Chapter 1

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.
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
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.*

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
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.
Investors began to realise that better returns might be available in other forms of investment vehicles and the growth and development of hedge funds is a prime example of these alternative investments. The result has been a huge challenge to brokers, custodians and fund administrators to come up with services for these hedge funds. As they operate in a very different regulatory environment and can utilise many products that are more technical and 'exotic' than those used in traditional funds, the challenge to develop capabilities to manage valuations, accounting and reporting have been enormous.

With equity markets recovering we are also seeing significant increases in volumes across all markets and products.

In the hard world of finance, banks will only advance more funding to a life fund/pension firm if they see action being taken to reduce costs. The outcome is a reduction in headcount, even though it is proven that in the long run in many cases this course of action creates more problems. However, the operations manager doesn’t run the firm and must deal with the consequences of the policies and strategies of the senior management. Managing this kind of scenario takes considerable skill. Maintaining morale, implementing the redundancy decisions and adjusting the procedures, processes and responsibilities, are all major challenges.

Enforced changes such as being required to reduce headcount can be difficult to manage for many reasons, but so
too can managing a growth situation, or managing a major change to the processes. Gearing up for volumes that do not materialise can be just as bad as failing to position the team to deal with growth. The operations manager’s judgement on how and when to move the function and the team forward is crucial.

What else is challenge?

THE CHALLENGE OF PERSONAL GOALS

Personal goals should include becoming a good manager, developing business skills and learning the technicalities of the job. Many managers possess either business skills or technical knowledge; it is surprising how few possess both.

It is important to recognise the need for both, in the supervisor as well as the manager. Fundamentally, it should extend to all staff and should be incorporated as part of the development of the team as a whole.

THE CHALLENGE OF DEALING WITH EVENTS

Operations as a function and the teams within operations are affected and influenced by events and circumstances generated from many sources (see Figure 1.1).
Sometimes these events have as their source situations that will affect the industry universally and sometimes will impact on a specific part of the industry. Some events are of course from internal sources.

As can be seen from Figure 1.1 an event in this context is something that causes change or disruption. As the nature of the individual events can be very different in terms of profile and size or impact, the management of events is not straightforward. The worst case scenario is a major disaster or incident. For example, if SWIFT were to go down for a few days, chaos would ensue. Equally, settlement problems and internal technology problems can be significant. Risk is described in more detail in Chapter 3. In short, though, the manager must be able to:

- rapidly assess the impact of the event;
- communicate the details of the issue and the contingency;
- instigate the necessary changes to procedures;
• manage and monitor the function until the impact of the event is over.

Precisely what has to be done will, as noted, vary. There may be only a need for information and awareness of the event; on the other hand, action may be required.

This action could be anything from full-blown disaster recovery to temporary changes to procedures and processes. Managing change in technology, for instance, can be either complex or straightforward depending on the project. Similarly, managing resource and infrastructure may entail minor periodic changes; alternatively, it may entail full-scale headcount reduction or the management of a merger or takeover of or by another company.

Ultimately, all changes need organisational and leadership skill, depth of knowledge and flexibility. Achieving these is perhaps the first challenge the manager has; using them is the second.

One of a firm’s greatest asset is its knowledge, its knowledge is its people, having someone successfully managing its people is perhaps the greatest asset of all.

David Loader