Eradicating the Innovation Dearth in Business Process Outsourcing: Practical Advice on how to Achieve it

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The maturation of the business process outsourcing (BPO) industry and the progressing sophistication of the buy-side (end-user organization) community has led to a worrisome issue...buyers are becoming increasingly disappointed that they aren't receiving "innovation" in their outsourced environments. The following article outlines why buyers today recognize the need to achieve innovation when they enter into an outsourcing agreement, and addresses measures that must be taken to achieve real progress in getting beyond the "operational" state of many outsourcing engagements.

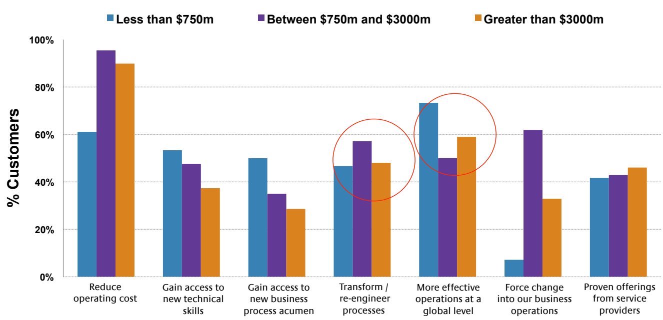
While innovation can take many forms, in outsourcing it generally implies that the service provider is using new and creative ways to improve productivity or even helping find new sources of revenue. In today's maturing industry, it's no longer just about cutting costs and maintaining standard process performance levels. If buyers fail to see evidence of innovation materialize in their outsourcing experience, they are likely to seek alternative means to achieve it, potentially even bringing outsourced processes back in-house

Buyers Today View Outsourcing as an Opportunity to Drive Innovation into Their Business Operations

Outsourcing research firm Horses for Sources recently conducted a study in which 209 decision makers within buyer organizations were asked the most important reasons driving them to evaluate outsourcing in 2010. The following findings (see Figure 1) across small (under $750 million in revenues), mid-sized ($750 million-$3 billion) and large ($3 billion+) buyers indicate the need to achieve innovation as a major factor, beyond simply reducing cost:

Figure 1: Buyers looking to drive change into their operations to become more effective globally

Question: How important are the following business drivers behind your company's outsourcing decision making this year?
Answer = Very Important



Source: Horses for Sources Research 2010
Sample: 209 Enterprises
Survey conducted in conjunction with Global Services Media and Shared Services and Outsourcing Network (SSON), January 2010

Cost-reduction dominates, but only where there is significant scale to exploit labor arbitrage opportunities. While the mid-large organizations (90 percent) overwhelmingly look at cost-reduction as their primary driver, smaller firms do not have the same scale to enjoy such immediate cost take-out potential; as a result, only 60 percent cited reducing costs as a main driver. They actually regard accessing new process acumen, technical skills and having support to operate more effectively at a global level as similarly powerful motives.

Empowering global operations and reengineering processes are coming to the fore. As we emerge from the recession, buyers' desire to leverage global sourcing to help them operate more effectively as a global organization, and re-wire their operations to support that process, is becoming even more apparent, with over half of all organizations citing the need to globalize and transform processes as prime outsourcing motives. And this is across all business sizes. The need to globalize is impacting all companies, and outsourcing is one method they are evaluating to help them achieve it.

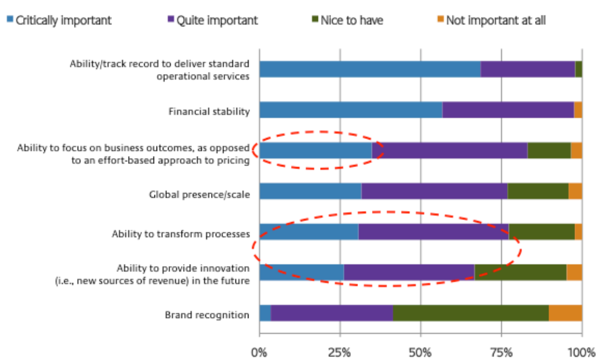
The mid-market increasingly views outsourcing as a vehicle to force change into their business operations. Many businesses are struggling to break out of the old way of running operations, and outsourcing is increasingly being viewed as a major change-agent, with close to two-thirds of mid-sized organizations citing this as a very important driver for outsourcing this year. While mid-market buyers clearly feel the need to combat fatigue from old business support models, large firms are less inclined to view outsourcing this way as they are more used to using customized sourcing approaches and captive/shared services models that are harder to change solely with outsourcing engagements. Small firms tend to use outsourcing more to augment the value it brings from an added resource, talent and globalization standpoint, but because of the lack of scale will struggle to force real change into their business models with limited labor arbitrage opportunity.

Smarter Buyers are Expecting Innovation from Their Service Providers

The same decision makers within mid-to-large organizations outlined the importance of specific attributes they looked for when selecting an outsourcing vendor (see Figure 2):

Figure 2: When evaluating service providers, financial stability and operational excellence are the table-stakes. Business transformation capabilities are the differentiators

Question: In today's economy, how important are the following attributes when selecting a service provider for IT/BPO services?



Source: Horses for Sources Research 2010
Sample: 209 Enterprises
Survey conducted in conjunction with Global Services Media, and SSON, January 2010

Service providers need a proven delivery record and financial stability just to get to the table. The vast majority of buyers now see these as table-stakes just to start a discussion. The Satyam fiasco has left some sore memories with clients who do not want to experience a repeat of their vendor almost going belly-up. Would you sign up with an electricity provider that might go out of business? The same applies to whatever company is processing your business transactions and managing your IT.

Once at the table, buyers are asking "what else can you give me?" Quite simply, there are a good number of providers today pushing services within a similar price-band and sufficient track record of adequate delivery. Furthermore, most large enterprises have already experienced offshoring and outsourcing to varying degrees for at least several years now, and are smart enough to realize outsourcing provides an opportunity to deliver more than simply cost savings. Consequently, the ability to provide outcome-based pricing that is based on business improvements is now a critical component among a third of buyers, and an important consideration for most of the rest.

Innovation is now becoming a major decision-swayer. While on the surface it may appear that transformation and innovation are only secondary considerations (i.e., not a deal-breaker for three-quarters of buyers), when you take into account that most service providers are offering similar solutions at similar prices, it is these categories that are fast-becoming the decision-swayers.

Achieving Innovation in Outsourcing Requires Decisive Behavior from both the Buyer and the Provider

While it's clear that today's buyers see innovation as the Holy Grail when outsourcing, it's also clear than most engagements today have struggled to progress beyond achieving standard operational results.

One of the root causes behind lack of innovation in outsourced environments is an over-emphasis on behalf of both buyers and service providers on the "quest for stability," which equates to "noise reduction." After the contract is signed, buyer executives don't want noise because they want to avoid their decision being second-guessed. The provider's delivery executives want all their dashboards to have green indicator lights, not yellow or red. Buyers consistently say, "I thought the process would be different, and that it would be more innovative. But it turns out that we have to extract the innovation we were expecting." And providers say, "But we get hammered when we try to innovate. If we introduce a new idea or concept, we might miss the service levels." Thus, every action taken by both party promotes stability, but hinders – even suppresses – innovation, because innovation, by inferred definition, creates noise.

There are several other major causes for lack of innovation. These include:

- Ineffective change management and communications
- Waning executive support after the contract is signed
- The wrong composition of skills among client relationship management and governance teams
- Misaligned compensation for service delivery executives
- Unempowered governance teams unable to drive the relationship toward innovation
- Not giving internal retained staff the rein to steer toward innovative initiatives

Another root cause for lack of innovation is that it costs the local account team money in terms of leveraging experts, process advancements and/or new technologies, as buyers are often reluctant to spend adequate funds on these efforts. The account team is often very motivated to achieve a profit target, and to the tactical account team, innovation is fluff that cuts into their discretionary funding. Moreover, being innovative is not necessarily an area in which service provider account managers excel. They are often more adept at tactical delivery and serving as relationship managers, not innovators.

Despite this myriad of innovation inhibitors, it's not as elusive or hard to attain as it at first blush appears. Later in this article we will discuss a range of techniques buyers can leverage to their advantage. But first, it behooves us to take a step back and define innovation.

What IS Innovation?

Innovation is not the service provider meeting or exceeding service level commitments. Those service levels are a component of the contractual agreement between the provider and the buyer, and thus should be met, plain and simple.

At the baseline, innovation takes a variety of forms including transformation, best practices, continuous process improvement, new technologies, business benefits, effective policies and achievement of the buyer's desired future state. But...what is it really?

And so we face another critical "gotcha" that detracts from getting innovation. Most buy-side organizations don't know what innovation really means to them within the constructs and desired future state of their own businesses. Many buyers and their operational staff have become bogged down over the years with "keeping the lights on" to the extent that they have lost touch with the innovative spirit and a hands-on knowledge of what innovation means to their firm and industry. Thus, they tend to over-rely on their service provider to deliver "it." But without benefit of insight into what types of innovation would help the client company attain and maintain its strategic objectives, how can a service provider be expected to deliver significant value-add innovation?

This by no means puts the entire onus on the buyer to dictate to the provider what shapes and flavors of innovation it wants. Indeed, a world-class service provider may well make strategic recommendations based on its knowledge of the market and/or market conditions, or discover a value-add innovative solution not initially recognized – or strategized – by it or its client. Rather, this underscores the need for four essentials:

1. An understanding of the new outsourced environment and how you can be innovative within it, not only as it pertains to the outsourced business processes, but also those activities still managed by the retained internal organization
2. Appropriate allocation of resources to pursue innovation
3. A strategic innovation plan and a process to keep that plan fresh over time
4. A true partnership-oriented working relationship between the buyer and the service provider. A collaborative approach to outsourcing is critical to fostering an environment in which innovation can exist and thrive

To aid in the resonance of our soon-to-be-discussed techniques for achieving innovation – from both the service provider and the internal retained staff – in an outsourced environment, following are several examples of innovation in the marketplace.

Yes Virginia, There is Innovation out There

One of our favorite examples comes from the 2004 agreement inked between IBM and a large consumer products firm for sales-after-service. Under the terms of the deal, IBM is providing consulting to help the client improve its customer service methods, and is also handling services for the client including warranty management, customer care and repair/exchange services for televisions, CD players and a multitude of other products. The outsourcing arrangement was part of a client-initiated program to increase efficiency, and was designed to help improve customer satisfaction and brand loyalty. After the in-scope after-sales service processes had been transitioned to IBM, IBM's R&D team began looking at the packaging used to ship some of the client's products and realized that a redesign would lessen breakage during shipping. Although packaging review was not in-scope per the terms of the outsourcing agreement, IBM proposed a redesign, the client agreed, and expenses (in terms of shipping and replacement, as well as damaged goods), were reduced. Now that's innovation!

Not all innovation comes in such large and sweeping fashion. A series of discrete innovations summed together can make a real difference. For example, ACS developed a custom web-based tool to streamline creation of manual checks as part of its Finance and Accounting outsourcing relationship with General Motors. This same custom application was then applied to GM's "retro" processing activities, which compare original purchase orders to actual amounts paid to vendors. As a result, GM has recovered overpayments to suppliers. The system is now planned for roll out across GM to encompass general office invoices to further improve cash flow.

We're also seeing increased efficiency and effectiveness – read, innovation – by the controlled offshoring of the more pedestrian components of patent research, clinical trials, investment analysis, etc. Who would have thought ten years ago that Contract Research Organizations (CROs) in the United States would be outsourcing the conducting of clinical trials for HIV cures to physicians and clinicians in India, or that investment banks would be outsourcing research on smaller capitalized stocks? Collectively, these examples of Wall Street and healthcare research efforts are being catalogued under the banner of KPO, or Knowledge Process Outsourcing. Multi-national BPO service providers, buyers launching captive offshore operations and India-based service providers such as Evalueserve, Scope e-Knowledge and marketRx are all delivering KPO work.

Techniques for Getting Innovation from Your Service Provider

Although much of this article has painted a picture of barriers to innovation, there are, fortunately, a variety of techniques for extracting innovation from your BPO relationships.

Innovation Reviews – Also known as Innovation Boards, these are quarterly, bi-annual or annual reviews that typically focus on state of the market, industry trends and relevant information, technology updates, solution demonstrations, site visits, etc. Further, they leverage other buyer peer groups to understand what is happening in the buyer's specific industry sector, other vertical industries and the outsourcing industry itself.

Benchmarking – Buyers should always activate their benchmarking clauses...unfortunately, most don't. When benchmarking, the focus should be on best practices and comparators of innovation, not just cost comparisons. Moreover, the benchmarks should be on both functional excellence and outsourced environments.

Stakeholder Satisfaction Surveys – These monthly, quarterly and annual customer satisfaction surveys should be 360 degrees covering multiple dimensions including innovation, and all internal and external stakeholders.

Act as a True Business Partner – Service providers should be invited to their client's annual planning sessions not only to be briefed on the company's strategic and business objectives, but also for ideas on how they can help the client achieve their objectives.

Financial Base Case – Buy-side organizations must ensure their financial base case has sufficient funding in the out years to pay for continued innovation. Funds must be set aside for business case investigation, evaluation and development... consider it a pseudo "R&D" budget for innovation.

Gain Sharing and Incentives - Gain sharing mechanisms, on a case-by-case basis, can be an effective way to pay for business case development, and should include mutual rewards for both the buy-side organization and the service provider. A "license-to-sell" innovation to the client by the provider is just as important as a gain sharing mechanism. Preventing the provider from making a case for innovation directly to buyer management is self-defeating.

Service Levels - Some SLAs must be tied to innovation or it will not happen. Project milestones, go-live events and pilots are tangible measures. Other measures include accuracy, customer satisfaction, productivity, Six Sigma (defects), work elimination, etc.

Outsourcing Management – The client's internal governance team should have a transformation or innovation owner. Further, the governance team should have sufficient staff and budget to help drive innovation, and must hold the provider accountable for innovation. The governance team must reassure and demonstrate to the provider that the relationship is long-term; otherwise, the provider will be inclined to disinvest in innovation and the relationship. The client organization must retain process management expertise at a level at which it can clearly articulate future state requirements, evaluate proposals brought forth by the service provider and work with the provider organization to agree upon the business case for change.

Executive Visibility and Support – Senior executives from the service provider organization must have high visibility with and access to senior executives from the client company. This includes steering committees, reciprocal headquarter visits, joint speaking engagements, regularly scheduled calls and quarterly and annual briefings. Facilitation of meetings and fostering face time between both firms' executives is essential. And this can't be done too often, as senior executives frequently move to different organizations.

Behavior/Communication/Culture – Buyers must be prepared to invest in and encourage change. For example, they should communicate their aspirations early, and share the risk and eventual reward with their provider. Transformation requires a partnership mindset, not a transactional orientation. Innovation is often not brought to bear because clients do not ask for it, define what they mean by it, motivate the provider to deliver it or put restrictions around it. Clients rarely help the provider understand what is important to them. Can the sacred cows be targeted? Can the recalcitrant be reassigned or moved out?

The Contract – The contract is by no means the only technique for ensuring innovation, but it is certainly an important and frequently used one. Transformation, and its associated requirements for innovation, must be a definable project in the contract; otherwise, it will not be funded and thus not be implemented. Build a fair cost structure into the contract that allows for innovation. Distinguish between what is in the base fees versus what is charged as a fee for transformation or enhancement. Transactional contracts that only focus on operational cost savings, and not broader-based business outcomes and benefits, are a real barrier to innovation.

Techniques for Getting Innovation from Your Retained Internal Staff

It is critical to recognize that while staff retention is important, not all staff will perform well and excel – and hence drive innovation – in a retained organization. Managing a relationship with a service provider that is performing outsourced process work is not the same as internally managing that process. Similarly, staff skilled at managing large internal operations may not have the foresight or skills to drive innovation in an outsourced environment. As a result, buyers need to develop a plan and strategy to identify, nurture and support key staff with the ability to identify opportunities for innovation in the retained organization and drive them to fruition.

Conclusion

A critical component of any outsourcing engagement is setting expectations around the intent of the relationship. Buyers of services should carefully access whether innovation is a vital element of what they want to buy. If it is, they must clearly identify what innovation means to them. Collaborative dialogue with potential service providers during the evaluation process is crucial to crystallizing the definition of innovation to be embedded in the relationship. As buyers progressively contract for service, transition services and govern ongoing relationships, they should build in the mechanisms necessary for innovation both for their service provider partners and themselves.

About the Authors

Bob Cecil has spent more than two decades helping clients transform their organizations and operations. With a primary focus on general and administrative processes, Bob has helped companies realign structure, governance and management processes; establish shared service centers; evaluate and transition services to outsourcing arrangements; plan and transition processes to offshore centers; re-engineer administrative business processes, and reduce overall cost structure and spend on goods and services.

Bob is executive director of EquaTerra's Business and Financial Processes Advisory Services, which includes the multifunction, finance and accounting (F&A), supply chain/procurement, customer care, facilities management and real estate, and other knowledge-based outsourcing or internal service delivery transformation engagements. He is also a member of the company's executive team.

Bob has been an account executive on many of EquaTerra's large multifunction and F&A engagements. He has:

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- Provided account leadership support for a major telecommunications company's $40 million F&A outsourcing transaction covering more than 60 countries on all major continents
- Provided account leadership support for a major automobile parts manufacturer's $30 million F&A outsourcing transaction for North America and France
- Bob's clients have included 3M, Bristol-Myers Squibb, BP, CNA, Colgate, Dun & Bradstreet, Federal-Mogul, General Mills, General Motors, Hewlett-Packard, Johnson & Johnson, Lockheed Martin, Marriott, Nestle, Pfizer, Tupperware, TXU and Siemens.

He is a regular contributor to several leading financial publications, including Financial Executive, Strategic Finance and CFO Magazine. He has spoken about shared services and outsourcing topics for the Conference Board, Institutional Investor, ICM, IDC, Sourcing Interest Group, and IQPC.

Phil Fersht is Founder and Chief Executive Officer of "Horses for Sources," the leading blog and research analyst organization covering global outsourcing strategies. Phil is an acclaimed industry analyst, practitioner, advisor and strategist across Business Process Outsourcing and IT services worldwide, having worked extensively in Europe, North America and Asia. During this time, he has advised on more than 100 major outsourcing and offshoring engagements and consults regularly with senior operations and IT executives on their global sourcing strategies.

During his career, Phil has worked at AMR Research (Gartner Group), leading the firm's BPO and ITO practice. Previously, he served as market leader for Deloitte Consulting's BPO Advisory Services, where he led numerous outsourcing and offshoring advisory engagements with Fortune 500 enterprises. He also worked for outsourcing advisor Everest Group leading the company's BPO research practice. Phil began his career at IDC across its European and Asia/Pacific operations.

Phil is a frequent author and speaker on IT services, Finance, HR and Procurement Business Process Outsourcing trends and issues. He was named both an "FAO" and "HRO Superstar" by FAOToday and HROToday Magazines for 2005, 2006, 2007, 2008, 2009 and 2010 and was featured as the cover story for the December 2006 issue of FAOToday as one of the outsourcing industry's most prominent advisors. He was also nominated for "Advisor of the Year" at the FAOSummit 2008. He speaks regularly at industry conferences, which have included The Conference Board, NASSCOM, IDC Directions, the Sourcing Interests Group and the Council of Supply Chain Management Professionals. He is also a regular columnist for several industry publications, including Global Services Media, SSON, FAOToday and Finance Director Europe.

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About EquaTerra

EquaTerra sourcing advisors help clients achieve sustainable value in their IT and business processes. Our advisors average more than 20 years of industry experience and have supported over 2000 transformation and outsourcing projects across more than 60 countries. Supporting clients throughout the Americas, Europe, and Asia Pacific, we have deep functional knowledge in Finance and Accounting, HR, IT, Procurement, Real Estate and Facilities Management and other critical business processes. EquaTerra helps clients achieve significant cost savings and process improvement with internal transformation, shared services and outsourcing solutions.

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Horses for Sources is the leading blog and research analyst organization covering global outsourcing strategies. Its mission is to bring together the new world of social media with traditional research and analysis to redefine the way in which advice, insight and knowledge is shared. Horses for Sources provides a unique environment for collective research, opinion, experience and knowledge across the global outsourcing industry to help enterprises explore new performance thresholds.

Led by industry expert Phil Fersht, the Horses for Sources team is a multi-disciplinary group of analysts and experts with deep domain knowledge in Business Process Outsourcing, (HR, Finance, Supply Chain), Industry Specific process outsourcing (Financial services and Healthcare) and IT Outsourcing (Applications and Cloud Computing).

Launched in 2007, the Horses for Sources has more than 80,000 regular visitors across the global outsourcing industry, and is widely-recognized as the leading destination for collective opinion, research, analysis and coverage of industry developments. With an entertaining style brimming with unbridled opinions, Horses for Sources is well-regarded across the industry as the platform that delivers the “real hard facts” about outsourcing.

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