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To Achieve Innovation from IT Outsourcing, Ditch Old Vendor Selection Processes

– Stephanie Overby, CIO

May 13, 2010

IT departments say they want innovation from their outsourcing vendors, and the vendors say they want to provide it. So why is innovation in outsourcing so rare?

There are countless obstacles to achieving anything resembling innovation when outsourcing IT, including ineffective change management, toothless governance, inadequate skills, perverse incentives and powerless managers. But the biggest barrier is inertia. When it comes time to draw up an outsourcing contract, everyone reverts to the safety of the status quo.

"One of the root causes behind lack of innovation in outsourced environments is an overemphasis on stability from buyers and service providers," says Phil Fersht, founder of outsourcing analyst firm Horses for Sources. "After the contract is signed, buyer executives don't want noise because they want to avoid second-guessing. The provider's delivery executive wants all their dashboards to have green indicator lights Every action taken by both parties promotes stability, but hinders—even suppresses—innovation."

To achieve innovation in IT outsourcing, customers and suppliers have to shake things up. And that starts with the traditional IT service procurement process of gathering requirements, issuing an RFP, selecting a vendor and signing a contract—that Holy Writ of the outsourcing relationship.

Ironically, contracting for innovation has precious little to do with the contract itself, say outsourcing experts and attorneys. While the contract codifies deal doctrine, in the most successful and innovative IT outsourcing relationships, it quietly gathers dust after the ink is dry. The contract is a consequence of a much more important negotiation—one that establishes a relationship between IT outsourcing customer and provider that will produce innovation while the legal documents sit on a shelf. To achieve that ideal relationship, all parties need to throw out the old notions that govern the traditional IT services procurement process and instead take the following approach.

1. Delay the RFP

In today's world of urgent cost cutting and speed sourcing, there's a rush to get the RFP out the door. But IT outsourcing customers need to decide upon innovation goals before even thinking about soliciting proposals or structuring the vendor selection process.

"If the enterprise wants any innovation, they should understand that the cookie-cutter RFP with the price-driven negotiation is not an effective vehicle," says Bill Bierce, co-founder of technology law firm Bierce & Kenerson.

2. Define Innovation

It's easier to agree on what innovation isn't than what it is. "Innovation is not the service provider meeting or exceeding service level commitments," says Fersht. "Those service levels are a component of the contractual agreement between the provider and the buyer, and thus should be met, plain and simple."

True innovation might mean continuous process improvement, emerging technology implementation, new best practices, IT transformation or competitive advantage. A clear definition of innovation is required so that the contract will reflect the appropriate financial and other terms associated with it, says Daniel Masur, a partner in the Washington, D.C. office of law firm Mayer Brown.

The sad fact is, many IT departments have grown so consumed with keeping the lights on over the past few years that they "have lost touch with the innovative spirit and the knowledge of what innovation means to their firm and industry," says Fersht.

Consequently, they rely on the outsourcer to define innovation for them, which puts the vendor in a difficult position, Fersht adds. A service provider can't be expected to deliver significant innovation without knowing what types of innovation would help its client attain and maintain its strategic objectives, he says. (See IT Outsourcing: 3 Reasons Your Vendor Won't Innovate.)

Fersht recommends drawing up a strategic innovation plan and a process for updating it. It should outline the outsourced environment and those activities retained internally, and how to innovate within the new framework.

3. Use Outsourcers as Consultants

Attorney Bierce recommends to his clients that they approach IT service innovation as a consulting project and solicit recommendations for change from potential providers. "This poses some challenges for outsourcers who claim to have trade secret processes for industry verticals, and that they would be exposed by putting out their trade secrets into an environment where the enterprise customer would then just bid out the work to a third party on a commodity pricing basis," says Bierce. "But this risk is small compared to the business opportunities."

Indeed, IT service providers from IBM (IBM) and Infosys (INFY) to Accenture and CapGemini emphasize their consulting business as a complement to traditional IT outsourcing to take deals to a higher level.

"I think the best [IT service providers] start by seeking to understand the complex and sometimes unique needs of IT and business professionals," says Forrester Research Senior Analyst Chris Andrews. "More and more, I see companies pointing to strategy sessions and methodologies to bring IT and business together to talk about the tactical and strategic role of technology."

Michael S. Mensik, partner in the Chicago office of Baker & McKenzie, believes IT departments could better ensure true innovation by spending more time with vendors up front, before the contract is signed, examining and modeling precisely how innovation will be achieved. He says both parties should discuss the processes that will need to be put in place to further innovation, the investments that each party will need to make and the change management measures that will be required.

While suppliers may be willing to put in a little extra work up front to get your business, much of this consultation will come at a price. "Whatever the competitive pressures, there is just so much that the vendors will do as part of an RFP process," Mensik says. "But I think in many cases the ROI on such an investment will be considerable. Coming up with a more detailed blueprint before committing to a vendor is, I think, one way of better ensuring success."

4. Lock Everyone in a Room

When it comes to the quest for innovation in IT outsourcing, the phrase "too many cooks spoil the broth" doesn't apply. Invite all key business and IT stakeholders and vendor executives to a conference room, advises Forrester Vice President and Principal Analyst John McCarthy. Then lock the door and hash out the laws that will govern the outsourcing relationship.

This approach ensures commitment from key internal stakeholders, which is important for outsourcing success, particularly transformational deals. "Any organization needing change has constituencies that will resist change," says Bierce. "This is not the outsourcer's problem but becomes its problem by default if the groundwork is not in place."

Arguing over—and ultimately agreeing on—details of the deal establishes a framework for the conflicts destined to come up over the course of the relationship, says McCarthy.

"I asked a CIO from a Fortune 500 company who had just led his company through a huge transformation project with a leading services firm what he would have done differently, and he said, 'I would have involved business decision makers in the process much, much earlier. I needed their insight and support to make this project work,'" says Forrester's Andrews.

5. Loosen the Purse Strings

The average outsourcing selection and negotiation process focuses on one point above all else—price. But if you want innovation, you're going to have to pay for it.

"Innovation costs the local account team money in terms of leveraging experts, process advancements or new technologies," says Fersht. "But buyers are often reluctant to spend adequate funds on these efforts."

Everyone wants value from outsourcers, particularly when times are tough, but stingy clients will get what they pay for, particularly if they haven't been able to clearly define innovation pre-contract. "The interests of the parties must be aligned," says Masur. "It is not realistic to expect a service provider to deliver the lowest possible price and still fund innovation initiatives and pass the resulting savings to the customer."

Even if you think you're paying a premium for innovation, it pays to verify the employee incentives put in place by the vendor. "Often the account team is very motivated to achieve a profit target and innovation is fluff that cuts into their discretionary funding," says Fersht. Talk to the provider about unique compensation plans that encourage innovation on your account.

6. Share the Wealth

Of course, the provider as a whole needs some inspiration to innovate, too, particularly of the profit-boosting variety.

The concept of gain-sharing—rewarding the vendor when the client benefits from lower costs, increased revenue or improved efficiency—has always been a controversial one among outsourcing customers. But if there were ever a time to consider it, it's when you're seeking something above and beyond from outsourcing.

"I know how hard it is to consider gain-sharing. The discussion becomes a mini-joint venture, with issues of risk, reward, decisional authority, institutional impediments and shifting roles," says Bierce. "But this kind of discussion can be valuable."

You might set up a jointly funded pool to pay for agreed upon innovation initiatives or sharing of savings generated by particular innovation projects, says Masur. And the client doesn't necessarily have to take a financial hit. The IT outsourcing customer might allow the provider to use the resulting products or systems to deliver services to other customers or waive its right to benchmark if a vendor consistently achieves high innovation scores in 360-degree performance reviews.