

1965

# Operational problems and how to solve them

Gordon C. Stubbs

Follow this and additional works at: [https://egrove.olemiss.edu/dl\\_hs](https://egrove.olemiss.edu/dl_hs)

 Part of the [Accounting Commons](#), and the [Taxation Commons](#)

---

## Recommended Citation

Haskins & Sells Selected Papers, 1965, p. 326-334

This Article is brought to you for free and open access by the Deloitte Collection at eGrove. It has been accepted for inclusion in Haskins and Sells Publications by an authorized administrator of eGrove. For more information, please contact [egrove@olemiss.edu](mailto:egrove@olemiss.edu).

# Operational Problems and How to Solve Them

by GORDON C. STUBBS  
Partner, Los Angeles Office

*Presented before a Conference on Operations and Administration for Member Firms of the New York Stock Exchange, Los Angeles—February 1965*

**A**T THE OUTSET let me say I have no intention of attempting a comprehensive coverage of the topic assigned to me. I am confident that you understand thirty minutes does not permit sufficient time to accomplish this task. I shall consider my paper successful if I touch upon a few key problems that affect each of you and that may stimulate your subsequent discussions at this meeting.

Originally, I had planned to have something to say in regard to revenues but recent events have changed my intentions. I am sure you are familiar with Keith Funston's recent letter of December 29 on the subject of Tentative Recommendations of the Cost and Revenue Committee. I feel confident these tentative recommendations will be the basis for some of your discussions later during this meeting. For this reason I shall, for all practical purposes, pass up any remarks on ways and means of increasing revenues.

## **CONTROL OF PERSONNEL COSTS**

Most of my remarks will be directed to control of expenses and more specifically to the control of personnel cost since this is the largest single cost in the brokerage industry. To date, no clear-cut evidence has been produced to indicate that costs have been reduced through the extensive use of electronic data processing equipment. Since personnel costs are relatively fixed, most of our efforts should be directed toward increasing efficiency in the use of personnel.

### **Supervision**

The most effective means of obtaining optimum efficiency of personnel is through proper supervision. Consider the nature of the industry: Its units have hundreds of routine transactions, extreme fluctuations in the work load, and clerical staffs relatively inflexible numerically, and have never been known for high wages in the area of clerical help. Certainly, these conditions are not conducive to maintaining the highest morale among office personnel and effective supervision is obviously essential.

Supervisors must supervise. Too often a person who is considered to be a supervisor is, in reality, only a clerk. A supervisor cannot

involve himself in operations, for as soon as he does he abdicates his responsibility to see that other members of that department are constructively employed.

A proper span of control is important for effective utilization of both employees and their supervisors. Where clerical work is routine, one supervisor can guide the work of several employees, whereas when the work includes unusual non-routine situations, more supervision is essential. As the caliber of personnel decreases, more supervision is required.

### **Organization Structure**

Equally important as proper supervision is a clearly defined organization structure with clear definition of authority and responsibility. Responsibilities among departments and sections also should be well defined through the use of organization manuals and charts so that the opportunity for "buckpassing" is reduced to a minimum. Further, management should sense ineffective organization structures when problem areas continue to manifest themselves.

### **Accounting Systems and Procedures**

Each firm should have established accounting systems and procedures that provide for both accountability and responsibility in processing each step of a transaction. One of the end results of the system should be cost information concerning the various services rendered by the firm. Reports developed by the system must be critically reviewed continuously to determine whether each report is, in fact, needed or whether reports might not be combined or prepared in a better manner. All too frequently these basic requirements of an accounting system are disregarded.

Costs should be accumulated on a functional basis, for unless management knows the cost of a particular function of the business the control of such costs is impossible. Continuing cost studies on back office, promotional, and production costs should be available to management for use as a tool in profit engineering.

Obviously, the system must be designed to meet requirements of regulatory authorities.

### **Scheduling**

A precise scheduling of work is necessary for efficient operations. Cut-off times should be specific. The order of work between depart-

ments should be established. Flow of work should be in batches at specific times—not piecemeal in a haphazard manner. As illustrations: Cut-off hours should be established for receipt of securities “over the window” from other brokers; the flow of work to the data processing department should be scheduled, with appropriate cut-off times.

### **Physical Layout and Equipment**

The physical layout of the office is often disregarded. Usually many opportunities exist where, by a change in physical layout—sometimes even by a minor change—the flow of work can be improved. Perhaps this statement is trite, but employees should have adequate room and facilities. Physical layout should be so arranged that supervisors can view their subordinates and thus accomplish their supervisory responsibilities properly and more readily.

Again we are stating the obvious, but too frequently enough attention is not given to proper filing space and record storage. Not only should attention be given to the space needed, but attention should be given to the provision of adequate filing and storage equipment and the related significant, but most generally disregarded, problem of record retention.

Office equipment should be constantly evaluated. The use of advanced data processing equipment and methods must be continually studied in the light of costs. The use of service bureaus and joint data processing centers must be constantly analyzed. Particularly in smaller organizations, care must be exercised so that bottlenecks do not arise through the use of inadequate or obsolete bookkeeping equipment.

Access to accounting data should be limited to authorized personnel. Although this subject is related more closely to establishing good internal control, nevertheless lack of such control most generally leads to confusion, which, as we all know, increases operating costs.

### **Training of Employees**

Conditions under which the industry operates continue to increase in complexity. Increased responsibilities have been imposed on brokerage firms and their personnel by regulatory authorities, and the squeeze on profit margins continues unabated. As a result of today's operating conditions, training programs are essential.

A good training program should provide, among other things, for rotation of assignments among employees. Time should be provided for

supervisors to instruct subordinates, particularly new employees. Employees should be familiar with more than one aspect of the operation. Not only must employees know specifically what they are expected to do but should understand why they are doing it and should be prepared to pinch-hit in at least one other function. In developing a training program, consideration should be given to available outside training material and facilities.

### **Salaries**

The necessity of maintaining proper salary scales is too often overlooked. Not infrequently an employee resigns because a deserved salary increase was not made. Yet the cost of recruiting and training the replacement may more than offset a proper increase in salary. A regular schedule should be established for the review of salaries, because clerical and other salaries in the brokerage industry, as in any industry, must be competitive. Salaries should be reviewed in relation to the tasks performed and adjustments made so that comparable positions receive comparable salaries. At this same time, consideration should be given to promotions.

### **Maintenance of Employee Morale**

The maintenance of a high degree of employee morale will contribute to more efficient operations. Job security, competitive wage scales, and a sense of belonging, under working conditions that are comfortable and friendly, will go a long way toward obtaining the optimum efforts from all personnel.

### **ERROR DETECTION AND CONTROL**

Because of the volume of paper work required to account for the large number of transactions in the industry, errors are bound to occur. A clerk writes the wrong security number on a ticket, a transaction gets posted to the wrong account, a wrong security is delivered, or a bad trade is made. Even if each transaction were reviewed by another person, errors would still be made. So long as errors are inevitable, procedures for correcting errors must be designed.

### **Timeliness of Corrections**

Corrections should be made on a timely basis. The sooner an error is corrected, the more easily the correction can be made. A transaction in which an error occurred usually will have been processed by several

people, and prompt inquiries are answered more easily when the transaction is still fresh in mind. Recently prepared records are generally readily accessible. When errors relate to a purchase or sale of a security, the sooner the correction is made, the less the difference is likely to be for buying-in or selling-out the error position.

### **Assignment of Personnel**

One solution to this problem of error correction is the establishment of a "trouble shooter" position. Usually personnel preparing the records are best able to correct their own errors. But, most personnel do today only that which is necessary today. So, unless the task of correcting errors is specifically assigned, numerous errors will accumulate in the records. In smaller organizations this task might constitute only a part-time job; in larger organizations more than one person might be required. When a significant number of errors occur in a short period, owing to heavy trading or for other reasons, and are permitted to accumulate, a special task force should be assigned to do nothing other than make corrections. An employee assigned to correct errors must have sufficient authority to research regardless of the department concerned.

### **Detection and Correction**

Routines for the detection of errors should be established. Perhaps the most common routine of this type is the periodic box count. Error routines will vary depending on the facts surrounding the transactions. On one extreme, errors may result from the frequency of one type of transaction, or on the other extreme, from the complexity of the transactions. Special programs may be established for the detection of errors, utilizing either mechanical or electronic equipment. Also, management should make fullest use of that type of person possessing the particular ability to locate errors merely by reviewing records and accounting reports.

Having established routines to locate errors, management should institute procedures to assure that corrections are made.

### **EXCEPTION REPORTING**

Because of the volume of transactions being processed, a supervisor cannot review each piece of paper generated by his subordinates. Thus, any procedure accomplishing segregation of those items that are

exceptions to routine can prove extremely valuable, for emphasis can be directed to the unusual items. This concept, known as "exception reporting" or "management by exception," is one not used to its fullest extent.

### **Definition**

First, what is an exception? An exception can be considered as something sufficiently abnormal or out of the ordinary requiring the control or the attention of some higher level of supervision. Those errors requiring special handling for correction may also be considered a form of exception.

The determination of what constitutes an exception must precede the establishment of any system of exception reporting. The limits within which a normal transaction will fall must be defined; then those transactions falling outside these limits are the exceptions that may require special attention.

### **Control**

After having defined and isolated the exceptions, proper control should be established over their ultimate disposition. Arrangements should be made to report these exceptions to a higher level of supervision for review and disposition. Such a procedure will give reasonable assurance that the isolated items are not allowed to continue unresolved.

### **Timeliness of Solutions**

A principal advantage of exception reporting is the segregating of desired information necessary for the timely solution to problem areas. Far too often, problems are allowed to be put in the background because the person who is in daily contact with the problem has neither the authority nor the resourcefulness to resolve them properly. Through the use of exception-reporting techniques, failure to make corrections would be highlighted, and appropriate action could be taken on a timely basis.

### **Potential Uses**

Although not thought of as such, exception reporting is already in use in several areas: Customers' margin accounts are reported to management on a periodic basis; unsecured accounts are reported when such accounts become a collection problem; unsettled customers' cash transactions are reported when the settlement time has expired; and

security positions out of balance, or "long" box or transfer positions, are reported periodically.

The use of this concept of management by exception should be extended to as many areas as possible. Illustrations of some areas in which exception reporting might be effective are:

Broker fails not settled within a designated period

Transfers and exchanges not returned from transfer agents within a fixed period

Mutual fund clearances when securities have been purchased under an accumulation plan and the customer's account and the fund distributor account have not been cleared

Dividend receivables, or other claims charged to brokers accounts, not settled within established time limits

The problem in exception reporting is one of implementation and is generally centered around defining, locating, and disposing of the exception. In the last analysis, however, the effectiveness of any program designed to locate and dispose of exceptions, as well as errors, depends on the attitude of management.

### **CONTROL OVER CUSTOMERS ACCOUNTS**

Because of the responsibility being placed upon brokers to provide suitable investments for customers and to control overtrading or churning, you will all agree that one of the biggest problems facing the industry today is supervising customers' accounts. In my view, the implications of this responsibility pose the biggest current problem and one of the biggest problems the brokerage industry has faced in recent years.

### **Laws and Regulation**

You are all aware of the legal and ethical obligations imposed upon the industry by the anti-fraud provisions of the federal and state securities laws, the New York Stock Exchange, and the National Association of Securities Dealers. Section 2 of the Rules of Fair Practice of the National Association of Securities Dealers is worth restating:

In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs.



Although the Securities and Exchange Commission has not prescribed general standards of conduct, they have developed several specific standards and have made reference to the above-mentioned rules in determining whether a firm or its representatives are meeting legal and ethical standards.

### **Responsibility**

The first step in this problem of supervising customers' accounts is in supervision of registered representatives. Responsibility for this supervision is, of course, in the "front office." However, this does not relieve the "back office" from the responsibility of furnishing useful reports that might point up unsatisfactory conditions in customers' accounts. The back office should take the initiative in developing the reports, for only the back office knows what information is available, how readily such information is available, and the problems encountered in developing additional information. This aspect of the problem clearly exposes the need for adequate communications between the back office and the front office—a condition that, in my experience, seems to be the rule rather than the exception.

Finally and most importantly, any report must be meaningful to the recipient. In my view, to be meaningful a report must be easily read and understood. All too frequently these basic requirements are ignored in preparing tabulating runs.

To approach this problem of supervising customers' accounts through margin clerks, or others who daily post all transactions to customers' accounts, adequate detailed instructions must be given to the clerks. Considering the extremely fluctuating work load of margin clerks, I do not place much value on this approach to the problem. Nonetheless, margin clerks should be aware of the firm's responsibility in this matter and should be encouraged to call unusual transactions and activities to the attention of responsible front-office personnel.

### **Use of Data Processing Equipment**

Here is an area wherein the principle of exception reporting may be used to good advantage, especially when electronic equipment is used. When data processing equipment is available, a program to assist in controlling customers' accounts might be accomplished by use of a comprehensive classification of customers' accounts into types of account according to purpose and by use of a classification of securities

suitable for certain purposes. Guidelines for accounts and securities having thus been established, periodic reports could then be prepared showing only those accounts that should be reviewed for suitability of transactions. A similar type of approach could also be used to control churning. Classifications for customers' accounts could be established for the expected number of transactions within a given period, perhaps on a monthly or quarterly basis. The guidelines for customers' accounts having been established, the data processing department could then provide a listing of transactions for accounts that should be reviewed by management.

Solutions to this problem of controlling customers' accounts can be and will be found. But corrective action to the problem cannot be delayed for, as you know, if the industry does not provide a solution, regulatory authorities will attempt to solve the problem and undoubtedly at much greater expense. Equally important is the possibility of legal action by customers, a situation always undesirable from the viewpoint of both costs and publicity.

Notwithstanding all procedures that may be developed in an attempt to control customers' accounts, nothing will ever completely replace the personal review of accounts by supervisory personnel, and nothing will replace the basic simple rule of "know your customer."

