Penny wise and pound foolish

Tighter technology budgets on the dealing desk do not have to equate to less efficiency, argues Peter van Wely, head of Inforeach Europe.

In recent months a swathe of articles and studies have been produced suggesting that for the buy-side the main IT priorities for 2009 are cost cutting and systems rationalisation. In a recent TABB Group report, for example, up to half of the buy-side firms contacted said they were considering changing their OMS and EMS providers. Is it possible to reduce costs and at the same time improve efficiency and performance?

Of course this should be the goal. In many instances in the past, firms tended to reduce costs during challenging times, sometimes scraping pennies off their IT costs but severely limiting their growth potential when the upswing started in the market. The fact is that in many firms up to 95% of their IT budget is spent on maintenance and support, implementation and testing. Only a small proportion is reserved for new technology, enabling the firm to react quickly to new business demands. During a downturn new projects are quickly cancelled or postponed, further reducing the ability to be progressive.

Firms should take a more rational approach to investing in new technology.

Peter Van Wely

Imagine in the above scenario cutting back to 85% on ongoing IT expenditure, while simultaneously increasing the budget for new ideas/demands from the market to 10%, achieving an overall saving of 5% in the firm's total IT budget. Not only is a sizable cut in the IT budget assured, but IT spending for new business development is doubled. This approach may sound compelling, but is it feasible? For most firms, I believe it is by focusing on some of the 'low-hanging fruit' in the dealing room.

Start by examining your major costs, among them the existing maintenance contracts. These contracts tend to increase annually and probably will cost a lot more today than at the start of the agreement. It is important to compare each contract to other systems agreements, based on the total costs, functionality and the period of the contract. Some systems may have been cutting edge once but are now legacy. Also ensure that contracts are reviewed on time, since there is a tendency for maintenance contracts to renew automatically. It is always better to renegotiate terms each year.

Seek out overlapping costs. In many instances with the growth of your desk and the increased functionality of your systems, you may discover unnecessary overlap between your systems.

Personnel costs. Today, in many areas, IT has become a commodity. Look critically at the commodity components of your IT suite – ASP, maintenance and support, for example – and decide what can and should be outsourced to a vendor. To do this effectively, it is important to employ competent IT staff that can manage the relationship with vendors and talk to the business people within your organisation. It is also vital to have a kernel of good programmers to develop algorithms and/or have a deep knowledge of FIX messaging.

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Trust but verify

The fourth kind of low-hanging fruit concerns the wider relationship and interaction with IT vendors. There have been and always will be a lot of smoke and mirrors in IT. Bear in mind that the goal of each vendor is to impress potential and existing clients and that during the process of selection, negotiation and implementation there are a lot of potential pitfalls. In approaching negotiations with IT vendors, the basics are very simple; like Ronald Reagan said: "Trust but verify." Is the vendor merely giving a sales demo or is what you see a production version? Ask your vendor what percentage is invested in development and support versus marketing and sales. This is the best way to know if they can keep up the pace. Is the product stable and performing to capacity – and can they prove it? What is included in the price and what is excluded? How flexibile is the system; can new business or market demands be quickly implemented and what will the additional functionality cost? What are the hidden costs (like per share transaction fees)? What are the maintenance costs and how many resources do you need to allocate to it? What are the implementation costs and timeframe involved? Is the vendor willing to install and maintain the system for a fixed price? What are the costs of integrating new technology with existing systems and architecture? Alternatively, how open is the system? It sounds logical, but a lot of money can be wasted at the outset.

A structured approach needs to be developed to deal with the issues outlined above. Form a 'SWAT team' that nails down the priorities for your business and introduce an algorithm selection process to determine when and what type of algo should be used. This should be supported by a vendor selection process and a technology design template.

Taken together, the actions outlined in this article will help free up money to invest in new technology in preparation for the upswing. There is a dividend from deploying new technology arising from lower trading costs through the increased use of algorithms/DMA, increased crossing opportunities, lower market impact costs and better transaction cost research. This in turn leads to less slippage, improved trading performance and an ability to better evaluate brokers. Last but not least, remember to aim to do more with less by investing in systems that can execute and monitor your orders more quickly and efficiently, increasing trader productivity by freeing up their time to concentrate on the more complex trades. ■

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