Restructure Your Operating Model to Achieve Earnings Growth: A Post-Crisis Approach for Securities Firms
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EXECUTIVE SUMMARY

In the last few years, capital market executives have had their hands full staying competitive and surviving the market downturn. They did this by making cuts, often silo by silo, and occasionally in ways that negatively affected clients.

It’s time for these firms to rework their operating models in a new way, with an approach that increases capacity and customer service at the same time that it reduces costs.

The best way to do this is through an end-to-end operating model redesign. End-to-end redesign is basically a simultaneous reworking of all, or many, of a company’s functions based on an understanding of what clients value. This is different from the operating model redesigns most capital market firms have undertaken, in which they’ve treated their functions (back office, technology, sales, etc.) as silos and have focused on reducing costs within each silo with little client perspective. With end-to-end redesign, the results are often superior—in terms of capacity increase, customer satisfaction, and cost savings.

An end-to-end redesign has the best chance of maximizing results when it simultaneously draws on three traditional operational levers: functionalization of selected activities in centers of excellence, process and IT improvements, and activity relocation.

Like any transformation program, end-to-end design has its challenges, starting with establishing the initial plan. An even bigger challenge, however, is implementation, especially at a time when employees have been through upheaval and may be suffering from “change fatigue.” So drawing up and following through on a thoughtful implementation plan is another critical success factor. This Perspective also includes implementation guidelines and best practices to give firms a sense of how they can go from the theoretical to the real and maximize the value of these new transformation programs.
Capital market firms have been under unprecedented pressure in recent years. Even before the financial crisis, competition was forcing down margins on basic services like clearing equity trades. And clients’ appetite for complex instruments, such as over-the-counter derivatives, was forcing new investments in technology and compliance. Then came the crash of 2008, which destroyed many weaker Wall Street firms, changed clients’ risk profiles, and altered the regulatory environment, perhaps permanently.

Given all that has happened, it’s no surprise that capital market firms—including asset servicers, wealth managers, money managers, investment banks, trading desks, prime brokers, and broker-dealers—have spent the last year and a half taking out head count and looking for other ways to reduce costs. Now, however, there is an opportunity for some forward-looking firms to rethink their operating models and position themselves to grow and build competitive advantage.

The new idea is end-to-end operating model design—a simultaneous reworking of all, or many, of a company’s functions based on an understanding of what clients value. This is different from the operating model redesigns most capital market firms have undergone, in which they’ve treated functions as silos and focused on reducing costs within each silo. While the siloed approach has been successful at short-term cost reduction, it hasn’t made companies more adept at adding new clients or improving relationships. End-to-end design, by contrast, does target these objectives, making it the best option for companies that want to add capacity and improve customer service as they are eliminating cost.

There are two main pieces to the transformation program we advocate. The first is a wholesale rethinking of the operating model, using this doctrine of end-to-end redesign. A “lean” approach can facilitate this, and can be pivotal in taking out functional costs and identifying process efficiencies once the needs of all client segments have been identified. However, these levers must be applied in a coherent fashion and in the context of the end-to-end redesign.

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Exhibit 1
The 2 Pillars of Transformation for Capital Market Firms

<table>
<thead>
<tr>
<th>Pillars</th>
<th>Key Levers</th>
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<tbody>
<tr>
<td>Redesign the Operating Model With Lean Principles</td>
<td>End-to-End Design, Functionalization in COEs, Process Improvements &amp; Transformational IT, Location &amp; Outsourcing Strategies</td>
</tr>
<tr>
<td>Deploy Robust Implementation Program</td>
<td>Data-Driven Design Approach, Establish Governance &amp; Leadership Sponsors, Engage the Formal &amp; Informal Organizations, Measure &amp; Report Results</td>
</tr>
</tbody>
</table>

Source: Booz & Company
With respect to the first tactical pillar, some readers may be thinking, “We have already reduced head count and cut costs—we are already lean.” Or “We have already moved this or that function to a low-cost overseas location.” While these changes do result in some cost reduction, in and of themselves they will not help companies do a better job of servicing clients or adding capacity to enable future growth. They are what we call “reactive transformation” moves, which by their nature are incremental and isolated (usually focused on silos) and may affect other areas of the enterprise in negative ways. What capital market companies really need is “end-to-end programmatic transformation,” which explicitly coordinates changes in ways that minimize negative trade-offs and improve customer satisfaction even while removing cost.

In the case of capital market firms, programmatic transformation starts with identifying the needs of different client segments and making changes to the entire value chain based on those needs. This focus results in improved products and services and additional capacity, enabling growth from both new and existing clients.

**Change 1: Undertake End-to-End Design of Operating Model**

Most capital market companies have undertaken restructurings by silo—front office versus back office; fixed income versus equities; North America versus international; business unit operations versus shared services and corporate functions; information technology. Almost by definition, these individual department restructurings do a suboptimal job of balancing supply against demand.

End-to-end design, in most cases, is better suited to workload balancing—ensuring that changes in individual functions (sales, shared services, IT, etc.) meet the needs of your various client segments. End-to-end design also has the benefit of positioning you to grow. If there are investments that need to be made—processes that need to be improved, or installation of a new technology system to speed customer service—they get made. Every service that doesn’t fit with the priorities of one of your client segments is either eliminated or, if it must be maintained, handled in the most cost-effective way possible.

Lean principles can help tremendously here. They provide a methodology and mind-set to analyze processes in detail, identifying where value to customers resides, spotting unnecessary expenditures, and instilling a culture of continuous improvement. Lean strategy incorporates five principles,
which together help optimize the evolving operating model and become the context in which all prospective changes are evaluated (see Exhibit 2). All things being equal, changes to the value stream that improve client service get implemented; changes that jeopardize client service do not. The preliminary lean analysis also makes it much easier to identify where wholesale cuts can be made.

Change 2: Create Centers of Excellence for Certain Functions

As firms rethink their end-to-end model, they will identify activities that are necessary to their operations but not usually noticed by clients.

One way that capital market firms are starting to handle essential tasks that don’t touch clients directly is by creating centers of excellence (COEs). These are specialized service groups that have deep expertise in a certain operational area and that perform that activity for multiple business units or geographies. Do the people who are creating monthly statements for the hedge fund unit really need to be part of the same organizational team as the executives responsible for maintaining relationships with hedge fund managers? COEs do not make sense for activities that require

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Exhibit 2
The 5 Principles of Lean

<table>
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<tr>
<th>LEAN PRINCIPLES</th>
<th>Description</th>
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<tr>
<td>Customer Value</td>
<td>- Identify value in the eyes of the customer. Focus on delivering this value, no more and no less.</td>
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<tr>
<td>Value Stream</td>
<td>- Identify the value-stream steps that create this customer value. Identify waste and eliminate any steps that do not add customer value.</td>
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<tr>
<td>Flow</td>
<td>- Ensure that the value stream smoothly and consistently flows value to the customer without interruption (inventories, queues, etc.) from beginning to end.</td>
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<tr>
<td>Pull</td>
<td>- Let the customer’s demand for products/services pull the work through the process. Each step in the process then pulls from its upstream source, so work is done only as required.</td>
</tr>
<tr>
<td>Perfection</td>
<td>- Create a culture of continuous improvement. Periodically review and revise processes in a controlled manner, always striving for improvement.</td>
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Source: Booz & Company
client interaction or high levels of customization, but they can be an excellent way to handle the tens of thousands of daily tasks that are routine and repetitive and that do not require direct client contact.

A COE that operates across business units and geographies can ensure that the best approach to an operation like reconciliations, when developed, will benefit not just the business unit that once would have come up with the process and technology, but the insurance unit in Sydney, the pensions unit in London, and the hedge fund unit in New York. It handles the standard processes at a scale and with a degree of specialization that functional departments could never do, and because each COE has a single “owner,” service improvements come more quickly, are more consistent, and get distributed throughout the organization. This leaves the client-facing business units free to concentrate on the higher-level, value-producing tasks that have been identified in the end-to-end design.

Change 3: Drive Improvements in Process Efficiency and Information Technology

The same lean analysis that business units might use to figure out what the end-to-end value stream should look like—and which activities must remain with them and which may be moved into COEs—will often reveal process inefficiencies: the sale of a block of stock that could be handled with straight-through processing but is still being done manually; the valuation of a security that is done on an analyst’s spreadsheet but never entered into a central database; the three hours that a cash payment supervisor spends waiting for a fax before executing an order. There are hundreds of inefficient processes that may have arisen over the years as a result of M&A, shifts in technology, or one-time work-arounds that became de facto ways of doing business.

Through tools like value-stream maps and workload balancing models, lean analysis can identify these process inefficiencies and find ways to eliminate non-value-adding steps, simplify handoffs, and rebalance the workload vis-à-vis demand to improve utilization and eliminate waste. Lean techniques typically yield savings of 10 to 30 percent, often by showing that a business unit or function can complete its activities with a smaller staff if it performs its work more efficiently. Most important, the process changes that result from a lean framework can speed turnaround times and reduce errors, benefiting clients directly and freeing up managers to spend more of their time on revenue-producing activities.

Process improvements at capital market firms often require big changes in IT systems. This is a major hurdle. The IT departments in most capital market business units are more oriented to making incremental improvements, like system upgrades, than order-of-magnitude changes. The project lists usually include dozens and sometimes hundreds of requests for specialized applications in support of ad hoc processes.
After the company has embarked on its end-to-end redesign, these one-off projects should be reconsidered and reprioritized. In their place, IT departments should focus on a few transformational initiatives to improve automation, standardization, scalability, and service delivery. One such initiative might push the company toward straight-through processing, a way of handling trades that eliminates the need for manual intervention and could, for instance, greatly reduce the opportunity for custody and accounting positions to be out of sync.

Some business units have scores of workers dedicated to spotting these inconsistencies or exceptions, to researching their causes, and to helping in the reconciliation process. The solution for this issue starts with a single source of transaction data—the so-called golden copy database—and a transaction capture hub that includes reference data, market data, and the risk parameters of each trading position. These centrally managed sources of data improve risk management. It is an IT solution that can cut down on mistakes, improve the client experience, and save tens of millions of dollars in reconciliation costs.

**Change 4: Align Location and Outsourcing Strategies to the Functional Model**

Offshoring is not a new concept in capital market firms—it can and does exist independently of end-to-end design. We touch on it here because we think most capital market firms use the strategy too narrowly—simply to achieve lower costs. The broader opportunity is to use location to also deliver greater efficiency, provide better customer service, and reduce risk—in ways that are consistent with the overall end-to-end design, the scope of the COEs, and the process and technology improvements.

In a smart footprint strategy, some types of standardized work (transaction processing and management, accounting, reconciliation, security valuation, etc.) could move between time zones, starting in India, for instance, at 9 a.m., when it is midnight in the eastern U.S., and being picked up in Atlanta nine hours later. With work divided up this way, processing times can be reduced and overtime wages avoided.

However, devising an optimal location strategy is not simple—many variables must be factored in. For instance, many clients prefer interacting with a local staff that speaks their language fluently; many clients also don’t want confidential information moving between sites. In addition, clients’ home countries may have regulations about the types of activities, including record keeping, that can be done offshore. Finally, the capital market firm must be sure that it will be able to find an educated, motivated workforce in the country where it wants to build its new processing facility. These considerations go into an optimization equation that has multiple parts.
DEPLOY A ROBUST IMPLEMENTATION PROGRAM

After two years of dislocations and downsizings, few of which had an orderly feel to them, it is understandable that employees might be suffering from “change fatigue” and might be overwhelmed at the prospect of a new initiative (see Exhibit 3).

These fears are not unfounded. While only one of the change levers described above is new to most capital market firms, change is always arduous. And at some companies, there may be several different change programs occurring simultaneously. For instance, the end-to-end design may begin at a time when some departmental restructurings are still in progress. With so much change going on, there is a balance, a kind of triangulation, that must be achieved, and only a comprehensive, programmatic implementation program will get you there.

Imperative 1: Take a Data-Driven Approach to Designing the New Operating Model

However you introduce it, your transformation plan is bound to make some workers uneasy—they will focus more on the challenges of change than its opportunities. You can get ahead of this by presenting analyses that demonstrate the benefits of specific changes in terms of employee productivity or customer satisfaction.

This is where the balancing act starts. For instance, at many capital market firms, the opportunity for location arbitrage is so great that the immediate temptation will be to look for ways to transfer operations to as many low-cost locations as possible. Before you commit to this, do a test to be sure the new geographic plan won’t impact clients in a negative way. Will the new location support your client segments or just provide cost savings? Too much emphasis on location can compromise the end-to-end design you are doing.

Finally, when you do nail down your new operating model design, articulate the changes to your organization as quickly as possible. The sooner workers know what’s coming, the more they can start preparing themselves for the transformation and help make it successful.

Imperative 2: Establish Governance and Leadership Sponsors

Large transformation programs work only when senior managers treat them as a priority. Executives and business unit leaders should form councils to advise the implementation team, which is the multidisciplinary group in charge of defining the new model, designing the solutions, and running the program.

For the implementation team, transformation is a full-time job. The team

Exhibit 3
What Change Means, and Why Workers Fear It

<table>
<thead>
<tr>
<th>Types of Changes Brought About by Operational Redesign</th>
<th>How They Are Perceived/Experienced by the Organization</th>
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<tbody>
<tr>
<td>- New methodologies (e.g., lean)</td>
<td>- Loss of autonomy or status</td>
</tr>
<tr>
<td>- New or revised processes</td>
<td>- Fear of job loss</td>
</tr>
<tr>
<td>- New technology/transaction processes</td>
<td>- Less interesting/important work</td>
</tr>
<tr>
<td>- Organizational restructuring (COEs)</td>
<td>- Concern over applicability of skills</td>
</tr>
<tr>
<td>- Geographic realignment</td>
<td>- Apprehension about learning new skills</td>
</tr>
<tr>
<td>- Outsourcing</td>
<td>- Fear of not meeting expectations</td>
</tr>
<tr>
<td>- Workforce reductions</td>
<td>- New colleagues, teams, supervisors</td>
</tr>
<tr>
<td>- Revised job descriptions &amp; expectations</td>
<td>- Relocation/family disruption</td>
</tr>
<tr>
<td>- New roles &amp; competency requirements</td>
<td>- Loss of security/confidence</td>
</tr>
<tr>
<td>- New cultural norms, organizational values, expectations</td>
<td>- Working environment inconsistent with personal expectations or values</td>
</tr>
</tbody>
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Source: Booz & Company
creates the plans, enforces discipline around deadlines, identifies problems, and quickly communicates solutions. It also runs the program management office, which is the entity that drives the new processes and new thinking into your operations and keeps unhappy stakeholders from interpreting directives in ways that may undermine the mission (a big risk in a complex transformation). Methodology becomes the rudder. We have already talked about lean principles; we know of one capital market company that used them extensively in a transformation, training some of its managers to become certified lean masters. Other methodologies can also work. Whatever the methodology, the key is that there is a team driving its adoption and that the team has the backing of senior leadership.

**Imperative 3: Engage the Formal and Informal Organization**

Early on in some transformations, we have seen senior managers come up with rallying cries—catchphrases that frame the goals of the new model in terms every worker can understand. Some examples: “We need to find smart ways to lower our cost profile and avoid layoffs.” “Our future depends on increasing revenue while keeping expenses flat.” “Our number one priority is reducing risk exposure for our clients and ourselves.”

Catchphrases like these are a top-down way of identifying desired outcomes and building institutional knowledge, akin to executive memos, corporate newsletters, and internal websites. Because they originate with management, we refer to them as formal mechanisms. Other formal mechanisms include the legal and HR processes needed to transition people to new roles or locations.

Informal mechanisms are multi-directional and are often more successful at improving the information flow and getting buy-in from workers. Singling out employees who exhibit a desired new behavior, creating advisory councils, and establishing communities of practice are all examples of informal mechanisms that can support change initiatives.

Transformation programs never achieve their full potential if stakeholders have to be pulled along—they work best when stakeholders have a clear understanding of the benefits that will accrue directly to them. Hence the need for engagement—it’s management’s best way of harnessing a program’s power.

**Imperative 4: Measure and Report Results**

The last imperative is to measure and report results, not just within the leadership or implementation team but to every corner of the organization.

Keep it simple. Less is often more when it comes to metrics; it can be smarter to focus on a few high-level data points, whose relationship to your core objectives is unmistakable, than to overwhelm yourselves or staffers with numbers.

Here are some straightforward metrics—objectives and areas to measure—that have helped capital market firms succeed in their change programs:

- **Value to customers:** Timeliness, accuracy, inquiry responsiveness, client risk reduction
- **Efficiency:** Unit cost, volumes (automated vs. manual, etc.), throughput time, error/rework rate
- **Risk:** Losses, aged exceptions
- **People:** Retention rate of top performers now and in past, voluntary attrition rate
- **Change adoption:** Levels of awareness and understanding, levels of confidence in new knowledge and capabilities, evidence of adoption and reinforcement

Sustained support for the program will depend on your ability to continuously demonstrate its value. This suggests that it may make sense to start with a few small projects or pilot programs whose near-term value you are sure of. Whatever you are aiming for—faster client service, a reduction in errors, capacity gains—track it. If you don’t achieve it the first time, fix the problem and relaunch. Then publicize your successes. Quick results not only benefit you financially but also increase your advocacy base throughout the organization and help your transformation gain momentum.
CONCLUSION

Capital market firms haven’t had a choice about changing their operating models in the last few years; market conditions have forced changes on them. But most of these “reorgs” have had one overriding goal: to cut costs. They haven’t involved investments—not very large investments, anyway—in pushing firms to become stronger at the same time that they were becoming leaner.

In our view, the time is right for capital market firms to transform their operating models in a smarter way. Yes, the business units of international banks, wealth management companies, and securities processing firms have to keep cutting costs. But the advantage will go to those that grow stronger as they do so.

End-to-end design isn’t easy; it requires a level of self-analysis that most financial services firms aren’t accustomed to doing, and it may lead to heated internal debates about client priorities, corporate resources, and efficiency. Also, implementation requires time and energy. The full benefits may take several years to materialize. When they do, however, they will be huge. And those who have done this new kind of work will be positioned to win.

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**Australia, New Zealand & Southeast Asia**

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