Alleviating Pressure Through Revenue Control

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Standfirst: Investment managers and brokers are under pressure to better control finance as the complexity of their structures increase and transparency demands grow.
The asset management industry is facing choppy waters while investment banks are already deep into the tempest; navigating this turbulent period requires a firm grip on core functions. Of these, revenue and expense is most prominent as firms evaluate how, where and why they operate. Although the business models of buy- and sell-side firms are based on different metrics their interdependence upon one another creates common challenges for their finance functions.

A decade of investment growth in emerging markets is falling away with the number of funds closing exceeding those opening at the end of September 2015, for the first time since 2006, according to data from market analysis firm Lipper. Global uncertainty around interest rates is driving up volatility across assets. Appetite for passive investment has created an enormous exchange-traded fund (ETF) market, with Europe's having grown to nearly half a trillion dollars in assets under management (AUM) in 15 years, according to analyst firm ETFGI.

This is changing the product set that asset managers offer, and they themselves have been through a process of consolidation, leaving firms with geographically diverse operations and complex internal structures. The search for higher yield in a low interest rate environment has further contributed to firms accessing a broader range of markets and instruments. Within that expansion the range of tools the investment managers use has expanded to accommodate greater numbers of passive investment strategies and more sophisticated fund investment approaches in order to manage low yield and high volatility. In turn their broker-dealers must offer a greater range of structured products and support systems for their clients.

This diversity of products and investment approaches represents a challenge for the chief financial officer (CFO) and the finance team more broadly, as they tackle the increased underlying complexity of managing fee structures across various product types and assets across multiple geographies.

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Exchange rate fluctuation has a direct impact on the firm's revenue, and in a period of dollar ascendancy and weakening emerging markets there is considerable risk in certain currencies which can affect overall revenue. Regulatory transparency requirements are increasing, without uniformity, across different jurisdictions. Investors too need more granular information to satisfy their diligence around the investment process.

Error rates and processing bottlenecks will become very apparent as firms strive to offer a clear view of cost to their stakeholders. A greater control is needed, with process automation and auditability becoming paramount for a transparent operation.

The pressure mounts

The sell-side faces cost pressure from top-down rules that either directly or indirectly restrict business. These include Basel III which increases the cost of capital across a range of functions and specifically targets certain classes of instruments, or the Volcker Rule which sits within Dodd-Frank Act and bans trading from a firm's own book except in limited cases. Investment banks are therefore re-evaluating their approach to certain business lines and clients.

Trading operations are usually set up by a product-specific desk such as FX, fixed income, equity or derivatives and are trading regionally, if not globally. As costs and revenues collectively need to be looked at, what was once purely the domain of the desk is being examined at a higher level. Firms need to look at the total cost associated with commissions earned and fees charged, across all of their product sets. They have to get that understanding because they may have multiple relationships with the same counterparty and therefore losing one apparently unprofitable line of business can impact further business lines where that relationship is delivering a return.

Buy-side firms also face their own complexities. Where they are global in nature they will typically have grown at least partly by acquisition and in some instances via organic expansion. The first challenge is dealing with the many disparate systems they have built to deal with revenue and expense. Most global companies operate in the money hubs of the world, for example; a firm can have local presence in New York, London and Singapore. One major challenge that results from operating in multiple locations, is that each unit tends to have its own technology platforms, which in many cases do not communicate with each other. The support for these platforms multiplies cost and the lack of common function reduces efficiency. Using common components or technologies can reduce the associated operational complexity, risk and cost.

Another challenge facing firms is the lack of a centralised view of revenues and expenses. The creation of a centralised model with a relatively common process and a consistent data structure lets firms look at their business holistically. One viable approach to achieving that, which also resolves the issue of multiple technology platforms, is the replacement of multiple legacy systems with one global product that is used to support many parts of the business in a multi-tenant structure. This allows the firm to run businesses regionally in a very unique way, by consolidating and capturing all of its data in a centralised location using a single model.

The concern around increased regulatory oversight is creating the need for greater transparency across these organisations. While specific regulations are unique to a country or a region, the themes that they convey are frequently global. One such theme is the need to prove service levels, rather than relying on competitive pressure alone to ensure that firms are adhering to the contracts that they have signed up for, such as best execution agreements. A second theme is transparency, driving openness in costs and often squeezing margins as a consequence. Many investment managers are finding themselves under greater pressure to prove themselves to end investors. They need to have consistency in their approach across their operations because whichever jurisdiction they operate in, they will face pressure from local authorities to disclose data and to provide audited information.

The better way

Gaining efficiency and clarity in the area of revenue and expense management will lighten the burden that buy- and sell-side firms face under these pressures. There are defined steps to achieving that.

Firstly, the technology being used for revenue and expense management must provide a cross-product view with the capacity to view profit and loss at a higher level than has historically been the case with the ability to view across desks and across geographies.

That level of flexibility is best achieved with rules-based technologies. These allow the user to build out definitive business rules that are specific to a given geography and/or business. Financial accounting is relatively consistent by necessity; there is typically one reporting entity to which everything must roll back, even where there are the different entities globally. Delivering that from a technology point of view is a two-pronged challenge. The inbound information that is being brought into the system has to be scrubbed clean and normalised for the user in order for them to run their fee calculations. In addition, at the back end, once all the fee and accounting engines are created, the platform has to feed a set of global financial books, typically one of the big general ledger platforms.

Increasingly, Broadridge is seeing regional centres of excellence developing that are, based on a managed service model that provides a standardisation of process and technology with the capability to support both the global operations and a particular geography or set of people. That managed service model is increasingly used by global organisations when they want to build out a specific expertise and/or global function, such as a trade expense managed service.

The local tailoring of a centralised system gives a firm both visibility and control over its function and mitigates any change in that function. Historically, firms will often have developed a lot of their revenue and cost systems in-house, working from spreadsheets and local packages upwards, but the bigger firms are now clearly moving towards outsourced vendor packages that are global in nature and / or come with a potential service capability that goes beyond just the technology. If vendors can bring expertise to the table or an operational component to their client's business, which can significantly enhance that business' efficiency and flexibility, it will benefit both the top and bottom line.

Selecting a partner to provide that sort of capability must be done carefully. It will require the provider to have a very specific set of capabilities that includes the technology component, the "people" component to provide industry best practices, and an infrastructure that can scale and therefore deliver cost efficiencies.

Broadridge has the technology and the expertise to run these processes better and less expensively than a client can. Providing the whole package at a managed service level can further deliver these efficiencies at a fraction of the cost that any market participant could realise on their own. The optimal partner will provide the reassurance of third party validation with flexibility in service provision: combining scalable technology, best practices in services and knowledge, and a strong infrastructure.

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