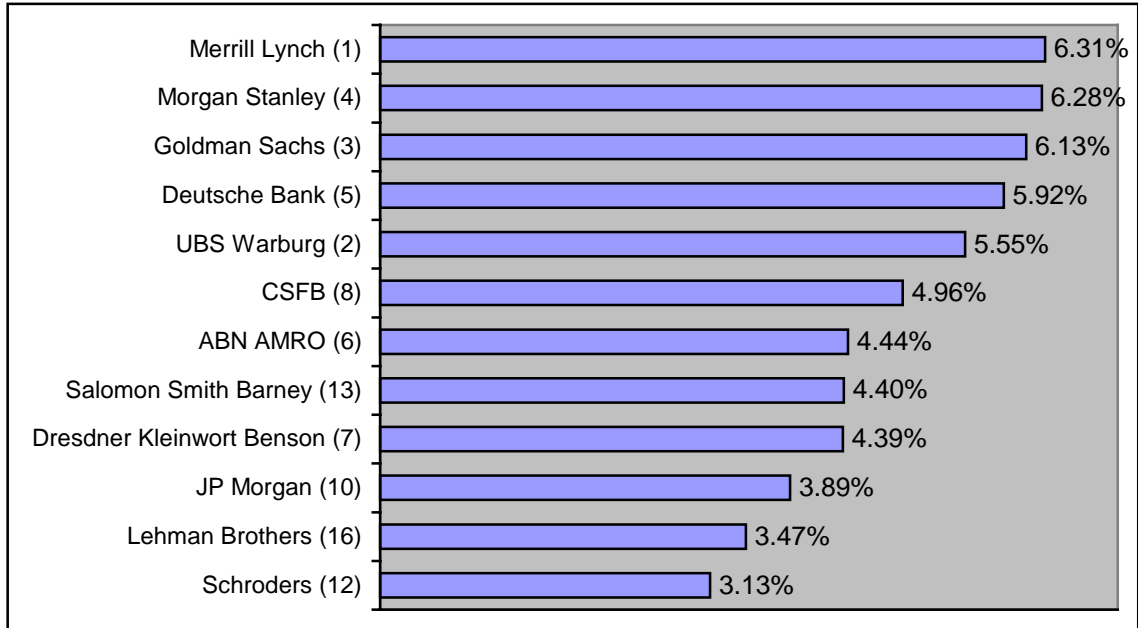
Source: Thomson Financial

Exhibit 2: Market Cap/GDP Ratios in Selected European Countries, 2001

<u>Country</u>	<u>Market Cap</u> <u>(US\$bn, Feb '01)</u>	<u>GDP</u> <u>(US\$bn, 2000e)</u>	<u>CAP/GDP</u> <u>(%)</u>
Austria	27.8	212	13
Belgium	166.8	251	66
Czech Republic	11.0	53	21
Denmark	110.1	174	63
Finland	228.3	125	183
France	1,355.1	1,431	95
Germany	1,153.4	2,136	54
Greece	84.5	123	69
Ireland	76.7	78	98
Italy	722.9	1166	62
Netherlands	644.9	377	171
Norway	60.8	146	42
Poland	31.3	164	19
Portugal	64.6	108	60
Spain	388.8	553	70
Sweden	330.5	227	146
Switzerland	777.2	263	296
Turkey	69.6	206	34
UK	2,490.5	1,387	180
EMU	4,914	6,437	76
Europe	8,683	8,634	101
Europe ex-UK	6,193	7,247	85

Exhibit 3: Selected Survey Results, Europe Ex-UK Market 2000 (Data Released January 2000)

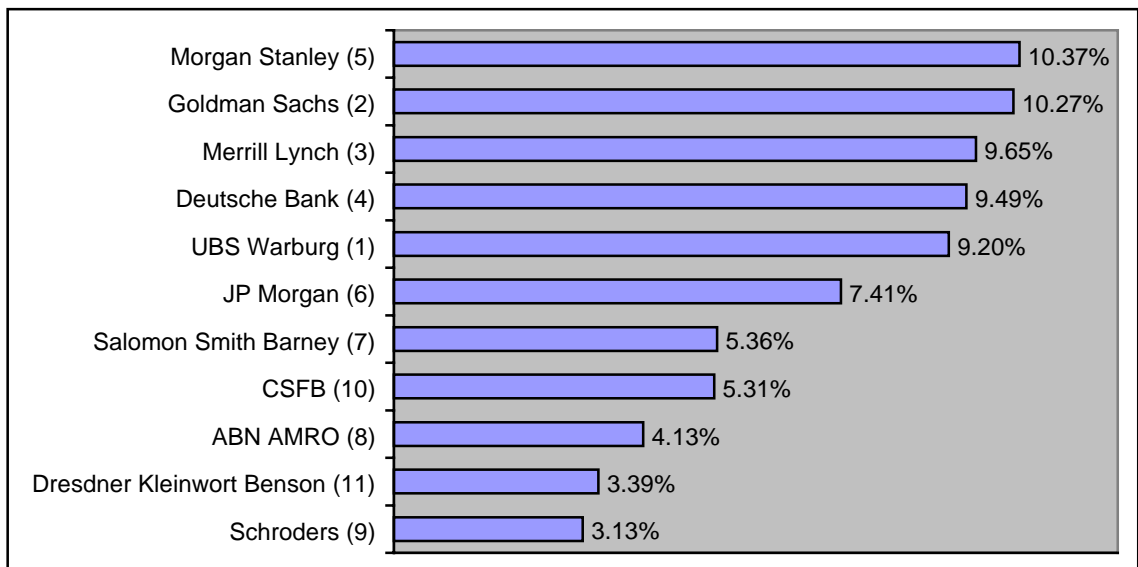
2000 Fund Manager Ranking of Brokers' Equity Product and Service, % of Total Votes



Source: Tempest Consultants/ Reuters Survey

Note: number in parenthesis reflects last year's position

2000 Fund Manager Ranking of Brokers' Overall Equity Research Product, % of Total Votes

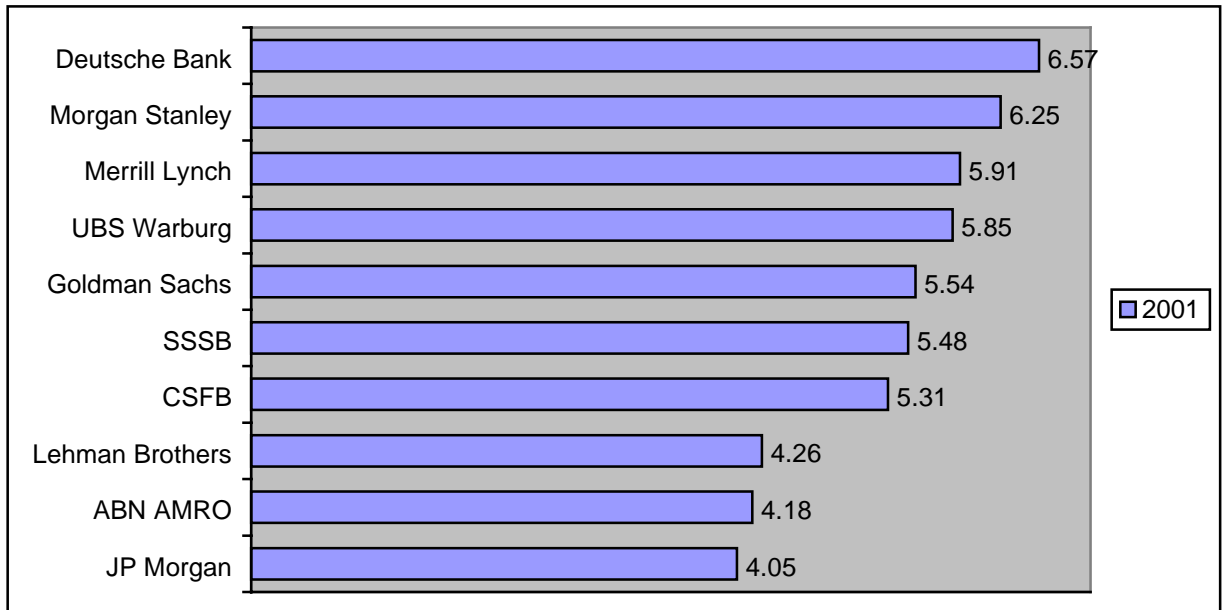


Source: Tempest Consultants/ Reuters Survey

Note: number in parenthesis reflects last year's position

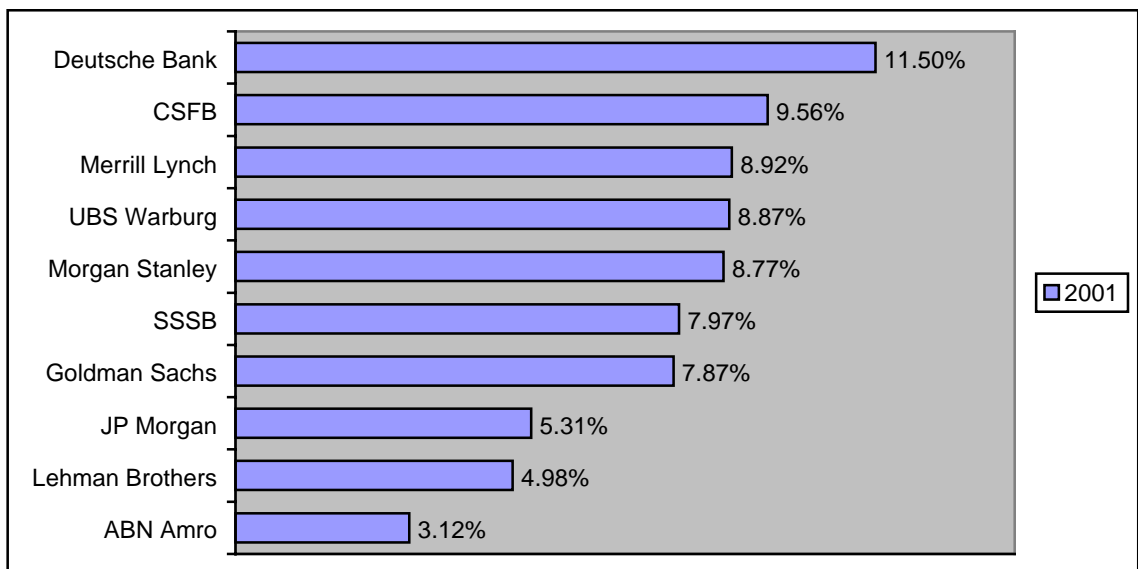
Exhibit 4: Selected Survey Results, Europe Ex-UK Market 2001 (Data Released January 2001)

2001 Fund Manager Ranking of Brokers' Equity Product and Service, Percent of Total Votes



Source: Tempest Consultants/ Reuters Survey

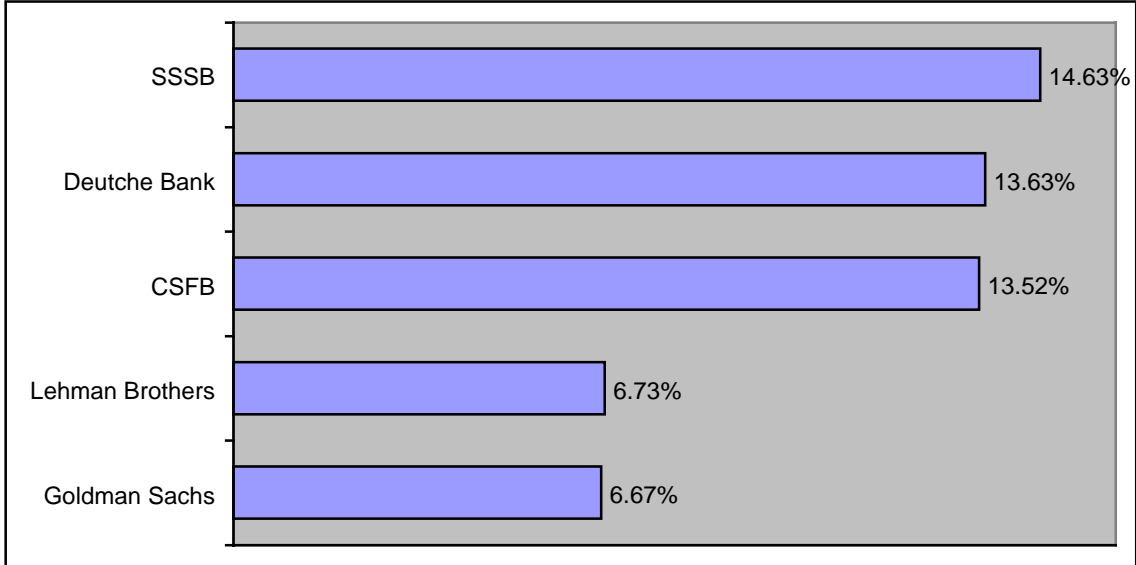
2001 Fund Management Group Ranking of Overall European Equity Research, Percent of Total Votes



Source: Tempest Consultants/ Reuters Survey

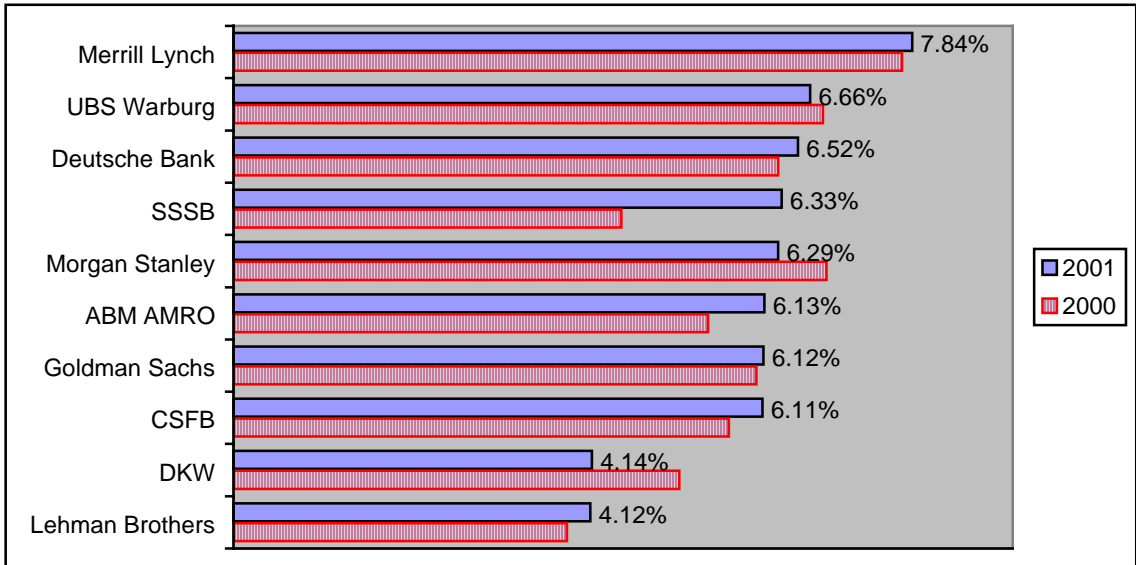
Exhibit 4 Continued: Selected 2001 Survey Results, Europe (ex-UK)

Fund Manager Ranking of Most Improved Broker Equity Product and Service, Percent of Total Votes



Source: Tempest Consultants/ Reuters Survey

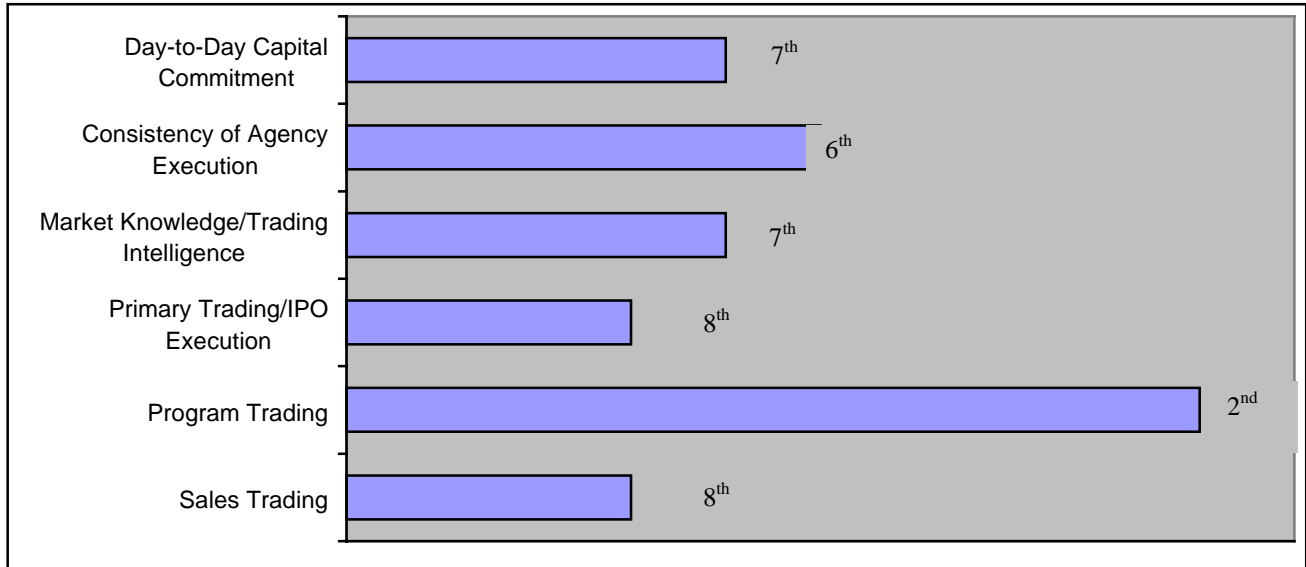
Fund Management Group Ranking of Equity Sales Teams, Percent of Total Votes



Source: Tempest Consultants/ Reuters Survey

Exhibit 4 Continued: Selected Survey Results, Europe(ex-UK) 2001

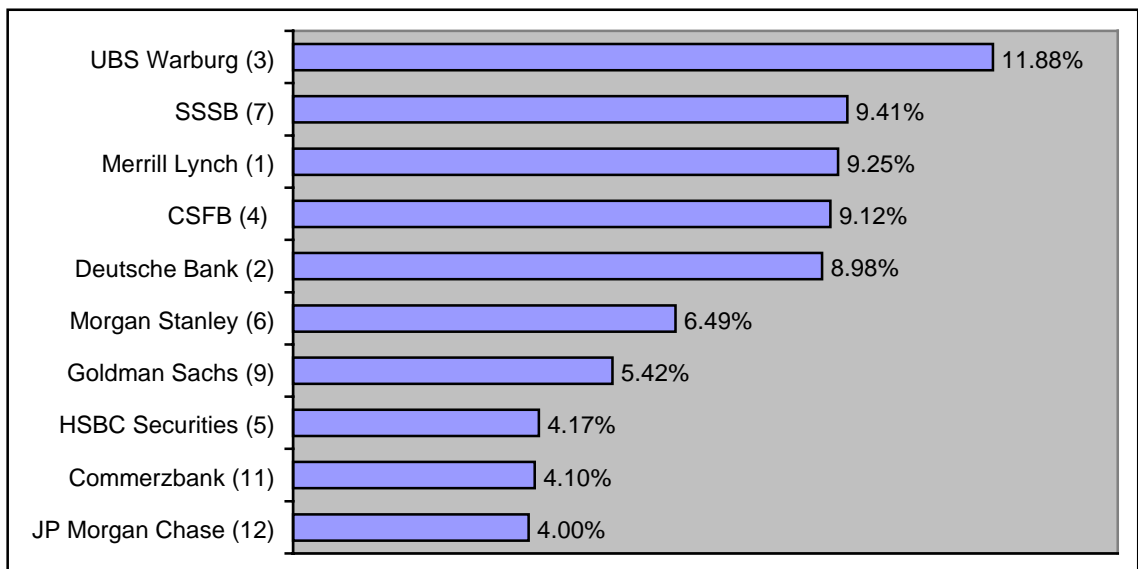
Fund Management Group/Head Dealer Ranking of SSSB Execution Expertise



Source: Tempest Consultants/ Reuters Survey

Exhibit 5: Selected Survey Results, Pan-Europe 2001 (Data Released June 2001)

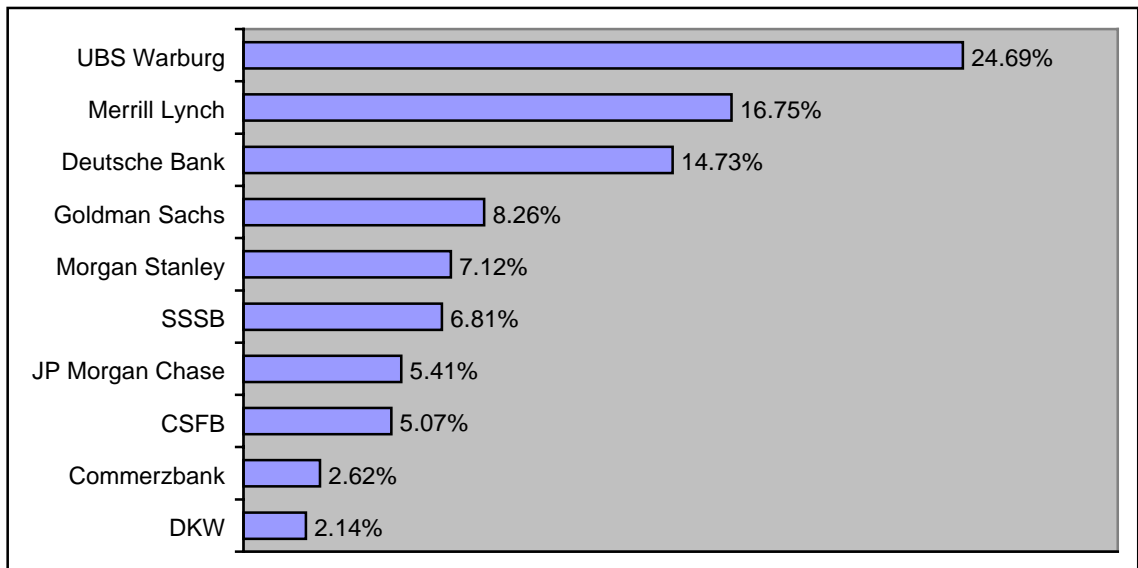
Leading Pan-European Brokerage Firm for Equity Research, Percent of Total Votes



Source: Thomson Financial/Extel Survey

Note: number in parenthesis reflects last year's position

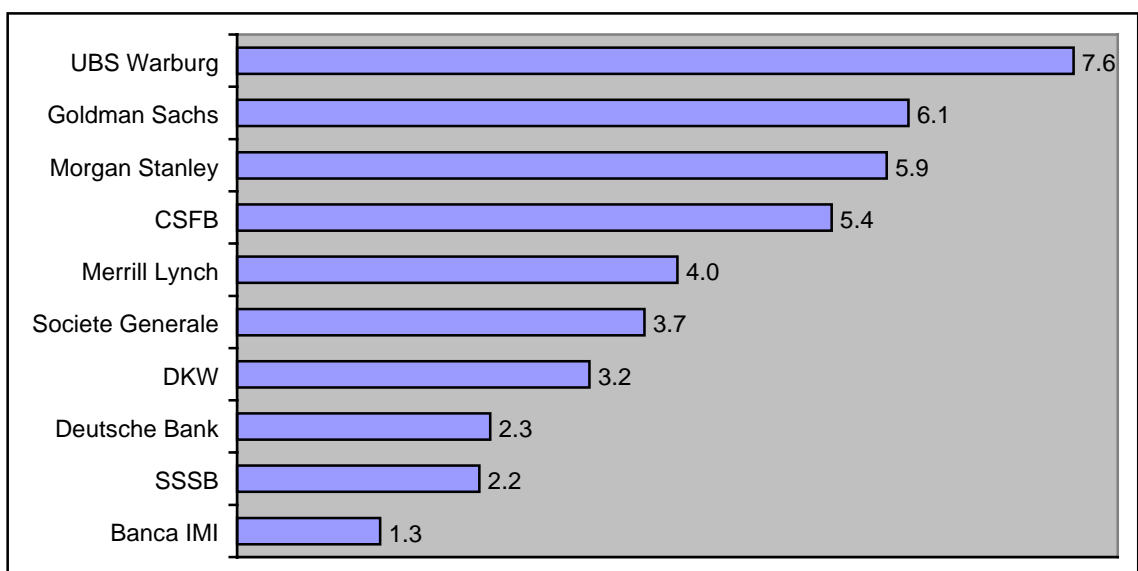
Leading Pan-European Brokerage Firm for Equities Derivatives Trading, Percent of Total Votes



Source: Thomson Financial/Extel Survey

Exhibit 6: Selected League Table Data, 2001

Equity Issuance Leaders, Excluding Equity-Linked Issues, January-June 2001, US\$bn



Source: The Wall Street Journal Europe/ Dealogic

Europe/Africa/Middle East IPO Issuance Leaders, January-June 2001, US\$mm

Managers	Number of Deals	Market Share (%)
Morgan Stanley	4	20.3
Dresdner Kleinwort Wasserstein	4	13.5
Societe Generale	3	11.4
Goldman Sachs	4	8.0
UBS Warburg	3	7.1
Schroder Salomon Smith Barney	5	5.6
Credit Suisse First Boston	3	5.2
Banco Santander	2	4.1
Deutsche Bank	4	3.4
Den Norske Bank AS	1	3.3
Top 5 Total		60.3

Source: Dealogic

Global Equity Issuance Leaders, January-June 2001, US\$mm

Managers	Number of Deals	Market Share (%)
Morgan Stanley	10	24.0
Credit Suisse First Boston	13	14.1
Citigroup/Salomon Smith Barney	21	12.5
Goldman Sachs	13	10.9
Dresdner Kleinwort Wasserstein	4	5.4
Societe Generale	3	4.6
Merrill Lynch	11	4.1
UBS Warburg	5	3.2
Lehman Brothers	6	2.3
Banco Santander	2	1.6
Top 5 Total		66.9

Source: Dealogic