Outsourcing
The New Strategic Imperative

Platform for Growth

Accelerated Demand
Introduction

Across the financial industry, outsourcing has become a vital component of business strategy. Whether safeguarding assets, connecting market participants or providing back- and middle-office support, outsourcing is helping financial institutions set and execute a successful growth plan while keeping the focus on their competitive differentiators.

Large asset managers have been outsourcing components of their operations for years, although early arrangements primarily involved delegating administrative, back-office functions. Today, outsourcing has evolved significantly. Institutions of all sizes are not only looking for back-office help but are turning to third parties for more complex needs such as operational support, financing solutions, advanced technology platforms, risk-mitigation tools and fiduciary-like functions. Most of all, outsourcing is no longer

---

1 Wealth and Asset Management 2021, Preparing for Transformative Change, Roubini ThoughtLab, 2016. Study based on a survey of 2,000 investors and 500 investment providers across 10 wealth markets, in-depth interviews, and economic modeling led by noted economist Dr. Nouriel Roubini. The study was produced in conjunction with a diverse coalition of sponsors, including State Street Corporation.
solely about gaining efficiencies or a focus on technology. Success lies in achieving a balance of technology, service and expertise.

“We’ve seen a significant amount of change in the industry over the last decade, and that includes outsourcing,” says Scott FitzGerald, executive vice president and head of sector solutions for the Americas at State Street. “Shifting market conditions, increased regulation and constant fee pressures are accelerating — and transforming — the demand for today’s outsourcing solutions.”

Outsourcing providers are no longer simply covering ancillary tasks. “Managers are now looking to external partners to take on complex, real-time activities while addressing changing investor demands, expanding regulation and technology-fueled expansion opportunities,” explains Mark McKeon, global head of investment analytics and product strategy at State Street Global Exchange. “And, increasingly, they’re looking for a single partner to help them efficiently provide the next-generation services their clients demand.”

How have these forces combined to change the way financial institutions use outsourcing today? How are outsourcing partners balancing technology and expertise to meet investors’ increasing demands for portfolio transparency, regulatory insights and risk management tools? And how can managers glean even greater benefits from outsourcing, by using these partnerships to capitalize on strategic opportunities?

Outsourcing Today — What’s New?

As the financial industry has grown, the demands put on asset managers have intensified. Managers now face intense pressures on multiple fronts: a heightened risk environment, increased regulation, rising operating costs, a more diversified set of clients and an expanding field of complex investments to pursue.
A recent study that explored the investment management industry found that although demographic, economic and technology trends are expected to unlock capital across a new diverse set of investors, there are mounting demands that these investors will put on managers. Asset managers, in turn, are looking to their outsourcing partners to offer the right combination of technology, support and expertise.

Today, the outsourcing industry continues to thrive. According to an Ernst & Young study, the largest service providers in the industry experienced a 16 percent annual growth rate from 2010 to 2015. However, as clients become more open to outsourcing across a wider set of activities, outsourcing firms are expected to deliver capabilities they may not be equipped to generate in-house. The same study that examined the challenges and opportunities across the asset servicing industry found that the key differentiating offerings are client service (72 percent) and best-in-class technology (67 percent).

**Motivations to Outsource**

Pressured to do more with less while delivering sophisticated services and results to clients, asset managers are looking to outsourcing as a solution.

- **59%** Cut Costs
- **28%** Critical to the business needs
- **57%** Enable focus on core business functions
- **28%** Access to intellectual capital
- **47%** Solve capability issues
- **17%** Manage business environments
- **31%** Enhance service quality
- **17%** Drive broader transformational change

Source: 2016 Global Outsourcing Survey, Outsourcing accelerates forward, Deloitte, 2016. Study based on 280 executives from organizations of all sizes and footprints in the Americas, Europe, and Asia.

1 Wealth and Asset Management 2021, Preparing for Transformative Change, Roubini ThoughtLab, 2016. Study based on a survey of 2,000 investors and 500 investment providers across 10 wealth markets, in-depth interviews, and economic modeling led by noted economist Dr. Nouriel Roubini. The study was produced in conjunction with a diverse coalition of sponsors, including State Street Corporation.

2 New opportunities for asset servicing: Global Asset Servicing Study, EY, 2015.

3 Ibid.
“The demands facing financial institutions today present many challenges for service providers, but they also offer compelling opportunities,” says State Street’s George Sullivan, executive vice president and global head of Alternative Investment Solutions. “Going forward, successful outsourcing partnerships will be those that can achieve a balance between innovation and experience.”

In recent years, there’s been a heightened focus on the true potential of investment data and new and emerging technologies. Today’s investment environment is putting pressures on asset managers to deliver results using advanced data and analytical strategies. However, as data volumes grow, asset managers and owners have to manage a complex quantity of information to make smarter decisions and yield better results. In a 2014 study, State Street found that 78 percent of investors were planning to invest in data and analytics capabilities over the next three years.

State Street 2014 Data and Analytics Survey, conducted by Longitude Research. Study included a global survey of 400 senior executives at investment firms during October and November 2014. Respondents were from 11 countries and included insurance companies, private and public pension funds, fund-of-funds, foundations, central banks, endowments, sovereign wealth funds and supranationals.
There’s an accelerated shift toward outsourcing from all asset classes, and the alternative asset space is no different.

While outsourcing is not new to the alternatives industry, its adoption is gathering speed. Hedge fund managers have been most inclined to embrace outsourcing strategies, with 80 percent of hedge fund assets administered externally today. In contrast, private equity and real estate managers have run their operations in-house. But that trend is changing. Private equity and real estate managers are beginning to make the shift to outsource, and now represent the fastest-growing segments in the outsourcing trend.

One possible reason behind the increased outsourcing activity is the strong flow of institutional capital into private equity and real estate strategies. "With significant growth in the number and size of funds, many in-house operating models are no longer scalable," explains George Sullivan, global head of Alternative Investment Solutions at State Street. "We’ve seen a significant uptick in private equity and real estate managers outsourcing their fund administration."

As institutional investors remain committed to alternative investments, the trend to outsource appears ready to grow. With continued pressures, including greater demand for transparency and more sophisticated reporting, managers recognize the need for external specialist support.

---

8 New opportunities for asset servicing: Global Asset Servicing Study, EY, 2015.
As the industry comes to grips with a new data-driven world, outsourcing partners are making investments in emerging technologies, analytical platforms and data management solutions. The industry has seen an increase in the number of financial service providers acquiring technology firms to stay relevant and secure their position in the market.

Today’s outsourcing partners are in a much stronger position than in years past. Many have embraced the changing demands of the asset management industry and expanded their service offerings. Ernst & Young found that growth through innovative new product offerings is considered the top strategic business objective for asset servicers in the next three to five years. It’s clear why asset managers are trusting their outsourcing partners with a greater scope of services.

Outsourcing Tomorrow:
Smart and Strategic

The investments that outsourcing partners are making to their technology and expertise create opportunities for financial institutions seeking a competitive advantage. Most critically, firms should view outsourcing today as more than just checking a box on administrative tasks; it should be seen as a lever to drive growth and investor gains in the future.

There are five ways to move from simple to smart outsourcing:

1. **Take a step back**
   Strike the right balance between strategy and cost. Let your firm’s objectives lead you to an outsourcing solution that makes the most sense for your business. Do you have the data you need to run your business seamlessly? Do you want to be insulated from technological obsolescence? Do you want to redeploy resources to roles that contribute to alpha generation vs. routine tasks? Use your review of outsourcing as an opportunity to transform your ideal end-state. Regardless of the functions they ultimately outsource, leading fund managers have one thing in common: They’ve moved their outsourced relationship from “transaction processor” to “strategic business partner” and created an outsourcing strategy that makes sense for their business.

---

10 Cross-sector valuation: What financial service companies should consider when acquiring tech targets, PwC, 2015.
Don’t settle for just any partner
Once you determine what’s driving your outsourcing goals, match those priorities to the right partner or partners. Today’s outsourcing landscape means you no longer have to settle for a one-size-fits-all provider. Find a partner that understands your firm’s ethos and unique value proposition — and aligns with your business operations.

Choose a partnership that lets you flex your capabilities in a more agile way
Technology continues to advance exponentially, driving the need for new operating models. Intelligent data management is now vital to help firms keep pace and maintain a competitive advantage. Outsourcing functions like data aggregation and management can help firms focus on enhanced service delivery while continuing to offer new data insights that help their clients make better-informed decisions.

Outsource the work, not the control
A common misconception is that in order to outsource tasks, managers and firms must be willing to forfeit control completely. But in fact, you’re free to maintain as much — or as little — control as you prefer. A balance between transparency and micromanagement can be reached if you choose the right partner, create a comprehensive service-level agreement with contingency plans and maintain open lines of communication — especially when it comes to regulatory compliance. Make sure your outsourcing partner provides a controlled environment that mitigates potential operational risk — so you can achieve peace of mind without the need to look over your partner’s shoulder.

Return to what matters most
With a like-minded outsourcing partner on your side, you should be well-positioned to not only streamline operations and position yourself for greater value over time, but also move your firm’s strategy forward. You can refocus your attention and resources on developing relationships and delivering greater value to those who matter most: your clients.
While the trends that led to outsourcing haven’t changed, shifting market conditions and client demands are forcing managers and outsourcing partners to diversify their capabilities. Asset managers are responding to new challenges and pressures by outsourcing investment operations functions at all levels. Meanwhile, outsourcing partners are investing deeply in technology, service and expertise. This has enabled firms to build a structure for future growth while managing risk, resulting in streamlined processes, enhanced investor returns and better levels of client service. With operations better positioned to address today’s needs, firms are able to leverage outsourcing partnerships in new, more strategic ways — so they’re ready for tomorrow.

“The best partnerships are those that provide mutual benefit: The investment firm realizes critical efficiencies, while the outsourcing partner deepens its offerings and value to the firm over time.”

GEORGE SULLIVAN
Executive Vice President and Global Head of Alternative Investment Solutions, State Street
Learn More

For more information visit statestreet.com.
For more information, please contact:

NORTH AMERICA
Scott FitzGerald
+1 617 664 8207
srfitzgerald@statestreet.com

EMEA
Joerg Ambrosius
+49 89 55878 133
jambrosius@statestreet.com

APAC
Kevin Wong
+852 2103 0203
kevin.sc.wong@statestreet.com

Important Risk Information
Investing involves risk including the risk of loss of principal. The information provided does not constitute investment advice and it should not be relied on as such. It should not be considered a solicitation to buy or an offer to sell a security. It does not take into account any investor’s particular investment objectives, strategies, tax status or investment horizon. You should consult your tax and financial advisor. All material has been obtained from sources believed to be reliable. There is no representation or warranty as to the accuracy of the information and State Street shall have no liability for decisions based on such information. This document contains certain statements that may be deemed forward-looking statements. Please note that any such statements are not guarantees of any future performance and actual results or developments may differ materially from those projected. The whole or any part of this work may not be reproduced, copied or transmitted, or any of its contents disclosed to third parties without State Street’s express written consent. State Street Corporation, One Lincoln Street, Boston, MA 02111-2900.