Co-sourcing:

Retaining control in an outsourced world

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MANAGERS face increasing pressure to reduce costs, thus fueling an outsourcing boom by institutional and alternative firms. Fortunately, buy-side managers are not on the vanguard of this shift, as Tier 1 banks have established and refined outsourcing models. We can think of the evolution of the outsourcing model in terms of three waves. First, outsourcing was functionality-specific. Providers would take over a singular aspect of the business such as reconciliations, pricing or investor reporting. While this approach offered increased efficiency and reduced costs, the result could be disjointed; integration issues, processing bottlenecks and misaligned expectations were typical. Frustration over these point solutions led to a second wave of all-inclusive, "manager-in-a-box," or total middle- and back-office offerings. With this approach, firms lost control over processes and technologies, and a one-solution-fits-all mentality pervaded. This was particularly problematic for established managers who had come to rely upon their own, fit-for-purpose solutions. The current, third wave in outsourcing is a co-sourcing paradigm that increases efficiency while eliminating the prior difficulties of retaining control.

☐ Geography matters [1]

Offshore locations—primarily Middle and East Asia—have become synonymous with the first two waves of outsourcing. With firms being able to deliver software cheaply, quickly and to a relatively high standard, the cost/benefits of offshore development outweighed the logistical disadvantages created by distance. However, employees are becoming increasingly disgruntled with the inconvenience of working with faceless teams in distant lands and time zones. More and more cracks are appearing in offshore models. Foremost among these are:

Staff costs are rising at a startling rate with no signs of decreasing. Historically, software developers in India earned one fifth of the salary of a similarly skilled engineer in one of the global financial centers, yet annual wage inflation for top software engineers in India now ranges from 16% to a staggering 30%.

Low staff retention is negatively impacting productivity and increasing delivery failure risk, with annual turnover approaching 25% in some organizations.

Time-zone fatigue is affecting morale and retention of top talent. Employees working in New York and London have spent a decade waking up to very early morning conference calls or staying up late for virtual meetings with their teams in India. The requirement to work off-hours in order to align to a working day in a distant time zone is wearing out IT leadership. This fatigue impacts the quality of relationships across the global team and increases delivery risk.

Erratic delivery performance in India has been a constant concern. While some firms have managed to produce repeatable successes, many have been unable to consistently execute IT delivery on-time and on-budget when their teams are half a world away. In some cases, firms report a 40% productivity reduction due to lack of time-zone alignment.

☐ Co-sourcing, a new outsourcing solution

These problems illustrate the increasing difficulty and reduced return on investment associated with traditional outsourcing models. We are currently witnessing an influx of interest in development services from countries that lie between traditional offshore locations and global financial centers. These "nearshore" locations offer many of the cost advantages and political stability of the traditional offshore development centers but with the added convenience of increased time-zone alignment and cultural synergy. Vendors who operate in a firm's local time zone and local language are ideally suited to act as a virtual extension of the firm's organization.

In the co-sourced model, firms use a combination of onsite, onshore, and nearshore resources for their technology and processes, letting vendors assume product support and development for both custom and purchased applications. This allows a company to continue utilizing its fit-for-purpose technologies, retain transparency and control over processes, and benefit from the cost reductions offered by outsourcing, while the co-sourced vendor does what they do best—provide low-total-cost technology services.

☐ Retaining control

Managers can effectively reduce costs via a nearshore co-sourced model, but they must also exhibit greater control over process and data than ever before. Vendors offering regulation certification can assist greatly in this task; however, the ultimate responsibility for compliance still remains with the manager. In this regard, co-sourcing shines above all other outsourcing paradigms, where the provider's services are a black box to the firm. In the co-sourced paradigm, rather than relying on vendor certification, the firm outsources technology, thus reducing cost, but still utilizes their own fit-for-purpose systems to hold on to control and transparency over operations.

GFT's Alternative Investment Practice provides technology and operational consulting services to hedge funds, prime brokers, asset managers and fund administrators. With over 3,000 financial IT professionals, we provide co-sourcing services from our nearshore locations in Brazil, Costa Rica, Spain and Poland.

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