

Guide to Outsourced Finance & Accounting for Investment Management Firms:

The Finance as a Service solution

Alternative Asset Managers face a pressing dilemma. Their focus is rightly on managing their investments and relationships with investors, but they still need to fulfill their duties and responsibilities for their own management company. And if such duties are postponed or under-managed, the fallout, from regulators and investors alike, can jeopardize the success of the entire firm.

This article examines how Investment Managers can tackle the finance function for their own management company, with a focus on the burdens and benefits of the various options. Many Managers begin using some in-house solution, eventually migrating to rely on an outside firm or adding it to the lists of a duties for a fund administrator. But a third option is growing in popularity: outsourcing the finance function, by using a “Finance as a Service” model.

And for any investment managers about to launch a fund, or who are relatively nascent in their evolution, the clock is ticking. The right choice for serving the finance function of the management company can mean the difference between establishing best practices early, the kind that allow the finance function to stay nimble and responsive for the life of the firm or facing the consequences of bad habits. Habits that began when the Firm chose the easiest solution, rather than one that truly suited their needs.



Option 1:

Keeping the numbers (and burdens) in-hand

For many alternative asset firms, managing the finance function in-house feels like the most natural solution. Managers at such firms pride themselves on running lean operations, and many of their founders have the legal and financial expertise to tackle the accounting and administration themselves. In the early days of the fundraising drive, the thought of bulking up with staff or reaching out to a service provider can feel like a luxury.

Some Managers might even conclude it's their responsibility to handle the accounting and finance function, feeling more secure in keeping the books, literally, close to their vest. There's a sense of security in owning the task, and ensuring that it's performed exactly as the founders believe it should be.

However, the workload for raising an investment fund, and eventually managing it, interfere with making the management company's own finance function a priority. Most other responsibilities will take priority over handling the books: due diligence on new investments, building and fostering relationships with investors, managing current investments, and eventually preparing for exits, all rightly take precedence daily.

It's also important to recognize that the finance functions for these firms go well beyond simply basic accounting. Risk insurance, HR, payroll services, choosing auditors, 401k options and the other elements make this more of a burden than it may look at first glance.

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And these aren't matters that can be delayed or avoided. For example, the industry has high compensation models, so the right benefits structure, 401k plan, or revenue sharing models aren't an afterthought, but key to attracting high caliber talent.

Even if the founders can still manage to juggle all their duties and the basic accounting for the management firm, they will question if that's the best use of their time. The hours that are devoted to the blocking and tackling aspect of the firm's accounting are hours not spent with investors, or investments, new or current. Investors commit to funds out of belief in the partner's skill in managing capital, not bookkeeping. And in this context, the finance function can be a distraction from their core duties as asset managers.

Yet, the finance function is hardly a mere distraction, as there is a real price to pay if ill-managed. In a typical scenario, a partner is paying firm expenses out of their personal accounts during the first year or so. They then struggle to find time to introduce a reimbursement process for themselves with everything else on their plate, which now happen to include setting up the infrastructure so that, say, the Bloomberg bills are no longer charged to their personal credit card.

Another firm failed to keep up to date with their registrations and discovered well past the deadline they were not up to date with filings for the state of California, which resulted in fines and suspension, and many hours spent rectifying the oversight. It's exactly this type of paperwork that is at once too basic to warrant the attention of one of the founders, but too crucial to ignore until someone has the time to get around to it.

Another aspect of the finance function for investment managers is that it's a constantly evolving discipline, with new regulations and new technologies emerging every year. The tech platform that seemed cutting edge three years ago, can prove woefully inadequate over time, and now the Manager has to gauge whether an upgrade is necessary, and what new system to explore. More often than not, the sheer volume of work a Manager must handle leaves them sticking with their inadequate system, because they don't have the time to manage an upgrade.

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Option 2:

Tapping the nearest talent

Some Managers might accept that the finance function is something worth hiring in-house staff. Many investment management firms find some success with this route, especially early on in their firm's development, but it comes with limitation and burdens.

Hiring an in-house accountant is one way to keep those numbers close while delegating the daily duties to someone else. But this belies the amount of work involved with managing the human capital for the function. The boom in private capital has prompted a talent war for every role at such firms, and accounting is no exception. Furthermore, without onboarding someone with the skills and experience already in-hand, there's a lot of training to get someone up to speed with the unique demands of each investment firm.

Even if the right person is hired and trained, there's no guarantee that they won't be recruited, choose to leave, or even run into something tragic such as an accident or illness that puts them out of commission for weeks or months at a time. Human capital risk also applies to the Manager who decides they'll own the finance function, as even the most talented Managers can have an unexpected event that prevents them from fulfilling their duties.

Relying on the Manager or a staff member to handle this core function keeps such tasks in a silo, where processes get tailored to the idiosyncratic habits and assumptions of that one person, preventing someone else in the firm from easily picking up the slack when there are distractions or turnover.

Other resources that don't have specific experience working with an asset management firm often prove to be a drain on the time and attention of the Manager, as they must invest heavily in getting the service provider up to speed on their unique accounting structure and finance needs.



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Often Investment Managers will tap a fund administrator when they're launching their first fund to handle the light bookkeeping. However this option does not provide the deep and dedicated resources needed across the breadth of the firm's accounting and finance activities, or a focused business advisor as the firm matures.

Option 3:

Choosing an outsourced "Finance as a Service" provider

One alternative that can meet the needs of a growing firm is to outsource the entire finance function of the investment management company to a designated service provider who delivers a "Finance as a Service" [FaaS] solution. Unlike a fund administrator that may offer a bookkeeping solution as part of its broader portfolio of services, these specialists are exclusively focused on the best practices in finance and accounting for this discipline.

This unerring focus is key. The process, technology and controls have been refined over multiple service engagements, and are informed by the latest legal, regulatory and industry trends. That's why the number one factor in choosing such a provider is industry expertise. Working with a provider that understands the unique challenges of asset advisors will save you time and resources as you grow.

Serving the alternative asset class, including Private Equity, Venture Capital and Hedge Funds requires an expertise in the distinct challenges and needs of such a firm. How the various entities are treated, how fees and expenses are allocated - a topic that remains in the glare of the regulators' spotlight - and the pace of such a business, from fundraising to capital calls, all the way to distributions create unique challenges. This kind of expertise requires years of training and deep proficiency, and the people with those skills are hard to find, and even harder to bring on board.

Industry expertise is so vital because these FaaS providers should be delivering a solution for the whole breadth of the finance function, tailored to the specific needs of the investment management company. There are best practices appropriate regardless of client, but a deeper expertise is invaluable in understanding when a firm needs a solution crafted to their own culture and priorities.

As part of the diligence into such providers, managers should solicit client references with a focus on the provider's experience. How many managers of similar size and complexity have they served? And how long do those relationships last? These outsourced providers must sustain client relationships over the long term, supporting the manager and the service provider in building the institutional knowledge to continually optimize the service offering.

The right provider should have an integrated technology platform that has been properly tested, with automated data flow and a built-in segregation of duties. Managers should expect easy, reliable access to their data so that they can spend time generating insights from it, not processing it. These providers should be freeing up the time of the firm's partners and in-house CFO for more creative and high impact activities.

This is not merely about choosing a bookkeeper. The FaaS provider should also offer HR, benefit support and payroll services, with expertise in the context of the investment management industry. Compensation at such firms is often sensitive information, and an outside provider can support confidentiality in ways that would be difficult for in-house staff to match.

A swift and rigorous employee onboarding process is also a necessity. This means appointing a key person from the firm to collaborate with the service provider, and ideally a senior person who has access to all the relevant information. The right service provider won't need full time "management," but in this initial phase, there needs to be ample communication to support accuracy, and assure all questions are answered.



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Once the FaaS provider's platform and processes are up and running, there should be a seamless flow of timely, accurate, audit ready financial information. And from that point on, the relationship should mature into one that fosters a dialogue where the service provider becomes a sounding board, a consultant in the firm's next stage of development. Early on in a firm's life it can be invaluable to have a trusted, informed advisor helping to shape the practices that will define it in the years to come.

Which is why it's important for Managers to find a solution to the investment management company's finance function as early as possible. A recent new manager won a major commitment from a large, top tier institution that meant they had to pass an audit as part of the arrangement which required their management company financials to be immaculate, up to date and quickly accessible. This was possible as a result of their outsourced accounting relationship.

There are many ways to deliver such "clean" numbers, but the reality of running an investment fund means that it is unlikely to be achieved by one of the executives taking on that burden. It requires sophisticated support with the industry expertise, well-defined processes and the technology to deliver clear financial information without adding another task for a Manager to handle. Given the competitive dynamics of the industry today, this is no time to cut corners when tackling the finance function, which in many ways, is the foundation for everything the firm aspires to accomplish.