InsideOps | Insights for Asset Management Operations Leaders

Optimizing a Middle Office Outsourcing Proof of Concept

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The asset manager's middle office is a vital part of the investment management process, responsible for verifying trades are processed in a timely, accurate manner and providing the front office with the information it needs to execute its trading strategy. It often supports business functions such as trade operations, performance measurement, attribution, risk, cash and collateral management, portfolio accounting and information delivery.

A middle office outsourcing arrangement forces the asset manager to consume the service provider’s data output. Assessing potential service providers is largely about the target operating model, service levels, interactions and handoffs between parties. However, it is also important for the asset manager to understand the technology that underpins the service, which can be a key differentiator and should be factored into the end decision.

### Pivot to the New

The focus on technology during an outsourcing assessment centers around the service provider’s ability to generate and deliver timely and accurate data to support the front office investment process. Historically, this has been validated through a due diligence process that begins with an RFP or RFI, followed by a more thorough review of the service provider’s capabilities. With the latter, the service provider demonstrates how its capabilities align with the asset manager’s requirements. Many asset managers are now taking this one step further and insisting that service providers actually prove the underlying platform can support specific use cases in the form of a POC. This next level of due diligence provides assurance that the service provider and its underlying technology will function as described. This also effectively minimizes the risk of critical gaps or potential service level degradation surfacing in the future.

Through a POC, asset managers gain insight into how the service provider’s core systems will support specific scenarios. They also gain exposure to data output along with the method in which they will be interacting with the data, and experience firsthand interactions with some of the people who would be supporting their business in the future. Conducting a POC during an outsourcing assessment can be mutually beneficial to both parties. The service provider has an opportunity to showcase its technology as well as its people. It also has a chance to gain a deeper understanding of the asset manager’s profile and business requirements, such as account structures, data aggregation, or unique performance measurement calculation methodologies.

### Considerations

Although there can be benefits to a POC, both parties need to weigh the cost against the expected results. As an asset manager, it is important to understand the expected outcomes versus the resources required to complete the exercise. The POC is best used to validate a small, prioritized, representation of some of the most sensitive business scenarios. If the service provider has made it through the initial RFP/RFI and an extended due diligence, it should have already demonstrated that it is capable of supporting the majority of use cases which are common across their existing client base. Therefore, we recommend firms apply the 80/20 rule and focus the POC on the subset of scenarios that represents the greatest operational risk or are the most unique.

Creating a like-for-like compare is not always achievable, therefore it is also important to understand the environment in which the POC will be conducted. Does the environment represent the production environment? If not, what are the important differences that will alter the results? Are the resources supporting the POC representative of the business as usual operations staff? Does it measure results as well as the mechanism and ability of the service provider to deliver them? Having clearly defined expectations of these important questions in advance of POC execution will help to rationalize and quantify the results in the end.

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The Proof of Concept (POC) has long been included as a standard step in the technology selection process as a way for vendors to prove they can do everything they promise.
Asset Manager’s Role

Asset managers should prioritize testing in areas that may require additional vetting. These may be the most sensitive and unique business cases, scenarios which occur daily that require further validation, or areas that have not been thoroughly vetted to date. To try to ensure meaningful results, it is important to clearly articulate expectations and confirm alignment around success criteria prior to the POC. Coming out of the exercise, asset managers will want to leverage pre-determined success criteria that can help to quantify and qualify the output.

Resources are a major component of conducting a POC. It is important to identify a healthy mix of individuals representing business and technology that will be responsible for coordinating tasks, preparing the data, and reviewing and evaluating output against expected results. Business and technology stakeholders should have shared expectations for final outcomes. It is also essential for the asset manager to have a defined set of expected results that can be measured against data sets or reports supplied by the service provider.

When considering executing a POC with multiple service providers, it is important to have a consistent point of reference while comparing the end results. Without a common set of use cases upon which to evaluate each service provider, the results can be inadvertently skewed towards one over another. With that said, through due diligence, the asset manager may identify potential gaps with a particular provider that may justify the need for service provider specific use cases.

Service Provider’s Role

The goal of the POC is to help get the asset manager comfortable with both the service model and the underlying technology. There should be an alignment between both parties of success criteria so expectations are known going into the exercise and evaluation criteria is clearly understood. It is important for service providers to share known limitations in advance with the asset manager; honesty is always a best practice. If expectations are misaligned from the beginning, the likelihood of a successful POC is reduced and the prospects of a long term relationship are diminished.

For service providers, this is an opportunity to showcase its people and technology. Having resources who are knowledgeable, responsive, and understand the use cases is necessary to present the provider’s entire service. A POC can be a representation of the company culture as much as it will demonstrate operational and technology capabilities.

Utilization of a standardized approach by service providers has potential benefits. Having a predefined framework that details the overall approach, including how to deliver data that will be configured to execute against specific use cases, will help to facilitate the process. Having a dedicated environment that is fully integrated with client facing applications, such as report generation and data extraction tools, can create the hands on experience asset managers are looking to receive during a POC. If parts of the proposed solution are missing during POC execution, this can potentially reflect poorly on the service provider’s offering.

Conclusion

A POC is an input into the decision making process that can be used by asset managers during the due diligence process as another tool to help define the future operating environment. POCs have evolved from software solution assessments and have brought added value to a service provider outsourcing assessment. Through use case validation, limitations in technology can come to light or service gaps can be defined, which would help to mitigate future risks.

In addition, the asset manager should be evaluating less tangible results, such as whether the service provider will be a good cultural fit, industry knowledge of the staff, professionalism, general preparedness and validation of the service provider’s ability to support the potential for evolving investment strategies.

Most outsourcing arrangements are, by nature, long term. Therefore, it is important to learn as much as possible about both parties. Due diligence provides the opportunity to discuss capabilities and operating models, while a POC offers the ability to further validate specific high touch scenarios which will ultimately help lead to a more informed decision. Having a clear understanding of service provider capabilities allows the asset manager to design an operating model that is based in reality and has the potential to evolve over the course of a long partnership.

Using a Proof of Concept when assessing service provider options

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