Capital Markets | Point of View

Capital Markets Operating Models

The Time for Structural Change has Come

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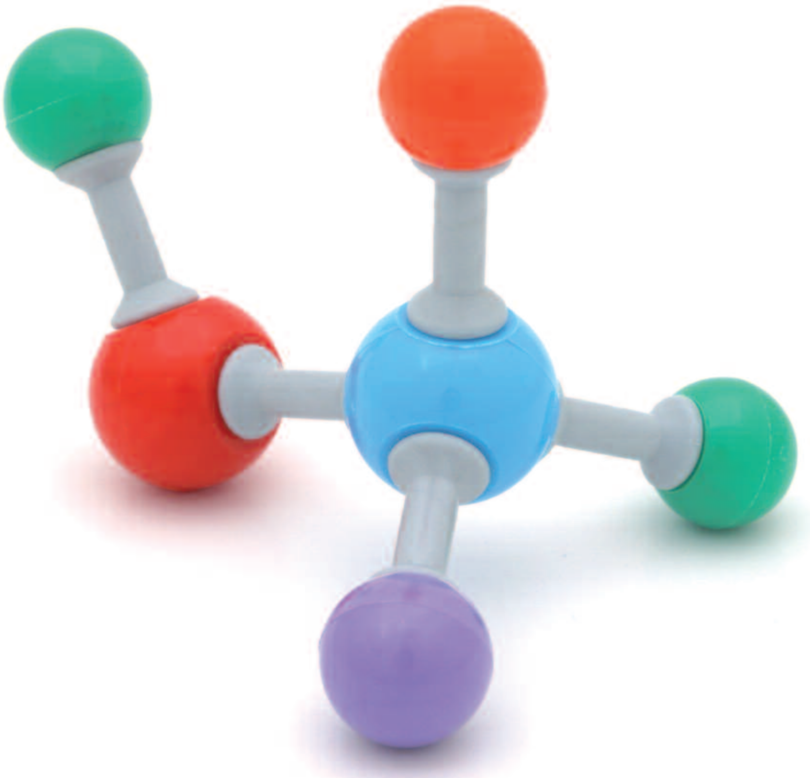

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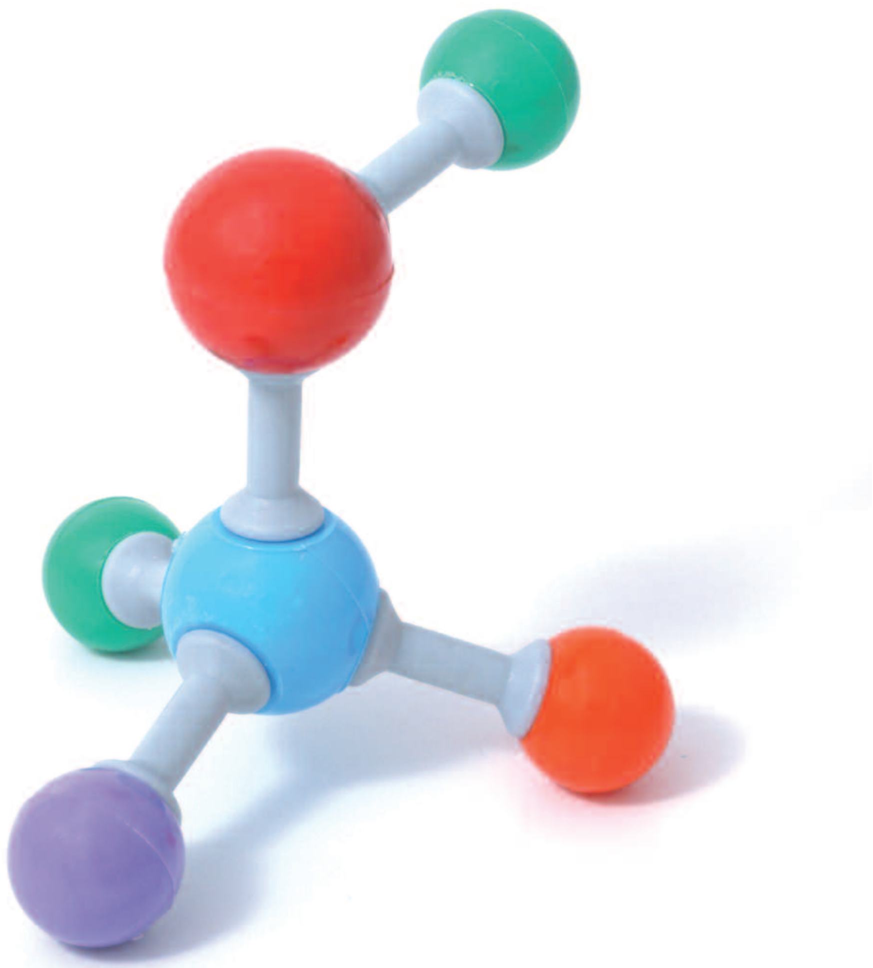

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Introduction

The Accenture High Performance Capital Markets (HPCM) Initiative[1] has collected several perspectives on how investment banks and wealth & asset managers operate their business at present and how this is likely to change in future. We examined the four key dimensions defining an operating model from our perspective including the service model (what to offer internal and external customers), the location model (where to operate the business, including location strategy and hubs), the organization model (how to operate the business, including organizational setup and levers of control as well as business processes), as well as the IT model (how IT is set up to enable business, including proximity to the business).

Setting the Scene – Recognize Operating Models to Address Changing Market Conditions

We currently see the rise of a multi-polar world[2] with multiple centers of economic power and activity, including potential new customers, increasing and multi-directional capital flows as well as new competitors entering the market place. Companies need to respond to this ongoing trend of advancing globalization. The current credit turmoil demonstrates a new dimension of the impact such a development has on market participants all over the world.

The crisis spread both faster and more intensely than crises did before due to a combination of sub-prime crisis, credit crunch, and liquidity shortage on a global scale.

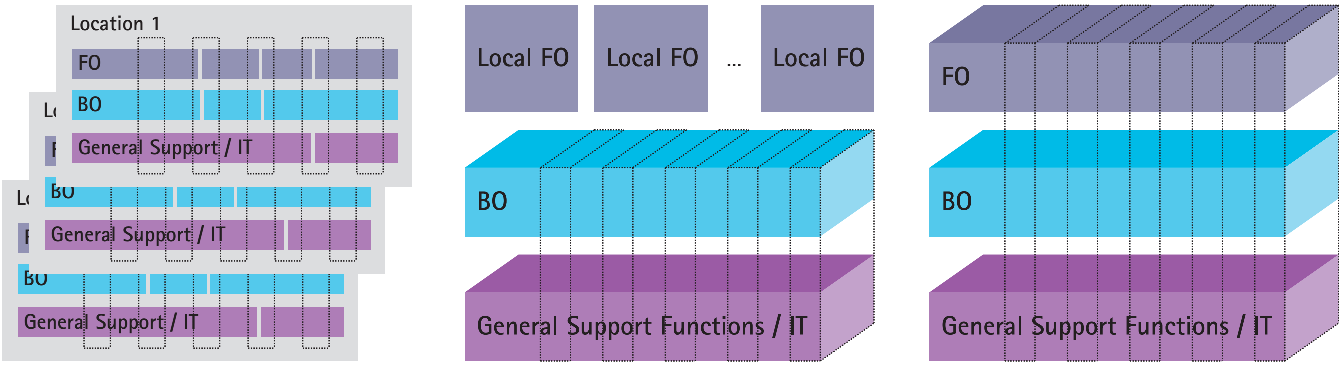
To meet the challenges of a multi-polar world, companies need a consolidated global operating model. This means seeking individual answers to what a company should do, how and where. The particularities of such an operating model depend on the answers to these questions, as there is no "one-size-fits-all" solution. The findings of our research suggest three major trends:

1. Put focus on market proximity and customer-centricity to realize growth opportunities

New growth opportunities are expected from increased institutional customers' demand for tailored and regional offerings, leading to financial service providers' investments in enhanced market proximity. We believe that those developments will be accompanied by increased standardization efforts in the

[1] The High Performance Initiative is a long-term strategic initiative including a multi-phased research program, which is designed to help understand what characterizes a high-performance business and how to help organizations become high-performance businesses

[2] Accenture, "The Rise of the Multi-Polar World," 2007



Distinct local setup with product silos and different applications across functions and locations

Hybrid setup with clearly local FO and standardized and horizontally integrated BO and support processes

Common global setup with a high degree of horizontal integration of processes across asset classes and locations

Figure 1: Operating Models – Exemplary Setup

front office environment to balance the additional investments through simplification of internal processes and IT.

2. Standardization and centralization stretch out to front office processes – break up silo structures

Mid and back office departments are focus areas to standardize and centralize processes. While the search for initiatives to improve efficiency and lower costs has been an area of continuous attention in the past, and is expected to remain a hot topic for these departments, standardization and centralization is a relatively new trend for the front office environment.

Especially in today's financial markets, product silo structures are, or will be, broken up. This means substituting established product-oriented IT platforms, organizational and/or reward structures – especially regarding P&L responsibility – by cross-product structures. Additionally, also the organizational boundaries between different business divisions (or organizational silos) like "investment banking" and "asset management" in large global banking groups are getting more permeable (again). This trend can be leveraged by intelligent operating model setups, which realize group-wide synergies.

3. Strive for execution excellence as prerequisite to handle intensified globalization

Execution excellence in both "run the bank" and "change the bank" activities is required to achieve the benefits strived for when increasing market proximity and standardization/centralization of processes, for example, to meet challenges related to time zones or intensified competition. If the goal of achieving execution excellence implies increasing offshoring activities, an often preferred solution is the setup of captive offshore centers.

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Put Focus on Market Proximity and Customer-Centricity to Realize Growth Opportunities

Service Model Changes – Consider Refocusing on Customer-Centricity

A service model – as part of an operating model – can be viewed from an external and internal perspective, which complement each other: Firstly, a service model is about delivering the right products and services to the right customers externally. Secondly, there are internally delivered services, which optimize the external performance of the company.

A key factor for a service model setup is market proximity. Market proximity includes establishing regionally distributed front office activities, especially sales offices, but also trading rooms. This local presence is critical for a business often referred to as a "people's business," emphasizing the necessity of closeness to the local or regional community. Market proximity also means understanding the legal requirements (rules and regulations) and being familiar with local standards, for example, local clearing and settlement procedures or fee structures at exchanges.

In this context, product- or asset class-oriented market players deploy a customer-centric approach. This means substituting asset class-specific team structures for new organizational set-ups, thereby providing one face to clients. Within its "Client-Centricity Initiative,"[3] Credit Suisse is exemplary in emphasizing customer-orientation instead of product-orientation externally. Internally, it also leverages extended knowledge of its customers resulting from customer-centricity when developing new and innovative solutions to meet client demands. However, if both customers and financial service providers are organized according to products, there is, of course, no true conflict of aims between customer- and product-centricity.

Leverage Opportunities from Localizations – Accept Limited Increases in Cost & Complexity

As local knowledge and networks in domestic markets determine the success of global players, some companies increase their efforts in sending people abroad, for example, from their home bases in the US to the UK, Asia, and the Middle East. Front office, research, and trading personnel are sent overseas not only to expand the business in terms of investing in new geographic markets, but to strengthen the "regional flavor" of a bank's offerings in different geographic regions, which are already served successfully. Despite the widespread need for cost-cutting initiatives, additional money is currently invested in this area to increase market proximity. In certain cases this might lead to the duplication of some processes and a minor increase in costs as well as in overall complexity of internal processes, but we found that selected industry players do regard this – partly – as an acceptable price to pay.

[3] Credit Suisse Group, "Annual Report 2006", p. 11 et seq.

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Standardization and Centralization Stretch out to Front Office Processes – Break up Silo Structures

Standardization and Centralization – Enhance Quality and Reduce Costs

We see a development towards increased standardization and centralization in internal operations. Within the front office environment, differentiated and globally distributed sales and trading activities can be accompanied by increased standardization. Standardization can refer to:

- Products (for example, developing products in one region which are available globally)
- Processes (for example, the development of new products)
- IT (for example, leveraging the options for intelligent parameterization of standard solutions)

Due to both increased cost pressure and the need to serve customers with a consistently high quality level globally, we expect enhanced standardization efforts in the future. The design of processes, which enable front offices/sales to offer customers identical products with the same quality globally, is of particular interest for many players as standardization and centralization lead to higher efficiency and maximized effectiveness.

Whereas the trend to increase standardization in the front office environment is just arising, the trend to increase standardization and centralization in the back office is not new, but continuing to grow. Standardized and centralized processing of mid and back office activities leads to higher automation and thus enables cost reductions. Another reason is the goal of increased and globally identical levels of process quality. For many it is also a requirement before implementing alternative sourcing options.

In the past, some investment banks tried to reduce the scope of their mid office. Partly, they did not even have a mid office at all (functions might have been covered by organizational entities like Finance, Operations, or Risk). However, the expansion of mid office scope offers a way to replace a more costly front office with cheaper mid office resources and to minimize manual labor in the front office. Given this background, it is clear why many see a chance in escalating the automation of the mid office, for example, during post-merger integration activities.

Breaking up Product Silos – Think beyond "Product Silos"

Due to the quest for more customer-centricity (and hence less product-centricity), breaking up silo structures and enabling cross-asset class processing is becoming a topic of increased interest. This involves industrializing back office services and setting up product factories, which deliver services across the whole organization. Such reorganization provides a basis for technology standardization, thereby enabling straight-through processing for complex products (STP).

Breaking up product silos can be assessed by five key criteria, which determine our understanding of product silos:

- Customer Contact: Some banks emphasize their capability of showing one face to the client, thus reducing their product-orientation. However, as product experts are also indispensable in satisfying a customer's specific needs, it is important that customers' specialists and bank's products specialists complement one another when necessary.
- P&L Responsibility: Typically, P&L responsibility relates to products. If a bank also changes these responsibilities, breaking up product silos would reach a considerably high degree. Currently, this is not regarded as an essential aspect when companies discuss breaking up product silos.
- Reporting/Governance: The design of reporting lines and governance structures can either focus on asset classes or include cross-asset class elements. The higher the asset class orientation, the more we can talk about silo structures.
- Hiring Strategy: The continuous hiring of product specialists suggests that a bank thinks in product silos – at least under the condition that no investments in generalists as qualified cross-product contact persons for customers are made at the same time.
- IT Platforms: If different asset classes are processed with separate IT solutions, this will be a clear indicator for product silos. The more cross-asset class processing on cross-asset class platforms is enabled, the less we can talk about silo structures. The current discussion of breaking up product silos mostly refers to implementing cross-asset class IT platforms. As this step of IT standardization (and the related process standardization) has a major impact on the whole service model, it should be regarded as a key indicator when determining if a bank is being organized in separated product silos or not.

These key criteria obviously demonstrate that there are different degrees of product silos organization. Currently, investment banks and asset managers pay most attention to cross-asset class IT platforms and the setup of customer contacts as "one face to the customer." As IT solutions contribute to efficient processes (characterized by automation and a high STP rate), they are also the linchpin for enabling cross-asset class processing from front to back office and thus standardization.

Breaking up Organization Silos – Realize Group-Wide Synergies

When we talk about organizational silos in large multinational firms, we refer to divisions such as investment banking and asset management – divisions, which are solely responsible for their own profitability (and hence not for the success of the company as a whole), or act rather independently from each other. This typically results in situations in which asset managers do not conduct their trading activities with the investment banking division of their own company, but with other brokers. Especially multinationals with investment banking as well as asset management and/or wealth management activities should leverage the asset/wealth management's client base in investment banking. Acting across organizational boundaries offers the opportunity to increase trade volumes in investment banking, for example. As a result, economies of scale can be achieved and synergies realized. Following restructuring, increased revenues can be attained, for example, from broker fees paid by wealth management divisions to investment banking divisions in the same company. As of today, asset managers at some banks always make an "internal" price request (including quote, fees, and other costs), giving the investment banking division of the same bank the chance to obtain the order. If the offered price is not "best execution," the asset manager might also give the investment banking division the option to revise the offer. This is just one example for realizing group-wide synergies. To achieve synergies across organizational boundaries, some obstacles have to be overcome. Asset management and investment banking divisions are for instance, often reluctant to share customer information with each other. Besides, investment banking divisions also tend not to offer service levels and prices designed to meet the requirements of an asset management or retail division of the same company. Due to difficulties experienced in achieving group-wide synergies, some American companies have already sold their asset management activities.

If operating models of multinationals are truly "global," they focus on realizing synergies through intelligent operating models. This allows the introduction of more shared services across investment banking, asset management, and/or wealth management in areas such as clearing and settlement, Human Resources or IT, thus inducing a shifting of functions, e.g. Cash Management and Payments moving towards a cross asset management/investment banking bundled service.

Custom-Build vs. Packaged IT Solutions – Consider Standardization as Challenge for Front Office IT

Many industry players already extensively deploy packaged solutions in the back office or are currently implementing such solutions while front office IT remains largely custom-built. This goes along with a higher degree of standardized processes in the back office in comparison to the more dispersed front office environment. However, we predict that packaged solutions will be adopted in the front office to a much greater extent in the future, thus achieving an equally high utilization rate as that of back office solutions today (and thus realizing cost reductions, e.g. from simpler maintenance). In light of the different requirements of local markets, increasing standardization is a key challenge in the front office environment.

"Despite the desire for centralization, local entities are retained where appropriate and necessary in order to maintain proximity to the business."

These local requirements include customer- and product-specific services such as the support for specialized local offers tailored to individual countries or certain regions as well as time-to-market.

Custom-built solutions per asset class and/or location can help meet local requirements. However, this leads to a lower degree of standardization of IT solutions across asset classes and locations. Both market proximity of the business and standardization of the technology (and related processes) can, however, only be achieved if standard solutions for front offices are flexible, i.e. if an intelligent parameterization of standard solutions is possible. Broadened deployment of packaged solutions in front office IT would result in increased shifting of responsibilities for maintenance and development to external partners in the future, as observed in the field of back office IT.

Keeping Local Entities – Respect Limitations to Centralization

So far we have discussed the trends of increasing market proximity with a focus on front office sales and trading activities as well as the desire for increased standardization in front offices. Standard solutions with an intelligent customization have been introduced as a promising way to achieve standardization and to enable market proximity of the business. Additionally, we have discussed that limited increases in cost and complexity are sometimes regarded as acceptable when, for example, sending front office, research, and trading personnel overseas. These aspects refer to the external aspects of a service model relating to customers and products.

Regarding the internal aspect of a service model, we have highlighted the continued trend towards increasing standardization and centralization of mid and back offices, especially against the background of cost pressure. However, some limitations of this last trend need to be addressed. Despite the desire for centralization, local entities are retained where appropriate and necessary, for example, in order to maintain proximity to the business. This can be observed in the field of service solution centers for IT services, for example. A certain degree of regional presence is essential for maintaining flexibility and a high service level for the business. The same logic applies for enterprise core functions such as human resources, finance, and planning and control. They can be both regularly standardized but physically centralized in one location – even if local presence is maintained for selected activities such as recruiting.

3

Strive for Execution Excellence as Prerequisite to Handle Intensified Globalization

The service model of a bank is essential for understanding the "what" of an operating model, both with regard to an external view (customers and products) and internally delivered services. In order to address the "how" of an operating model, execution excellence needs to be emphasized. It covers "run the bank" and "change the bank" activities. Achieving execution excellence in "run the bank" is related to the following key dimensions:

- No redundancies in processes (except if implemented on purpose)
- High degree of automation / high STP (resulting in fewer mistakes from manual work and enhanced performance, thus higher processed volume)
- Reduced cycle times (enabling up-to-date information, thus higher transparency and better control)
- Fast reactions / response times in case of manual exceptions

In addition, the capability to "change the bank," i.e. elaborating and implementing the changes characterized before, is crucial. Depending on the individual situation, change capabilities have to be strengthened when embarking on the journey towards a new global operating model. This covers general capabilities, such as program management for implementing long and complex initiatives, as well as relevant specialized capabilities in functional areas such as Human Resources. Experiences in managing staff in offshore locations and the ability to avoid trouble with high attrition, for example, are key factors in determining the success of an off-shoring project.

Implications on the Location Model – Manage Time Zone Complexity

The location setup answers the question where execution excellence has to be achieved. The desire for market proximity leads to a wider distribution of business and internal service locations. Especially sales hubs are distributed regionally, while the degree of regionalized trading activities is lower. Local trading might, for example, focus on order entry and order management only, whereas other trading activities are centralized in one or more hubs. In order to adapt to different time zones, most banks prefer centralizing mid and back office functions in more than one hub (e.g. one hub per time zone). In addition to internal service hubs, some local support for internal services can be found in those front office locations where they might be required, for example, when physical proximity to the business is regarded as advantageous.

Hub models with a limited number of globally distributed hubs need to consider the time zone aspect regarding truly global solutions. Challenging projects such as the worldwide introduction of global books are currently being discussed at different companies and they are all intent on aligning global trading across time zones. Not only is enabling technology essential for attaining this goal, but organizational, governance, and process considerations such as trust between traders, an aligned trade strategy, and adjusted bonus systems, also play considerable roles in the process.

Outsourcing and Offshoring – Achieve Cost Reductions and Execution Excellence

Offshoring is a key concept to address the growing cost pressure and the increasing need for scarce capabilities. Banks look for providers that can further reduce their costs, realize economies of scale, and offer access to scarce resources.

Mitigating the risk of cultural breaks when operating off-shoring is regarded as an important aspect when deciding about offshoring projects – and the involvement of external providers. However, even if cost reduction is currently of great importance for many industry players or can be regarded as an area of permanent interest, quality of the delivered services together with the desire to increase efficiency and time-to-market are becoming a more important motivator for outsourcing and offshoring projects other than just cost-cutting targets.

In line with the above-mentioned trends, shared services, business process outsourcing (and offshoring) projects are being evaluated and tested across many companies. Back office functions (for example, settlement), IT functions (especially development), and Human Resources, as well as parts of the finance functions, are some of the areas currently being examined for outsourcing. To summarize our observations, three hot topics can be outlined:

Business Process Outsourcing

Outsourcing stretches out to front office processes, covering, for example, the area of research.

Data Management

Outsourcing regards market data acquisition and reference data services (including data acquisition, validation, and cleansing), for example. While the desire for cost reduction remains a reason for outsourcing, the goal of achieving a high quality level has become a more propelling rationale.

Application Development and Application Maintenance

Outsourcing covers core trading systems transformation as well as Murex and Calypso as trading systems.

Some initiatives labeled as outsourcing projects are still set up as captive solutions. However, the management of captive shared service centers is perceived as increasingly challenging – especially if offshoring locations are involved. Key difficulties with offshoring activities regularly include insufficient knowledge of local markets, a lack of experience from similar projects, the low reputation as employer in those markets, and thus the management of a relatively high attrition. Thus banks often have to send a lot of required management staff abroad for a very long time and can not fully realize the expected benefits.

Outlook

In order to set up and shape a truly global operating model, the three trends identified and the changes in all dimensions of the operating models have to be addressed. Next to these, we believe that any operating model discussion needs to take the human factor into account.

Increase Efforts to Attract and Retain Talent

The investment banking and asset management businesses are to a high degree, a "people's business," that deserve special attention as qualified and highly skilled front office people are vital for achieving market proximity. In light of the increasing difficulty in attracting and attaining experienced personnel, human capital determines largely the competitiveness of a company in the financial services industry.[4] Companies should therefore make special efforts in keeping and/or recruiting the appropriate talent when defining their operating model setups, especially regarding the organization model.

Reintegrate or Outsource Captives not Meeting Original Expectations

Given the increasing complexity of the management of scaling up offshore captives – including cultural differences – and related costs, banks increasingly discuss strategies about how to deal with their captives. Besides increasing investments in today's structures, the reintegration of captives is sometimes considered an option. Alternatively, the responsibility to manage captives might also be transferred to third parties. Future decisions on the options "further investments," "reintegration," or "outsourcing" are likely to be different for business processes and IT outsourcing, for example. We expect to see soon first-movers who decide either to re-integrate or outsource their offshore captives and who will be followed by other market participants.

[4] Accenture, "The 2007 Global Awareness Tracking Study," 2007

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