



Operational Assessment: An Essential Step in Establishing an Efficient Operational Infrastructure

From rising investor expectations to new regulatory requirements, more and more is being demanded from a manager's operating infrastructure. How well do your firm's current systems and personnel meet your business requirements? Are they capable of fulfilling increased expectations? Is your infrastructure scalable? In a recent SEI webinar, our panel of experts offers practical advice to help managers assess their operational capabilities.

Panelists

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JAY A. BURSTELL, PricewaterhouseCoopers

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TOPICS EXAMINED

KEY TRENDS: CONTEXT FOR THE ASSESSMENT

WHY NOW? WHAT'S THE IMPERATIVE FOR AN OPERATIONAL ASSESSMENT?

GUIDING PRINCIPLES

OVERVIEW OF ASSESSMENT PROCESS

DECISION CRITERIA: BUILD, BUY, OUTSOURCE

KEY INDUSTRY TRENDS

Three trends in particular are converging to transform the investment management industry:

- ◆ **Era of the InvestorSM** – Power has shifted to investors and their representatives in a new Era of the Investor, as investors demand greater transparency and customization.
- ◆ **Rise of the Bureaucrats** – Regulatory reform is imminent, with proposals pointing toward historic changes on the horizon.
- ◆ **An Emerging Operational Renaissance** – Several factors are combining to raise the bar for operating infrastructures: enhanced investor due diligence, increased investor and regulatory expectations and uncertain economic and market conditions.

Challenging business fundamentals – In addition, while markets have recovered to a great extent, industry assets under management, revenues and margins have declined from peak levels, flows have favored certain investment strategies and several firms are below high water marks.



WHY NOW? WHAT'S THE IMPERATIVE?

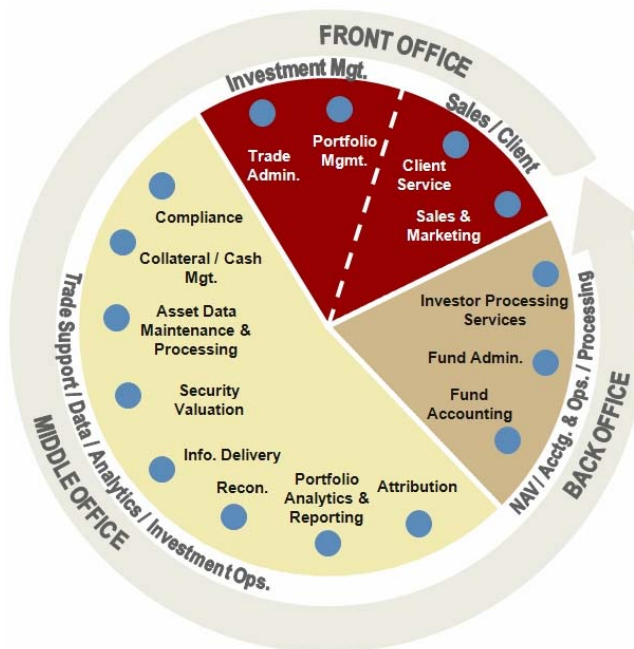
Every one of these trends has significant implications for the operational infrastructures of investment managers, who are grappling with:

- ◆ **Need for sustainable efficiencies** – Headcount reductions, cuts to variable compensation and elimination of low-hanging fruit such as non-essential travel will only go so far. Once managers have harvested savings from these areas, they must delve into their business models and process flows in order to achieve sustainable efficiencies and enable economies of scale.
- ◆ **Bifurcating product trends** – In evolving their business strategies, managers must increasingly differentiate between two types of investment strategies: intellectually rich strategies clients are willing to pay a premium for, and intellectually inexpensive strategies that are vulnerable to commoditization and the threat from passive strategies. A movement in either direction will have significant bearing on manager operating platforms.
- ◆ **Increased focus on risk management** – In response to investors, regulators, and market risk, managers are evolving their risk management practices from a reactive to a more proactive approach that treats risk as an inherent element of the investment process.
- ◆ **Demands for greater transparency**—Taking a variety of forms, these demands will increase the pressure on managers in a tight profit environment.
- ◆ **Industry consolidation** –Mergers and acquisitions are creating scale players that can exert pricing pressure on other managers.

“Investment managers are outsourcing a growing share of their operations, increasingly extending this approach from back-office to middle-office functions—a trend that is not expected to reverse.”

- Jay Burstell, PricewaterhouseCoopers

Operations Defined





GUIDING PRINCIPLES FOR AN OPERATIONAL ASSESSMENT

Have an ideal in mind – While firms don't have the luxury of a clean slate, the economic crisis provides an opportunity for fresh thinking: if you were to start over, how would you design your operational infrastructure? Then map that concept to your people, your technologies, and your business plans.

Start with firm objectives — Is the firm focused on growth and innovation? Or stability and client retention? How do you plan to achieve these objectives? A clear strategic direction will guide you in defining and developing your operational model.

Consider the nature and characteristics of your business – Large, complex global businesses are difficult to capture in a comprehensive, enterprise-wide view, but can apply capital and intellectual resources to advance their operational systems. Smaller to mid-sized firms may find it easier to wrap their arms around the issues, but not have all the skill sets or resources needed to do the job.

Determine your focus – While every operating environment should be designed with efficiency, innovation, and client service in mind, no firm can be all things to all people. For example, if you have a strong customer focus, perhaps you don't need to be the best technology firm. Defining your focus will help you understand how you can partner with others to achieve what's most important to your firm's future.

“If you can tie it all together – bringing front-office folks together with your operational people, pulling in your story and your communication plan – then you can give those in your firm a sense of where you're going and what's most important. And the more you draw people into the process, the more accountable you make them.”

-Keith Brown, Beacon Consulting

Manage communications throughout – The assessment process itself sends messages throughout the organization, which means both communication and confidentiality are critical, especially as you evaluate middle office functions.

Apply metrics to measure status and progress– Quantification is a critical tool in determining your current competitiveness, as well as gauging progress toward your objectives.

“More often than not, we find organizations lacking the underlying metrics to assess their processes and activities, both internally and in the ways they leverage their service providers. They're very good at analyzing cost centers and organizational units. But most can't get underneath that to discover where there is potential for scale, where there is duplication, and where improvements can be made in front-end processes, as opposed to back-end controls that generally just mean hiring more people for a given function.”

-Keith Brown, Beacon Consulting

Objectives of Operational Assessment

Better manage your business:

- Increase efficiency
- Reduce costs
- Provide accurate, reliable data
- Enhance ability to scale business model and extend product lines
- Mitigate financial and reputation risks
- Provide redundancy, meeting BCP and DR requirements

Better serve end investors:

- Enhance the client experience
- Expand reporting capabilities
- Improve transparency
- Respond to client needs for new products



OVERVIEW OF THE ASSESSMENT PROCESS

Process Methodology

Standardization – In every region, various investment products bring different levels of complexity, activities, and names to describe what’s going on, perhaps 90% of middle- and back-office core processing at its heart is essentially the same. This means organizations have a great opportunity to find ways to standardize processes, leverage utilities and centers of excellence, build scale into the organization, and use technology to support the firm’s business plan.

Apples to apples – Even once you’ve captured employee and activity data, this assessment is not so simple. It’s not as easy as comparing one employee versus another. You need to look at the data in ways that cross boundaries and create a true apples-to-apples perspective based on such factors as the amount of risk inherent in the process, the timing of the activity, and what is a value-added versus a non-value-added activity. Lastly you want to look at the level of automation brought to a process. From this you can start to measure how to deploy technology, decide what process changes to pursue, and determine whether to consider an outsourcing provider.

“Standardizing processes lets you create an environment allowing you to ‘plug and play’ technology and operational best practices, so every region benefits from the best way to do things.”

- Jay Burstell, PricewaterhouseCoopers

People Review

Assessing productivity – It’s vital to look from a pure process perspective at where your operations personnel are spending their time. Is there downtime you can harness productively? Or are these folks operating at 120% capacity and heading toward burnout? This will help you balance workloads across the organization.

Right people/skills? A key question to ask is, “Do we have the right people to drive change? Or do we need help from the outside?” Many organizations have great subject matter experts who understand the nature of what they’re doing. But how do you move the focus from the “what” to the “how”? If you’re implementing highly configurable, highly customizable systems, you need people who can drive change by redefining how these processes ought to occur. If you go down the path of outsourcing, you’re making the doers in your organization become reviewers, and making that shift in mindset is another challenge.

Right organizational structure – Middle-office outsourcing unquestionably is a partnership. There are many different needs from a middle-office perspective, and essentially everything is driven by data. So it’s vital that firms start to create this level of granularity, in order to understand what they’re going to keep and what they’re going to outsource without letting anything fall through the cracks. As a result, the right organizational structure and rules of engagement with service partners is critical to ensuring accountability.

Systems Review

Assessing suitability – The last piece in assessment is looking at your underlying technology architecture and your systems environment. Many investment managers choose what they deem to be the best system out there—but that isn’t necessarily the best system for their organization. It may be either too heavy or too highly complex for their capabilities. Having the latest and greatest system is less important than having one that fits your needs.



Business- vs. IT-driven – Reports comparing FTE allocations against technology spending can be an eye-opener for firms that think they're putting their IT dollars in the right places. The question is: where are you going to generate savings and process improvements from your investment? Where are you going to find scale, gain efficiency, eliminate duplication? In many cases, you may be able to leverage a service provider whose infrastructure is better equipped for the task than you are on your own.

Among other things, the foregoing process permits a manager to: (i) identify areas for process improvement; (ii) identify and assign risk ratings to any operational gaps; and (iii) better integrate technology in support of the firm's business objectives. Managers then must make decisions such as whether to rationalize technology, whether to invest in new technology and personnel or whether to outsource certain functions.

“Middle-office outsourcing is different from back-office in that you have to be able to interact with the relevant systems. Your solutions provider must be able to provide you with access to your data and transparency into various processes – allowing you to access and interact with important data such as portfolio exposures and to monitor the status of various processes such as account openings.”

- Jim Warren, SEI

DECISION CRITERIA: BUILD, BUY OR OUTSOURCE?

Core competency – When determining whether to outsource or not, your firm's core competency is a major consideration. If you have a simple investment model that is easy to process, implementing a new system may not be overly complex. But if you are an alternative manager, have a wider breadth of products or have a significant growth agenda, you will need dedicated resources and have substantial ongoing maintenance needs.

Levels of control – Your solutions provider must be able to give you tools to allow you to touch data intraday, to interact with processes and see their status. Middle-office outsourcing is different from back-office in that you have to be able to interact with those systems. It can't just be a paper environment or hard-copy reporting. You need integration into the system.

Competitive strengths – The nature of your investment process drives much of this thinking. How do you differentiate yourself? The simpler your process, the more you need to focus on the best ways of achieving hyper-efficiency, scale, and repeatability. Is your strength customer service? Then you'll want a solution giving you added horsepower in that area. By the same token, a boutique firm that is actively trading varied securities and using derivatives as a hedge will need infrastructure capable of handling sophisticated products. The tradeoffs in terms of needed technology support should be fairly apparent.

CONCLUSION

For managers to remain competitive, their operating infrastructures must achieve five critical objectives: (i) liberate senior management to focus on the ultimate drivers of their success, which are investment performance and investor relations; (ii) enable flexible product packaging in an era when investors increasingly dictate how a manager packages its investment strategies; (iii) establish a scalable business model; (iv) satisfy increased investor and regulatory expectations; and (v) enhance, or at least not detract from, the investor experience. A sound operational assessment is an essential first step in achieving these objectives.



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