TOP LINE

# Capital Markets Firms Focus on Cost and Compliance

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**Adapted from *Global Capital Markets Spending Forecast, 2004–2007***
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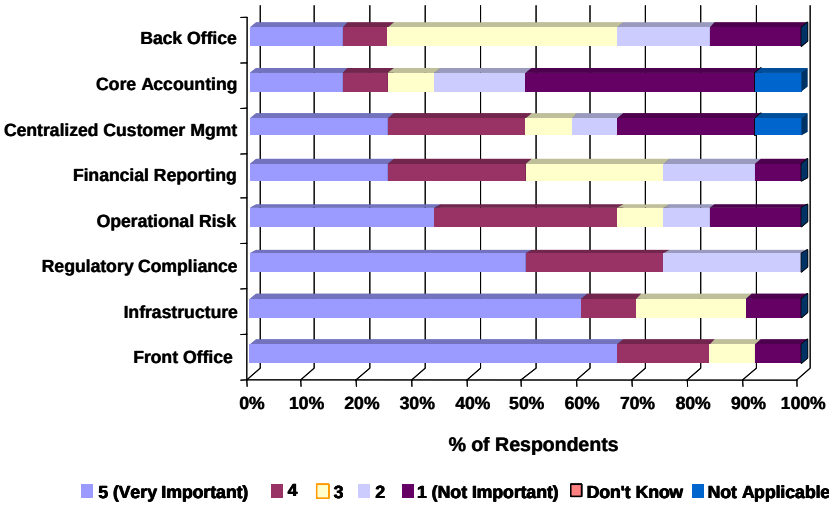
By their nature, capital markets firms are aggressive investors in technology. It is an industry in which investments are frequently rewarded with high short-term returns in the form of revenues and market penetration.

Unfortunately, it is also a business which is subject to economic volatility that can inhibit long-term IT planning. Many projects are driven by a desire to quickly take advantage of a market opportunity; managers in charge of such projects are not accustomed to spending constraints.

However, the relationship between capital markets firms and IT is changing as cost issues and long-term planning become more important. Capital market firms are trying to gain control over factors such as risk management and data storage using automation and improved IT infrastructure. These initiatives will affect the kinds of opportunities available to IT vendors serving this market, rewarding those vendors that can help capital market firms remake their IT infrastructure. Capital market firm's attitude towards these priorities can be seen in Figure A.

**Figure A: Key Business Issues Ranked by Level of Importance**




Source: *Financial Insights Spending Survey, 2004*

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## Cost

The role of cost management is on the rise, particularly when it comes to front-office applications. During the boom years, many capital markets firms added front-office applications without any thought to how they affected overall infrastructure. In most companies, the back-office side was not quite so chaotic, but large amounts of inefficiency was often tolerated.

IT spending among these companies remains relatively healthy, growing at just over 5% annually, which is marginally faster than the financial industry overall. However, much of this spending is going towards technology replacements of underlying infrastructure, rather than new technology initiatives, indicating a cooling attitude towards the early-adopter strategy that marked the boom years.

## Staffing

Just over a third of capital market firms IT spending goes towards internal IT staff, but this number has been shrinking for a decade. However, capital markets firms are not very adventurous in their use of outsourcing. Three-quarters of firms surveyed spend less than 10% of their IT budgets outsourcing; one-quarter spend less than 5%. Outsourcing is generally limited to non-strategic, labor intensive processing activities. Many firms are also using or evaluating application service providers for particular software applications.

When these companies do outsource, they tend to do so overseas at higher than average rates. Many capital markets firms are building their own overseas facilities to handle particular activities.

## Automation

Automation is a key force reducing IT staff in this industry. Over the last two years, capital markets firms have been putting in automation procedures for fixed income trading, derivatives, and other key areas. These efforts will allow these companies to lower their transaction costs. Meanwhile, front-office automation will be important as companies revamp their IT infrastructure with an eye on supporting new products and creating better links with back-office applications.

## IT Infrastructure

Data infrastructure is now an acknowledged challenge everywhere in the financial industry but especially in capital markets, where the movement of massive quantities of data is routine — and the time value and financial value of data is very high.

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Infrastructure issues were rated as “very important” by nearly 60% of capital markets firm surveyed. These companies need to build a scalable, reliable, and secure infrastructure in order to support transactions and maintain the trust of their customers. Many capital markets firms must also integrate several years of technology investments — many of which were driven by short-term business issues — that have become disjointed . In fact, many companies often go over budget on their integration projects due to underestimating the extent of the integration problems they face.

## Compliance and Risk Management

Capital markets companies live in a market that is inherently dangerous. Therefore, one main focus of IT for these firms will always be measuring and controlling these risks. One example is credit risk management, which has become more prominent due to high profile failures at measuring large credits risks.

Luckily, this industry self-examination is coming at a time when new regulations are forcing these companies to clean up their acts, allowing capital markets firms to address multiple issues at once. Regulations such as Sarbanes-Oxley, the Patriot Act, new SEC rules, and the Basel II capital accords as pushing IT spending on transaction monitoring tools, documentation and verification, and storage and records management. Every single capital markets firm surveyed indicated that legal compliance was at least a somewhat important driver of its IT spending; about half said it was very important.

## Conclusion

Once missing from the mindset of capital markets executives, long-term IT planning has now become an important priority. While this new attitude might make it harder for some vendors to sell into capital market firm — IT managers are no longer throwing money at the next hot technology without doing due diligence — it represents an opportunity for companies that can help these organizations with their pressing compliance and infrastructure needs.

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