# Next generation offshoring in the investment management space: The keys to driving success

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It may be the last frontier for offshore outsourcing of financial services; typically wary of risk and historically cushioned by solid margins, investment managers have historically eschewed offshoring of business processes as aggressively as their counterparts in the credit card or mortgage space. However, as operating models and financial structures change dramatically due to economic conditions, offshoring must, of necessity, become a strategic tool for asset managers to manage costs, transform service levels and support the development of differentiated offerings which can effectively compete in a global, highly competitive marketplace. But it will take readiness on behalf of two parties asset managers and providers to make the change.

## It Starts With A Change Of Mindset For Asset Managers In A Changing World

What are the implications of what is likely to constitute a 'perfect storm' to drive the adoption of offshore outsourcing by the investment management industry? First and foremost, it will represent a huge challenge for the asset management community in terms of mindset change, operational readiness and commitment to execution. The extent to which asset managers, traditionally part of the financial services industry's more conservative and risk averse class, are willing to adapt will affect the pace of adoption.

Traditional business models will no longer be effective in an environment which is changing considerably. Firstly, there is a clear trend toward 'globalization' with customers demanding a more international portfolio of assets and ever increasing interrelationships and linkages between international capital markets. For example, according to research by Oliver Wyman, fund flows into global and emerging market funds in the last 5 years have aggregated to over USD 400 billion, while there have been net outflows from U.S. / Europe / Japan funds.

Secondly, the complexity of multiple market movements is compounded by a bewildering array of complex asset classes and products which are available to institutional and retail investors. Throw increasingly informed and demanding customers into the mix and new, unique challenges are created for asset managers - for example, John Doe is now investing a greater proportion of his portfolio in complex alternative assets and he expects his financial advisor to stay on top of his needs and the market. In parallel, the regulatory authorities have significantly stepped up the focus on compliance and reporting requirements for the industry as there is increased scrutiny of fraud, compliance, money laundering, among others.

Topping all this off, cost pressures continue to be a source of concern as innovative asset managers are transforming the price / value equation for their customers with bundled advisory services alpha-beta separation, enhanced customer support and aggressive transaction / service fee structures. For wealth managers, consolidation among retail brokerage players and the flow of funds towards discount brokers and RIAs is driving increasing focus on operating costs.

As the business becomes more complex and competitive, asset managers must focus on their core value proposition target the right customers, structure and offer the right products and deliver better than market returns. They cannot afford to be distracted by managing unwieldy operations, be burdened by high transaction costs or deal with the daily paperwork of compliance reporting. At the same time, it is an imperative to manage risks judiciously and strike the right balance between cost effectiveness, meeting compliance requirements and customer satisfaction. This makes the case for a new business model, such as that presented by offshore outsourcing, but success is dependent upon the availability of mature, reliable partners with industry specific solutions to meet the need.

## But The Provider Community Will Need To Step-Up

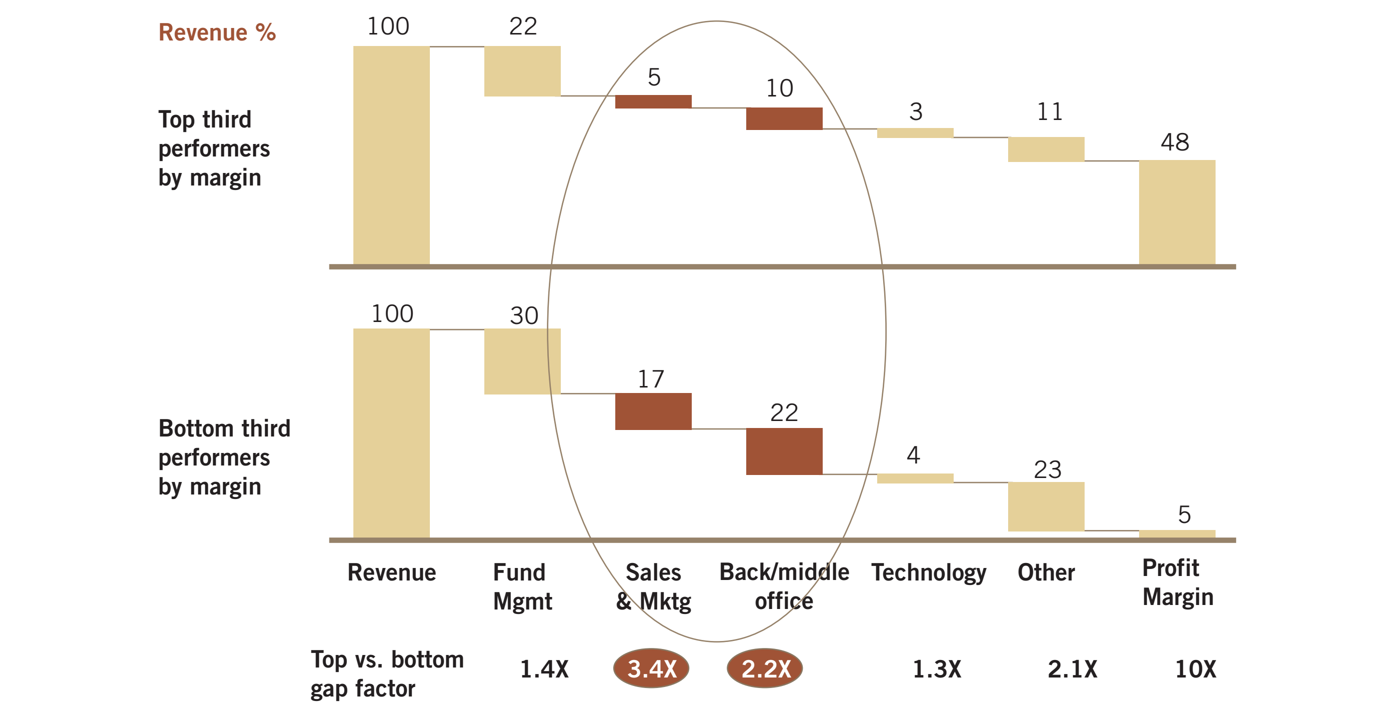
Looking at the flip side, adoption of outsourcing in the asset management community represents a tremendous opportunity for offshore providers who can tailor traditional business process outsourcing delivery models and build new capabilities for this marketplace. The opportunity to build 500 FTE+ programs with multiple clients while creating significant barriers to entry for competitors is attractive for providers who can make the cut.

Today, offshore providers can easily take on ownership of a number of transactional back and middle office activities with minimal risk and significant impact on cost around simple back office activities relating to account set-up, data conversion and maintenance work. The asset management community 'gets' this. But the following table shows how attacking a spectrum of costs across sales and mid / back office operations has driven profitability for players in the asset management marketplace and, most importantly, separates the leaders from the followers.

As shown, offshore delivery models which include adequate scale and scope can have a greater impact on operating margins. For example, conveying enough scope to an offshore provider can result in additional value beyond cost arbitrage through increased front-to-back agility. The right provider can build and support sophisticated asset allocation models, enabling investment managers to enhance their decision making ability. And, over time, the provider can, through deep knowledge of underlying process and metrics, develop a variable unit pricing model which allows more flexibility than outsourcing's traditional FTE pricing structure.

But are offshore providers able to step up to change the value equation for the asset management industry? There is a significant gap in both the extent of domain knowledge and track records of delivering end-to-end processes which providers must overcome in order to serve this segment. This business is significantly more complex than processing credit card statements or payoffs for mortgage loans. Given the small base of the domestic asset management and wealth management sectors in offshore locations like India or the Philippines, availability of trained resources continues to be a substantial concern. And the risks of non-compliance are considerably higher.

### Sales and back office costs drive profitability in the Investment Management industry




Source: U.S. Institute / McKinsey Asset Management Benchmarking Survey

Moving processes offshore can, however, work well as both Fidelity and State Street have demonstrated through the establishment of large captive operations in India which continue to scale and are delivering consistent results. And as a result of this success, a number of retail brokerage firms and institutional asset managers are following suit with outsourcing pilots from simple account set up and compliance reporting to more complex licensed transactions and portfolio advisory services.

## Making The Change…

What will push adoption of offshore outsourcing in the asset management industry? The 'next generation' business model will only take hold if the industry can tap into a provider market offering the ability to customize, flexibility to vary pricing to meet the peaks and troughs of the market, and a deep understanding of processes-end-to-end with a truly robust compliance structure governing their operations. Offshore providers must lift their games to deliver these capabilities in a consistent and transparent manner.

And a mindset change on the part of the asset management community is the second part of the equation. Asset managers must pursue the evaluation of offshoring in a more strategic way, rather than continue to test the same waters, assessing the feasibility of simple processes which do not form the basis of a compelling business case.

This will first entail rethinking the traditional focus on transactional back-office outsourcing to a more comprehensive mix of offshoring across the spectrum of front office, middle office and back office activities, as shown in the following chart.

Second, this more comprehensive approach must be accompanied by a 'right-shoring' approach where the business model is designed to include an optimum blend of onsite and offshore services to serve end-to-end customer needs. And last, there is clearly a much larger value play; offshoring can contribute to competitive advantage and be an effective lever to improve the customer experience by providing a range of enhanced services from 24X7 supports through multiple channels to the provision of highly skilled offshore resources to provide specialized analyst support to both investors and customers.

Given the current lack of 'industry maturity' in the class of offshore providers 'big bang' approaches wherein large scale offshore programs (with multiple 100 positions being offshore) and functional outsourcing upfront (e.g., outsource all of commissions and reimbursements) are highly risky. Sequential, phased programs will be the way to go. The following table illustrates what an optimal offshore roadmap might look like for a typical program.

**Create 'Mixed Complexity' Opportunity Clusters to balance risk and reward**

| Phase 1 | Phase 2 | Phase 3 |
| --- | --- | --- |
| **Middle Office**<br>▪ Reconciliations Settlements<br>▪ Exceptions Processing<br>▪ New Account Set-up<br>▪ Account Servicing<br>▪ Broker Administration<br><br>**Back Office**<br>▪ Data Management<br>▪ Cash Management<br>▪ Collections<br>▪ Fund Accounting<br>▪ Ledger Functions | **Middle Office**<br>▪ Trade Matching<br>▪ Investment Accounting<br>▪ Post-Trade Compliance<br>▪ Performance Reporting<br>▪ Limit Monitoring and reporting<br>▪ Regulatory Reporting<br>▪ Statements<br><br>**Back Office**<br>▪ Cost Basis Operations<br>▪ Fund Administration<br>▪ Transfer Agency<br>▪ Securities Servicing / Custody<br>▪ NAV Calculations | **Front Office**<br>▪ Portfolio Planning Support<br>▪ Portfolio Analysis<br>▪ Pre-Trade Analytics<br>▪ Pre-Trade Compliance<br>▪ Forex / Multi-currency support<br>▪ Commissions and Re-imbursements |
| First 6-12 months | 12-24 months | Beyond 24 months |

To deliver this roadmap, offshore providers will be compelled to advance their skills and considerably enhance their delivery models. This first requires a sea change in the modus operandi of the offshore outsourcing industry as a whole. Today transition to a new operating model is highly dependent upon knowledge transfer models which rely on the client's ability to train the providers' employees from 'scratch'. Rather, next gen providers must demonstrate deep domain knowledge and operating prowess.

Additionally, providers must take a process level view which mandates end-to-end ownership of quality and service levels rather than managing fragmented tasks with time and material metrics. Next, the pricing structure must change, perhaps structured in the way that the industry prices-x basis points based on the size of the investment. And last, the provider community must demonstrate intimacy with prevailing compliance requirements, providing evidence of adequate controls, and contractually assuming liability for lack of compliance.

## What Is The Trajectory Of Change?

Simple answer - we don't know yet. The asset management industry's catalyst for offshore outsourcing will be no different from those of other industries; it will likely depend on the velocity of early take up by respected, more progressive asset management firms. And like all other transformational changes in business models, when demand is evident, providers will invest in delivery models which meet the complex needs of the industry. Whoever steps up though is looking at an enormous and highly valuable opportunity!

To learn more, please write us at **info@wns.com**