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Special Edition

New perspective conducive to success in Asian financial business

- Interview with Andrew Murfin, Regional Head of Group Operations, Asia Pacific at UBS AG -

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Executive Summary

Many financial institutions have tried to expand into Asia in recent years in the wake of Asian economic growth, but more than a few ended up scaling down or discontinuing their Asian operations, unable to improve their high-cost structures. UBS is pursuing a shift in its operations strategy to overcome challenges facing its Asian business. NRI's Yasuki Okai talked to Andrew Murfin, UBS's head of operations in the Asia-Pacific region, about UBS's operations strategy.

Andrew Murfin

Joined UBS AG in 2000 after working at J.P. Morgan and Credit Suisse.Worked in various roles at UBS, mainly in Asia Pacific operations. Promoted to regional head of UBS Investment Bank's Asia Pacific securities operations in 2003. Subsequently promoted to head of Asia-Pacific investment bank operations. Promoted to current position in 2012.

Yasuki Okai

Joined NRI in 1988. Initially assigned to Systems Science Department.Involved in developing financial product valuation models and drafting securities portfolio management proposals for financial institutions. Temporarily reassigned to NRI Europe in June 1993. Involved in building risk management frameworks. Appointed Managing Director in April 2011 after serving as manager of Financial Technology & Market Research Department. Promoted to current position in April 2013.

Factors behind change in operations strategy

Okai: You are currently in charge of UBS's entire operations in the Asia-Pacific region. I've heard that UBS has been revising its post-trade operations model in recent years, including middle- and back-office processes. What led you to do so?

Murfin: After the global financial crisis, many financial institutions were forced to make major cost cuts, which resulted in large-scale layoffs, including in operations departments. However, once the markets embarked on recovery from 2009, financial institutions ramped up hiring again. We decided that such repeated cycles of hiring and firing are not a sustainable model.

Another factor was regulatory tightening. Basel III was under discussion and the Dodd-Frank Act was passed in the US. In response to such developments, we decided that a complete reorganization was needed, including in operations departments.

Operations account for a large share of a financial institution's total cost. Additionally, post-trade costs' share of transaction costs is rising. Our overall profit margins would end up shrinking unless we changed how we provide post-trade services.

At UBS, we are always thinking about efficiency and profitability. Previously, every financial institution seemed to believe it could grow its profits at will. Financial institutions were consequently not very concerned about costs or profit margins. Going forward, however, financial institutions no longer have much prospect of rapid growth like in the past. Due to stricter regulations, even businesses that were previously highly profitable cannot be counted on to remain as profitable in the future. With post-trade costs growing and the financial industry's operating environment changing drastically, we believe that if we neglect to take action in response to these trends, we could find ourselves behind the curve.

Okai: Many securities firms are trying to make inroads into the Asian market, but they are vexed by trading inefficiencies and rising costs. Such challenges will prompt many firms to rethink their overall Asian operations.

Murfin: I agree. Running a securities business is more costly in Asia than in countries such as the US, partly because Asian securities exchanges and clearinghouses charge very high fees, reflecting that many markets are unfortunately monopolized. Healthy competitive forces are largely absent. Another issue is severe market

fragmentation. Everything differs from one market to the next and there is little if any linkage between markets.

Okai: And the pool of people with specialized knowledge is smaller in Asia than in Europe or the US.

Murfin: Yes. Over the past few years, such people are in short supply even in the Hong Kong and Singapore markets. For example, whenever we lost a highly knowledgeable employee working in trade settlement, we would have to offer 25-30% more in compensation to hire a replacement to do the same job. This is a byproduct of Asia's growth. Asia's cost-benefit advantage over other regions is shrinking.

Okai: Trading volume, even on a pan-Asian basis, is tiny in comparison to the US. Trading volume in individual countries is even smaller.

Murfin: That's right. Based on volume alone, it is hard to find support for assertions like "investors should prefer Asia over other regions" or "IT systems should be developed on a market-by-market basis."

In these markets, running costs are very high due to a dearth of low-cost local vendors and a multitude of region-specific applications. We therefore have to ultimately formulate a pan-Asian strategy. It is difficult to formulate business plans on a country-by-country basis.

Okai: Japanese securities firms are encountering similar problems. They are now rethinking their Asian businesses.

Murfin: In the past two or three years, many securities firms from throughout the world have attempted to build businesses in Asia. Both major and mid-tier players sought to enter the Asian market through organic growth and/or M&A, but they appear to be having severe difficulty.

The problem is that to provide full service, you need to serve the primary market also. To be involved in equity IPOs, you need a capital markets division and high-quality research capabilities. You also need a very strong sales force for distribution. And you need to be able to provide direct market access (DMA) and algorithmic trading.

If all companies built such infrastructure themselves, the cost would be huge and initial profits would be extremely small. In the event of a market downturn and decline in trading volumes, losses would rapidly grow. Japanese securities firms are presumably also encountering such challenges.

Okai: Japanese securities firms incur heavy research costs when they enter Asian markets. Are KPO (knowledge process outsourcing) services becoming more widely utilized to supplement in-house research capabilities?

Murfin: Yes, a growing number of vendors are entering the KPO business. Fortunately, UBS has a large equity business, so we can afford to have in-house research capabilities.

Okai: Japanese securities firms have in-house research departments, but they could realize substantial cost savings by using KPO services.

Murfin: We are periodically approached by KPO vendors. They apparently aim to provide KPO-based research to many companies. If we were to purchase such research as needed, we could convert research to a variable expense. The advantage of the KPO model is that you pay for only what you need. If you know what your core businesses and non-core businesses are, I believe you can be more flexible in your business approach.

Four pillars of UBS's operations strategy

Okai: The distinction between core and non-core businesses ties into UBS's operations strategy, doesn't it?

Murfin: Our operations strategy has four components.

The first is to take a step back from day-to-day demands and rethink the operations model. This involves understanding our business processes and services and clearly identifying core and non-core operations. Through this process, we identify which services and business processes are truly sources of competitive advantage.

Clients take for granted that we proficiently provide many post-trade services. Even if we provide such services well, there is little reputational upside and contribution to business expansion. If there are any problems, however, we could lose business. For such services that are not a source of relative advantage, we may identify the most efficient approach and commercialize it in the aim of building market infrastructure or we may decide that we would be better off purchasing the service from an outsourcing vendor.

The second component relates mainly to location. We cannot going forward justify keeping large numbers of staff in high-cost locations performing core processing functions . We search throughout the world for low-cost locations and near-shoring opportunities to outsource to nearby countries. In such locations, we aim to build strategic partnerships with a few selected ITO (IT outsourcing) and BPO (business process outsourcing) vendors, custodians, and other service providers.

The third component is transition to a service-based model. In nearly all financial institutions, operations-related personnel expenses are allocated to operating divisions. However, we want to switch to charging for services. We believe that doing so would enable the operations function to think in terms of profitability as an individual business unit and also give rise to healthy competition and innovation.

The fourth component is IT. We have to build scalable engines that utilize leading-edge workflows technology to drive efficiency. Integrated workflow enables dynamic management. In other words, management information systems enable decision-making in real time instead of at the end of the day or the next day.

Okai: Regarding the third and fourth points, IT also must be flexibly adaptable so that users can choose only certain services.

Murfin: Yes, we are endeavoring to speed up implementation through agile development. IT also supports open modular architecture when we provide services such as trade confirmation, settlement or bookkeeping.

Okai: If you convert a cost center into a service center, will that lead to a change in not only operations and IT but also people's mindset?

Murfin: Our internal culture will likely change substantially. Managers and leaders will have to drastically change how they think about profitability, service and management. We will have to make decisions using a total cost to service concept, taking into account not only personnel expenses but IT and other costs also such as premises etc.

Additionally, every employee must have the attitude that they are running their own business instead of simply following standard operating procedures without question .

Okai: It will likely be very difficult for operations personnel to think of their counterparts as customers.

Murfin: It will, but I think that we can instill such skills. In addition to establishing training programs to develop the requisite skills internally, we will consider bringing in resource from outside as needed.

Okai: UBS's operations model, which actively utilizes external skills, sounds very rational and practical.

European financial institutions are generally proactive in terms of such optimization, whereas US financial institutions generally seem to prefer to keep everything in-house.

Murfin: I think that difference is largely cultural. There is no right or wrong approach. US companies seem to want to have more control and ownership and to determine their own destinies. My attitude, however, is that you can determine your own destiny without owning everything.

Differences between Japan and Singapore's markets

Okai: UBS recently initiated a business alliance with NRI for providing post-trade services in the Asia Pacific region. Is it fair to say that for UBS this alliance is another step in reforming operations and the result of seeking alliances with external parties?

Murfin: Yes. In Asia, it is difficult to change how markets operate. At UBS, we therefore seek out like-minded external partners that will support us from the outside.

Okai: I previously heard that Singapore is the global service hub for UBS's Asian business and that UBS's main Asian operations centers are in Singapore and Hong Kong. In the latest ease-of-doing-business rankings, Singapore is ranked first and

Hong Kong is ranked second, while Japan is all the way down in 20th place. Do you take such factors into consideration in optimizing your operations location-wise?

Murfin: We take many factors into consideration. Regulations are complex in Asia. This complexity certainly complicates business to some extent. However, the authorities in both Singapore and Hong Kong have, through regulation or deregulation, been successful in creating an environment that is conducive to investment from overseas and allows companies to easily go public.

Okai: I feel that one difference between Japan and Singapore is that regulators have different visions of the kind of markets they want. While Japanese regulatory authorities seem to be most concerned about safety, Singaporean regulators appear to place priority on business and market vitality.

Murfin: Visitors to Singapore seem to feel that it is a very safe place to do business. In fact, in comparison to other markets, Singapore has stricter regulations on data security and confidentiality of customer information. Singapore is by no means a perfect market, but I feel that Singapore demonstrates that it is possible to balance growth and safety.

Okai: Lastly, I want to ask you about Japan. The Japanese equity market has been booming for the past year. Has this had any impact on your day-to-day operations or organization?

Murfin: Transaction volume in the Japanese market has increased considerably, but we have been able to accommodate the increased volume with only minimal cost increases. In addition to utilizing low-cost delivery centers, NRI's I-STAR enables us to handle large transaction volumes with straight-through processing.

Okai: I hope that we have more opportunities to work together in the future. Thank you for sharing your valuable insights today.

about NRI

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