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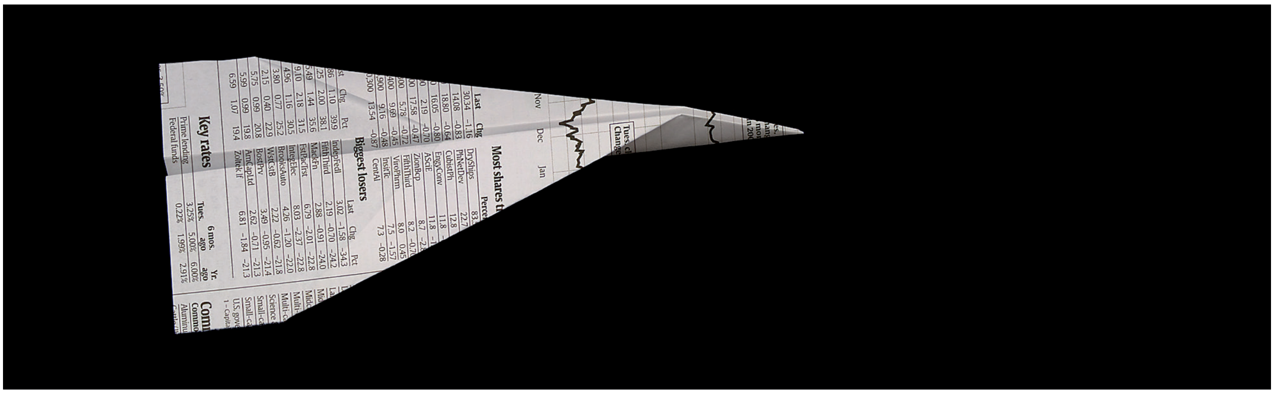

Streamlining Equities – Ten Operating Strategies for Competing in Today's Markets

Jeff Penney

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> *"Whosoever desires constant success must change his conduct with the times."*
>
> *Niccolo Machiavelli*

Equity sales and trading ("Equities") is a core business for many banks and broker-dealers, both on its own merits and because of its synergies with corporate banking and wealth management. Like all capital markets businesses, Equities is under increasing pressure from electronic trading, reduced leverage, increased capital requirements, regulation of over-the-counter derivatives, and limitations on proprietary trading.

New operating conditions call for a leaner operating model to protect revenue and maintain growth, starting with a re-evaluation of the product silos that require so many specialists. Profitability also depends on the firm's ability to deliver resources to clients and capture trades with greater efficiency. Success requires re-thinking the entire legacy organization, looking at new ways to combine or expand roles, and re-evaluating the required team skills.

Adopting the ten initiatives discussed in this article – covering sales, trading, and operations – can help management streamline the Equities organization for greater top line revenue and increased operating leverage.

Sales Initiatives

The traditional sales model in Equities is essentially product-centric, with silos linked by an account management process. In contrast, a client-centric organization aligns sales according to client functions: Advice, Execution, and Financing. In this model, salespeople with client coverage responsibility are supported by small teams of product and sector specialists. Improved teamwork and product penetration drive revenues, and savings result from leaner management and fewer dedicated product personnel.[1] Banks and broker-dealers should consider the following changes:

1. Recast "Research Sales"

Traditional "research sales" professionals typically align with cash equity to deliver research-related resources to clients. Recasting this group as "generalists" with broader responsibility for connecting their clients to all resources and products paves the way for "product specialists" to focus on high quality opportunities rather than originating leads. Savings result from the need for fewer dedicated product salespeople.

1 See *Institutional Investor Coverage: Managing Clients Across Multiple Products.* High Line Advisors, LLC. February, 2011.

2. Create "Execution Sales"

Once a client makes an investment decision, a trade takes place in either cash or derivatives. Generally, the client's trading activity is co-ordinated and may even be overseen by a single person. Consolidated management of people who execute these trades aligns coverage and encourages teamwork. Savings result from the elimination of middle management in product silos.

3. Rebalance Client Coverage Assignments

Client coverage across multiple product areas requires co-ordination among salespeople who cover individuals at the same institution. Such co-ordination is critical if the broker-dealer is to maximize client wallet share. Product-centric coverage generally results in each client being covered by a different, bespoke team. When coverage is reassigned so that the same group of salespeople works together on a group of clients, communication improves. Just as a regional office benefits when salespeople are co-located and share a common set of clients, client-oriented account reviews across multiple products occur naturally, with the team collectively responsible for meeting the budget.

4. Fortify Multi-Product Marketing

Client account planning should encompass all products. Client meetings that push a single product often fail to identify broader client opportunities. Skilled multi-product marketers drive revenues by probing for client needs that can be addressed with existing products. The resulting opportunities can be incorporated into client budgets and pursued by both generalists and product specialists. Teamwork among product marketers and client generalists ensures that no revenue opportunity is left uncovered.

5. Deploy Sector Specialists

As pure execution commissions decline, broker-dealers must generate more of the resources and ideas that clients value. Sector specialists provide clients with market color and short-term trading opportunities backed by core investment theses. As an addition to a traditional Equities organization, sector specialist teams often fail to reach critical mass across all sectors and are the first to be eliminated in a bear market. Client demand for alpha suggests that sector specialists are an essential part of the new model. Increased revenue results from systematic delivery of trading ideas to clients and from better informed decision-making by traders who commit capital. Savings result from consolidating desk analysts, specialist sales, and other sector experts into a single group that serves multiple internal and external constituents.

Trading/Product Initiatives

An operating model that relies on client generalists and multi-product marketers can deploy fewer product specialists dedicated to structuring, pricing, and risk management. Product groups can be streamlined further by centralizing risk management and product manufacturing via the following strategies:

6. Implement a Central Risk Desk

Traditionally, market risk is managed within individual trader positions. Increased capital charges and restrictions on proprietary trading are catalysts for reducing the size and number of such positions. The distinction between position traders who speak with clients and sales-traders has also begun to blur: both can provide liquidity and bring equities onto the firm's balance sheet, but need not manage the exposure over time. Equity risk across a number of positions is a core competency of the "portfolio" or "program" trading desk. Positions may be moved into that trading book and managed by a few traders who rarely interact with clients, thereby minimizing conflicts of interest. Clients continue to value consistent execution coverage as well as access to sector traders who see all flow and provide commentary. It is possible to maintain a minimum number of sector traders aligned with sector specialist salespeople. Savings derive from merging the remaining traders with sales-traders to cover clients.

7. Merge Secured Funding Activity

As highlighted by the global financial crisis, the risk in funding the balance sheet is as critical as market risk. Centralization of secured funding activity provides visibility into sources and uses of collateral and reduces risk as well as funding costs.[2] Secured funding activity for the benefit of the firm as well as its clients naturally occurs in several "delta-one" products, including prime brokerage, securities lending, total return swaps, and certain options structures. ETF trading is also driven by arbitrage between the index and the underlying stocks. Consolidating the management and staffing of these products provides savings in personnel as well as balance sheet charges.

8. Centralize Structured Products

Firms with both an institutional global markets business and a retail-oriented wealth management business often maintain redundant platforms, personnel, and distribution relationships for structured notes and fund products. Failure to combine or share resources frequently reflects conflicting priorities and an absence of trust between the two groups. A joint venture (JV) simultaneously satisfies fiduciary concerns of the wealth management business as well as the commercial objectives of the institutional trading business. If the joint venture fosters competition both for the raw materials used to construct the product as well as the distribution of the final result, the profit of the JV is maximized and returned to both businesses.

2 See *Collateral Management: Best Practices for Broker-Dealers.* High Line Advisors, LLC. March, 2011.

Operations Initiatives

Additional operating leverage derives from shared middle office utilities, particularly in client integration and ongoing service as outlined here:

9. Reengineer Client Integration

Client integration or "onboarding" often involves multiple product silos and control groups and can become bogged down as a result. The proliferation of documents associated with electronic trading, listed and OTC derivatives, repo, securities lending, and margin is often fragmented among interested product silos. A centralized integration process can track documents, manage prioritization, and co-ordinate negotiations and approvals. Centralized document control also eliminates duplication of client data and reduces the risk that asymmetric terms appear across documents.

10. Normalize Client Service

The success of firms with a prime brokerage operation is based on excellent client service. However, this high level of service is offered only to a subset of hedge fund clients that use leverage, while firm operations supports other, "non-PB" products and clients. Combining classic prime brokerage with clearing of other products can eliminate redundant systems and middle office operations. The goal of the firm should be to unify clearing, post-trade client service, client reporting, margin collection, and financing. Such an approach avoids inconsistent client interactions and also enables moving post-trade client service out of the front office and into the operations back office for additional savings.

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The strategies described in this article have consequences that ripple through the entire Equities organization. No single strategy in isolation is sufficient to improve results. They work best when taken in combination and therefore require conviction and co-operation to implement. Change can be difficult and disruptive, but firms will find it rewarding when they successfully adapt to new market conditions.

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