

# 'Best of breed' - the only way forward?

*Analytical information is a central foundation of any modern asset management business. Analytics are used for many reasons, whether it is to aid decision-making, provide insight into the underlying risk in the business, offer insight into the past or future, or to communicate with clients and stakeholders. Good analytics, in the right form, are very powerful. Used correctly, they can help underpin the process of winning new business, retaining existing business, meeting investment targets and increasing assets under management. At its zenith, the discipline goes beyond the generation of analytics, providing the intelligence that helps senior management to assess their business strategically. It can supply a holistic view of an investment strategy, where analysis moves beyond just performance and risk to a wider analytical field - including price sources, intra-day trading, analysis of positions, sources and validations.*

The focus for over a decade was on 'best of breed' analytical engines to satisfy specific requirements for asset classes, strategies and geographies. This has resulted in asset managers renting, owning or subscribing to various systems, services or calculation engines. These may be outsourced, built in-house, installed vendor software or supplied by service providers. While these individual solutions are meeting specific business requirements on a stand-alone basis, the question arises: are they complementing one another or does the multiplicity of these facilities increase business complexity, risk and fragmentation.

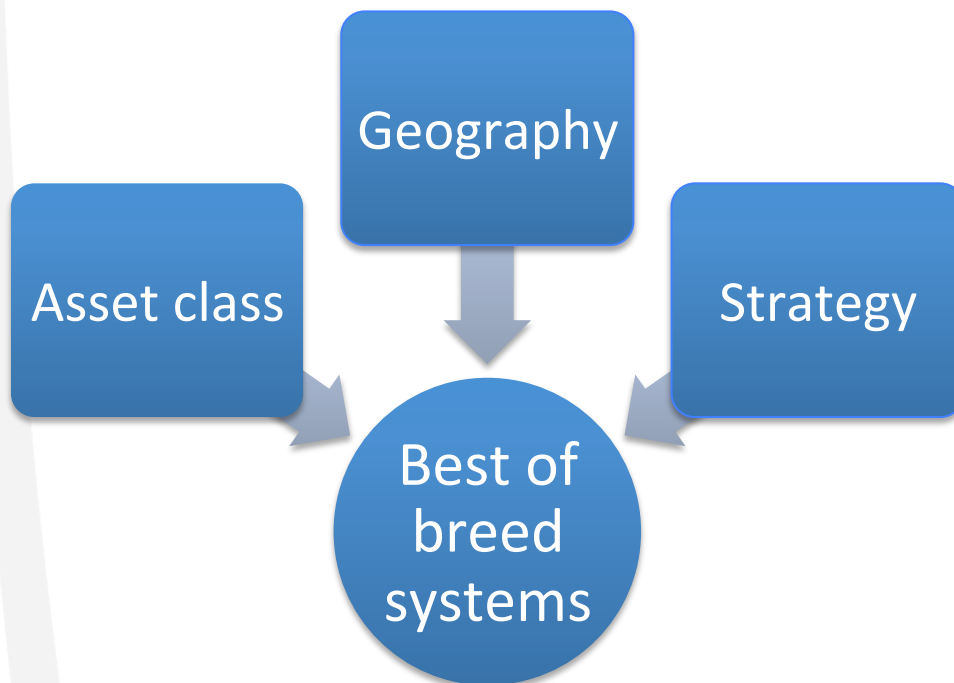
As a result, in recent years, some investment managers have reduced the number of analytical engines through rationalisation in an effort to simplify their systems and IT landscapes. But can broader and fewer systems deliver the expertise and business agility required? The answer for most companies with a global footprint is to make better use of the existing applications and to evolve to smarter systems that are quicker to implement, removing the need for ongoing expensive and large-scale upgrade programmes.

Best of breed has traditionally meant buying the most specialised system for that asset class and investment strategy, but in today's asset management world best of breed has evolved and asset managers must now ensure that they also extract full value from these systems. This means fully understanding the system's ability and ensuring that it efficiently fits into an overall configuration of best of breed systems in the most efficient and effective manner.

## **A defining problem**

To begin, there is a need to define what 'best of breed' actually is. In practice, what constitutes best of breed often comes down to the individual you are talking to. For example, the fund manager that manages asset-backed securities has a totally different impression of what the best of breed fixed income attribution model is from, say, the head of performance or head of risk. Furthermore, both of these roles will also have a different perspective from the vendor.

**Figure 1: The different types of best of breed systems**



Whether best of breed is applied to an asset class, geography, or strategy (see Figure 1), it essentially means a commitment to not making any compromises on functionality. The asset manager needs at least an 80 percent fit between the system and the asset manager's business – and as much as 95 percent in certain key business areas. If the asset manager doesn't have that fit, the Pareto principle (that 80 percent of your business comes from 20 percent of your customer base) means that you have compromised and that the system can no longer be regarded as 'best of breed'.

Regardless of the definition, there is a problem that an asset manager must face when adopting the best of breed approach instead of deploying one system that 'does everything'. Multiple systems lead to IT complexity and the only way to truly bring those disparate systems together is through an aggregation platform that addresses this issue.

#### **Moving away from best of breed: one experience**

We learned of a case of a sizeable investment house that provides a good example of the problems encountered when attempting to move away from a best of breed approach. This firm tried to change every investment management system to a best of breed configuration, but in trying to do so, the transition proved problematic. After four years of problems, only its performance system actually went live. Having suffered from taking the best of breed approach, the firm then decided that it needed just one system for everything. The firm also chose the one system approach because the firm's IT team wanted to make their life simpler by managing a single system. The firm tried to replace every system across the organisation simultaneously with a single front to back office enterprise solution. However, it then had to make so many compromises with the enterprise system that the business users were disappointed with the functionality made available. As a consequence of the entire experience, the firm suffered from a reduction in its competitiveness in the market it serves and produces less analytics now than it did before the enterprise solution was deployed. We

anticipate that this firm and perhaps others in a similar position will start to move back towards the best of breed approach before long.

This is a good example of where an investment management firm didn't manage its best of breed programme efficiently. Enterprise systems can result in a lot of unexpected development work, requiring the vendor to build additional functionality and the IT team to supplement that lack of capability.

We see that there is often an inherent conflict between business and IT teams when best of breed systems are being evaluated. The business users demand best of breed in the revenue-generating areas of the business - the market facing teams. However, in some cases the IT team wants a simpler architecture and therefore is more liable to opt for a one-vendor approach. The answer is an aggregation platform that bridges the business versus IT gap, where the asset manager can plug in other best of breed engines whilst also benefitting from a consolidated point from which to draw the data. Therefore the users have the crucial business perspective that they need but the IT team is still in control, so both parties are satisfied.

### **Simplification vs. agility?**

Whilst we think best of breed is the way forward for the industry, it doesn't mean that asset managers need to have all those systems internally. All specialist vendors also offer ASP or hosted solutions. However, if an asset manager's IT strategy is to 'lift out' all those engines and move them to a hosted solution, they will have less visibility into those systems and therefore the need for a data centralisation point within the asset manager is increased. Many asset managers have tried to move away from best of breed because of the technology implications, but the technology can be simplified by outsourcing it, as long as the data can still be centralised.

Moving away from best of breed may simplify an asset manager's systems but it is often not in the best interests of the business. Broader, more generic systems will mean reduced functionality, less business agility and the cost of deployment is far greater. Upgrades and testing will take far longer and therefore cost more. If the strategy is to replace an old back office system, the best approach is to gradually 'shrink' it whilst retaining the specialised, value-add areas - not to remove it in one project. Indeed, some legacy systems are so highly tuned to the needs of the organisation that to replace them is a five-year project. If an asset manager has a strategy to replace an entire system, the best thing to do is to underpin that system first with an integration or aggregation platform. In this way, as the asset manager adds a new capability, it won't be delivered to the business users from the old core system, it will be delivered from the integrated platform.

What is needed is a platform that brings the results and output of all of an asset manager's specialist systems together in an efficient way, consolidating and maximising the data therein and realising their full potential. In this way asset managers can unlock the value of their best of breed systems and make them work more effectively for their stakeholders and clients.

### **Weighing up the cost**

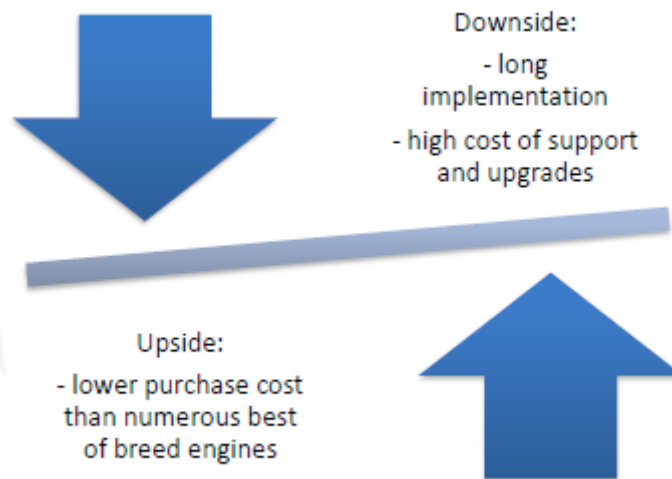
As we've discussed, some IT managers understandably desire fewer systems. After all, it simplifies the technology layer and would appear to be 'cheaper'. But that usually comes at the price of less specialism. Best of breed isn't necessarily the most expensive and fewer systems do not necessarily mean less cost. In many cases, specialised systems should lower the cost base and enhance business agility.

The lengthy time for deployment is another hidden cost of a front to back office solution. The asset manager is sometimes unable to react to market change or trade in every asset class, simply because the front to back change is so intrusive. How many asset managers can afford to start a three-year implementation project for an enterprise solution in the current regulatory climate? Typically the deployment of a specialist system for a specific asset class takes months to implement, instead of years.

If one analyses the internal costs of implementing, supporting and upgrading an enterprise solution, the result can be surprising. With an enterprise solution, an asset manager could be making a simple

performance upgrade but this may have implications for the investment accounting system or risk system, resulting in downtime and delays. Every time a change is made to one piece of code, the regression-testing task is immense. Codes become so complex (due to the fact that so many different consumers are using the system in a multitude of ways) that it becomes unfeasible to test every one. Inevitably, 'bugs' get into the system. Therefore, the costs of supporting such an application are high (see Figure 2).

Figure 2: The enterprise system cost balance



From the IT perspective, it is cheaper to go for the front to back office enterprise solution - one system that does it all. For an IT Director, it is more expensive to take the best of breed approach because he/she will need to buy all the different systems and find ways to reliably integrate them. From the business perspective, however, a 'one stop shop' drives up the cost of doing business, mainly due to personnel overheads. This is because the data consumers have to do more work to supplement the analytics that they are receiving from the system. These are hidden costs that are often overlooked when considering an enterprise solution. Ultimately the IT team should be servicing the business, not the other way around. The consumers should be saying 'I need to reduce my costs, so you need to be giving me a better service'.

Therefore the cost of ownership of an enterprise solution is potentially higher than having several nimble specialist systems, where both the asset manager's costs and the investors' costs should be lower. If an asset manager deploys systems that are more agile and with simple architectures, they are safer to operate, the costs are lower and deployment is more rapid.

### The risk implications

One might also argue that the business risk is higher with an enterprise solution. The asset manager may become aligned with one vendor and if that vendor decides to take their system on a development course that doesn't fit with the asset manager's long-term strategy, substantial problems can be encountered.

Post-Lehman, it's the same kind of risk that has driven companies to consider using multiple custodians and multiple prime brokers. Asset managers must carefully consider their vendor relationships and ensure that they have a view on the economic viability of their suppliers and of their future ownership. The vendor landscape is highly likely to change dramatically in the coming years. In the worst case this may result in the source code in escrow, but who is going to maintain that system if the vendor goes bust?

Large enterprise systems are by their nature slow moving. If your investment house sees a new business opportunity or moves into a new business area, with a politically strong new front office team, will the single

system model be able to react quickly enough? Ultimately, asset managers need to be driven by their market and business opportunities, not restricted by a cumbersome IT policy.

Finally, there are often barriers to deviating a system strategy once an asset manager is committed to an enterprise solution. For example, problems can arise if an asset manager with an enterprise system then buys a best of breed solution for one particular area of the business. It is very difficult for that solution to be integrated back into the enterprise system in order to get a holistic view.

### **The data management challenge**

It could be argued that this drive towards best of breed has also resulted in a new form of data management challenge. Most recently, the industry has been focused on solving one key segment of the data management challenge - creating consistent and complete reference data that can be distributed throughout the organisation. In doing so, asset managers need to ensure that all processes, systems and people are working from the same starting point – as they all have the same ingredients. However, this new analytical data management approach could prove to be just as challenging.

A large insurer came up against this problem when Lehman Brothers collapsed. When Lehman Brothers found itself in trouble, the insurer wanted to know how much exposure it had to Lehman. The company couldn't get a full picture of its exposure because so much of the data was located in different business units. To make matters worse, the insurer also didn't have direct relationships with the counterparties that Lehman worked with that were adversely affected by Lehman Brothers' downward spiral.

The insurer recognised that it needed a full exposure perspective for such instances. As a result, the insurer is now in the process of trying to consolidate its exposure analysis across its various businesses. It has over a dozen different risk engines; some built in-house, some bought from vendors. Each of the business units has chosen an engine to perform a specific task. The problem was that at a group level, it didn't have a platform to aggregate all of that data. On a stand-alone basis, best of breed was the correct approach because that is what the insurer needed to manage each particular set of assets; however the group level decision hadn't been considered in terms of how it was going to gain an overall picture of the total exposure. There was a need to bring control to that disparate landscape.

### **Conclusion**

Best of breed is a pragmatic option that maximises existing investments and knowledge. However, in order to be a viable long-term solution, companies must deploy manageable system architecture and simplify business processes in order that this optimal functional breadth does not come at the cost of business agility. By deploying systems that can provide management information on key business issues, such as analytics, this can be achieved.

Best of breed is well established and is the only way to support a complex global business. Some asset managers are trying to move away from best of breed but that is likely to take their businesses backwards rather than forwards. The correct approach is now about extracting the best from the best of breed systems for the business. In other words, the new paradigm is to achieve 'enterprise best of breed'.

Most investment management firms have evolved a best of breed set of applications and outsourced services in order to support their complex business needs. It is the level of specialisation required that has driven the industry down this road. As the industry continues to evolve to meet the needs of customers and regulators, this fragmentation of IT and business processes will increase. Applications today need to be smart. They must have strong elements of interoperability and be able to protect and extend the existing investments made. It is now uneconomic and more often than not too risky to consider consolidation of applications to a small number of large, all-encompassing solutions.

The asset management industry regularly faces periods of intense change, and needs to move rapidly during such periods. History has shown us that the only way this can be achieved is by implementing and

supporting specific applications to deal with the specific and fast moving changes. In more stable times, some investment houses look at this IT complexity and begin to move toward an infrastructure that is more static. Many within an asset management firm often see a stable IT infrastructure as a utopian dream. But can it really allow the investment house to move as the market requires it to?

In summary, the actual risk and issue with best of breed is in the speed and manner in which many of these systems have been implemented. Usually this results in an 'IT spaghetti' involving many interfaces and a high level of data movement around the enterprise. The way to address this is not to remove the specialised systems and replace them with a generalist solution, but to remove this 'spaghetti' with a more stable model. A stronger business model is to implement integration platforms, where the best of breed systems plug into this platform that acts as a central conduit. In this model, data traffic is reduced, errors and risks are lower and management is simpler.



To learn how Anova can help you maximise your investment in best of breed systems, please contact:

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