Embedding Innovation into Outsourcing Contracts

Steven Barker, National Archives.

"Innovation is often an imprecise 'nice to have' aspiration in many contracts…

and a future dispute point when <u>unstated</u> expectations have not been met…"

Have you contracted for innovation?

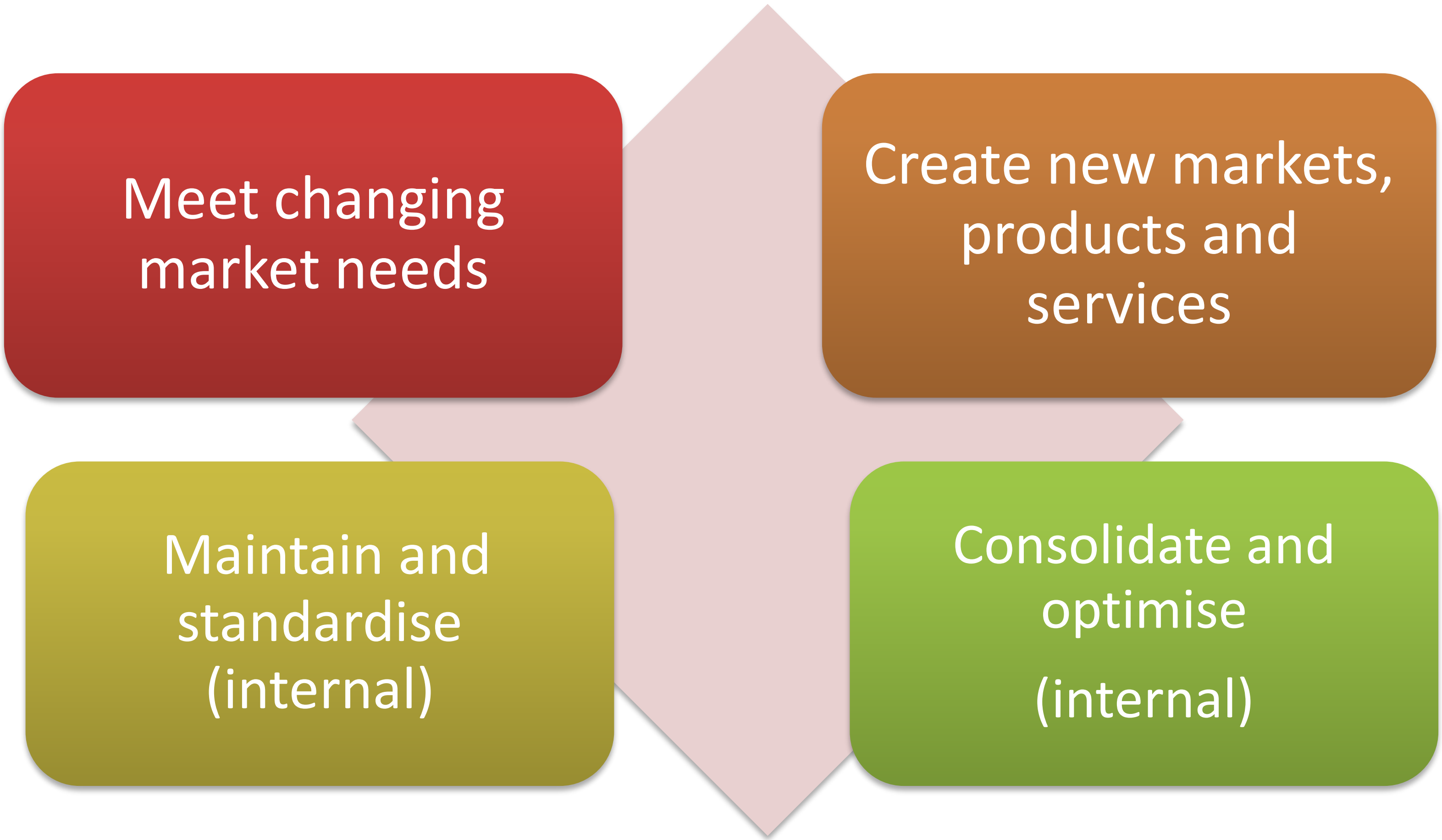
Oshri & Kotlarsky research (2011)*

- …innovation is important in partner selection
- …65% do not formally measure it
- …57% do not currently pay for it
- …the majority have no contractual mechanisms

How will you define and embed Innovation into current and future contracts?

*Dr. Ilan Oshri and Dr. Julia Kotlarsky of Rotterdam Business School and Warwick University – Study of Drivers of Innovation in Outsourcing

What kind of innovation is wanted?



Innovation categories

Strategic and Incremental

Strategic and Radical

Operational and Incremental

Operational and Radical

Operational and Incremental

- These bring operational and personnel changes that do not impact the client's specific business processes – but improve 'back office' operations and cost efficiency

- Usually these offer the ongoing maintenance / BAU of existing infrastructure, business applications and services

- Often relies on the selection of a supplier who does these tasks as **their** core business e.g. facilities management, travel, payroll, telecoms, IT

Maintain and standardise: 'more for the same'

Operational and Radical

- Consolidation and harmonisation of back-office processes, functions and platforms

- Often involves the de-duplication of current internal and external provision where the objective is to drive out internal efficiencies and secure financial gain

- Often rely on upgraded technology or business applications and require supply side investment and change management skills

Consolidate and optimise: ‘more for less’

Strategic and Incremental

- These bring supplier innovations to the client's business process and change the way the client business operates in some important way

- Required to maintain continuity of client facing operations, OR seen as an upgrade or enhancement of business functions to maintain market continuity

- Usually only contracted to supply side partners with intimate knowledge of the client business and where both parties have strong change management skills

Meet changing market needs: 'a better business'

Strategic and Radical

- These innovations significantly enhance the clients product/service offerings for its existing customers or enables entry into new markets

- Often requires a complete overhaul of business architectures, systems, information and processes

- The client will operate at some future point with new models of product and service delivery – that they could not have achieved without the supplier specific skill and expertise

Create new markets, products, services: 'Game changers'

Innovation outcomes

Better business

…internal and external

Game changers

…external

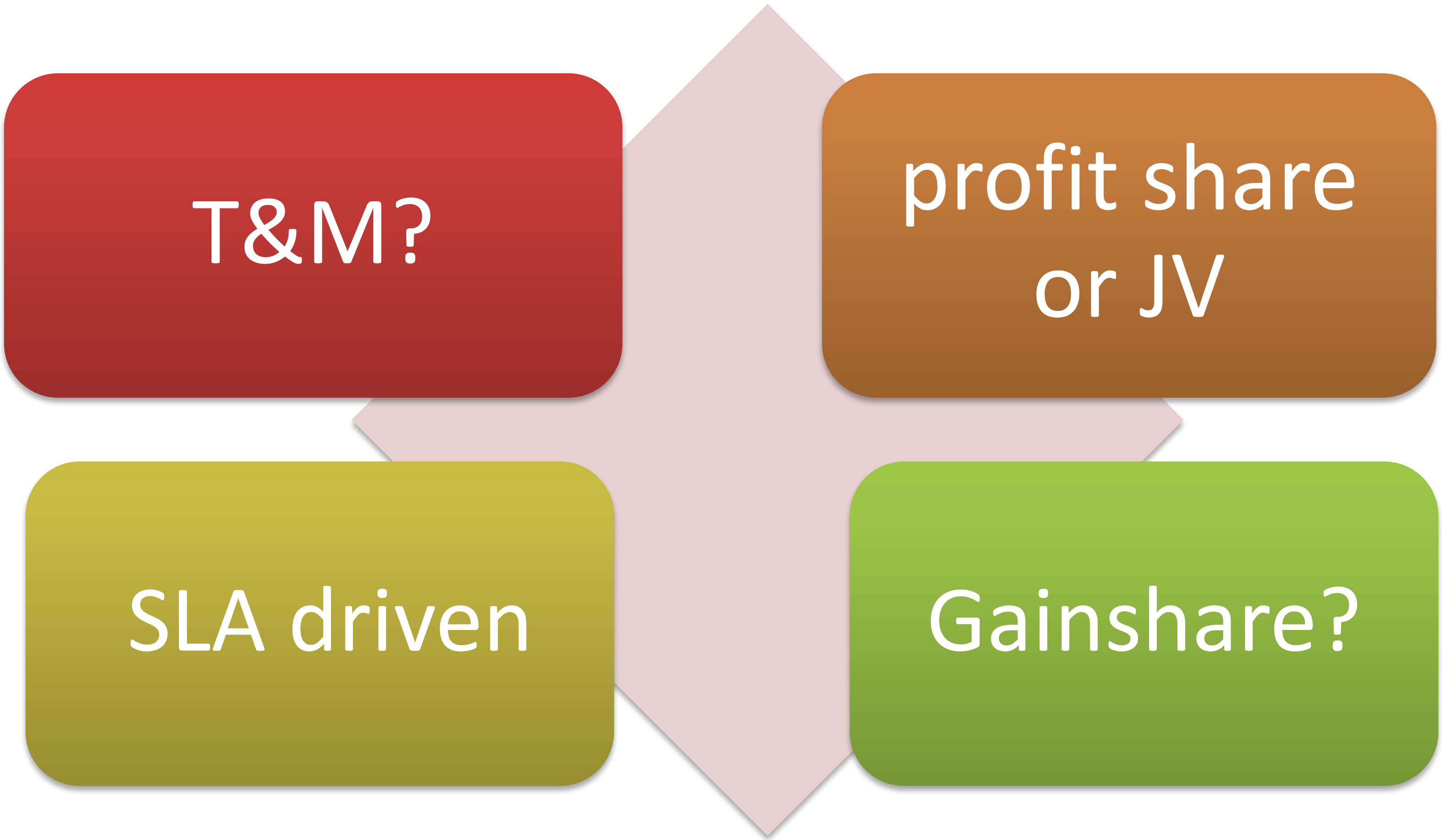
More for the same

…internal

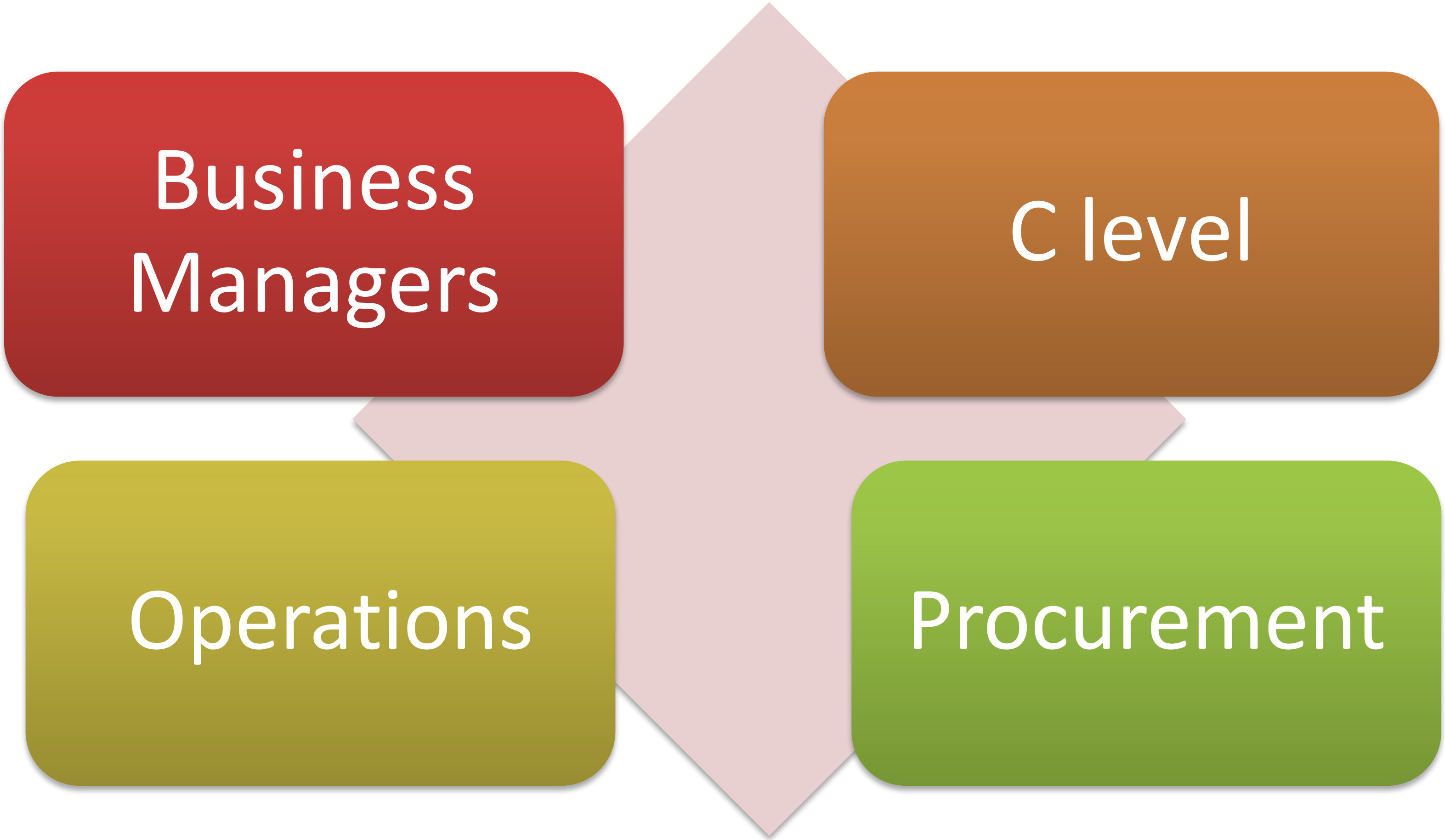
More for less

…internal

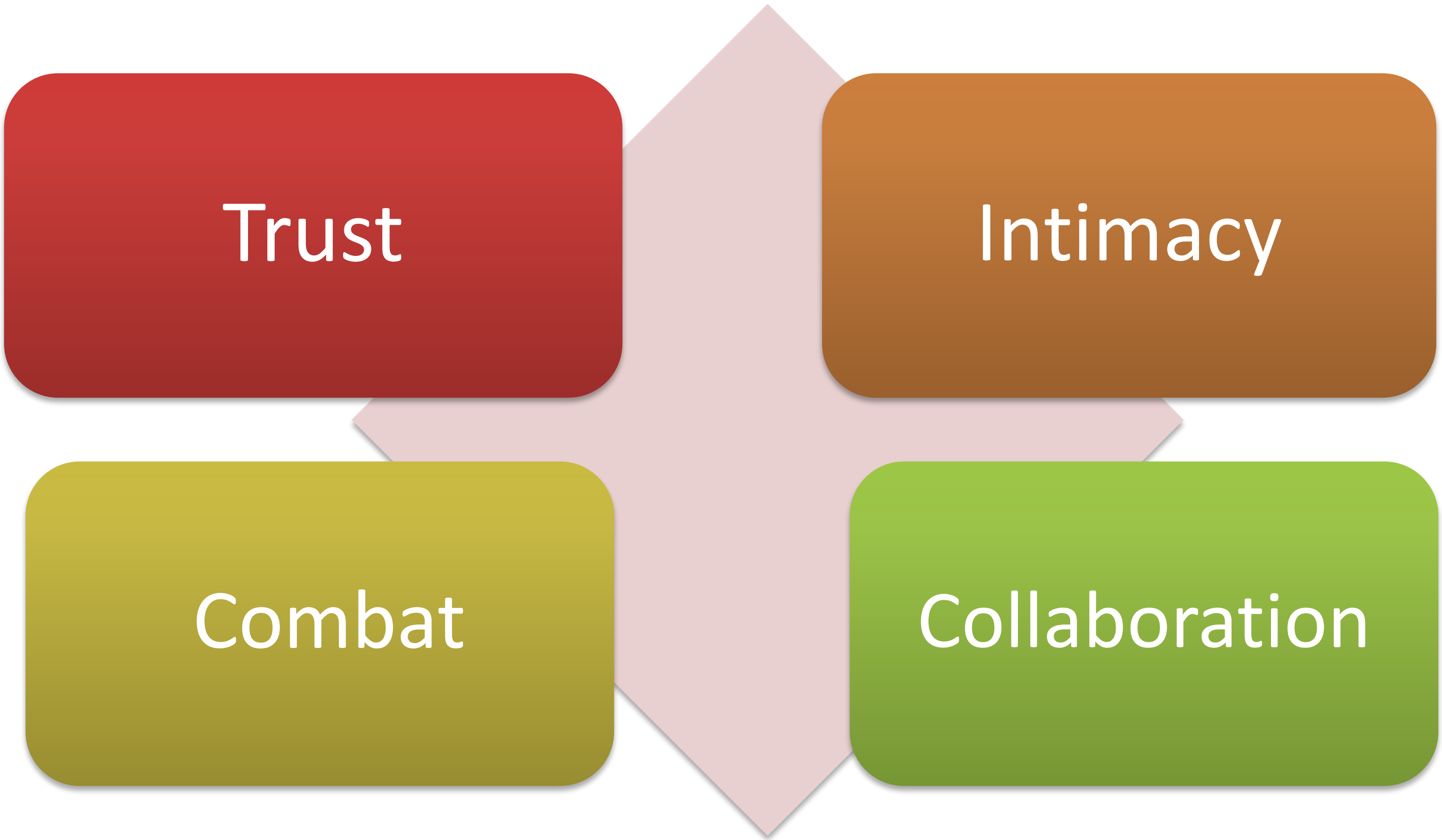
Innovation funding



Innovation ownership – client side



Innovation relationships



Planning for Innovation

Jointly define the term ‘Innovation’ as distinct from ‘Business As Usual’

Then, in five sequential steps…

1. categorise
2. design measurement instruments
3. create the appropriate contractual term(s)
4. build relationships
5. execute and measure

Step 1

Categorise the innovation type and impact

Decision makers on both sides need to consider and define what type of innovation is required i.e. high or low impact, incremental or radical.

Then to agree what is the desired impact of this innovation and, therefore, who is the best ‘owner’ within the supplier and within the client – this will inform decision about governance arrangements later…

Step 2

Design measurement instruments

In which all stakeholders (both client and supply sides) develop the metrics upon how and how often each innovation activity will be assessed.

This will determine the expected behaviour of all parties and provide an common baseline of understanding at Governance Boards

Step 3

Create the appropriate contractual term(s)

The commercial elements should be crafted to cover the responsibility for investment by either or both parties and include:

- performance targets
- compensation
- appropriate rewards
- clear ownership of risks
- ‘others’ (?)

Step 4

Build relationships

In which the client organisation and the supplier invest in appropriate resources, processes, methodologies and governance structures that support each innovation activity

This is distinct and separate from Business As Usual, and is expected to be fluid, changing and dynamic

This is where the core client/supplier relationships will be forged and the outcomes of Governance Boards will inform the appropriate contractual terms of the contract

Step 5

Measure innovation

In which both parties' monitor and verify the health and financial outcomes of the innovation programme.

Transparency of financial commitments and performance is fundamental for this to be successful.

Discussion points

a) How many people at this event have a contact where Innovation is an EXPLICIT requirement?
b) How many people at this event are aware that their current contracts have an IMPLICIT expectation of Innovation?
c) Who is responsible for driving Innovation into a contact? – the supplier or the customer… or both?
d) Who should own the innovation programme?
e) How should innovation be funded?
f) Who should fund the innovation programme?

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