Future operating models and co-sourcing considered

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1. How to choose an operating model that fulfils your business needs.

2. 6 potential benefits, no matter what type of outsource model you choose.

3. Considering the pros and cons of outsourcing and co-sourcing.

Seven out of 10 C-suite executives surveyed in the Private Funds CFO Insights 2024 said their funds are outsourced to a specialist provider.

This trend is unsurprising given the growing complexities around fund administration, increased regulation and advancing technology – not to mention growing LP demands. But not every manager wants to fully outsource, with co-sourcing emerging as an alternative operating model for some private fund managers, as Paul Watson and Lynne Westbrook now explore.

Fund administration has historically been a binary choice for managers – either perform the work in-house or outsource operations entirely to a third-party service provider. And while these options are still on the table, so too are more nuanced options such as co-sourcing, where tasks are performed by teams from external providers, but with some or all of the work performed using the fund manager's own technology and processes.

In-house vs outsourcing vs co-sourcing

Whether a fund manager completes its own fund administration in-house, outsources it entirely, or adopts a co-sourcing variation, there are different factors to consider.

Completing administrative tasks **in-house** means a fund manager stays in control of their processes, providing them with access to their funds' data quickly and efficiently, meaning they can deal with performance and other data-related investor queries at speed. But as funds grow, so the administrative and controls burden grows too, which can dilute the manager's ability to focus on their key value-add activities like investing.

Outsourcing meanwhile allows the fund manager to move functions out of their organization to an external service provider, allowing for scalability – of cost, technology and resource – as their funds grow. This removal of the administrative burden allows managers to focus their energy on value-add activities such as portfolio management and value-creation.

With **co-sourcing**, a fund manager appoints an external service provider to execute administrative duties for them, with some or all of the work being completed on the fund manager's own systems and processes, effectively keeping their data in-house. The fund manager benefits from outsourcing the work to a specialist team with broad industry knowledge and a robust control framework, while retaining control of their data in-house. In the age of efficient data consolidation and transfers via APIs, this shouldn't be such a concern of course. Managers just need an efficient method of receiving and ingesting data for their information needs.

In both outsourcing and co-sourcing models, the primary objective should be that the third-party becomes a trusted partner to the manager, acting as an extension of the manager's in-house teams.

How outsourcing and co-sourcing differ

Outsourcing involves a fund manager appointing a third-party service provider to undertake certain activities relating to the day-to-day operation of a fund, such as client take-on, fund compliance, management of drawdowns and distributions, fund accounting and reporting. The third-party team will have expertise in private markets and can therefore suggest improvements to processes and technology. The scope of the role is as narrow or as broad as the manager determines and can range from delivering specific services to support an in-house back-office team, to providing most or all the back office and operational support necessary for a fund to function. Essentially in a comprehensive outsourcing model, the external provider would complete all the required work on their own systems, before returning the agreed deliverables to their client.

Co-sourcing allows a fund manager to engage the skills and expertise of an outsourced provider, with work completed on their own in-house software instance. This allows the manager to retain control of their data internally, while still leveraging industry and regulatory experience of an expert service provider. Co-sourcing can appeal to fund managers nervous at the prospect of fully outsourcing, to get them used to the concept of working with an external provider.

The case for co-sourcing

Co-sourcing isn't for everyone, and sometimes can be used as a stepping stone to a more comprehensive outsourcing arrangement. Co-sourcing can be a good interim step on a longer-term journey to outsourcing, where the administrator gets a flavour for the workload and complexities while working out a transition strategy, giving the manager immediate traction while not immediately engaging in a long conversion process.

There are several reasons why fund managers do turn to co-sourcing:

Sharing of IT support – a fund administrator will rely on the manager's IT support to maintain its systems. Issues can be picked up quickly by the managers' IT teams, so that any impact to workflow is visible to both parties. However, it remains the responsibility of the manager to keep their systems current and do risk assessments as in a co-source arrangement the administrator is not in control of upstream or downstream staff, and not aware of other system implications, interactions or cost constraints. Whether a co-sourcing or outsourcing model, the manager should look to the third-party to help identify best–practice on the use of their systems.

Consistency of work outputs – data produced by the administrator will be delivered in a format which matches the manager's expectations and requirements, ensuring a golden source of truth is established and maintained on the manager's systems.

Human capital – the focus for recruiting and retaining talent is maintained by the administrator. Fund managers can recruit staff specifically for checking work provided by the outsourced provider, and for other value-add services, rather than to complete the processes, knowing that the administrative talent will be provided by the administrator. The administrator is better positioned to manage peak workloads.

Close relationships between teams – as is often the case with strong outsourcing relationships, the administrator's teams will work side by side with the fund manager's, becoming an extension of the in-house function. This allows for two-way communication and speeds up interaction as there is less of a requirement for formal communications, allowing for more realistic timeframes and expectations to be set.

Control framework – the fund administrator will use its own control environment, ensuring all work is completed under the remit of its own control assurance framework, for example as evidenced by its ISAE 3402 qualification, or equivalent. However, it is worth noting a fund administrator's control system will cover all the operations undertaken by the delivery team and cover any IT systems that are governed or owned by the third party. Where a partner accesses a manager's IT system, the manager must have their own IT control system in place.

LP access to data – with fund managers able to access their own fund data in real-time, they can provide responses to any investor queries received.

To outsource or to co-source – some considerations:

There are a number of factors you should consider when deciding on the right operating model for your business, as summarised in the table below:

	Outsourcing Model	**Co-sourcing Model**
Description	Full outsourcing of administration activities, utilising the technology of the third-party administrator.	Full or part outsourcing of administration activities, operating within all or some of the fund manager's technology stack.
Staff	Fund Administrator.	Combination.
Technology	Utilising fund administrator's full technology stack, meaning less operational effort for the fund manager.	Platform agnostic service delivery channels. Combined use of fund administrator and fund manager systems, allowing the manager to maintain control over technology and data. Manager carries responsibility for ensuring systems are kept up to date.

Data Accessibility	**Medium Complexity** as data can be shared through APIs, a key area of focus for Aztec.	**Low complexity** as using fund manager's in-house systems. There is a risk however, that the administrator will need to pull data from the system to enrich it, should the fund manager's system not have the required functionality.
Process Optimisation	Administrator's responsibility, a significant area of focus for Aztec.	Fund manager's responsibility. Split processes have inherent inefficiency and can be challenging to optimise.
Ongoing Investment Commitment	Ongoing investment in people, process and technology is the sole responsibility of the fund administrator.	Provision of staff is the administrator's responsibility, as is the investment in people. Investment in technology would remain the responsibility of the fund manager, the burden of which – in hosting IT systems, keeping up to date with moving technology and regulation – should not be underestimated.
Cost Implications	**Lower** – the fund administrator will benefit from economies of scale that an in-house service would not. Third-party fund administrator fees are also considered chargeable to LPs.	**Higher** – fund administrator fees can be charged to LPs, but infrastructure spend cannot. No economies of scale running a single client platform. Cost of technology can be high for the fund manager.
Implementation Complexity	**Low/medium -** A good fund administrator will have onboarding expertise, although the transfer of existing funds may be more challenging than the establishment of a new fund.	**Low/medium** – There will be some complexity for the fund manager in transferring processes for an existing fund to the administrator. **Low** – Less complexity in establishing processes for a new fund directly with the administrator.
Control framework	Full ability for the fund manager to take advantage of the fund administrator's control framework i.e., ISAE 3402.	Restricted ability for the fund manager to take advantage of the fund administrator's control framework (i.e., ISAE 3402). Controls can be costly to establish, run and assure.

The decision between outsourcing and co-sourcing isn't a binary choice. Developing and implementing an out- or co-sourced operating model should be a collaborative discussion between the fund administrator and the fund manager, and one that can be tailored specifically to the needs of the fund manager.

Whether you're considering a co-source or an outsourced model, we would be delighted to talk to you about developing an operating model which works specifically for your business.