Opus Nebula

UNTRUE EFFICIENCY?

UNNECESSARY COMPLEXITY IS AFFECTING YOUR BUSINESS

In this ebook we show how value is lost when one of economics' most basic theories isn't thoroughly applied.

We'll explain efficiency and how it affects your firm by looking at organisational structure and operational processes.

Read on to find out more.

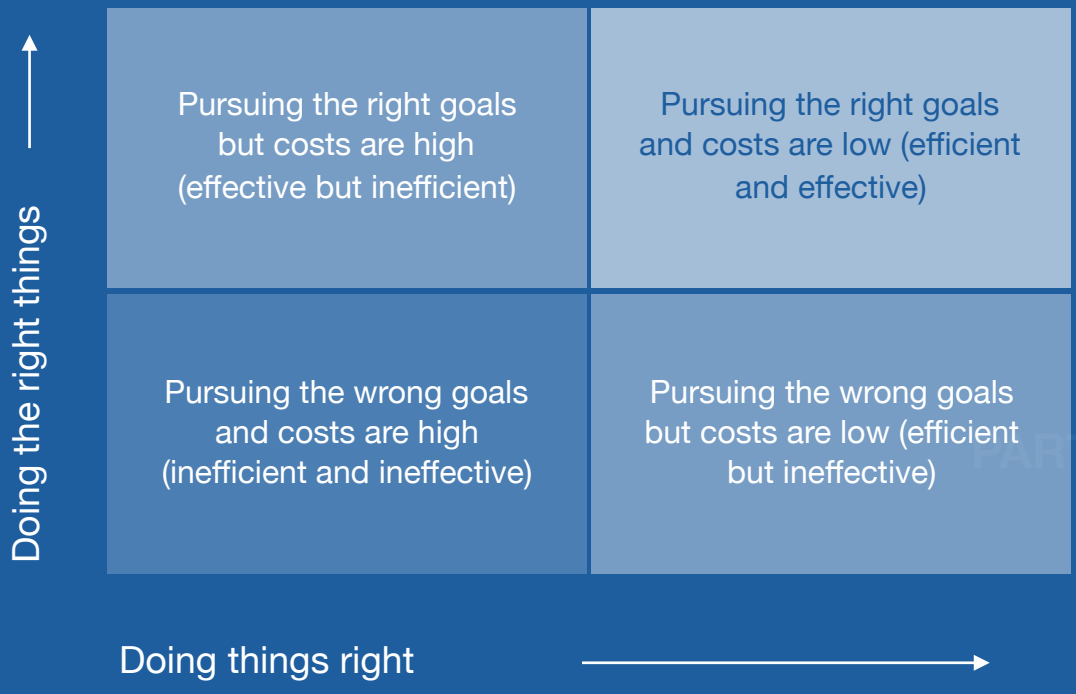
WHAT IS **EFFICIENCY?**

In basic terms, efficiency is a measure that describes the relationship between input and output, i.e. achieving maximum output through minimum input.

When expressed as a percentage, the ratio between input and output shows how efficient a particular action, or process is.

Distinct from effectiveness (but often confused) it summarises the notion that you should not only do the right things, but also do the right things right.

The following illustration explains:



UNTRUE EFFICIENCY

This notion can be applied to any endeavour as costs aren't always financial - think time, energy, materials and so forth - but regardless of the situation, efficiency is found in the top right corner and anything in the bottom left is futile.

Such a concept should be pretty easy to understand and there's no mathematics or philosophic thought embedded into it but if you are interested, an efficiency ratio is usually expressed in terms of work in and work out:

$$\eta = \frac{Wout}{Win} X100$$

And delving into texts on consequentialism would likely explain efficiency on a much deeper level than we will do here.

Efficiency is also often referred to in terms of wastage. Dictionary definitions include "lack of" and "minimum" wastage in their descriptions highlighting not only the pursuit of a goal, but also the prevention of loss to achieve it.

In commerce, efficiency can be categorised further, specifically when you are trying to improve it.

Apparent Efficiency \

Increasing production output without changing any input and without consideration of sales or market demands.

True Efficiency \

Meeting actual demand through minimum input.

Imagine a construction worker hammering a nail. Each time the nail is struck energy is lost through vibration, heat, and friction. The more energy that's lost, the less efficient the action is.

The efficiency ratio isn't really applied practically in the financial services industry - or most others - because work in versus work out is largely unquantifiable in the real world until you attribute specific measures to each. Instead, the Cost/Income Ratio (C/I Ratio), which assesses the efficiency of a firm, or, if you so wish, a business unit, department, or function is used. Essentially, they are the same thing.

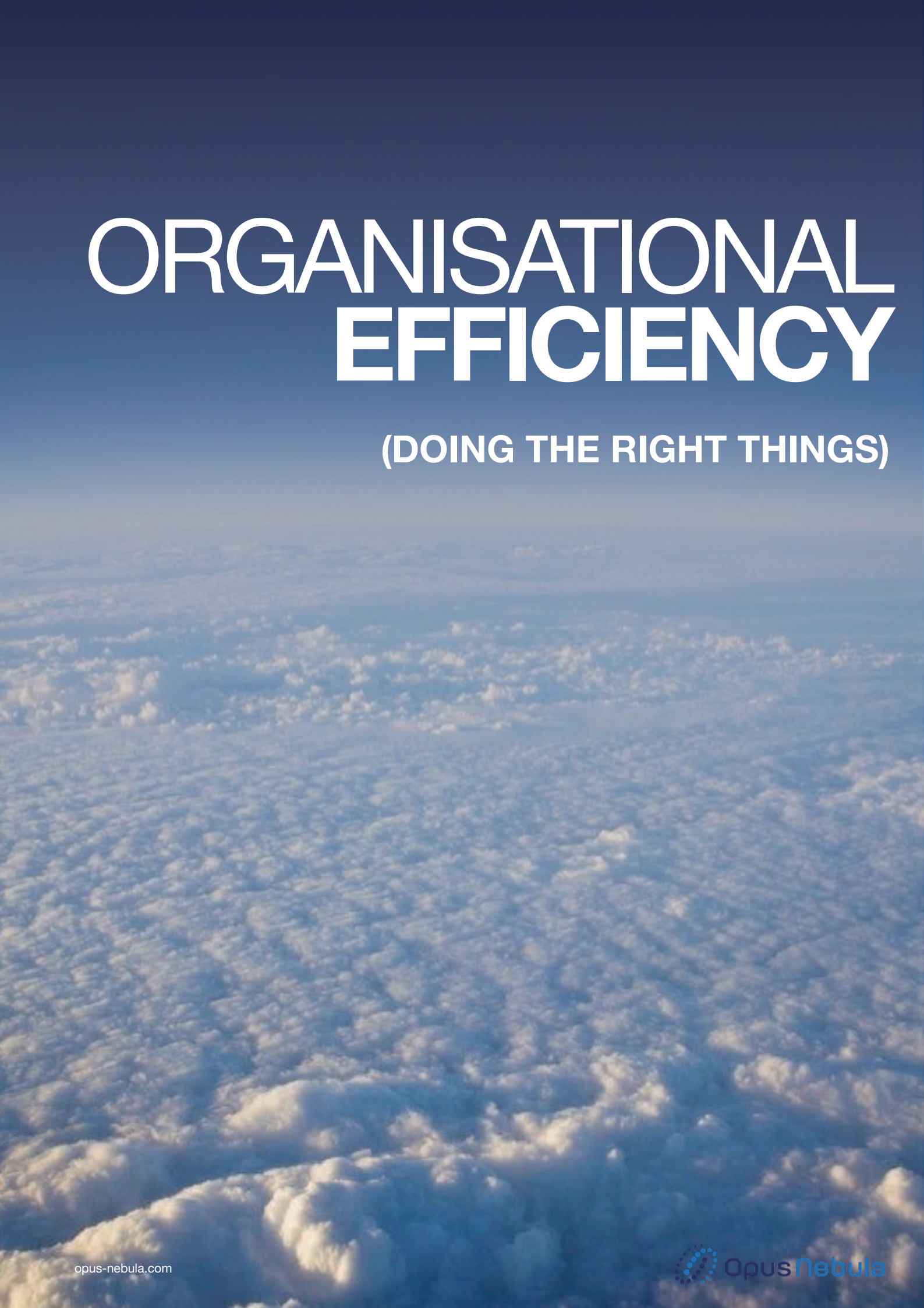
The C/I Ratio is a measure of the efficiency of a company and shows the resource or “cost” required to generate the income achieved. The lower the C/I ratio, the more profitable the firm should be and changes in it suggest improvement or decline in operational cost, or conversely, improvement or decline in income.

Application of the C/I ratio to retrospectively assess a firm’s overall efficiency is simple enough but its use to measure the efficiency of a particular function within the firm is problematic.

Alongside overall costs being notoriously difficult to attribute, the proportion of income to assign to each operational function is usually unknown, so instead, you calculate its efficiency by analysing it's use of time.

So, we know what efficiency means and have an idea of how to measure it, but what does that mean practically?

First, let's work out how to do the right things...



ORGANISATIONAL EFFICIENCY

(DOING THE RIGHT THINGS)

Organisational Efficiency strives to minimise expenditure of resources by matching them to the firm's overall objectives. It ensures that the functions an organisation undertakes themselves contribute directly to the overall goals of the business.

This means viewing the business holistically and determining both the strategic importance of each functional element and the contribution it makes to operational performance.

Through doing so, the firm identifies where its focus should be placed and realises the true value of the constituent parts. Only once that's understood can the firm's structure be appropriately and efficiently designed.

It's an exercise that a business goes through on inception, but may be forgotten or overlooked once live and operational. As businesses evolve, their priorities and goals change and also, as time passes alternative solutions and technologies emerge, so it should make sense therefore that the business' structure should change too. Efficiency cannot be achieved without doing so.

Viewing your business in such a way will either ratify your current structure, or more likely, highlight areas where efficiency can be improved.

Whilst some redundant processes might be eradicated completely, performing such an exercise usually identifies opportunity for outsourcing and partnerships - two of the most common ways of increasing efficiency at an enterprise level.

However, it's not just a matter of listing processes and saying yes or no to them, a little more work is required than that. It also requires knowledge of your available options, as achieving efficiency often involves breaking processes up and separating administrative or repetitive tasks from the real value-add.

For example, it's important to distinguish 'output' from 'production'. A truly efficient organisation recognises that often, it's the output of a process that's important and not necessarily the means of producing it.

So if a firm believes it provides an exemplary client experience, in part through the provision of world-class client reporting, the provision of the report is much more important strategically than the process employed to produce it.

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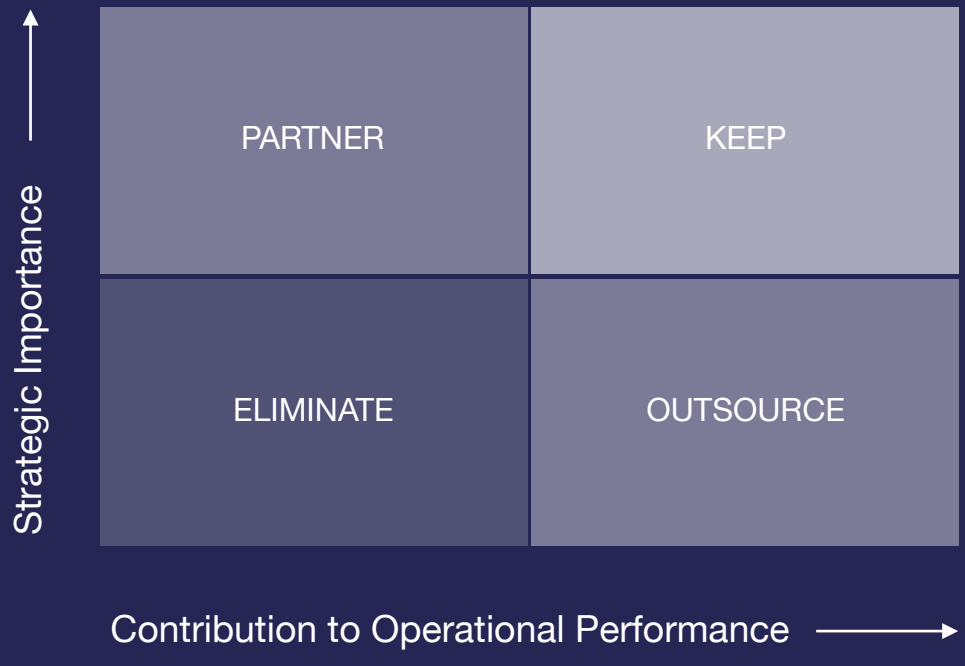
The matrix below shows the two most important factors to consider when you're evaluating the necessity of business functions.

Strategic Importance - Does it provide a competitive advantage?

Operational Performance - What's its contribution to the smooth running of the firm and what's the impact of error?

Using the model is simple. Evaluate and rank each function in terms of strategic importance and operational performance and plot them in the matrix accordingly. The quadrant they appear in will be a good indicator of how each should be treated.

Note: Remember to distinguish between provision and production. Provision of client reporting is strategically important, but its production may be not.



It's a good starting point. Obviously, individual circumstances and your own knowledge of your firm, the industry and your operating environment may take precedence over the outcome, but we can generalise to demonstrate the point.

Tasks that are strategically important are usually kept in-house so control is retained.

Tasks that are required for operational necessity but have little or no relevance strategically can be outsourced safely.

Strategically important but operationally insignificant tasks are good candidates for partnerships and alliances with expert suppliers.

Altering the shape of the organisation to ensure it's focussed on value-add processes not only makes it more efficient, it strengthens it too.

You see it everywhere. Car manufacturers assemble vehicles using components from numerous suppliers. Airlines supply food and refreshments that are prepared by others. Even the most basic bicycle is likely a combination of 3 or more manufacturers.

They do so to access and subsequently provide the expertise of their partners to strengthen their own product. In each case, it is more cost effective than attempting to match or improve it through their own efforts.

It happens in our industry too. Amongst lots of examples, Agencies are used for Marketing, cleansed and ordered market data can be purchased and of course software is bought or subscribed to, to facilitate many key activities and as technology and communication continues to evolve, more and more opportunities to increase business efficiency arise.

When competition is fierce and you're looking to distinguish your firm from your peers through differentiation and competitive advantage, you need to offer the strongest products and services possible at the lowest price. To do so absolutely means building an organisational structure that utilises the expertise of others.

The question you should be asking yourself is not just should we, but instead, why aren't we?

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Forward thinking companies that will survive in the future are already taking full advantage of this kind of structure and for you to continue to compete, you must do the same.

Well thought out and chosen alliances will improve your products and services exponentially and pass the efficiency burden on in exchange for a computable cost.

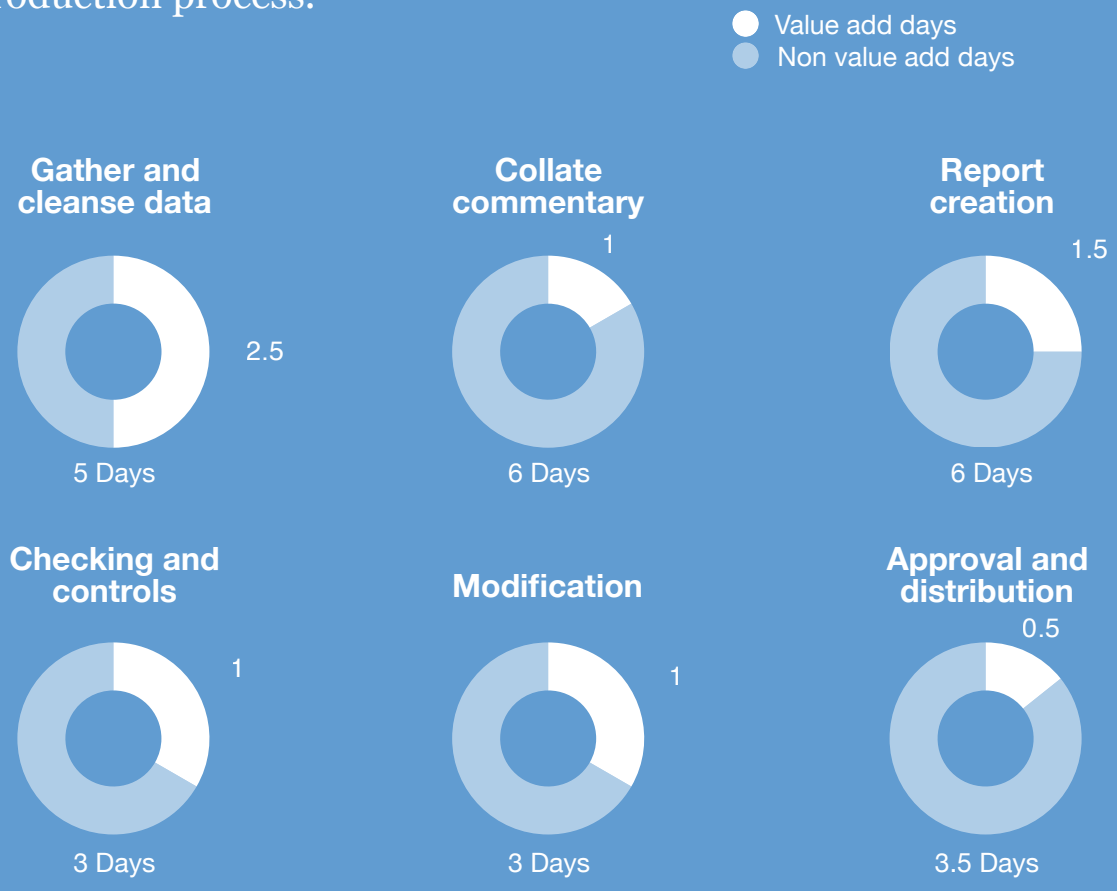
As a result, you can focus all your efforts on your key strengths and remove the administrative and operational pain that surround tasks and functions that add little value to your overall service.

Once that's in order, the next step is to ensure efficiency in the operational processes you continue to run.

OPERATIONAL EFFICIENCY

(DOING THE RIGHT THINGS RIGHT)

The efficiency of an operational process can be calculated through the comparison of value-add and non value-add time. This is called Process Cycle Efficiency (PCE), “Flow Efficiency”, or "Value Add Ratio”. It works by dividing the Value Add Time - time that absolutely contributes to the goal - by the lead time or total elapsed time (the total time it takes). Take a look at this example which shows the various steps of a report production process.



Value Add Time is 7.5 Days and Elapsed Time is 26.5 Days. Despite some tasks overlapping and running concurrently and therefore the report being produced in 10 days, t’s only a PCE of 28%. A perfectly efficient process would be 100%.

In the day to day running of most organisations, theoretical efficiency doesn't really figure. PCE isn't monitored and the C/I ratio, whilst probably present in stakeholder information, isn't generally a focus or a performance indicator of many employees.

It's rare for efficiency theory to be referred to in departmental processes and enterprise-wide resource decisions. For example, a request for additional headcount is not usually plotted on a graph to prove need and functionality - including speed - often drives software purchase decisions regardless of any theoretical efficiency effect.

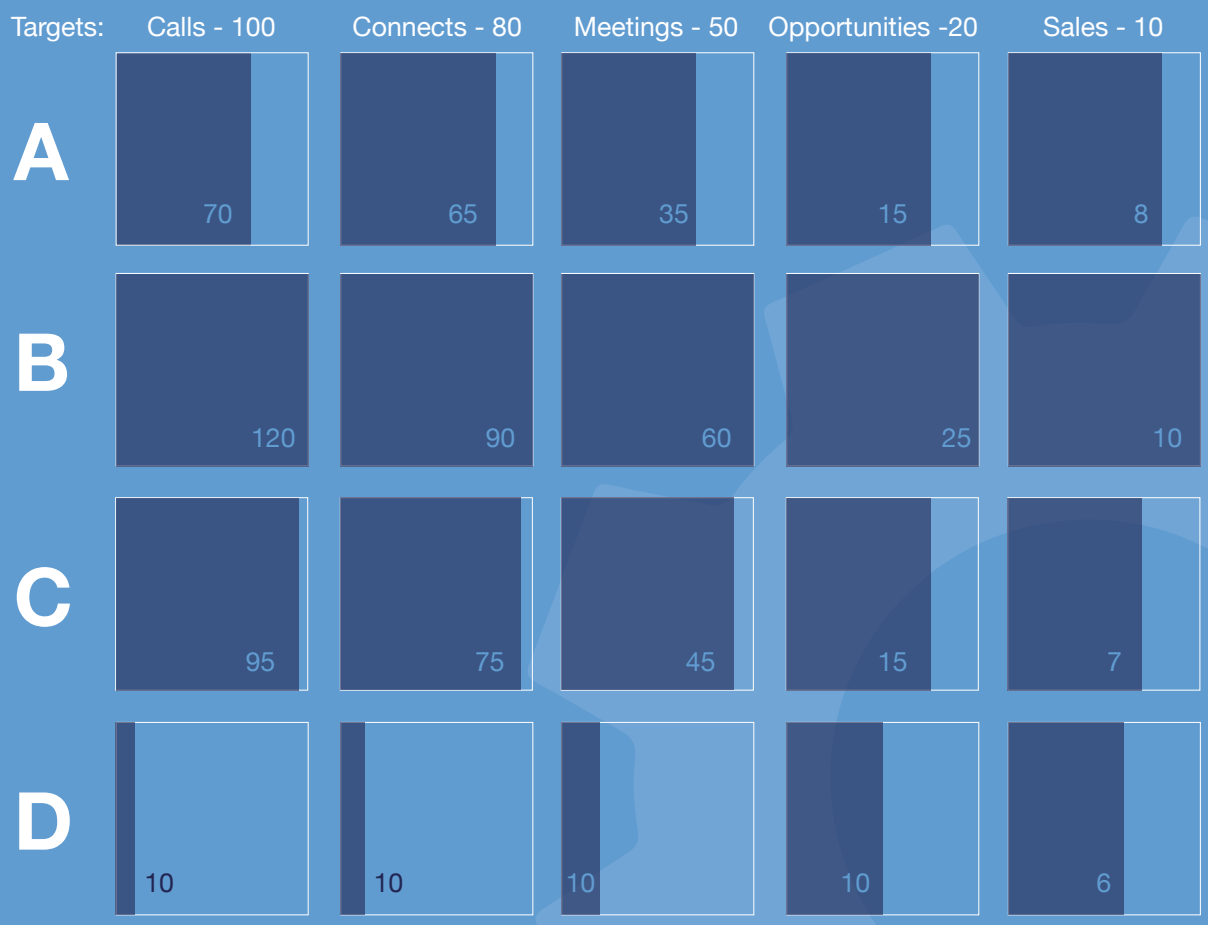
Generally, if a desired outcome is being reached with the resources made available to do so, then its efficiency is unlikely to be at the top of anyone's agenda.

Determined quests to increase efficiency are often initiated through forced cost-reduction exercises. For established firms in financial services, this means they appear when desired outcomes are already being delivered and efficiency or lack thereof has not been considered for some time.

However, a long-term, simmering, and strategic goal of most companies must be to increase and improve the efficiency of their internal operations. That helps the bottom line and demonstrates focus to investors and management. After all, when resources are limited, it makes sense to maximise the use of each...

And this is where a little analysis can provide a much clearer picture than just gut-feel or observation.

Before we examine how it can help, let's look at another example. The data on the next page is fictitious and extreme to make a point. It shows the monthly targets of 4 sales people and their performance through a simplified sales process. The question is, whilst they're all effective, who's the most efficient? Why? And how efficient are they overall?



If the goal of the sales function is only to make sales, then Salesperson B is clearly the most effective. However, how much effort was applied to make the target? Salesperson D made 60% of the target with much less effort. Are they more efficient?

Whether you're comparing team member performance, the performance of one machine over another, or indeed, machine versus human, efficiency is a crucial factor. Whilst two or more options can be equally effective, one is almost always more efficient.

Experts in operational efficiency aren't hard to find and they can recommend improvements and reduce the likelihood of error quickly. However, they're typically constrained to internal resource, i.e. doing the best with what's currently available.

What's actually needed to ensure efficiency, is an awareness of how processes can be re-designed to incorporate external input allowing a re-design that truly is efficient in the theoretical and practical sense.

UNTRUE EFFICIENCY

Most firms have their hearts in the right place – they know what goals they're trying to achieve, but a lot are inefficient in doing so. Generally, this is due to unnecessarily complicated process flows, conflicting priorities and of course human involvement and the variation in productivity and quality it brings.

However, whilst not perfect, efficiency can be calculated (or estimated?) through the PCE and through focus on time and resource cost and we can therefore understand efficiency and the balance required between both.

For example, if you are required to reconcile *n* funds daily, you could evaluate the performance, cost and output of people, system, time, etc. and build an efficient process. Likewise, you can determine efficiency in a report production process through consideration of volume, frequency, time, and so forth.

It's rarely perfect. As human productivity is variable, and maybe, reconciliation breaks vary in complexity, it's also difficult to quantify and today, with focus placed squarely on digital transformation, efficiency might just be assumed or perhaps even overlooked.

The Holy Grail in doing so is to make use of technological advances to find the right blend of people and machine and eliminate wastage.

Once you've acknowledged and understood the human variable, your goal must be to minimise it. If you don't, an operational process can never truly be efficient because the effort, or input isn't minimal.

In the previous report production example, how much would efficiency increase if production activities were largely completed elsewhere and automated? Miminising human involvement in undertaking or supporting the processes where it is unnecessary has to be the focus of any organisation that wants to be efficient.

"Once you've acknowledged and understood the human variable, your goal must be to minimise it

EFFICIENCY, SIMPLICITY & SPACE

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When computers were introduced into our workplaces, they brought and delivered promise of time savings and increased productivity. A couple of generations later, big data provides us with the information we need to continually work better, quicker, and smarter.

During that time, computers became faster. Processing power increased and software and hardware improved its functionality, supporting a technological evolution pretty much designed to increase efficiency and therefore output in everything we do.

Consequently, employees, departments, functions and entire organisations are constantly asked to deliver ‘more'. The time released through technology is now absorbed by the increased depth of information required. Once, a client may have been happy with knowledge that their investment has risen in value, they now want to know how, why, and more recently, at what cost and risk.

Today, we have access to more data than we could ever absorb, understand, and use, but instead of making our work more efficient and smarter, perhaps it’s making it busier, introducing unnecessary complexity to processes and endeavours that were once simple.

Complexity can be a damaging force in any organisation and is difficult to avoid as a company grows and evolves. If a company suffers from it, it cannot operate with speed and therefore also cannot be efficient.

Organisations born in the digital era don’t have the challenges of legacy functions and can provide simpler answers for customers and can swoop in, disrupt and take business away from incumbents who are too busy working out what their data is telling them, or if they haven’t reached that point, busy performing unnecessary functions and not focussing on strategically or operationally vital processes.

Just look at the success of Uber, AirBnB, or Netflix who simplified rides, accommodation and movie rental respectively and destroyed many of the businesses they left in their wake. It could not have been possible without the notion of simplicity and efficiency in everything that they were doing.

However, they've now grown and evolved. Now, they too have rivals that are further simplifying their business models and taking market share in the process of doing so. That's the complexity trap.

THE COMPLEXITY TRAP

Unfortunately, the complexity trap is inevitable. As a business grows, meetings, metrics, red-tape, and so forth increase, creating inefficiency in processes once designed to be exactly the opposite. Complexity is the ultimate enemy of efficiency.

> **Complexity is the ultimate enemy of efficiency**

Whilst you can't avoid it, you can manage it through your own simplification efforts. Like structural and operational design, simplification also increases efficiency.

There are great examples. In 2004, after realising that left turns (in the USA) meant more wait time in traffic, increased cost as a result of idling engines and more risk of accident, UPS decided to simplify their delivery routes by eliminating them. Not only did it remove complexity, it reduced cost and improved customer satisfaction too - as the parcels were delivered more reliably and on time.

There's no formula for simplification. Rather, it's the aim of the business and the culture it generates. It's a basic concept. Simplifying your business creates 'space' or additional capacity. By removing complexity, you can perform better and more efficiently. It frees up time and resource which you can then trade in to increase profit, or use to develop and grow your business through the provision of deeper and better quality work or increased client service.

Organisations that do so are the envy of their peers. They produce product and deliver services quickly and expertly. They have a motivated and engaged workforce and not only customers, but fans.


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EFFICIENCY?

Inefficiency is a bad thing. It costs money, wastes time, reduces quality, and can destroy morale.

As an industry matures and service and provision amongst competitors standardises, only the most efficient survive and that redefines how firms are structured, where focus on key strengths is of paramount importance and strategic alliances and partnerships are sought for the mutual benefit of the participating entities.

It's only when you begin to analyse each step of each function and look at each task performed in respect of its strategic and operational importance that you realise your own efficiency status and can start to improve it.

You need to optimise your business structure, remove unnecessary human involvement in your remaining functions and remove as much complexity as you can from your business model.

Costs Money

Spending more money than you need to arrive at the same result as another option is inefficient.

Unprofitable products should be discarded and unnecessary processes should be removed. They only deplete your bottom line.

Wastes Time

If processes suffer any delay or rely on decision to progress, you are inefficient.

Time squandered cannot be retrieved. It's lost forever, never to return.

Reduces Quality

Inefficiency creates unhappy employees and unhappy employees produce lower quality work.

No firm should settle for sub-standard output. Strive for excellence.

Destroys Morale

Perseverance with inefficient processes is not admirable. Employees will eventually lose trust in you.

Employees that have to perform rote and unfulfilling tasks aren't usually happy about them.

Where possible reallocate the resource to strategically important work.

Talented employees will get demotivated and leave, less talented employees may stay. Which do you want in your organisation?

Without doing so, efficiency becomes more of a *feeling* that's experienced by you and your employees and *feelings* can't be easily measured, at least not in a way that will contribute to your C/I ratio.

It's not a one-off exercise. Improving efficiency means regular focus, embedding such analysis into functional responsibilities and making the search for the optimum ratio part of the organisation's day-to-day. It means committing to outsourcing and partnering where appropriate and working with expert providers to deliver the elements of your business that are crucial to your success but do not have to be undertaken in-house.

But the product of efficiency isn't just cheaper and quicker operations. Its outcome is found in the culture of the organisation and its trajectory. Efficiency allows you to provide better products and services and creates the space required to succeed and expand. The more efficient you are, the more space you have.

Shareholders want to see the best C/I ratio. Inefficient operational processes are one thing, structural efficiency is another. If you're not doing either, you are inefficient, no matter what the reported numbers tell you. Regardless of your reported ratio, if you haven't simplified your business, optimised your structure and removed waste from operations then you're inefficient and lagging the competition, especially new entrants. You're not operating with the absolute minimum of waste and you haven't taken advantage of all the options available to you through advancements in technology and communication. Even firms with the most healthy C/I can find areas to improve. They don't even have to look that hard.

We call it **Untrue Efficiency.**

About Opus Nebula

Opus: a great body of work
Nebula: in the cloud

Established in 2014.

Reporting as a Service is cloud-based and provides a complete, scalable, flexible, and future proof client and fund reporting solution to investment firms of all sizes. It allows investment firms to provide reporting of the highest quality to their clients without the costs and complications that are associated with on-premise software and local support and maintenance teams.

Like all great solutions, Reporting as a Service is simple to understand and use. Your data, your team, our system, your reports.

Opus Nebula have been providing Reporting as a Service to investment firms, including some of the industry's most recognisable names for the last six years.

Opus Nebula

To find out more about Opus Nebula and how we help firms like yours, visit our website at www.opus-nebula.com. Contact us personally or via enquiries@opus-nebula.com to arrange a meeting and see a live demonstration.