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Extend the business value of outsourcing: turning provider relationships into innovation partnerships.






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Introduction

As competitive pressures intensify, CIOs are finding themselves in the executive boardroom's hot seat. Increasingly, IT is being recognized as an essential change agent inextricably linked to business success, and company leaders are calling on their CIOs to play an integral part in driving that change. At the same time, CIOs are being pressed to reduce the cost of IT services and improve their transparency, flexibility and resiliency.

Many CIOs have turned to outsourcing as a means of answering these demands, but the business context for outsourcing is continually changing. Firms are being transformed through global expansion, mergers and acquisitions, and other equally disruptive emerging business models. New technologies are evolving at an unabated speed, and they are being adopted at rates that are unprecedented. These changes bring new capabilities and opportunities for growth, but also a fierce desire to capitalize on them. Outsourcing relationships have had to adapt to this increasingly dynamic world.

Current outsourcing models allow for greater flexibility and client control, and eliminate the need for the all-or-nothing transformations associated with traditional models. The quality of the client-provider relationship has also changed. Today that relationship is much more strategic, reflecting the current preference for increased collaboration and partnering. Outsourcing risks and rewards are shared, and increasingly value propositions are structured around the client's business objectives.

Innovation partnerships are a natural extension of these new outsourcing relationships, giving client companies direct access to the outsourcing provider's extended capabilities, including research, development and consulting as well as the provider's own experience, best practices and lessons learned. Tapping into these wider—and often proprietary—resources is enabling organizations to gain insight on specific problems, test their future visions and, in general, experiment well beyond the realm of their outsourcing contracts. The results are often life-changing for companies, enabling them to implement business and technology solutions they never could have implemented on their own.

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Innovation partnerships enable companies to take advantage of the outsourcer's wider capabilities and preeminent resources in research, development and consulting to solve specific business and IT challenges, increase strategic effectiveness, and implement new, better ways of doing business.

Collaborative innovation—both internally and externally—is a critical element of business success, and it is changing the way outsourcing relationships are viewed.

The convergence of outsourcing and innovation

In 2006, following extensive interviews with 765 CEOs and other business executives on the subject of innovation, IBM released the findings of its Global CEO Study.[1] The results have strong implications for all business leaders, but particularly those interested in outsourcing and other external business relationships.

What's certain is that innovation is increasingly on the minds of CEOs. Two-thirds of those interviewed for the study said they are looking to innovate but didn't agree on what or how they should innovate. Eighty-seven percent predicted the need to enact moderate to major innovative change in their organizations in the next few years to address emerging pressures and opportunities. Eighty-three percent think that innovative changes in a competitor's business model are likely to change their entire industry.

The CEOs also stressed the overwhelming importance of collaborative innovation internally across customary silos, but also externally outside company walls. They are seeing almost as many good ideas come from their business partners as from their employees. And they are getting about twice as many innovation insights from their customers as they are from the internal sales and service units that work directly with those customers.

What CEOs are realizing is that they need to build flexibility into their organizations and broaden their communications channels. They no longer feel the need to create and own everything in house. They now believe that the key to future success lies in their ability to synthesize good ideas from a variety of sources, test them and make them rapidly available across the extended enterprise.

To the CIO, this translates into building and maintaining an infrastructure that can scale rapidly and absorb new business relationships, and keeping IT strategically aligned with the business to shorten the path from idea to implementation to market. It also means bringing technical and services innovations forward and providing the guidance and insight to maximize their business impact. This is the context in which outsourcing and outsourcing relationships have come to be viewed.

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Outsourcing's rollercoaster ride

IT outsourcing has long been the subject of debate, with questions centering around its ability to deliver projected benefits and business value. Still, few would argue its potential to impact the business in a positive way. Research has shown that companies engaged in IT outsourcing consistently outperform their peers, with better business performance and bottom-line results over the long term.[2]

While outsourcing is certainly part of mainstream operations today—with 85 percent of CIOs saying they outsource one or more IT functions[3]—skepticism remains high. The fact is the failure rate associated with outsourcing agreements lies somewhere between 40 and 70 percent.[4] There are numerous reasons for this, but at the root is the provider's inability to meet client expectations.

When outsourcing is undertaken as a cure-all, cost-cutting maneuver, and pricing is fixed for the duration of the contract, customer satisfaction is difficult to achieve. With the average outsourcing contract lasting five to seven years, requirements changes are inevitable, and service levels established at the start of the contract are likely to become dated and a barrier to the dynamic enterprise. Without periodic price, performance and cost/value checkpoints to verify and adjust the contents of the original agreement, the relationship between customer and provider is likely to erode over the contract term.

The new outsourcing agenda

It's clear that the outsourcing decision process has changed. There is a greater tendency toward holistic outsourcing with companies combining business process, application and infrastructure outsourcing to achieve a more significant business impact. Optimizing across business and support silos is recognized as providing an opportunity to substantially reduce costs.[5] However, it requires working across traditional boundaries—organizational, cultural and technical.

Outsourcing relationships are now being judged on how well they deliver business value, not just on their ability to cut costs.

Furthermore, outsourcing is no longer solely about operational efficiency and can't be boiled down to satisfying service level agreements and lowering costs. In a constantly changing business arena, where increasing globalization presents a chronic threat to business survival, companies now expect outsourcing to drive greater strategic effectiveness and business value beyond the scope of the outsourcing agreement.

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There is increasing agreement that what's really needed for outsourcing success is a strategic partnership between client and provider.

Innovation partnerships enable clients to address their broader business challenges and visions, and to increase the value derived from their outsourcing relationships.

With faster and better technologies always on the horizon enabling new capabilities, communication between provider and client becomes a vital element of the outsourcing agreement. Studies have repeatedly shown that the key to successful outsourcing is having the right type of client-provider relationship.[6] The more collaborative, open-ended and flexible the outsourcing relationship, the more value can be realized.

There is now an appreciation on both sides of the fence that what's really needed is a strategic partnership that is mutually beneficial to both client and provider. Strong collaboration, governance and cultural alignment between the client and provider organizations are key ingredients. They can make it easier to anticipate conflicts and adapt to changing business conditions. Without them, problems can escalate out of control and derail both parties' ability to focus on value creation. The result: Important opportunities for innovation and transformational improvements can be missed.

Seeing beyond the services contract

Much has been written about the role of innovation in driving business growth and profitability. In a globally connected economy, where standing still almost certainly leads to vulnerability and obsolescence, innovation has become a top priority. Coupled with the increasing rate of change and technology adoption in the business marketplace, innovation is reinventing even the most sacrosanct business models. Often driven by a collaborative fusion of ideas from business and IT, innovative thinking is enabling organizations to improve current processes, increase agility and reduce costs, and in the process, rise above an evolving status quo.

With this kind of teamwork and value exchange already at work in an outsourcing relationship, many organizations are seeing the merit in leveraging the outsourcing provider's extended resources—research laboratories, technology development, IT and business consulting practices—to help them innovate. They are forming innovation partnerships to address their broader business challenges and visions, and to increase the value derived from their outsourcing relationships. These arrangements, which can take many forms based on clients' desired level of commitment and resource availability, are helping clients resolve long-time business problems, implement better solution alternatives and

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Clients can become part of the research and innovation think tank—often at no additional cost.

Innovation partnerships enable companies to address changing business conditions and technology advances more easily and effectively.

Working with providers that understand and often drive technology advances enables companies to stay a step ahead of their competition.

find new, more profitable ways of doing business.[7] At the same time, they are enabling providers to gain the deep process and industry knowledge needed to build next-generation solutions customized to clients' business needs.

In the best of these relationships, outsourcing providers are opening their doors and allowing clients to work with leading researchers and become part of the think tank, often at no additional cost. Whether the provider dispatches innovation experts to meet with clients a few times a year or dedicates scientists on a full-time basis, the resultant tactical and strategic partnership seems to benefit both client and provider. In short, these partnerships are leading to better, more productive outsourcing relationships over the long term.

In the case of ABN AMRO, a prominent international bank, a jointly staffed value creation center was formed to guide the evolution of the company's infrastructure in support of emerging business and technology strategies. The center enabled ABN AMRO to bring its most difficult challenges to the table and work directly with the scientists and innovators best equipped to solve them. The resulting solutions, which include global ATM and self-service technologies, have created new business opportunities and competitive advantage for the company and built a sturdy foundation for ongoing value creation.

Business and technology evolve continuously, and innovation partnerships enable firms to stay in sync with these changes. Over the course of an outsourcing contract, new competitive forces will certainly arise and demand attention. An innovation partnership provides companies with the resources and savvy to respond more easily and effectively. They are better equipped to refashion their business model and consider alternative strategies. Moreover, working with individuals who understand—and often drive—technology advances, companies can stay ahead of the curve. This sneak peek at the future gives them the foresight and intelligence to implement the right systems and processes before competitors and do it in ways that their competitors can't.

Making innovation the linchpin for outsourcing

Innovation is like magic—to the audience, it defies expectations; to the performers, it is the result of highly focused trials and errors and intense practice to make it naturally flow as part of a unique presentation. Behind the magic

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is a proprietary secret—the competitive advantage—that attracts and often mesmerizes the audience. The magician rarely works alone. There is an entourage of talented assistants, prop handlers and stagers who collaborate closely to create the perfect, seamless effect and make the performance a successful one.

Like the magician, clients can enhance their business by partnering with the right talent. They can make innovation integral to an existing outsourcing relationship, and in this way, improve the quality and benefits of a contract. They can also use innovation to forge new outsourcing relationships.

When companies make innovation a fundamental element of their outsourcing agreement, the results can be dramatic.

Consider the example of a small Indian telecommunications company. In 2004, executives at the company knew that impending government deregulation in India would provide a flood of new opportunity for providers like themselves. Preemptively, they decided to outsource their entire IT operation in order to focus on the company's strength in customer services. Outsourcing would enable the telecommunications provider to transform its fragmented IT processes and overcome the inefficiencies that were impeding its ability to grow. But the company's executives also wanted to change the customer experience by offering services their competitors couldn't match.

The executives made innovation a fundamental element of the company's outsourcing agreement, assessing providers based on their ability to deliver innovative solutions, not just outsourcing efficiencies. The resulting innovation partnership led to the implementation of systems that predict customer buying behaviors and enable customers to self-manage their accounts. Such innovations have been major drivers of growth and customer satisfaction for the telecommunications provider, which saw its subscriber base increase ten-fold in just three years.

Seizing larger innovation opportunities

While many innovation partnerships are formed to benefit a single client, others can be structured to benefit a wider audience, with client and provider coming together to develop industry-changing solutions that can be sold commercially.

While many innovation partnerships are formed to tackle a client's own business challenges, others are initiated to change whole industries. Today's most forward-thinking business leaders are leveraging their outsourcing providers' technological know-how to launch marketable solutions that attack long-standing industry problems, in areas such as consumer sales, customer care operations and supply chain management. They are changing the nature of the client/provider relationship and entering into joint ventures to share in the development, marketing and profit associated with these solutions. Companies looking to leverage an innovation partnership on this grander scale often have the genesis of an idea and need a partner's help in taking it forward technically and commercially.

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In an innovation partnership, the client's challenges become the outsourcer's challenges, and the same visionary thinking and expert resources are applied.

Success requires a collaborative commitment

Innovation partnerships succeed because they weave the client's agenda directly into the outsourcer's research agenda. In essence, the client's business and IT challenges become the provider's challenges, and the same visionary thinking and expert resources are applied.

Partnership agreements must be structured with a strong collaborative commitment. The client should be the lead participant in the process, sharing business requirements and industry insights and actively appraising researchers' ideas and logic to ensure that they support the client's desired visions. The provider brings to bear an enormous breadth of capabilities and assets, an understanding of what is possible and a knowledge of what has been done across industries. Together the client and provider seek the best solutions, independent of source, to the unique client challenges.

Making a collaborative commitment is critical to the successful execution and outcome of the innovation partnership, with both parties lending their best people to the effort.

Like providers, clients must be willing to assign their best people to the innovation effort to impart knowledge, brainstorm and assess the worth of new ideas. While this redirection of key players may increase the intangible costs of the outsourcing engagement, client involvement and knowledge transfer are critical to the ongoing success of the innovation partnership, and the costs are easily offset by resulting business value.

Moreover, by making their employees an integral part of the innovation process, clients foster a workplace where creative thought is encouraged and rewarded, and they are more likely to retain top employees. On the flip side, when they shift all the creative thinking to the provider, their internal ability to innovate can dry up, and it can be difficult to retain valued employees.

Establishing a hothouse for new ideas

Embarking on an innovation partnership was new territory for one busy government agency. Without the internal mechanisms in place to promote and capture innovative ideas, the agency responsible for maintaining and enforcing driver and vehicle records in over 40 million transactions annually needed help if it was to realize its e-modernization goals.

Along with its outsourcing and innovation partner, the agency deployed a "new propositions" process and onsite innovation center to encourage a flood of new ideas from employees and to provide the tools and techniques for generating ideas. Light assessment criteria were applied at the outset to allow the bulk of raw ideas to make the initial cut. As new ideas were funneled through the evaluation process, criteria became more stringent, but employees could still take pride in their contribution. Agency employees actively participated in the creation, evaluation and implementation of the ideas, pushing forward those that held promise for the agency and retiring those that proved unproductive.

The collaborative commitment is central to the execution and, ultimately, the achievements of the innovation partnership. Other success factors underscore its importance:

- ***Shared vision.*** *Both client and provider must be able to visualize and realize benefits from the partnership. Daily outsourcing concerns should not overshadow or inhibit either party from looking beyond the present.*
- ***Joint governance.*** *Both parties must see eye to eye on the rules of engagement and opportunity, respecting the need for mutual gain and agreeing upon ownership of the resulting assets. A joint governance structure helps ensure that the partnership stays on track by managing innovation priorities, assigning appropriate resources, monitoring progress and reducing the risk of conflicts.*
- ***Personalized process and outcome.*** *The client's challenges and goals should always be the focus of innovation discussions and proposed solutions. Providers need to understand what clients are trying to accomplish and stay fixed on delivering it.*
- ***End-to-end business/IT view.*** *The innovation team should integrate subject matter experts from different disciplines to optimize the creative thought process and assure that requirements from all lines of business are considered.*
- ***Business-as-usual efficiency.*** *The innovation partnership should operate in parallel with the business, positioning clients for rapid, nondisruptive change as innovation opportunities emerge.*
- ***Willingness to challenge conventions.*** *Individuals who dig in and resist change threaten the success of any innovation partnership. Minds must be open to new ideas and willing to question current methods.*

Selecting an outsourcing and innovation partner

IT outsourcing providers are no longer judged strictly on their ability to satisfy the terms of the agreement. Today, that capability is merely the entry fee for further consideration. Companies look at a variety of factors in selecting an outsourcing provider, including demonstrated delivery capabilities, technical skills, reliability in meeting customer requirements, financial stability, reputation and, of course, price. However, the ability to collaborate effectively has grown increasingly important in vendor decisions. According to a recent IDC survey of end users, having a solid working relationship was more important than all other vendor selection criteria by a considerable margin.[8]

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Outsourcers that are selected as innovation partners must have the depth of technology and consulting expertise to drive thought-leading ideas and solve industry-specific business problems.

Outsourcers should have the technological and industry foresight to understand the complexity of the business/IT puzzle and how the pieces fit together—now and in the future.

When innovation expertise is added to the list of requirements, companies need to look for providers that have the depth of research, development and consulting expertise to drive thought-leading ideas. These providers are typically investing heavily in IT services, tools and automation. They are adept at developing and bringing together the hardware, software and services to solve industry-specific business problems.

When competencies like these are organic—within the very DNA of the organization—there is a genuine understanding of where technologies and industries are headed and how business processes relate to applications, the network, the infrastructure and the changing global landscape. Outsourcers with this knowledge are setting the trends rather than simply responding to them. They truly understand the complexity of the business/IT puzzle and how the pieces fit together. Such a perspective enables these outsourcers to provide headlights to the future. With the knowledge and capability to base their innovative products and solutions on real developments, not blue sky suppositions, their innovations are more likely to be relevant and hold their technological and business value over the long run.

Willingness to share risks

Outsourcers should be willing to put their own skin in the game, sharing the risks as well as the opportunities. In the case of the Indian telecommunications provider, the outsourcing agreement was contingent on the outsourcer's willingness to tie its revenue to the provider's own. If the telecommunications provider made money, so would the outsourcer. To implement that strategy, the telecommunications provider's payments to the outsourcer were based on the revenue generated by the outsourcing transformation—and the innovations it spun off. No pricing template existed for such an agreement, and the parties worked through more than a hundred iterations to develop a model that was advantageous to both.

The importance of cultural alignment

An innovation partnership cannot yield its best results without cultural alignment of the organizations involved. For example, a manufacturing company that is determined to improve its industry's global supply chain is rightly justified in looking for an innovation partner that not only shares its vision, but has accomplished internally what the company hopes to do externally across an entire industry.

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Clearly, no two organizational cultures are the same, but serious differences can lead to clashes that make collaboration difficult. To succeed, both client and provider should embody a mature view of risk taking and the innovative process as a whole. Their corporate values should encourage external collaboration, openness and candor. They should have a common approach to decision making and problem solving, as well as similar management styles, governance frameworks, communication mechanisms and financial practices.

Before entering into an innovation partnership, both client and provider should assess their cultural fit to ensure that collaborative efforts will be productive.

Although some of these cultural characteristics may be intangible and, so, hard to discern in a potential partner, clients and providers should take the time to understand them before entering into an innovation partnership. Adequately evaluating cultural fit better enables both companies to set acceptable expectations for the partnership, measure progress objectively and resolve conflicts constructively. Diagnostic tools and techniques, which show prospective partners how to uncover, understand and reconcile their different ways of working and thinking, should be used to assess cultural alignment and narrow the gaps.[9]

Conclusion

Outsourcing is commonly pursued by organizations as a quick fix to reduce costs rather than as an investment designed to enhance capabilities, increase agility and profitability, and strengthen competitive advantage. But the outsourcing agenda is changing, and companies are increasingly focused on driving this greater business value. They are venturing into innovation partnerships to boost the value of their outsourcing relationships.

To succeed at the highest level, innovation partnerships require that both client and provider make a strong collaborative commitment, agree to share risks as well as rewards, and ensure the cultural alignment of their organizations.

Innovation partnerships enable companies to take advantage of the outsourcer's wider capabilities and preeminent resources in research, development and consulting to solve specific business and IT challenges, increase strategic effectiveness, and implement new, better ways of doing business. To succeed at the highest level, these partnerships require:

- ***Strong collaborative commitment*** *to assure the involvement of top client and provider resources, and the implementation of a joint governance framework to manage priorities and monitor progress*
- ***Risk-reward model*** *in which both client and provider have a vested interest in the outcome, sharing in whatever risks and profits result from the innovation partnership*
- ***Cultural alignment*** *in terms of values and vision, ensuring that both provider and client can work together flexibly and amicably to set expectations, measure progress and work through conflicts.*

Related publications

CEOs are expanding the innovation horizon: important implications for CIOs, IBM Global Technology Services, May 2006, http://www-935.ibm.com/services/us/cio/empower/empow_wp_gts_ceosareexpanding.pdf

Using collaboration to enable the innovators in your organization, IBM Global Technology Services, November 2006, http://www-935.ibm.com/services/us/cio/empower/empow_wp_gts_usingcollaboration.pdf

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