

Citigroup's John Reed Retires, Sandy Weill To Unify Two Disparate Cultures Into A New Business Paradigm

After 35 years at Citigroup and its predecessor Citicorp, chairman and co-CEO John Reed has informed the board of directors that he will retire from his positions, effective at the company's annual shareholders meeting on April 18, 2000. Sandy Weill, the legendary Wall Street veteran, will assume the chairmanship of Citigroup and will become sole chief executive officer of a firm he largely created with the merger of Travelers (and its affiliate Salomon Smith Barney) with Citicorp. Mr. Weill built his reputation and career on aggressively growing the old Shearson franchise through the acquisition of brokerage firms (Haden Stone, E.F. Hutton, Lehman Brothers) and assimilating them into a highly entrepreneurial, extremely well-run financial services giant. Weill must now work his magic again in assimilating the disparate cultures of Citibank, Travelers and Salomon Smith

Barney into one cohesive business enterprise that will become the new business paradigm for the most efficient and highest value delivery of all financial products and services within the industry. Weill who plans to retire himself within the next few years will develop a plan of succession with the Board, which would come up with a successor within two years. Thus, Weill has a free-hand to chart the course of Citigroup over the next three or so years which may well leave a lasting legacy in shaping the future course of the financial services industry.

By sheer force of his personality and his will, Weill has been responsible for the remarkable transformation of Shearson and Travelers. His management style of quickly assessing the economic drivers of the business, cutting to the bottomline and boldly reconstructing business units, has largely

been constrained by Citigroup's awkward co-CEO structure and Reed's controversial dismissal of the highly regarded Jamie Dimon, Weill's right-hand man and heir apparent. With the retirement of Reed and the absence of a gifted senior manager like Dimon, there is a significant vision and leadership vacuum at the top of Citigroup that Weill and the Board must fill. In the meantime, the internet revolution is underway, fast transforming the financial services industry, and Weill and Citigroup do not have the luxury of waiting for a successor to pick up the load.

The internet revolution has changed everything. The primary economic drivers of the business are no longer brokerage commissions, trade execution, financial products or even disjointed financial services, but convenient, fairly priced compre-

continued on page 25

Have We Oversold Technology and Internet Companies And Are Now At A Teachable Moment?

Is a 10% return still a reasonable long-term return expectation? Last year, the average internet IPO return was 197%. In order to make the top quintile of "America's 1,000 Most Important Companies" that account for 90% of the market value of all publicly traded stocks, a company had to generate better than a 93% return. There were 18 companies last year that chalked up returns of 1,000% or more. We are clearly in a period of unprecedented innovation, driven by technology, telecommunications and the internet. A third of last year's top performers were not trading three years earlier. The average internet company in the *Wall Street Journal* Shareholder Score Card registered average compounded annual returns of 148.8% over the past five years. There is a clear economic transformation from the old

economy to the new economy underway, and we are very fortunate to witness how this is manifested in stock prices and company valuations.

Yet, for all the euphoria that is driving internet and technology stocks up, we cannot ignore the fundamental laws of economics. Nobel laureate, Peter Drucker, said, "Profit breeds competition, and excess profits breed ruinous competition." What a 197% average internet IPO return means is that the extraordinary demand for these securities in concert with the absence of liquidity has driven their prices to stratospheric levels. This same absence of liquidity also means that if there is any bad news, these stocks will take a correspondingly significant heart-stopping plunge. By definition, IPOs should be fairly priced, based on their revenues,

earnings and growth prospects. Yet, if internet IPOs were up 197% on average last year, doesn't that mean they are trading at three times a fair and well-reasoned price based on all the pertinent data? Are we now beyond the realm of investing and entering a period of speculation where stock prices bear no relationship to their fundamental economic value?

This is a wonderful opportunity for internet entrepreneurs, but as is always the case, rarely does a great sales story translate into an excellent investment. Even given that the internet will transform commerce around the world, and even assuming optimistic expectations of performance, the market is, in effect, tripling (or more) a reasonable economic valuation. This is the sort of valu-

continued on page 30

ECNs. Without the linking of these market centers, buy and sell orders could be distorted, or worse, manipulated. The major brokerage firms supported a middle ground of linked markets but not a centralized market that would include ECNs determining the best price available. Phil Purcell, chairman and CEO of Morgan Stanley Dean Witter, stopped short of advocating a centralized or unified market but supported linking all trading venues to guard against market fragmentation which would take liquidity away. Purcell believed everyone should have open access to the markets but felt the "competition should be between orders, not handlers," thus putting Morgan Stanley slightly more in the camp of the NYSE than the investor, as the handlers ultimately determine price and thus, best execution. David Komansky, chairman and CEO of Merrill Lynch opposed a centralized or collective market in preference to a series of linked markets. To get on the market, firms would have to qualify as brokers/dealers do today. He felt linking of markets was imperative in order to avoid market fragmentation and to strengthen all markets in case of a downturn. Henry Paulson, chairman of Goldman Sachs, said most orders should be displayed for everyone but made the case that large institutional orders should not be displayed because they could move a stock's price. Paulson also called for "catch up" regulation with the innovation and technological breakthroughs that have occurred that are fast redefining the industry.

The NYSE was not an enthusiastic supporter of a centralized or linked markets, which would preserve the role of its market

makers, specialists and traders. Chairman and CEO, Richard Grasso, was concerned that institutions might be exempt from displaying big block orders and felt institutions would not send their orders to a centralized monolith. Yet, to the contrary, Fidelity and other leading institutions are either creating ECNs or taking their order flow permanently off the exchange floor to ECNs for better, fast, cheaper execution. Grasso would like to keep the traditional trade execution system of the NYSE while offering electronic trade execution for those who want it. But without linking and matching the best prices among the exchanges or the ECNs, the NYSE would not be in compliance with its public obligation of providing the best price available. Thus, Levitt's mandate for a public policy would require best-price available within, among and outside the exchanges.

Frank Zarb, chairman and CEO of NASD, urged caution as the regulators and legislators started to get down to the "nitty gritty." Zarb said, "The genius behind stock market innovation is not a centrally prescribed single market but free competition." Zarb's comments captured the consensus of the major brokerage firms and left the NYSE as the only participant in the hearings which was not supportive of linking the exchanges and market centers to ensure the best price available.

Arthur Levitt of the SEC has proposed a solution where the NYSE would become a publicly traded company, thus making its allegiance to the public and its shareholders, not its 1,366 members who own the governing seats on the exchange. The NYSE would

then buy NASDAQ, creating one regulatory body that would be spun off separately from the consolidated exchanges. The new regulatory organization would govern the exchanges and ECNs. Though the consolidation of NYSE and NASDAQ would be very close to a central or collective market, if it had links to ECNs and an agreement on "best price available," we could be very close to the compromise position most firms would prefer.

Shortly after the Senate Banking Committee hearing concluded, the NASDAQ board had a conference call with the NYSE to discuss a possible merger. At the urging of Arthur Levitt, these talks are continuing. Independently, NASD is moving forward to make the NASDAQ a for-profit organization through a two-step private placement that would raise \$1 billion. The proposal is under review by the SEC and the 5,500 members of the NASD. The NYSE continues to pursue its plans of going public. With both the NYSE and NASDAQ pursuing courses of action that would segregate their regulatory and exchange businesses, Arthur Levitt's vision of a faster, better, cheaper market governed by one regulatory body is not only possible, but totally consistent with the actions of all the participants. Maybe we should pay more attention to what is being done than what is being said because once the NYSE goes public and the NASDAQ becomes a for-profit enterprise, their regulatory arms have to go somewhere, and Arthur Levitt has a great idea of how they might be reconfigured. ■

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Continued from page 3

hensive advice that will manage a mind-boggling array of financial information (risk, return, income and estate tax efficiency, liquidity, cost structure) in terms specifically meaningful to each investor in helping them achieve their long-term goals and objectives. The delivery platform is no longer a brokerage, insurance or banking delivery platform, it is an on-line, virtual real-time balance sheet and income statement incorporating all the client's assets and liabilities. Products are immaterial as it is

process or what one does with the products that adds value. Organizational structures built around products or distribution channels are outdated and largely obsolete.

The new business paradigm will be built around customized investment processes that facilitate the highest level of professional investment counsel to be consistently and routinely offered to each of the eight major market segments (high net worth, foundation and endowment, defined contribution, defined benefit, profit sharing,

public funds, Taft Hartley and family office) of the institutional and high net worth markets. The banking, insurance and brokerage platforms disappear at the client and financial consultant level. The core account relationship for everyone will entail a savings account, checking account, credit card, term life insurance and home mortgage – all tied to a virtual real-time balance sheet and income statement with electronic bill payment and credit lines. The core account relationship for all clients can be

substantially automated and managed by call centers open seven days a week, 24 hours a day, and virtually 99.9% of all questions and inquiries will be answered immediately on the first call. Citibank's old branch customer service representatives, now called client financial analysts, would man the call centers for these core account relationships and would be salaried employees. Indeed, only 12% of investors with more than \$250,000 invest through a bank compared to 44% who invest through brokers. Only 20% of investors with more than \$250,000 said a bank is their primary service provider, according to Oliver Wyman, a New York-based bank consulting firm. Clients with less than \$100,000 are served by Citibank's branch brokers. They would be compensated on the revenues they generate. Clients having investable assets of more than \$100,000 and less than \$1.2 million, not entailing estate tax problems or ERISA considerations, would be handled by today's Salomon Smith Barney's financial consultants who are well-

versed in investment products and the investment process. For clients with more than \$1.2 million, Salomon Smith Barney senior investment management consultants who are adept at estate planning and ERISA

Sandy Weill's challenge is to create a unifying vision and to build the processes and technology which will both empower the firm to add value and streamline its organizational and cost structures, while developing a highly motivated client-driven service culture that is geared to adding value. Citigroup has more potential than any other financial services firm to build a new financial services business paradigm because of the breadth of its product and service menu, because its Salomon Smith Barney Consulting Services Division has more industry-leading senior investment management consultants than any other firm on the street, because Citibank has made higher level advice their primary focus in in-branch client service, and because they have Sandy Weill who is not shy about marshalling and aggressively managing the resources of the entire organization. Mr. Weill doesn't have to ask for permission and is a master at execution. There is a tremendous opportunity to create an industry-leading franchise here. ■

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issues would be in the vanguard of providing the highest level of financial counsel in the industry. The ultimate transformation occurs when there is no difference in Citigroup branch brokers, Salomon Smith Barney's financial consultants and senior investment management consultants.

Fidelity's On-Line Investors Help Lehman Brothers Become A Major IPO Underwriter

Continued from page 2

to investment banking clients as it translates into higher prices and more capital for the issuers without having to sell a bigger piece of the company to the public in order to get it.

To drive this point home, Fidelity executives accompanied Lehman Brothers investment bankers to pitch meetings with prospective IPO clients, and the pitch is definitely working. Tracey Curvey, executive vice president of Fidelity On-Line Brokerage, says, "We think we are one of the most powerful distribution channels in the world. We have relationships with 15 million consumers, and that is the power Lehman wants to unleash on these issuers." The more IPO business Lehman wins, the more IPO shares Fidelity can offer its best clients. This is important to Fidelity because access to IPOs has become a crucial selling point for customers with \$500,000 or more

in investable assets. "We cannot be in this business without access to IPOs," says Ms. Curvey. Issuers see the same dynamic at work on the other side of the equation. Mark Hirschorn, CFO of DeltaThree.com, Inc., a New York company that Lehman took public in November, said, "If Lehman had not been able to deliver Fidelity, co-managers like Merrill Lynch, would have had stronger economic interest in our deal." Clearly, Fidelity has become an important factor in Lehman's investment banking success.

Since Lehman's 1994 spin-off from American Express and its brief assemblage into what was Shearson Lehman Hutton, Lehman has not had access to retail investors. Lehman has also completed its transformation from a bond house to a full-service investment bank, having expanded its Equity Division since 1997, attracting

many top equity research and investment banking teams.

With the fall of Glass-Steagall, Lehman Brothers has become a most attractive acquisition target for progressive, internet savvy firms like First Union Securities, Wells Fargo Securities, Charles Schwab and even Fidelity. Thus, with the wonderfully symbiotic relationship between Fidelity and Lehman, one could certainly understand the interest on both firm's part to work more closely together, possibly entailing the acquisition of part, if not all, of Lehman before someone beats Fidelity to the punch. Rarely does synergy like this manifest itself in even the best conceived mergers. It would be a shame if some organization other than Fidelity actually capitalized on the Lehman Brothers' new found prowess in investment banking by making Lehman an offer it couldn't refuse. ■