IMpact: An investment management podcast series

Episode 4: Insourcing vs. outsourcing: Considerations for the investment management industry as it navigates this decision

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Reese Blair: *Hello, everyone. I'm Reese Blair, your host of IMpact, the new investment management podcast series from Deloitte. IMpact brings you hot takes and fresh perspectives from top experts in the industry. Whether we're discussing issues like regulation, recession, or resiliency, we'll take a deep dive into the latest news, trends, and challenges facing investment management professionals. Our mission is to help you focus on investing in what matters. So, tune in, learn something new, and walk away with insights that will help you make an impact on the IM industry and the world around you.*

Reese Blair: Welcome back, IMpact podcast listeners. Thank you for tuning in to another deep dive into the world of investment management. Today, we're tackling a decision that I think keeps operations leaders, portfolio managers, and even some C-suite executives up at night: Should you develop capabilities in-house or leverage external expertise?

From boutique hedge funds to global asset managers, the choice between insourcing and outsourcing can fundamentally impact everything, from trading operations to middle-office functions.

I am excited to explore this with someone who's been at the forefront of operational transformation in investment management. Podcast listeners, please welcome James Kearney, a managing director at Deloitte, who spent decades helping investment firms optimize their operating models.

In addition to Deloitte, Jim has worked with some of the industry's largest players, guiding them through critical decisions, like whether to build proprietary trading and ops solutions in-house, or partner with technology providers to structure their operational backbone for scale.

Jim, thank you for joining us on the IMpact podcast. I know our listeners are eager to hear your perspectives on how firms can make smarter outsourcing, or insourcing, decisions in today's complex investment landscape.

James Kearney: Thank you, Reese. I'm really happy to be here.

Reese Blair: Now, Jim, I teased it a little bit in my opening remarks, but I was hoping that maybe you could share a brief introduction of yourself to our audience.

James Kearney: Sure, of course. Like Reese mentioned, I'm a managing director at Deloitte, and while relatively new to the organization, before joining Deloitte, I spent 32 years at a top 10 asset manager. During my career, I've built and managed large global organizations. I focused on processes, optimization, especially within the middle-office and back-office functions.

A couple of things that I'm pretty proud that we did include developing a global investment operations function in which we had to navigate complex operational regulatory environments across multiple jurisdictions, and we implemented a lot of new technology and ended up outsourcing some key capabilities to be able to build scale and be able to have more opportunities for the organization.

Reese Blair: That's incredible, Jim, and I know that's one of probably tons of stories that your three decades of experience are going to bring to bear here in the conversation. I'm really looking forward to you sharing some of those stories with us today.

But before we dive in, just so that everyone is on the same page, I was wondering if maybe you could provide a brief background on how you would define insourcing and outsourcing.

James Kearney: Sure, of course. So, as the name kind of implies, insourcing involves utilizing internal resources, capabilities, technology to perform a function or a task that's key to the organization. The approach lends itself to internal development and investment within the organization and leads to better control over processes and outcomes.

Outsourcing, on the other side of the coin, involves contracting external organizations to help certain business functions and tasks. This can provide organizations with access to special skills, industry resources, technology, or other things that they either don't currently have, don't feel like continuing to do, or don't have the opportunity to avail themselves of.

Reese Blair: Thank you, Jim. I can imagine that the thought process of whether to go down the route of insourcing versus outsourcing could be overwhelming for some, so maybe wondering if you could share where do you think companies should start when they're thinking about making a decision between insourcing and outsourcing?

James Kearney: Sure, of course. Before an organization really looks at the insourcing-outsourcing question, I always try and get people to look internally first. Consider your broader business strategies.

What core capabilities do you have that support that strategy, and what can you be great at? What can you excel at? What can you be world-class at, and what do you do that sets you apart from everybody else?

Once you know what's most important and what you can be great at, you start to realize what you want to retain (i.e., insource), what you want to make sure you invest more on, but also that starts to give you a line of sight into what can be distractive—what you really don't want to do, what you're not going to be able to be great at.

And therefore, that starts giving you a beat on where are the areas you might want to really start looking, is there an opportunity to be able to do outsourcing.

Reese Blair: That's really helpful, Jim. I love that notion of starting on the inside first, asking yourself those thought-provoking questions. I really think that's a powerful way to begin the conversation, and really, a good place for leadership to start in this conversation. So, let's take this a little bit further. What would you say are the main opportunities that are presented by outsourcing?

James Kearney: Of course. So, outsourcing, first and foremost, can definitely give organizations a greater opportunity and more agility across the organization. You can get access to expertise. You might be able to find some cost efficiencies. Definitely scalability is something that comes into mind when you're thinking about outsourcing.

Some things, like we were talking about before, to keep thinking about though are what functions are not core to your organization and can be handled more efficiently by that external provider? Is there something that you don't do very well that you can find a provider who does do very well? Or is there certain specialty technology or expertise, things of that nature, that you currently don't have, and it's really not worth the effort or it's not feasible for you to be able to get into that space? Is this somewhere where a provider can help you there?

Reese Blair: Jim, it sounds like there's some common themes across both insourcing and outsourcing that I probably want to break down in detail a little bit more. We talked about cost, we talked about technology—maybe, let's zoom in on ownership and accountability, because I'm sure those are two common themes that we probably want to unpack for our listeners.

And so, I'd be curious to get your take on what the pressure points may be in each of the insourcing and outsourcing operations model when you think about ownership and accountability.

James Kearney: Sure, of course. So, ownership and accountability are always huge ideas and things that organizations have to be thinking about, and they need to be managed on a continual basis.

When you think about a controllership model and you think about what you can do from an operating perspective, one thing you want to do is that in an insourcing model, you're naturally going to have more control.

You're going to have more control over the process, you're going to have an easier time tracking metrics. You're going to be able to assess performance and be able to react to things that come up and provide feedback in a much more meaningful way because, obviously, you have all of the control. You own everything from the beginning to end.

As you might assume, in an outsource model, you need to rely on not just a controllership model but also an oversight model. And that's going to require a lot of communication and planning to coordinate with whoever your partner's going to be, and you're going to have to be able to have a feedback loop within your organization and the organization of the partner to make sure that you can track the appropriate metrics, assess performance, and provide feedback. But it's going to be with a partner.

So, it's not just within your own organization; you have to be able to do that in partnership with the other provider.

Reese Blair: That's really helpful, Jim, and it's so interesting because I've been hearing so much from various clients that I serve around this concept of exploring the evolution of their controllership model, and so that's been something that I know is top of mind.

And again, coming back to those themes (we talked about cost, technology, ownership, accountability), I want to tease on the intersectionality of controllership models and technology. How would you say insourcing and outsourcing impact maybe the consideration of a controllership model with the use of technology? How does technology come into play?

James Kearney: When you think about technology, just with anything, there's a total cost and there's a lifetime cost, from what it takes to acquire the technology, to maintain it—and not to mention the training, systems users, upgrades—all the things that go along with when you own any kind of asset. You have to be able to utilize, you have to be able to maintain it.

However, you also have to think about other things. The ability to be able to keep that technology not just up to speed, but also think about regulatory changes, thinking about optionality, customization, all the things that go into there.

On the other hand, if you outsource and use technology from a provider, it can give you the ability to be able to leverage specialized expertise, industry experience. In large organizations, we often see a hybrid approach where some technology ownership is internalized, and some technology ownership is externalized.

And it really does play into (going back to that core principle about what can you be great at) what technology do you need to be able to perform those core functions, and what technology is better in the hands of somebody who is outside of your firm and has that technology as part of their core capabilities.

Reese Blair: Thank you for sharing that concept and really unpacking that for us, Jim. I can't emphasize that enough. I mean, the notion technology ownership, it could be a burden, and it could be something that could also be a game changer and a differentiator for you. I think that's something to keep in mind, and thank you for sharing your perspective on that.

Maybe I want to pivot a little bit from talking about technology and maybe thinking about additional challenges that companies may face when trying to explore the options of insourcing versus outsourcing. And I maybe want to focus this pivot around maintaining quality controls, especially when you're trying to scale your operations.

So, maybe hum a few bars for us on what would companies face when trying to maintain quality control while scaling their operations within the insourcing and outsourcing context?

James Kearney: Sure, of course. For both operating models, there's a challenge of global teaming and trying to coordinate between different time zones. I've followed some models where you had different time zones combined together with 24/7 coverage—communication, collaboration are paramount. As we talked about before, controllership and quality go hand in hand. So, ownership and accountability needs to grow as the business scales and the capability scale accordingly.

Reese Blair: So, Jim, again, let's keep teasing this out. How do you think some of these challenges can potentially be addressed?

James Kearney: I think recognizing the importance of a good partnership and constant engagement is key to maintaining either operating model. Whether the partnerships and the coordination is internal or external, you need to be able to make sure that you have the ability to understand what's going on, especially when you think about the follow-the-sun model, or working with multiple third parties.

There needs to be an intentional planning and coordination of handoffs, SLAs, who's going to do what, what you can expect from each other. And where you're giving up ownership, you need to also understand, like we talked about before—you're not giving up accountability.

So, interacting with your counterparty; collecting and analyzing performance metrics, quality metrics; understanding and giving feedback on the performance of your partner is paramount in making this effort work.

Reese Blair: Thank you, Jim, I appreciate that. I mean, we've addressed some of the tangible considerations of exploring an insourcing versus outsourcing model. As we wrap up our conversation here today, last but not least, I'm just wondering maybe what are some of the intangible considerations of the insourcing and outsourcing model? What would you say folks should be thinking about or potentially considering as it relates to intangibles?

James Kearney: I think that in addition to what we stressed about communication and business objectives, organizations should also consider the importance of cultivating growing firm culture, motivating personnel while holding them accountable, and an adjustment in the compensation models.

The latter two are especially key components of controllership model and either or both the insourcing or the outsourcing model.

Further, the organization should consider whether employees or potential hires are developed as specialists versus generalists. Specialist roles could potentially benefit from insourcing model as organizations develop expertise in-house. On the outsourcing model, you might find a more generalist role, and you might find that people are more generalists and are being enabled by the outsource provider that you choose.

Reese Blair: Couldn't have a conversation about insourcing and outsourcing without touching on human capitals. Jim, thank you for starting to take us down that path of thinking about specialists versus generalist roles. Very thoughtful and very insightful.

We're going to wrap up here shortly, Jim, but before we do, I wanted to get your take on what would you want our listeners to glean from this conversation? What would you say is the most impactful observation, if you will?

James Kearney: I think I would say that in both insourcing and outsourcing models, commitment and dedication are a big piece of what you need to do, regardless of the model you choose. There's never really a right answer; it's very much like what makes sense for the firm and going back to those key principles about what do you want to have core and what don't you want to have core.
Regardless of what path you take, or whether you go and how far from an insourcing or outsourcing model you go, you need to always remember: While you can give up responsibility to a partner, you can never give up accountability. You'll always be accountable, and you need to make sure you take that very seriously.

Reese Blair: Well, Jim, that brings us to the end of today's discussion on the strategic choices shaping investment management operations. I want to thank you for sharing your insights on how firms can thoughtfully approach the insource-outsource decision. The concept of ownership, accountability, technology costs, all resonate with me and, hopefully, they do with the audience as well.

Speaking of which, to our listeners, remember whether you're building internal capabilities or partnering with external providers, the key is aligning your sourcing strategy with your firm's core competencies and growth ambitions.

Until next time, this is the IMpact podcast. We're not just spending time; we're here to invest time in the ideas that matter. Thank you for listening, and as always, keep making an impact.

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