

ADVANCED OPERATIONS MANAGEMENT

Second Edition

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David Loader



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Second Edition

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*To my wife and my colleagues who gave huge support to
me in preparing this book and to all the
operations managers past, current and future
without whom there would be no
financial services industry*

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PREFACE

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Operations management is a vital component of any organisation in the financial markets. Without a highly efficient operational capacity any business would be vulnerable to competition and would find the overall cost of its business unviable. It is also the case that operations teams and the functions they perform have both altered radically in the last 5 to 10 years, illustrated by the active role in risk management that operations teams perform today. Traditionally a predominantly processing function, the changes to the structure of the industry have been significant and this has fundamentally altered the operations scope so that today its functions are both processing but also about risk control, client service, revenue or profit protection and in some cases revenue generation.

The fundamentals of operations management are still about accuracy, quality service and the ability to devise procedures to successfully clear and settle transactions. Today, the emphasis is also about effective asset and cash management, controlling risk and meeting the challenge of diverse and globalised trading and investment.

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The high levels of sophistication of the so-called end-user in the fund management and retail markets creates the need for sophisticated services to be provided by banks and brokers as well as agents, custodians, depositories and clearing houses. The result of this has been significant rationalisation and revamping in most areas associated with the operations function.

Technology plays a major role in the operations function and yet it is the personal service that is still seen as of great importance, and this is increased where technology has had the effect of standardising processes and output. The ability to differentiate firms' products and services is a crucial business factor.

Advanced operations management is about the extra responsibility of business change management, identification of skill sets, development of multi-talented product and risk-aware teams of people, responding to fluctuating business demands, regulatory change and above all being aware of and responding to the ever intensifying competition.

It is not an easy role and it certainly demands multiple skill sets in the manager concerned but it can be an immensely satisfying role with real challenges and, increasingly, rewards.

The age of the professional in operations management is undoubtedly here and, importantly, it is widely recognised.

ABOUT THE AUTHOR

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David Loader is actively involved in the international financial markets as a director of the Derivatives and Securities Consultancy Ltd, Computer Based Learning Ltd and Derivatives Management Services Ltd. He has over 30 years' experience in the financial services industry, much of the time at senior management level including operations director within major investment banks such as Warburg Securities, SBC Warburg and Warburg Futures & Options Ltd.

David is heavily involved with all three companies of which he is a director, providing a variety of services in training and consultancy to a broad base of clients world-wide. He designs and delivers training courses at all levels on many areas of the financial markets and, in particular, those related to operations. He has been commissioned to deliver programmes to audiences in a variety of countries for industry organisations – such as the Singapore Exchanges, the Stock Exchange of Thailand, the Australian Financial Markets Association and the Malaysian Exchanges. In addition to his work for clients in the UK, he has delivered training and

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consultancy in centres such as Milan, Prague, Singapore, Hong Kong, Boston, New York, Bermuda, Mumbai, Sydney, Johannesburg, Brussels and Frankfurt.

David is Managing Director of the Derivatives and Securities Consultancy Ltd, an affiliate member of the Securities and Investment Institute, a member of the Institute of Directors (*IOD*) and also a member of the Guild of International Bankers. Since 1999, David has been involved in CBL, which has been developed as a sister company to DMS Ltd. David is the senior author of CBL's *visUlearn* products, which cover the financial services industry. His practical knowledge of the financial industry is combined with his unique teaching ability, culminating in the innovative *visUlearn* range of multimedia training products.

Chapter

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THE CHALLENGE

In 1995 Nick Leeson changed the way operations would be viewed in financial institutions and markets forever.

In the late nineties Y2K highlighted the utter dependence of the markets on technology.

On 11th September 2001 the importance of disaster recovery and business continuation policies were graphically and tragically illustrated.

In 2002 the problems of Enron and the demise of its auditor, Andersen, in a little over seven months showed the consequences of reputation risk.

These were all headline making events and yet for the operations managers and directors involved, each one presented the kind of challenge, albeit on a more significant scale, which is faced daily in the process of settling business in the financial markets. Today outsourcing/insourcing, regulatory change, operational risk management and the wider use of more technical products in trading and investment are providing massive challenges for operations managers.

THE PROFILE OF OPERATIONS

Despite the phenomenal size of the market, settlement or the operations function is still often a little understood process. A bit like today's motor car which, to all intents and purposes, runs itself with virtually no involvement of the driver in maintenance, many in the trading environment and its support areas have little idea of what happens after the trade. Even fewer clients, particularly private ones, are aware of the vast mini-industry that enables those trades to be turned into realised profits or losses, dividends or unit trusts, insurance policies or mortgages. There are obvious reasons why the settlement process has become somewhat remote. Technology and automation have, in many cases, removed the need for paper evidence of ownership of securities or even cash. Collective investment schemes will buy and sell assets but this is irrelevant to the investor in terms of settlement because the manager deals with it, not them.

The way in which operations is used as an all encompassing term suggests that it is singular in format.

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Similarly, the term 'bond market' suggests there is only one type of bond, which of course there is not.

People unfamiliar with the post-trade environment are often amazed at the complexity and diversification of the processes when they look into the subject. This is equally the case for people working in businesses that supply services to organisations in the financial markets such as technology companies that have large numbers of highly trained technical staff – e.g., programmers. In some companies their training will also include an understanding of, at least at a general level, what the client needs the technology for. These staff are often surprised at how critical and complex the various processes and procedures in the settlement chain are and correspondingly how important the systems are.

Operations in any type of organisation, be it a retail bank, broker, fund manager, custodian, fund administrator or an international investment bank, is a hugely complex function, dealing with many counterparts and systems and entailing many deadlines and actions that must be fulfilled.

OPERATIONS IS A BUSINESS

To be successful for a business, the operations function must be both efficient because it impacts on profit and loss (*p&l*) and controlled because it is a source of risk. A considerable part of its function is related to routine processes and procedures that apply to particular types of products or services. Record keeping, reconciling,

payments and instructions are the everyday work of operations teams. For this reason some might suppose that it is predominantly an administration function, but that ignores the potential that operations has to be much more than just a supportive process. It has a product and any product has the potential to be sold and therefore to make money.

For instance, fund administrators and custodians make money out of operations-based services and they do so by developing and delivering efficient, cost-effective and above all innovative services to their clients in much the same way as a structured products team does in the front office environment.

Operations is in reality a business. It is as simple as that. It has an infrastructure, objectives, products and costs. Costs are high on the agenda in any business and that is very much the case in operations functions. Consider the following question. Why are there companies that insource the work of operations teams? The answer is because it is cheaper for the client to pay them than run a team themselves. The outsource/insource arguments are not solely based on cost issues but they are, nevertheless, a very significant consideration. Quality resource is another key business issue and, like effective cost management, the quality of resource is a vital component of a successful operations team. The outsource issue can be affected by the resource issue, particularly if the recruitment market is poor and quality staff are hard to get and very expensive. The inability to manage resource and cost will usually have only one outcome: once the cost

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of settling a bargain becomes too high, the operations team is vulnerable to comparison with an outsource option. This is a fairly clear challenge for the operations manager and their team.

Any type of business is unsustainable if it is making a loss. For years the cost of operations was accepted as a cost of doing the trading. It was absorbed as a service charge to the dealers. Naturally, managers were expected to manage the business as efficiently as possible, but whatever the cost, the front office underwrote it. Today, that is no longer the case. Operations is seen as an integral part of the business, a contributor to profits and losses, a cost that must be justified and stand up against comparison with competitors. It is no longer just accepted. Pressure is on the manager to deliver settlement performance, with the cost effectiveness that makes the service competitive in its own right and helps the competitiveness of the firm as a whole.

There are challenges because operations is a business, but there are also challenges from other sources including change.

THE CHALLENGE OF CHANGE

There can be no doubt that the global capital market infrastructure underwent an impressive amount of development and improvement over the last several years.

ISSA (2000) *Recommendations 2001 Status Report*

Change affects businesses, markets, regulation and individuals in different ways. A market change may boost trading and profit or commission but impact in a different way on operations by generating a possible problem. Change also creates both opportunities and resistance at staff level, and that can cause untold problems for the managers and supervisors. The performance of the procedures and processes, and the quality of the service delivered is still about people, however automated the business becomes. The people issue is the hardest to manage.

Most other problems can be relatively easily defined and solutions devised. That is not always the case with people. Even if the problem is easily defined, the solution may be difficult to find or implement. Any team needs stability and once a breakdown of the respect and coexistence of the staff, supervisors and managers happens, whatever the reasons for it, it is potentially disastrous. By way of example, even the introduction of extra headcount which, in normal circumstances, might reasonably be expected by the manager to prove a positive action, can in fact cause a far from positive reaction. A problem (shortage of resource) and its solution (hire extra staff) cause another problem (extra staff disrupt the accepted pattern). It appears to be a no win situation. Why is this the case? The manager needs to understand the workings of the operation and the minds of the staff and to recognise what motivates and de-motivates people. In the above example, extra headcount might not have been needed or possibly the salaries of the new staff were above those of existing staff, possibly the staff were

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simply not consulted and communicated with and so resentment was fostered. This may all seem fairly trivial but any manager that ignores the feelings and opinions of their staff is plunging headlong towards disaster.

So, we come to another challenge, management style.

THE CHALLENGE OF MANAGEMENT STYLE

Managers are people, not robots; so there is a different style for every manager depending upon their own particular personality. Football provides a good illustration of this. Some managers scream and shout even when their observations are totally wrong, mouth off in the media and are larger than life personalities. Others are more studious, think before they speak and loathe to be in the limelight. Two different ways of doing the job both of which can be successful or fail, depending on the type of people in the team and above all the skill of the manager to handle personalities, including their own.

It can also depend on the type of business, the workflow, the senior management style and the business strategy; in fact, so many influences can affect the manager and their style of management. Not surprisingly, their style can change as the manager experiences different situations and reacts accordingly. Some who start off being open and accommodating become tougher, whilst some who start with a firm 'I'm in total control' stance relax.

The secret is the ability to change in order to find the right level and then not to vary the style. Veering between 'tough' and 'approachable' unsettles staff completely.

Knowing when and how to delegate, empowering people, developing talent, motivating and being strong enough to deal with difficult situations that occur occasionally are all part of being a successful manager.

Challenges arise because operations is a business, and change happens.

Change is a key factor today in the industry and it is showing no sign of abating. The mergers of exchanges, clearing organisations, banks and fund management companies have a massive impact on the operations team. In the UK and elsewhere there have been changes to the regulatory environment. Europe has seen the introduction of the eurocurrency, the expansion of the EU and a significant fluctuation in the level of business as the major economies of the world experience variable growth.

THE CHALLENGE OF GLOBAL MARKETS

The impact of global markets cannot be underestimated. During 2002 the big pension and endowment policy providers had to deal with the result of exposure to falling equity markets and the impact that has had on their liquidity ratios and the performance of the investments.