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Morgan-Citi's first challenge: Duplication

Big cuts seen coming at new wirehouse

By Dan Jamieson
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Reps at both Smith Barney and Morgan Stanley, as well as other industry observers, see a long slog ahead for the new joint venture between the two firms.

"How does this even click?" asked a Smith Barney representative in the Southwest, who asked not to be identified.

The combination will be "a behemoth," this broker said.

Frank Campanale: *Citigroup "had no choice" but to sell. "It's insolvent."*

"There's complete duplication across all their businesses, office by office ... in every single department and region," said Frank Campanale, chief executive of Advanced

Equities Wealth Management, a unit of Advanced Equities Financial Corp. in Chicago.

"They're going to have to cut their way through all of that," said Mr. Campanale, who formerly ran Smith Barney's money management consulting unit.

"Never have two wirehouses as large as Smith Barney and [Morgan Stanley] attempted a merger of equals," Brad Hintz, an analyst at Sanford C. Bernstein & Co. LLC in New York, wrote in a research report last week.

Many reps at Smith Barney had been hoping they would be spun off from Citigroup Inc.

But Vikram Pandit, chief executive of New York-based Citigroup, told employees as late as November that a spin-off of Smith Barney was not going to happen.

CLINGING TO POWER

Now, with the bank yet again on the brink of failure, the sale of Smith Barney is seen as a desperate move by Citigroup management to keep their jobs.

Citigroup management "has the resourcefulness of cockroaches," said a West Coast Smith Barney broker who asked not to be identified. "They've got incredible survival skills."

Citigroup "had no choice" but to sell, Mr. Campanale said. "It's insolvent."

Some headhunters said Morgan Stanley Smith Barney, which some wags have dubbed "Citi Morgue," will be a tough sell to recruits.

"How can you consider it?" asked one recruiter who works for Smith Barney and asked not to be identified. "You don't know what the story's going to be. Who's running it? What are the products going to be?"

To that point, in an *InvestmentNews* poll conducted last week (see Page 26 for complete results), wirehouse reps and regional brokers were asked,"Would you want to work at the newly formed Morgan Stanley Smith Barney?"

A resounding 73% of those responding to the question said no.

But another recruiter who also works for Smith Barney and asked not to be identified said the size of the new organization won't necessarily be a detriment.

"Bureaucracy is what banks have to offer," said this recruiter, referring to Bank of America Corp. of Charlotte, N.C., and Wells Fargo & Co. of San Francisco.

Morgan Stanley Smith Barney will be a "true financial adviser firm," the recruiter added.

Wells Fargo this month completed its merger with Wachovia Corp. of Charlotte, N.C., and its St. Louis-based Wachovia Securities LLC unit. Bank of America completed its purchase of Merrill Lynch & Co. Inc. of New York on Jan. 1.

A string of layoffs and branch closures are expected at Morgan Stanley Smith Barney.

Total cost savings of $1.1 billion are projected, with more than half coming from cuts in personnel and technology and operations.

The promised 30% in savings from staffing reductions will require 2,000 job cuts, Mr. Hintz wrote in his report.

But "to deliver the savings promised, [Morgan Stanley] will have to cut deeper to offset the cost of the [broker] retention packages," Mr. Hintz wrote.

CUTS LOOM

The cost cuts will come in the first 18 months of the venture, James Gorman, Morgan Stanley co-president, said during an analysts' call last week.

The deal is expected to close in the second half of the year.

Mr. Gorman will be chairman of Morgan Stanley Smith Barney.

Integrating the two operations will "be a political war all along the way," Mr. Campanale said.

"It will be a series of ice pick fights ... from the broker level all the way up to senior management," said the West Coast Smith Barney rep.

But in conference calls last week, Mr. Gorman downplayed any cultural differences.

"The culture of the organizations is very similar, the management structure, the approach to business, the kind of business is very similar," he told analysts. "I think the fit actually is going to be fantastic."

With 20,400 producers at the combined firm, observers expect there will be room to cut.

Mr. Gorman has a history of cutting less-productive brokers.

In 2005, soon after coming over from Merrill Lynch to run Morgan Stanley's retail business, he jettisoned the bottom 10% of Morgan Stanley's sales force.

"They'll draw a line at $300,000 or $350,000 and say goodbye" to producers under that level, said a Morgan Stanley broker.

However, Smith Barney has more productive brokers than Morgan Stanley did when Mr. Gorman took over.

Lower producers at Morgan Stanley Smith Barney, together with some lower-producing Merrill reps, will move to smaller and independent firms, predicts Darin Manis, chief executive of RJ & Makay, a recruiting firm in Colorado Springs, Colo.

This year, Merrill, Smith Barney and Morgan Stanley all cut pay for lower producers.

With payouts of from 20% to 25%, "the love obviously isn't there" for lower producers at the wirehouses, Mr. Manis said.

For brokers at both firms that management wants to keep, a retention package is expected.

Brokers have yet to hear details of the offer. The same package will be given to both Smith Barney and Morgan Stanley brokers.

Meanwhile, recruiters were scurrying on news of the deal. They were busy taking calls from reps, but also worried about what the loss of a major player would do for their own businesses.

Smith Barney and Morgan Stanley are big clients of recruiters. That business will now likely be cut significantly.

And with one less firm competing for brokers, recruitment deals are expected to drop even more.

"Happily," the firms will no longer be recruiting from each other, Mr. Gorman said last week.

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