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CITIGROUP STRATEGIC AUDIT

An Undergraduate Honors Thesis
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Background

Citigroup (C) is a publically traded, global company in the finance industry that serves consumers, businesses, and governments. There are various smaller subsidiaries held by the large conglomerate and offer a wide range of products including:

- Consumer banking and credit
- Corporate and investment banking
- Securities brokerage
- Trade and securities services
- Wealth management

Citigroup prides itself on being a full-service firm that runs the gambit of services on Wall Street. Despite their reach and broad product line, they only own about 9% of market share in the financial services industry and is the fourth largest bank in the industry (Morningstar, 2018). However, this speaks less to Citigroup’s success but rather the industry as a whole. The financial services industry is saturated with institutions ranging from Morgan Stanley and J.P. Morgan to the credit union down the street. This hyper-competitive environment is an ever-present concern for the company that informs their history, current decisions, and long-term strategy.

With many subsidiaries that perform an array of tasks, I will focus on the investment banking and whenever possible the mergers and acquisitions segment of their business.

The firm’s history is important in the development of their success and market share. The company’s past is checkered with events that follow the development of the United States. The highlights of the company are as follows:

History

- Citigroup is founded in New York (1812)
- The bank pioneers financial relationships with Latin American countries (1891)
- The bank and management are criticized for their part in the Great Depression (1933)
- Citigroup goes on ‘merger spree’ purchasing Aetna, Travelers, and Shearson (1988)
- The bank plays large role in the technology bubble (2002)
- The US Government bails out Citigroup for lending bad mortgages (2008)

This brief timeline shows the long length of the company’s tenure in the financial industry. However, it also shows the constant threat of malpractice and the scope of their shortcomings, in particular, the Great Depression, the technology bubble, and the Great Recession. In all three previous catastrophes, Citigroup failed to act in the best interest of their customers and chose to find loopholes in existing laws to make a short-term profit (Citigroup 1, 2018).

Major Issues

These shortcomings have affected the mergers and acquisitions segment of their business in particular.

- Industry pressures in the saturated North American financial services market
- Consumer distrust of the industry and Citigroup
- Political and legal issues
Although the company is exposed to risk in three distinct directions, they are all interconnected and reinforce one another.

**Vision, Mission, and Values**

**Vision**: ‘Provide financial services to all around the world and be the institution for

**Mission**: ‘To provide financial services to customers across the globe for economic and financial growth’

**Values**: ‘[To] make a positive financial and social impact in the communities we serve and show what a global bank can do,’ and ‘[To] improve the quality of lives of their customer’

However, the current strategy seems to be at odds with the company’s purported vision, mission, and values. Recently, the bank has sold off their 27 banks and 250,000 clients in Puerto Rico and Panama to the Bank of Nova Scotia, which diminishes their foothold in Latin America and the international financial at large. Analysts that have researched the sale of these banks were soured by the news because it showed Citi’s shortsightedness and unwillingness to stick out an uncertain time in the region. This move and many others clash with the company’s vision (Gomez, 2016).

**Situation Analysis**

Citigroup has many different products and revenue sources. Although, their arguably most important segment is the merger and acquisition. The M&A segment is nested within their corporate and investment banking products. Even within this subset of Citigroup’s business, there are two different models.

The business to business facing service model puts Citigroup in a broker position. For example, if Walmart wanted to acquire Trader Joes, Citigroup would represent Walmart as a buyer agent and would be responsible for overseeing the acquisition. A typical acquisition can take months and Citigroup acts on behalf of Walmart to wade through the following steps of the process.

**TABLE 1**

1. Acquisition Planning: Contact Trader Joes about a potential acquisition
2. Valuation Analysis: Conduct a thorough investigation of Trader Joes’ financial information to find an accurate company value
3. Negotiation: Start a negotiation with Trader Joes on an adequate price and conditions of an acquisition to reach an agreement
4. Due Diligence: Perform a deep-dive into Trader Joes information to ensure that the acquisition is what it seems
5. Purchase and Sale Contracts: Bring both parties together to sign documents
6. Financing Strategy: Determine what financing method Walmart will use to acquire Trader Joes

It is possible that Walmart could perform all of these steps internally. However, the army of lawyers, bankers, analysts, and proprietary algorithms that Citigroup employs serve as the framework for the company’s value proposition. If Walmart chose to engage directly with Trader
Joes, it is likely that they would erroneously value Trader Joes or fail to negotiate the best terms, which even the smallest misstep could result in a loss of millions or even billions of dollars. The security and the expertise offered by Citigroup serves as their value proposition to their clients and allow them to provide a needed service. As well, the company garners a profit from the transaction by charging a ranging from 1.5%-3% of the final acquisition price. However, Citigroup has the flexibility to work out an arrangement that fits their clients need, whether it be a client prefers to be billed hourly or a one-time down payment (Citigroup 2, 2017). The other business model within the M&A segment is to use this expertise not as a service but for the company’s own holdings. Instead of garnering a fee for an acquisition, Citigroup seeks to acquire banks and other companies to expand their business and reach. Although, often they hold on to these assets and attempt to either restructure and then sell for a gain in the market. Because Citigroup is a holding company at its core, the mergers and acquisition portion of their business plays an integral role in the long-term business. According to their most recent financial document, it contributes nearly 23% of their entire revenue (Citigroup 10K, 2018). Although the company is operating at a loss, the M&A segment is still profitable but has trended down 1% from the previous year.

Value Added
Table 1 provides a granular view of the value added to their clients. Similar to other service-oriented businesses, the major cost center is labor. In particular, the labor costs constitute 68% of the operating costs of the mergers and acquisitions division (Citigroup 10K, 2018). Transactional lawyers, investment bankers, and computer engineers are necessary for nearly every step of the process, which requires are highly-skilled require a proportional wage. The second largest input costs are goodwill or intangible assets. These include the proprietary algorithms and methods to sift through large amounts of data for calculating the valuation price and evaluating M&A decisions. It is difficult to pinpoint an exact value on the role intangible assets play because the valuation of a particular idea or process is difficult to estimate in the market. These inputs make up a large portion of the M&A business, and many of the big investment banks compete from this same pool of talented employees and information.

External Analysis
The landscape that Citigroup competes on is highly competitive and has many moving pieces. Porter’s Five Forces is a helpful tool to perform an analysis and create an index on the competitive rivalry that Citigroup faces.

Threat of New Entry
The threat of new entry into this already crowded market is low. Because large investment banks benefit from economies of scale, new entrants would struggle to offer the services and attract the talent necessary to compete with Citigroup. The large capital investment needed to rival them stand as a barrier that would bar any new banks from entering the market. The intangible assets or the “know how” in this industry also reduces the threat of new entrants and potential competition.

Supplier Power
The supplier power in this instance is difficult to parse because the input costs are not commodities but rather highly-skilled labor. Although, the qualified candidates are pulled by the attractive compensation packages that Citigroup offers. As well, non-compete contracts are common among the industry and greatly reduce worker bargaining power as they have little option to seek offers from other firms. This makes the supplier power for Citigroup moderate.

**Threat of Substitution**

The likelihood that an M&A could be substituted by its competitors: JP Morgan, Goldman Sachs, Merrill Lynch, Morgan Stanley is very high. At all of these big banks, there is little difference between the process and results they can provide. Most of the differentiation comes from Citigroup’s staff, algorithms, and network. However, even on these factors, the difference is negligible and the threat of substitution is considerably high.

**Buyer Power**

The bargaining power of the buyer or the corporations looking to engage in a merger or acquisition is perhaps the largest determinant in Citigroup’s external analysis. Because of the threat of substitution looming, these large banks compete with one another by trying to outbid each corporation looking to merge with or acquire a company. This pushes margins down and gives the buyer considerable power to dictate terms of their agreement. Therefore, the power of buyers is high.

The composite of all these four forces demonstrate that the competitive rivalry of the industry that Citigroup operates is high. The industry’s competition shows that the line separating a successful and declining investment bank is razor thin. However, the 10K’s of JP Morgan and Goldman Sachs contain an interesting metric to their success in the M&A business. The two firms spend 34% more on risk management than Citigroup and it has paid off (JP Morgan 10K, 2018). This comes amid Citigroup’s recent involvement with the FIFA corruption scandal has resulted in regulatory fines that have affected the company’s bottom line. As well, Citigroup has had to budget even more for expected litigation and fines rather than expanding and perfecting their core business.

Although even beyond their own competitors and industry, Citigroup interacts and is sensitive to macroeconomic factors. A PEST analysis provides a framework to evaluate the external pressures.

**Political**

The political environment is more complicated than ever for Citigroup. Following the financial crisis in 2008, the government has jumped to regulate the industry. The Consumer Financial Protection Bureau (CFPB) has been set up with the expressed purpose to be the industry’s watchdog. The agency has been a thorn in the side of Citigroup as they recover from their missteps leading up to the crisis.

Although, the political calculus changed after the election in 2016. Where the Obama administration gave the CFPB and other regulators discretion to monitor Citigroup’s industry, the Trump presidency has worked to lift regulations. The current administration believes that the
CFPB has overstepped its mandate and effectiveness by enforcing regulations and has stripped the agency’s ability to enforce any actions on large banks. This changing political landscape puts Citigroup in a precarious position. On one hand, Citigroup will be able to operate without as much scrutiny from the government. Although, recent legislation and agreements have certified that there will not be a bailout waiting for them and bad actions will have far-reaching political consequences. So, the political factors are looking favorable for Citigroup at the moment, but they should be cautious about the political costs and ensure that they can stay out of the way of more regulation.

Economic
The leading economic indicators all point to a continued upswing in the economy. Unlike in years past, the financial market is on stable footing. As well, the movement from the Fed in interest rates will help Citigroup capitalize on the increase in interest rates as lenders benefit.

Social
The social environment that Citigroup operates may also provide considerable obstacles. Similar to the political costs of Citigroup’s involvement in the financial crisis, the public is distrustful of banks and Citigroup in particular. Therefore, the company has to show a good faith effort to repair these relationships, especially among younger consumers to help them in the long run.

Technology
The technology that surrounds Citigroup is changing as the industry increasingly utilizes data analytics and pricing algorithms to make investment and M&A decisions. Among Citigroup and its competitors, there is an arms race to most accurately price and value companies. So, the technological landscape is an important consideration for its business. Citigroup needs to continue to develop new technologies and be proactive in integrating them to their business.

Opportunities
The external opportunities are everywhere for Citigroup, but they must position themselves correctly.

- Their foothold in emerging markets allows them the ability to penetrate more international markets
- Low-interest rates give them the ability to invest in new projects with low-interest payments on borrowed money
- For M&A especially, they should continue to partner with large organizations like Costco to build relationships at all levels

The opportunities that seem most promising are all related to things that the company already does well. In the financial industry especially, risk is quantified and minimized surgically. Thus, the opportunities must reflect the measured and conservative nature of the industry.

Threats
On the other hand, the external factors that may negatively affect Citigroup are important to identify potential landmines and guide a contingency plan to deal with the external.

- The lack of political and legal stability in new, emerging markets
- Another cataclysmic event like the financial crisis
The competition in their industry may pose a considerable risk for Citigroup. In countries that have little financial infrastructure, there is large potential for Citigroup, but it poses more risk than doing business in the United States. The instability in developing countries could pose a major barrier to entering the market especially in Latin America, where financial institutions have borne the costs of corruption and monetary risk. As well, the financial crisis shows the existential threat to Citigroup’s business at any given time. This is also underlined by the level of competition in the market with other players in the market.

Internal Assessment
The trajectory of Citigroup is mostly dependent on their internal resources and management. However, an analysis of their resources, competencies, strengths and weaknesses paints a better picture of the company to make a recommendation.

Resources
Citigroup has many resources at their disposal. Most notably:
- Cash reserves- $103,514 million
- Infrastructure- Branches and offices around the world, Financial
- Human Capital – Workers
- Technology- Algorithms, trading strategies etc.
- Intangible Assets/Goodwill- $6,678 million

Competencies
The core competencies for Citigroup begin with their employees. In nearly all of Citigroup’s meetings, the CEO begins by talking about how much of the company’s success is driven by their employees (Citigroup 1, 2017). Beyond the motivational aspects of this sentiment, his analysis is not far off. The infrastructure of Citigroup in its M&A segment means little without the workers and Citigroup rates as one of the top places to work on Wall Street for in-house lawyers doing corporate M&A.

As well, a distinctive competency for Citigroup is their position in the International market. Other companies with even more market share have been outpaced by Citigroup in this segment of their business. The situation fit and management structure is set up with a different CEO in each region. This allows the company to have management be responsive to each respective regions and issues.

Strengths
The path forward for Citigroup is predicated on what they do well.
- Global outreach to emerging markets especially Latin America and Asia
- Brand recognition and subsidiaries
- Full-service firm for all financial needs, economies of scale

Weaknesses
- Consumer distrust after the 2008 financial crisis
- Small market share and little penetration into the industry as a whole
- The US market is relatively stagnant and provides little growth potential

Strategy Goals
A strategy should meet the following criteria and goals to weigh between different paths for the company.

1. Best guide the company in long-term economic prosperity measured in revenue, market share which are all factors in determining stakeholder value
2. Create a strategy that is profitable but also serves the best interest of their customer and avoids their missteps of the financial crisis

The first measure of an alternative is purely market driven. Although the stock market is an imperfect measure of value, it is the best model to determine long-term equity and confidence in the company. Thus, the stock price of Citigroup provides a fairly accurate, objective metric to evaluate success.

The second goal is difficult to quantify what is best for the customer in the long-run. However, the baseline is compliance with current regulatory frameworks set in place. This can be measured by an independent audit of the company’s operating activities. As well, the feedback from current customers can be gauged to determine how well Citigroup adheres to their second strategy goal.

**Strategy Alternatives**

**Alternatives**

1.) *Lean into their international market advantage.* All indicators within their financial statements show that focusing on their business abroad is their best choice. According to recent financial filings, 35% of the adjusted growth has come from the international operations of Citigroup’s business (Citigroup 10K, 2018). However, they are still only putting a relatively miniscule amount of money into the international segment of their business. This alternative is grounded in their strengths. The M&A segment of Citigroup has a special interest in these new markets as Latin America rushes to corporations from small, locally owned business. They should catch the wave and use their position to profit on the trend.

2.) *Acquire Many New Domestic Banks.* Citigroup may be may be able to mitigate their competition by buying up smaller banks in the United States to increase their holdings and benefit from the economies of scale associated with more capital. This would require new, organic expansions to be put on hold to free up resources to consolidate their position.

3.) *Acquire or Partner with a Big Law Firm.* While Citigroup performs considerable legal work in-house, they often are required to seek outside counsel for litigation as well as complex mergers and acquisitions. According to their SEC filings, this represents a considerable expense ranging upwards of $100 million dollars a fiscal year (Citigroup 10K, 2018). This strategy alternative would seek to reduce costs from going to outside law firms and paying a premium each time a deal needs to be litigated.

**Evaluation**

1.) On the first metric, the international market strategy seems to have financial support. There are a few likely scenarios in that the international brings about more risk than was
expected for Citigroup and they experience severe losses. However, their competitive advantage in the international market gives them the ability to be the first to serve under-tapped market and increase their market share among the world, resulting in an increase in profitability.

The second metric is more difficult to forecast. It would be helpful for the customer’s in the underdeveloped countries because they can provide much-needed liquidity in the market. However, a hostile takeover of local banks or transplanting an American business may have consequences for Citigroup in the long run. It will depend primarily on how this strategy is implemented. Given their current strengths, this path seems like a feasible strategy alternative.

2.) For the first strategy goal, the acquire domestic banks strategy alternative is dubious. The banks in the United States are much expensive to acquire than international banks. With this considerable financial burden, Citigroup runs the risk of spreading itself too thin. Also, the amount of capital needed to access the benefit from economies of scale are astronomically high. In this respect, stock prices would reflect the added distress of buying smaller banks in the United States with a decrease in value.

As for the customer, this strategy could benefit them in the long run by offering better rates from the increased economies of scale.

3.) The third alternative would provide a cost reduction to provide a long-term financial gain that would likely increase the stock price. However, this strategy would only go so far. The cost reductions would not be enough to make a complete strategy. This criticism is also shown in the second strategy goal because it may eventually allow Citigroup to pass the savings to its customers. However, this relationship is tenuous. This strategy is entirely feasible, but on its own, it doesn’t meet all the strategy goals.

**Strategy Recommendation**

The strategy recommendation that would best fit Citigroup’s business is a combination of strategy alternatives 1 and 3. Because of Citigroup’s competitive advantage in the international market, it is the most feasible and best plan for Citigroup’s M&A business looking forward. They should go in with this approach and reallocate the resources for new ventures in the United States and become even more globally facing. Citigroup should work directly with the business community to provide services that fit the customer’s needs and long-term economic growth in the new markets.

This approach provides an opportunity to maximize revenue, where pieces of alternative 3 allow Citigroup to reduce their costs. With the financial capital necessary to expand to the global M&A market, acquiring a law firm may not be feasible. Although, Citigroup should partner with a law firm and negotiate a volume discount for legal services to drive costs down. To learn from their competitors, Citigroup should also spend more on risk management initiatives comparable to JP Morgan Chase and be wary of the legal and regulatory ramifications that await any misstep.
This recommendation wouldn’t largely change the current enterprise strategy. The mission for Citigroup contains aspects of the global market. However, there needs to be an even sharper pivot from the executives at Citigroup that their business is increasingly moving abroad.

Inter-O rganizational
The recommendation requires interaction with businesses in new markets and creating relationships abroad. As they delve further away from their home market, the strategy also should shift to understand each new market and partner with local businesses. As well, the legal services part of the recommendation requires a strategy that works closely with law firms instead of as merely a vendor.

Corporate
The corporate strategy will almost be similar to the status quo. Citigroup will still be in the M&A business. However, the location and the size of the firms will be different. Therefore, the strategy at the corporate level will not need much tweaking but should work to be more cohesive in its actions.

Business Unit
The new approach and a recommendation provide a clear narrative about how Citigroup is going to compete. They are going to use their position in the international market to gain more market share and further differentiate themselves from their competitors.

Operational/Functional
This new approach will require the many different departments within Citigroup to become more coordinated and will enact the change in strategy. The legal department will have to work even closer with the outside law firm to provide a smooth transition to the cost reduction. Also, the M&A department will contribute by seeking relationships with the

Implementation Plan
The plan for this shift in strategy will require this sequential plan:

1. Shift 15% ($122 million) of current funding budgeted for new operations in the United States market to new operations abroad with a yearly increase of 3% each year until it reaches $200 million (implement immediately, complete by 1.5 years)
2. Reach out to law firms and request bids on volume discounts associated and exclusivity in partnership (implement immediately, complete in 1 year)
3. Construct offices and branches around the world to provide management the ability to be even more sensitive to regional challenges (implement in 2 years, complete in 8 years)
4. Evaluate performance based on the net present value of the 5 years of cash flows following the initial investments (5 years)

The structure of the company will allow Citigroup to keep its place in the US market but have the funding to expand abroad. As well, the hiring rate in the United States will decline as new operations will stall domestically. However, there will be an uptick in hiring abroad among the local workforce and by US workers willing to move.

Projection
Because many of the funds for the strategy recommendation are being reallocated, Citigroup will avoid large costs of debt. However, the discount rate will be affected, as the risk level in a domestic project will be less risky by an average of 2.74% which translates to $126 million in the cost of capital budgeting for Citigroup in a year (Citigroup 10K, 2018).

As well, the revenue associated with this project would add $2.1 million to Citigroup in its first year with an industry average of 1.5% growth each year. With these assumption and financial statements, Citigroup’s initiative should bring about $100 million over 15 years.

Although the recommendation may work in theory, there need to be controls in place to calibrate and measure the results of the plan. These controls are both financial and managerial. The project must have shown considerable progress at the 5-year mark of implementation. The plan doesn’t require that Citigroup makes money but rather the project is on track to become profitable in 15 years. The managerial controls begin with the willingness to act on these financial indicators and responding to new information. As well, it involves managing employees and branches to ensure that they are performing according to plan.

If at the 5-year mark the recommendation is not projected to be profitable in the long-run, then a committee including executives, managers, and workers should perform an “autopsy” of the plan and determine whether there is simple fix or Citigroup should wind down this new initiative. This would allow the company to reverse course or tweak the plan to the present concerns.
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