Execution Cost Management:
Improving Margins, Strengthening Relationships

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Vision

The dislocation over the last 12 months of sizable capital markets institutions poses both challenges and opportunities for the cash-equity trading divisions of sell-side organizations. Buy-side clients are reexamining their brokerage relationships in light of reduced coverage, market uncertainty, and fewer internal resources and commission dollars. Sell-side firms that were not exposed to toxic assets or risk-seeking ventures turned sour are well-positioned to capture market share, but will likely need some guidance about how best to scale their businesses back. Sales and trading managers' greatest challenges will be identifying new ways to align their goals with those of buy-side clients, and controlling costs associated with achieving those executions and servicing those accounts.

Because there's no foreseeable respite from the volatile and worrisome market conditions that we're in now, it's never been more important for the tools and processes that brokers use to measure, monitor and analyze their variable execution costs to be reevaluated and improved upon at every opportunity. Brokers themselves must keep up with marketplace changes by reevaluating liquidity sources and negotiating aggressive rates with execution venues and clients whenever possible.

While variable execution costs are never top of mind, they are now playing a more significant role in client relationship management. Although sourcing of liquidity overrules any and all financial incentives, variable execution costs demonstrate that venue's commitment to execution quality. In the same way that Transaction Cost Analysis (TCA) provides the buy side with useful and actionable data—such as market impact and opportunity cost estimates—execution cost management (ECM) provides cash-equity desks with information that helps them improve trading efficiency.

In the future, the true costs of trade execution will be calculated by effective ECM technology that can evaluate a trader, desk or a smart order router; ECM technology would also evaluate connectivity tolls, clearing and settlement, technology and client support. Through a detailed and thorough analysis of the costs of servicing each client, ECM will help improve broker profitability.

The tools that will compute the costs of servicing clients are, in fact, at the heart of a critical transformation that we're seeing in the brokerage industry. In years past, technological services have been bundled; as a result, the actual "a la carte" cost of each service was carefully hidden. Now that the industry is entering an era of increased transparency, the data that clients receive from their brokers will explain far more than the quality of the execution—the data will attempt to articulate the overall return on relationship. This exchange of information will ensure that the commission rates the buy side pays are commensurate with the quality of the execution, and other services they are getting in return. Showing clients details on how order flow was handled and

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how the broker was compensated for each trade will be new yardsticks by which brokers are measured.

With the relationship strengthened, brokers will be better able to improve profit margins; they'll have a better understanding of how trading decisions were made, and how to source liquidity in the most efficient way possible. Execution cost management will be more than just a set of numbers that helps quantify trade cost savings: It will also be an effective way to analyze trading performance. The combination of TCA, commission rates and variable execution costs will allow the industry to see the true cost of execution. The benefits of wide-scale organizational improvement will only be realized, however, by brokers who uncover the hidden benefits of knowing the true cost of every execution.

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Introduction

Brokers have a duty and a right. While it is a broker's fiduciary responsibility to approach every venue necessary to achieve best execution for their clients, they also have the right to manage the costs of fulfilling their obligation. Brokers who achieve best execution at the lowest possible cost can improve the margins on their execution business, and offer more competitive rates to capture additional market share. Managing execution costs is trickier said than done because of the perceived conflict between that and achieving best execution. However, there is a way forward.

Execution cost management is a process that brokers implement to gain a more concrete understanding of their trading businesses' profitability. For some brokers, ECM is but one component of a complex web of services and business models. For pure trading shops, however, it is their core measure of profitability. Execution cost management can be defined very broadly: In addition to variable costs (execution fees, messaging charges, clearing and settlement), ECM can also include fixed costs (exchange memberships, hardware, bandwidth, support staff, etc). However it is defined, determining the execution costs associated with a trading desk, trader or client is not an easy task. Reconciling monthly bills with an historical blended execution cost may work for brokers satisfied with the status quo, but to seize on the rare circumstances of today's markets requires a deep analysis of order flow. Execution cost management requires that brokers have an accurate and granular set of data, and the right tools in place to monitor trading decisions and track results.

This report focuses on variable execution costs because, in an environment of declining commission rates and lower volumes, there is increased pressure on brokerage profitability. Brokers seeking to capitalize on the diffusion of order flow away from bulge-bracket brokers need better ways to examine, measure and monitor execution costs in order to offer competitive and sustainable rates.

Today, three trends are driving flow away from the major sell-side firms:

- *Bulge-bracket layoffs*: Almost all of the major brokers have announced firm-wide layoffs. This trend means less new research and technology support, and fewer sales traders. The buy side will recalibrate commission allocation accordingly.
- *Commission protection*: Asset owners are becoming increasingly insistent that their commission dollars go to companies with unblemished records and public images. This trend favors niche brokers that may not have a sophisticated ECM process in place.
- *Broadening relationships*: Bulge-bracket firms are impacted by poor market conditions that threaten their business models. This trend causes

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buy-side clients to seek smaller, stable sell-side relationships with business models that are less subject to market fluctuations.

Many brokers are analyzing their variable execution costs, but most are only scratching the surface regarding the amount of information they're uncovering. Part of the problem is that execution venues disclose varying amounts of cost data to brokers. The result is an inconsistent and untimely set of data that only allows brokers to question figures that are clearly erroneous. Unless further regulatory stress is placed on the individual execution venues to provide more accurate execution cost data, brokers are left with the messy business of assembling and analyzing the data on their own.

In the interim, CFOs at smaller brokerage houses are burning the midnight oil trying to turn inconsistent raw data into usable information. Among the brokers that TABB Group spoke to for this report, the consensus is that the analysis of execution costs and the solutions to mitigate these costs both need improving. Therefore, with resources already as constrained as they are, few small- and mid-size brokers are able to capture, aggregate and analyze all of the necessary data to make the best decisions.

One of the reasons brokers review costs is to determine the right prices to charge their clients. The buy side is notoriously fickle, so it is important to be able to offer and defend a fair commission rate. Once a relationship is established, there are only so many times a broker can go back to the client and discuss commission rates without trade data analysis in hand.

Though the current environment is increasingly competitive, the duty of the broker remains the same: achieving best-ex while minimizing variable execution costs. With better ECM tools in place and an infrastructure to support this analysis, brokers will be able to determine *exactly* how each client impacts the bottom line.

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Execution Quality is Not Enough

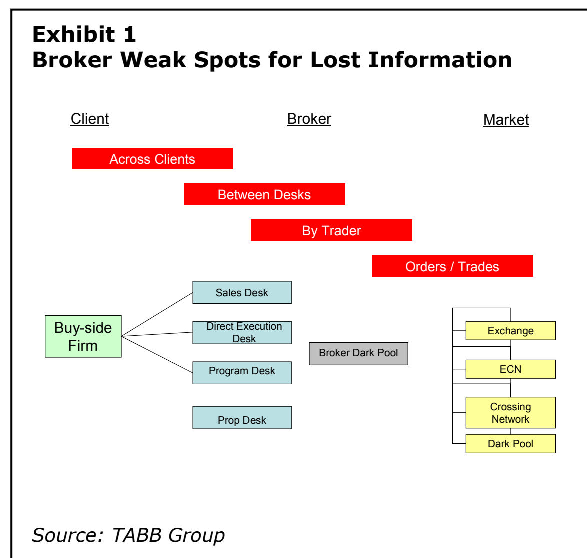
The importance of transaction cost analytics (TCA) is unquestioned. While best execution is a process that requires diligence—it's not like throwing darts at a dart board—TCA provides a quantitative assessment of trader performance. It is a critical data point within the best execution review process. However, for all of the time and effort spent on TCA, brokers also need better tools to manage the true costs of execution.

In recent years, variable-equity execution cost analysis has been overshadowed by TCA for a few reasons: First, the fiduciary obligation (on the parts of both the broker and the buy side) is focused on execution price—it doesn't really matter to regulators what costs are paid to meet best execution. Second, there are few commercial ECM applications. Third, most brokers believe they have enough experience to break down market costs on their own.

Compared to bulge-bracket brokers, most small- and mid-tier brokers have a limited number of clients. This makes ECM easier—at least in theory: Most small- or mid-tier brokers know exactly how much flow is required per client to compensate for that client's related execution expenses. Because a smaller broker may not have as wide a variety of offerings as a full-service broker, the challenge is to provide the smaller firms with the same quality of execution at a reduced price. To effectively scale the business, brokers will need tools that provide more detailed information as they grow larger.

Though nearly all larger brokerage firms already have rigorous ECM processes in place, some are still relying on antiquated practices and basic assumptions to conduct this analysis. Untangling trades and assigning orders back to specific desks or clients becomes a daunting process when we consider the number of relationships and interactions between sales traders, program desks, direct execution platforms and prime brokerage groups. Any gaps in information result in costs that are not efficiently managed across the organization. And with today's changing market environment, larger firms that have not updated their ECM infrastructure will find it almost impossible to track the details at each level across the organization (see Exhibit 1).

Exhibit 1
Broker Weak Spots for Lost Information



Source: TABB Group

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Regardless of its size, any broker should be able to break costs down to the desk, trader, trade and/or client level (see Exhibit 2). Instead of using basic assumptions and relying on educated guesses, trading activity should be analyzed to reveal the true costs of executing. The person in charge of a desk's P&L needs to know which traders are most efficient in achieving best execution at a cost-effective price. It is details like these that can help the head of trading at a brokerage house identify the firm's weaknesses and improve the bottom line over the long term.

Exhibit 2
Variable Execution Cost Analysis

Item	Report By:	Sample Use
Desk	Desk A Desk B Desk C	Add/Take/Routed Dollar Amount
Trader	Person A Person B Person C	Add/Take/Routed Percentage
Trade	Tape A Tape B Tape C	Add/Take/Routed Share Volume
Client	Client 1 Client 2 Client 3	Commission Allocation by Desk, Trader, Trade

Source: TABB Group

For example, one way to measure whether an individual desk or trader is maximizing client profitability is to compare gross commissions against gross commissions less explicit execution fees. Relatively speaking, a high net-to-gross ratio, measured from 0 to 1, indicates the desk or trader is sourcing liquidity in a more cost-efficient manner.

Pricing Complexity

Variable execution costs include the fees paid to execution venues for removing, adding and routing out liquidity. The 11 lit markets with protected quotes under Regulation National Market System (Reg NMS) charge a fee for removing liquidity and a rebate for providing liquidity in Tape A, B and C securities (see Exhibit 3).

Exhibits 3
Sample Pricing Across Major Lit Venues

		Pricing								
		Tape A (dollars/100 shares)			Tape C (dollars/100 shares)			Tape B (dollars/100 shares)		
		Take	Post	Route	Take	Post	Route	Take	Post	Route
MAJOR EXCHANGE										
NASDAQ	>55m removed	$0.295			$ 0.295			$ 0.295		
	>35m add/ >55m removed or routed	$0.290		$ 0.290	$ 0.290		$ 0.290	$ 0.290		$ 0.290
	>35m added		$(0.280)			$ (0.280)			$ (0.310)	
	>20m added		$ (0.250)			$ (0.250)			$ (0.250)	
	All others	$0.300	$ (0.200)	$ 0.300	$ 0.300	$ (0.200)	$ 0.300	$ 0.300	$ (0.200)	$ 0.300
NYSE (HYBRID)		$0.0800	Free	$ 0.300	$ 0.0275	$(0.0275)	$ 0.250			
	ETFs under 5099	Free	Free	$ 0.300	Free	Free	$ 0.300			
	ETFs over 5100	$0.300	$ (0.300)	$ 0.300	$ 0.300	$ (0.300)	$ 0.300			
ARCA	>45m added and >90m total (added, removed, routed) in Tape ABC	$0.270	$ (0.280)	$ 0.290	$ 0.270	$ (0.280)	$ 0.290	$ 0.280	$ (0.230)	$ 0.290
	>30m added and >60m total (added, removed, routed) in Tape ABC	$0.290	$ (0.270)	$ 0.290	$ 0.290	$ (0.270)	$ 0.290	$ 0.280	$ (0.220)	$ 0.290
	>85m removed and routed, and >2m routed in Tape ABC	$0.290	$ (0.23)	$ 0.285	$ 0.290	$ (0.230)	$ 0.285	$ 0.290	$ (0.220)	$ 0.285
	All Others	$0.290	$ (0.23)	$ 0.300	$ 0.290	$ (0.230)	$ 0.300	$ 0.300	$ (0.220)	$ 0.300
BATS		$0.250	$ (0.240)	$ 0.290	$ 0.250	$ (0.24)	$ 0.290	$ 0.250	$ (0.300)	$ 0.290

Source: TABB Group LiquidityMatrix Dec'09

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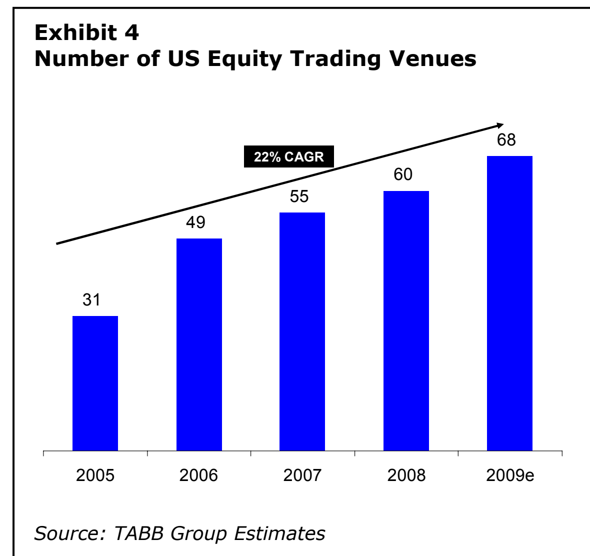
Reg NMS also mandates that a routing charge must be applied when a better price is available at a venue other than the venue at which the order was placed.

Market centers and exchanges constantly experiment with new pricing structures in order to attract liquidity. Maker-taker fees are the largest variable execution costs that a broker incurs on a daily basis. Assuming liquidity is the same and share pricing is equivalent, the decision on where to execute is an important one. In fact, executing in the cheapest manner possible (assuming the same price existed at all times) by sourcing liquidity at venues with the lowest take fees in 2008 would have saved a broker 16% in make-take fees paid to lit venues; for the institutional brokerage sector this totals $1.9 billion.

The rate of change among pricing models and the challenge to untangle variable execution costs make achieving best execution in the most cost-effective manner a challenge. Volume discounts, such as those offered by Nasdaq OMX and NYSE Arca, are continuously being updated to reflect changes in the marketplace; these discounts intended to undercut competitors are just one way for venues to protect their respective market shares. These battles within the price wars make the marketplace a more complex animal than it already is; they also underscore how risky it is for brokers to rely on archaic ECM processes. In addition, the ever-increasing number of execution venues—not to mention the proliferation of opaque or confusing pricing models—makes it all the more difficult for brokers to keep tabs on sourcing liquidity at the lowest cost (see Exhibit 4).

Exhibit 4
Number of US Equity Trading Venues



Source: TABB Group Estimates

Recognizing that cost savings can be attained during execution is half the battle of understanding just how important ECM is for brokers. Certainly, TCA has been helping equity desks determine implicit costs for years. But there is a hidden benefit to measuring variable execution costs more precisely: An analysis that considers both sides of the equation can help a trader decide which execution venue is optimal.

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Execution Cost Analysis

Thanks to feeble reporting and inadequate technology, it's not unusual for equity desks to miss trading-cost savings opportunities. Execution cost management must be performed without significant outlays of cash or resources. Its reporting mechanism must be thorough, configurable to various business needs, and support ad-hoc inquiries. The right tool is one that helps various groups from management, finance, operations and trading departments identify, measure and monitor trading costs.

Few brokers create a full audit trail of an order, from the receipt of the order from the buy side to the detailed explicit costs. Although the data-gathering and reporting requirements may seem overwhelming, most brokers have the basic infrastructure to support this analysis. Execution cost management technology is an add-on feature to trading technologies—including connectivity to front-end systems (OMS/EMS), smart order routers, FIX engines, and customer relationship management (CRM) tools—that most brokers already have in place. Trade data is collected as part of the trading process and does not interfere with other system functionality. Additionally, ECM technology is able to aggregate information from as many sources as a broker requires, and can create reports based on multiple datasets feeding into it.

Entrants into the space, such as Firm58 and The William Ryan Group, Inc., are bringing a more formal ECM process within all brokers' reach. These technologies give firms the flexibility they're looking for; data can be reported in any number of ways once it is collected and normalized. Vendor solutions often offer slick interfaces and analytics that would not be cost effective for an internal IT team to build. The result is timely, intuitive data that is immediately actionable.

Execution cost management technology is also important because brokers can benefit from knowing more about their business. The ability to track desk and trader results, improve net trading performance, measure algorithm efficiency, and calculate client profitability are all crucial to scaling an effective brokerage business.

The Do-it-Yourself Approach

Many large brokerage firms build their ECM tools by using spreadsheets that sit on top of an enterprise database. Internal resources and trading support groups are responsible for maintaining data and updating information. While this is a feasible solution for some firms, enterprise databases are costly to build and expensive to update as frequently as marketplace changes dictate. The intricate puzzle of maintaining an accurate trail of executions and keeping variable execution costs low are tasks that, at large firms, must be shared among multiple full-time employees.

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The problem is that few internally built solutions can translate costs effectively into day-to-day and second-by-second choices. Custom-built solutions can take days—even weeks—to assemble using various groups to calculate the results. Once results are finally assembled, it's sometimes the case that they're not as accurate as they should be because disparate systems that do not talk to one another can each come up with very different figures about how variable execution costs are impacting the profitability of the business.

It is in instances like these—when data is incomplete—that brokers will make back-of-the-envelope estimates and attempt to fill in blanks. Scalability is limited because the more groups and desks that are tinkering with these spreadsheets and databases, the more difficult this data is to maintain. Case in point: when brokers divide total revenue by share volume, and use the results broken down by venue to determine average costs. Though many brokers say they are comfortable with building out their own cost-analysis solutions, they also admit that having more detail about their order flow would prove beneficial. Many more inputs can be used for additional calculations and analysis. These inputs would broaden the resulting output and allow management, finance, operations and trading groups to extract and benefit from the rich information at their fingertips.

Access to Better Data

As brokers do more and more volume, scalability of an organization is limited by how well costs are understood. Basic analysis—for example, examining revenue inflows and comparing client costs—may not reveal the true reasons a business is underperforming. A number of elements—such as access fees, bandwidth utilization, ticket/share volumes, and market data costs—should be factored into the cost analysis to prevent overspending on any one client.

Weak data sets can make tracking variable execution costs difficult for firms to manage. Because each venue has its own methodology and its own unique way of reporting variable execution costs back to market participants, there's always a risk of executing at too high a cost. And that is exactly what happens when an equity trading desk doesn't have the information it needs to make the best possible decisions.

Brokers who want to trace costs to a specific client must extrapolate from exchange, ECN and dark pool information that is not detailed enough to break down exact charges. Factoring in millions of quote messages and execution venues' inconsistent reporting standards, a broker is left to scrub and normalize data as best he can. Breaking down FIX messages into reportable data such as net fees (the cost of removing liquidity minus the rebate provided) or actual dollar amounts, for example, is not easy to do without having a robust process in place or an ECM technology solution installed.

Another variable execution cost that brokers are keeping a close eye on is that of connectivity tools. Certain OMS and EMS vendors, as well as FIX network

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providers, charge brokers to route client orders. Brokers we interviewed remarked that over the past year or two, connectivity tolls have been rising. In order to show clients the negative impact toll pricing has had on net commissions, the sell side can gain an ally in the battle to keep these rates as low as possible. With data in hand, the sell side, too, can negotiate for the lowest rates.

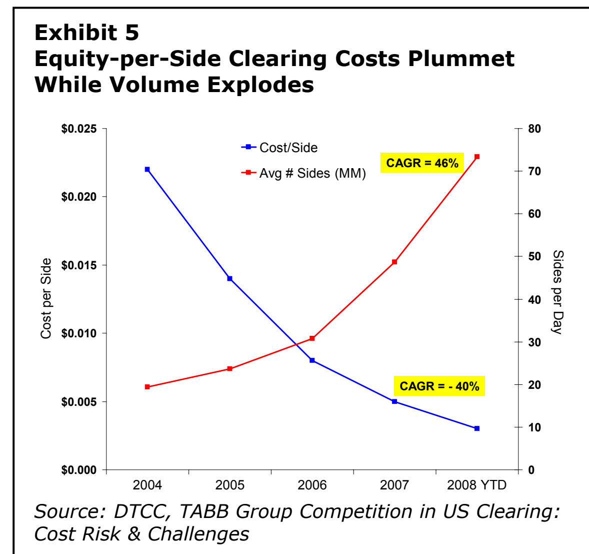
Clearance Effect

There are various ways to view and measure clearing costs: Brokers can either view clearing costs as a percentage of commissions, or as a percentage of overall ticket costs. In both cases, share-volume tiers and varying price structures can complicate this analysis. For example, many brokers will only consider NSCC fees as the primary source of the clearing cost even though they can include other components—such as technology, personnel, penalties and Omgeo fees—that factor into the total expense.

Moreover, clearing fees will vary by institution, from how the clearing is done to the relationship between the broker and the client. For the sell side, the decision whether to absorb the fixed cost of self-clearing or the variable cost of using a clearing firm is a complex one. Either way, clearing costs reduce commission margins.

According to TABB Group's 2008 report, *Competition in US Clearing: Cost, Risk & Challenges*, "average equity clearing costs per side have *fallen* more than 40% per year, while the average annual volume has *grown* by 46% over the last 4 years." As orders are executed by algorithms and other advanced electronic execution strategies, clearing costs become a bigger outflow for the broker (see Exhibit 5). For example, Immediate or Cancel (IOC) orders will create trade breaks in greater number and in higher frequency, making trades costlier to settle. Many firms are reevaluating clearance costs and clamping down on clients with high clearing costs.

Exhibit 5
Equity-per-Side Clearing Costs Plummet While Volume Explodes



Source: DTCC, TABB Group Competition in US Clearing: Cost Risk & Challenges

Though explicit costs like execution and clearing are considered easier-to-measure components, they are often pushed aside because they can be negligible compared to implicit trading costs. Equity trading is now supported by pennies and fractions of pennies, and fees that were once negligible are garnering more attention.. The only way brokers will ever have a firm grasp on improving business is to measure the true cost of execution more precisely, and report it in alignment with the client's overall activity.

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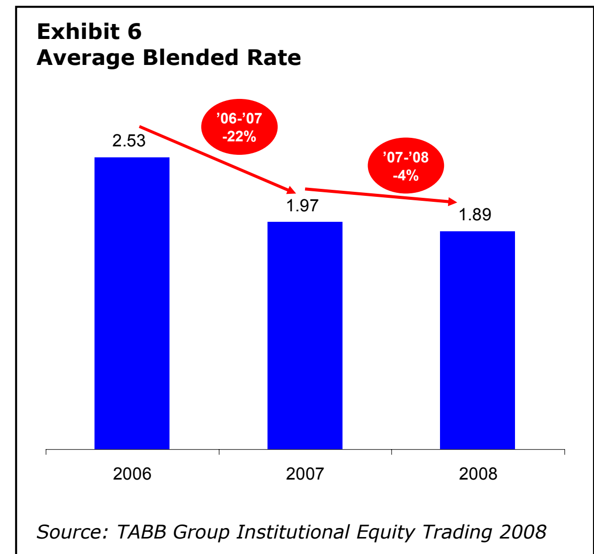
Determining a Fair Price

When trading costs begin to exceed revenues, a broker has three choices: charge a higher rate, cut services, or trade more efficiently. In theory, the expense associated with supporting a cash desk must go hand in hand with the scalability of the business. The importance of tracking client profitability is driven by the steady downward pressure on average blended rates and increased opportunities to capture additional order flow.

Commission rates are hitting all-time lows—an average blended rate of 1.89 cents per share, according to TABB Group's report, *US Institutional Equity Trading: Crisis, Crossing and Competition* (see Exhibit 6). In fact, rates are so low the buy side is beginning to realize it may not be able to receive the services it values for such a low rate. Most buy-side firms, including traditional mutual fund companies and hedge funds, will demand a fair all-in rate. Low commission rates are a double-edged sword because the buy side wants to pay the lowest rate, yet does not want to pay more in commission dollars to get the attention of a broker. Although brokers will increase rates when they have to, this is not a favorable response.

Exhibit 6
Average Blended Rate



Source: TABB Group Institutional Equity Trading 2008

Therefore, brokers must determine what a fair rate is and do whatever they can to meet expectations while keeping their commission rates in line with their brokering costs. To a broker, a "fair rate" is one that pleases the client but also earns the broker a reasonable profit.

Today the perspective from the buy side is one of constant uneasiness and insecurity: Is the buy side receiving a level of service commensurate with the commission dollars it is spending? There is a growing recognition that current rates may not yield the level of service or coverage they have come to expect in years past. Translation: All sides are open to negotiation. Traders want to pay a fair rate, but when they don't have all the data about the cost of supporting their accounts, it is difficult to determine what a fair rate is (and difficult to defend any changes in the level of service). The buy-side trader is a data-driven professional; when brokers bring execution cost data to the negotiating table, it helps the buy side understand the commission rate. The more frequently execution cost data is presented to the buy side (and the more detailed this information is), the easier it is for the head trader to explain and defend commission rates.

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High-frequency trading shops are particularly complex in this regard. In a market dominated by traders, not investors, brokers must figure out how they can service high-volume players without losing sight of underlying costs. A high-frequency strategy can be particularly costly for a broker if the appropriate safeguards and client profitability measurements are not in place.

One way brokers handle high-frequency shops is to design a cost-plus model in which trading costs are passed on to the client. "Passing-thru" the costs prevents the broker from having to charge exorbitant fees, or taking on the risks of execution (including execution expenses). Because high-frequency and statistical-arbitrage firms' execution strategies involve maximizing arbitrage and short-term opportunities by taking and receiving liquidity, these firms are heavily reliant on direct market access (DMA) and self-sufficient execution. Again, data is an important factor for brokers that service these players, for example, the information to know when to pull the plug, or when to request a meeting to discuss the overall relationship.

Client Metrics

Brokers need client metrics that consider all trade-activity components. With these metrics, they could evaluate profitability client by client. These analyses would be instrumental in validating rates, and would certainly be fodder for more fact-based discussions about the true costs of trading.

There are a couple of ways in which a broker can get a clear picture of just how profitable a client is: Similar to internal analysis, a broker can create client metrics on a per-trade basis; this snapshot can either be broken out by trader or taken as a holistic view of the entire desk. Examined in conjunction with client activity, the results of these findings can help a broker determine how much to charge the client: Charge too little, and the client could be excluded from certain value-added services to which higher-paying clients are entitled. Charge too much, and a broker may not get the business because another broker may already have quoted the client a better rate.

In either case, brokers should always be on the lookout for execution venue pricing inconsistencies so they might better advise clients about how to reduce their execution costs. Daily client metrics don't just keep CFOs happy—they also satisfy inquisitive clients who want detailed answers about their trading costs. Client metrics can also help brokers ensure variable execution costs remain a small percentage of the overall cost of trading. Buy-side clients value brokers who are willing to share information and help them understand where commission dollars are being spent.

Transparent Brokerage Model

While minimizing variable execution costs can be the main cause of concern for an agency trading firm, it's just one of a host of factors that full-service firms must consider when they compute their overall cost of trading. Full-service brokers must look at a client relationship as a whole in order to have a full

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understanding of what it costs to service those needs. Services will vary across asset classes, geographies, and clients' willingness to absorb other broker services.

As in any relationship, in trading it is the sum of many small parts that determines health and stability. Although brokers make their money by trading, execution costs are just one component of the total return on relationship. Full-service brokers that offer capital, research and electronic trading services should be amenable to disclosing fees related to these services. Full-service brokers should also add supplying ECM analysis to clients to their menu of services. In addition, ECM analysis should figure in to agency brokers' conversations with their clients. The broker-client relationship should be a transparent one; it's imperative that brokers show their clients exactly how much trading costs them. This includes fixed costs as well as variable costs such as technology upgrades, connectivity needs and full-time employees.

However, the relationship can't be all give and no take on the broker's part. The buy side should also be more upfront with the sell side about what it thinks are reasonable fees, and which services it'll expect from that broker as the relationship develops over time. If the buy side values compliance and research above all else, this information, too, should be communicated to the broker. Once the buy side and sell side are clear about the level of service that's optimal for a particular trading relationship, it is a lot easier to put a price tag on the services provided in return.

The easiest ways to increase confidence between the two sides is through robust reporting and delivery of those results. Transparency can be achieved at all levels of trading activity, from the trade itself to identifying the desk or client responsible for increasing the trading costs. Brokers who communicate openly with their clients, operate under a straightforward business model, and are willing to disclose their fees line by line will have a better chance of keeping customers happy in the long run.

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Conclusion

In a perfect world, all brokers would be conscientious about optimizing quality of execution and cost-effective routing, always bearing in mind the factors that determine execution costs. If this were true, this information could be shared with the client as part of a broader assessment of the broker's value to the client. Internally, brokers would incorporate this data into its client-profitability models.

Variable execution costs can be tracked, calculated and reported on more precisely as ECM technology is implemented by firms of all sizes. Many brokers already feel they have a strong grasp on their execution choices and are continually monitoring venues for the best prices and best executions. Still, there is more that ECM technology can do to help them make the best trading decisions as the structure of the marketplace evolves and expands.

The future of managing equity variable execution costs is combining the data with TCA and improving trade decisions by reducing bills. Some brokers are further ahead of the curve than others in tracking costs, and are better able than others to drill into the weeds. Some brokers can even demonstrate proficiency in how execution costs are handled, which helps them arrive at fair commission rates. Still others can only monitor their fills to determine that fees are not outweighing the costs of doing business.

Altering trading practices is not always so obvious. Changes to smart order routing to reduce take fees might be easy to implement, but the data leading to those decisions may not be a part of the everyday process. In order for brokers to make better decisions, it will require more trading data and information that helps to make better liquidity decisions. Brokers that have details about where their orders were executed, how much liquidity was added or removed, when shares were routed to an alternative venue, and on which systems those orders were generated will be key components of future ECM discussions.

Execution cost management will also be used to make clients feel more secure about their trading costs. As commission rates compress, the buy side will better understand how execution costs impact its commission rates, and the rationales behind sales trader decisions. This will also lead to more reporting requirements for brokers—requirements for which brokers will have to demonstrate that the costs of all services are minimized when they are unbundled.

It's every broker's goal to improve profit margins and strengthen relationships with clients. A broker won't grasp the true cost of executing, though, until he tracks the execution costs of every transaction. Brokers who mine critical cost considerations—those who look for diamonds in the rough to optimize their profitability and enhance their relationships—will differentiate themselves in today's evolving trading environment.

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About

TABB Group

TABB Group is a financial markets research and strategic advisory firm focused exclusively on capital markets. Founded in 2003 and based on the methodology of "first-person knowledge," TABB Group analyzes and quantifies the investing value chain from the fiduciary, investment manager, broker, exchange and custodian. Our goal is to help senior business leaders gain a truer understanding of financial markets issues and trends so they can grow their business. TABB Group members are regularly cited in the press and speak at industry conferences. For more information about TABB Group, go to www.tabbgroup.com.

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Matt is an analyst at TABB Group. He joined the company in November 2005, following four years with T. Rowe Price Associates at its corporate headquarters in Baltimore, Maryland. Simon's is the author of "Portfolio Decisions and Trading: Aligning Execution to Investment Needs"; he co-authored "Hedge Funds 2008: Perspectives on Prime Brokerage, Volatility and Expansion," "Institutional Equity Trading 2007: Divining a Path to Liquidity," "European Institutional Equity Trading 2007: The Buy-Side Perspective," and "Liquidity Management: Pushing Automated Trading Beyond Agency Brokerage." He earned a BS degree from the University of Maryland, College Park and is currently pursuing an MBA at Fordham University.

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