



## GATEWAY INSIGHTS

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### # 17 The benefits of outsourcing for overseas fund managers

When working with overseas fund managers who have an interest in Australia we often get asked what are the barriers? What are the hurdles? Can we do this ourselves? Can or should we outsource everything? In this Insight we look at one way both domestic and offshore managers can make entry into the Australian financial marketplace easier, by using outsourcing as part of their market entry strategy. To discuss this topic of outsourcing, we're pleased to introduce our second guest author, John Williams, Managing Director of Lumina, Australia. Lumina provides specialist outsourced accountancy and advisory services to domestic and overseas fund managers and is based in Sydney.

#### **Some of the challenges for fund managers.....**

Start up, and smaller fund managers while facing major challenges from a volatile market, could also be unwittingly risking breaches of their AFS Licence (**Australian Financial Services Licence**).

During the global financial crisis when a hundred billion dollars were wiped off the equity market in a single trading day, it highlighted the need to pay attention to management fee structures, capital adequacy and the regulatory provisions of an entity's AFS Licence.

During the crisis, the management fees of fund managers were affected in three primary areas:

1. The lower value of funds under management (**FUM**) from falling prices;
2. The lower value of FUM which results from the flow of funds from equities and property to cash; and
3. Lower performance fees a consequence of falling fund values.

In absolute terms, the bigger the manager, the bigger the hit to fund valuations they will take. However, for managers with over \$1-2 billion FUM, their size alone often acts as a natural hedge.

In a volatile market, start up, and smaller, fund managers face far greater risks. These smaller funds, in particular, can see their limited resources stretched by competing demands.

The most immediate risk is that falls in FUM valuations and management fees could place capital adequacy provisions under pressure, which could in turn lead to breaches of AFS licences.

In the process of building their brands, smaller funds typically have a greater weighting of their income derived from performance based fees. Accordingly dramatic falls in equity and/or commercial property prices have a greater impact on revenues of start up and smaller

funds. For many, this can put enormous pressure on both their profitability and balance sheets and in some circumstances, their ability to meet the terms of their license.

A key challenge for smaller and start up funds is their relatively high proportion of fixed cost bases. The natural hedge of large fund managers is that they are more able to reduce their costs as the scale of their operations increase.

### **Different approaches to outsourcing**

Due to their relatively higher fixed cost bases, small funds need to examine strategies which result in costs which are correlated, or flexible, to their income. The great majority of fund managers are savvy to the potential cost savings provided from outsourcing. Many funds are benefiting from outsourcing middle office functions, such as fund registry, fund administration and fund accounting, as well as custodian services for fund assets and there are some well known names in this space providing high quality services. However, the industry has lagged when it comes to embracing outsourcing for the funds management entity.

There are two key advantages to small funds which outsource the accounting functions of the fund management entity. Overall costs are reduced because outsourcing gives you the flexibility to adjust costs to the scale of the operation. Equally importantly, it allows small funds to focus on building FUM and their offering without the worry of the finance function and regulations. Compliance extends well beyond ASIC's AFS Licence requirements, it also includes compliance with Australian Taxation Office regulations, Offices of State Revenue, the Australian Stock Exchange and, for a growing number of fund managers, overseas compliance, such as the United States SEC regulations.

Most companies pursue outsourcing to not only realise immediate and sustained cost savings but to implement solutions to improve cash flow, achieve real business outcomes, to drive top line growth and in the specific case of the funds management industry, to assist with compliance.

### **Some facts and figures...**

According to survey results from the International Association of Outsourcing Professionals (IAOP) released on 15 April 2010, outsourcing has established itself as a strategic management practice that leading companies around the globe (not just in funds management) are increasingly using for high-value, knowledge-based processes.

Among the key findings in the survey:

- **Outsourcing Becomes More Strategic:** Strategic issues are playing an important role in outsourcing decisions at most companies. In January, about 50 percent of respondents indicated that greater business flexibility and preparing the company for future growth have become more important reasons for them to use outsourcing.
- **C-Suite Driving Decisions:** Outsourcing decisions are being made at higher senior executive levels, the results show. Two-thirds of respondents indicated in January 2010 that senior executives were increasingly involved in outsourcing versus only 13 percent who said that senior executives were less involved.
- **Smarter, Skilled Profession:** Knowledge-based outsourcing is becoming more important to companies and the industry is filling this demand. In both the northern hemisphere autumn of 2009 and January 2010, 40-plus percent of respondents indicated that the outsourcing at their organisations was increasingly focused on knowledge-based activities compared to less than 30 percent who said they were increasing the outsourcing of lower-skill level positions.
- **Rapid Technology Adoption:** Cloud computing and SaaS are being examined by 88 percent of outsourcing customers surveyed in January and 66 percent of providers are exploring these technologies for the delivery of services to their customers.
- **Bundling Services:** This January, 45 percent of survey participants stated that their company was more focused on bundling services with fewer outsourcing services providers versus 18 percent who indicated that they were doing more multi-sourcing.<sup>1</sup>

## **Advantages of outsourcing**

Until recently, outsourcing has been about taking existing processes and running them elsewhere at lower costs – a concept known as “labour arbitrage”. Increasingly though, senior management recognises outsourcing as an efficient and effective way of continually tapping into the right expertise.

By outsourcing the accounting and finance functions, senior decision makers:

- Have more time to focus on their strategies and competing effectively;
- Have ready access to the real-time data that stakeholders increasingly demand;
- Are able to access clear, concise, flawless information as a result of proven internal control systems, transparency and expertise;
- Can be confident that the business continues to meet Australian compliance requirements;
- Have access to trained and experienced staff; and
- Have better anticipation of operating revenues and costs.

## **How does it work in practice – an example**

Established in the US in the early 1970s, this company is one of the largest specialist fixed-interest managers in the world. Lumina has provided full-service financial management to this highly successful member of the Australian financial community since 1999.

Lumina manages their Australian finances because of the complex and highly regulated market and compliance issues that must be addressed in order to have an Australian presence. Lumina not only ensures that the company fully meets its obligations on time and to the letter of the law, gives advice on a full range of issues such as salary packages for key individuals, and effectively delivers to management detailed reporting around other matters that they would find difficult, if not impossible, to resource in-house.

A key benefit of this arrangement for the company is that their relationship with their auditors is as efficient and cost effective as possible.

As the company’s Managing Director in Australia has publically stated “Australia is a substantial market for [us], but the country’s regulatory and compliance systems are complex. Given the billions of dollars we work with here, the regulations certainly cannot be taken lightly. By relying on Lumina, we can be confident that our financial management requirements are being fully met. That frees up our people to focus on maximising returns for our investors.”

## **Summary**

Outsourcing success is based on long-term, strategic relationships with established companies specialising in their field of expertise.

Gateway believes that consideration of outsourcing of services for overseas fund managers wishing to enter the Australian market should be a key priority. Service outsourcing can cut costs; ensure your business is at the forefront of technical innovation; improve output through optimising business process; and increase competitiveness through reduction in costs and allowing talented fund managers to focus on what they do best.

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<sup>1</sup> IAOP Press release dated 15 April 2010 “Outsourcing Being Used More Strategically for Higher Knowledge Processes, IAOP Survey Shows”.