

Digital Innovation and Design 1

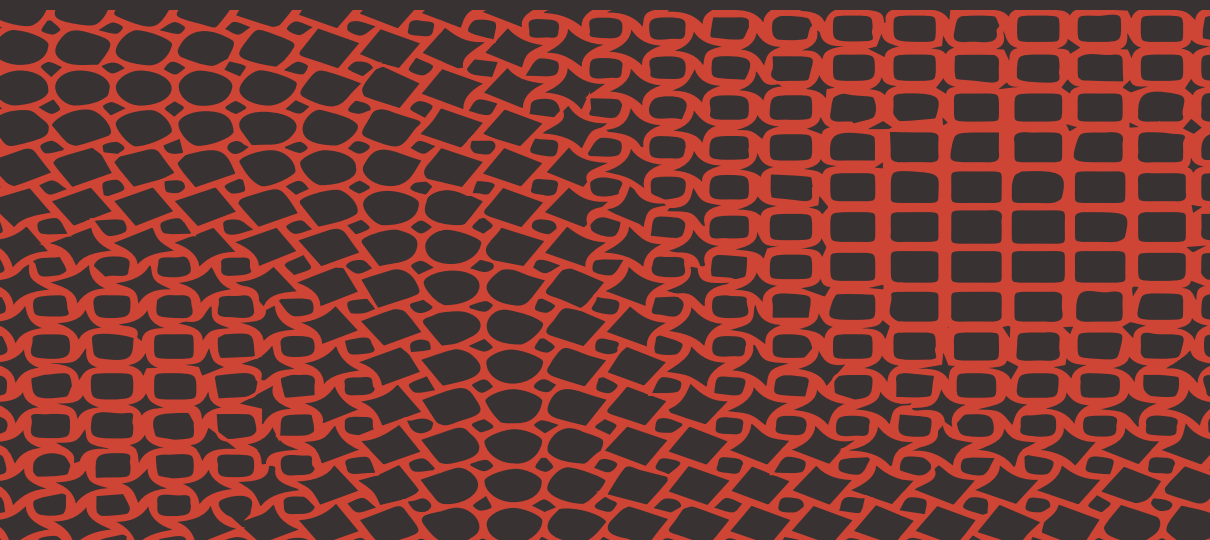
Outsourcing and Innovation

A Comparative Study
of Italy and the UK

edited by
Giovanni Vaia, Ilian Oshri



Edizioni
Ca' Foscari



Outsourcing and Innovation

Digital Innovation and Design

Collana diretta da | A series directed by
Giovanni Vaia

1



Edizioni
Ca' Foscari

Digital Innovation and Design

Direzione scientifica | Scientific editors

Giovanni Vaia (Università Ca' Foscari Venezia, Italia)

Ilan Oshri (Loughborough School of Business and Economics, England)

Outsourcing and Innovation

A Comparative Study of Italy and the UK

edited by
Giovanni Vaia, Ilan Oshri

Venezia
Edizioni Ca' Foscari - Digital Publishing
2015

Outsourcing and Innovation: A Comparative Study of Italy and the UK
Giovanni Vaia, Ilan Oshri (eds.)

© 2015 Giovanni Vaia, Ilan Oshri per il testo

© 2014 Edizioni Ca' Foscari - Digital Publishing per la presente edizione

Qualunque parte di questa pubblicazione può essere riprodotta, memorizzata in un sistema di recupero dati o trasmessa in qualsiasi forma o con qualsiasi mezzo, elettronico o meccanico, senza autorizzazione, a condizione che se ne citi la fonte.

Any part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means without permission provided that the source is fully credited.

Edizioni Ca' Foscari - Digital Publishing

Università Ca' Foscari Venezia

Dorsoduro 3246

30123 Venezia

<http://edizionicafoscar.unive.it/>

ecf@unive.it

1a edizione dicembre 2015

ISBN 978-88-6969-043-3 (ebook)

ISBN 978-88-6969-049-5 (print)

Progetto grafico di copertina: Studio Girardi, Venezia | Edizioni Ca' Foscari

Questa ricerca è stata realizzata con il supporto di Engineering SpA

This research has been realized with the support of Engineering SpA

Acknowledgments

The authors wish to acknowledge Gruppo Engineering for sponsoring the research. Special thanks to Maria Cristina Barbero, Gianluca Cozzolino, Alfredo Belsito for efforts and enthusiasm in understanding the nature of innovation in outsourcing relations.

Abstract

This research has been conducted by Prof. Ilan Oshri, Director of the Research Centre for Global Sourcing and Services at Loughborough University, Prof. Giovanni Vaia, Director of the Digital Enterprise Lab at Ca' Foscari University Venice, sponsored by Engineering, an Italian firm. The results of this study are based on a cross-industry survey carried out in 2015 with 150 client firms in Italy (75 firms) and the UK (75 firms) at the executive level who were directly involved in achieving innovation through outsourcing. In this study, researchers answer this question by comparing innovation performance of Italian and British client firms: how can companies achieve innovation through outsourcing engagements?

Summary

Giovanni Vaia, Ilan Oshri

Outsourcing and Innovation

A Comparative Study of Italy and the UK

Outsourcing and Innovation

A Comparative Study of Italy and the UK

Giovanni Vaia (Università Ca' Foscari Venezia, Italia)

Ilan Oshri (Loughborough School of Business and Economics, England)

Summary 1 Executive Summary. – 2 Trends in Outsourcing. – 3 Innovation in Outsourcing: Background. – 4 About this Research. – 5 The Nature of Innovation. – 6 Achieved Benefits from Innovation. – 6.1 Cost Saving Benefits. – 6.2 Improve Service Offering. – 6.3 Process Transformation Effect. – 6.4 Number of Innovation Solutions Delivered by Supplier. – 6.5 The Quality of Innovation Delivered. – 6.6 Interval Between Innovation Solutions Delivered by Suppliers. – 7 Differences and Similarities: The UK and Italy Outsourcing Sectors. – 8 Pricing Models for Innovation. – 9 The Content of the Contract and Innovation. – 10 Knowledge Exchange and Capabilities. – 11 The Relational Aspect. – 12 Innovation Mechanisms. – 13 How to Achieve Innovation in Outsourcing: The Innovation Ladder. – 13.1 Step 1: Strategizing Innovation. – 13.2 Step 2: Designing Measurement Instruments. – 13.3 Step 3: Assessing Supplier's Innovation Capability. – 13.4 Step 4: Designing a Relational Contract for Innovation. – 13.5 Step 5: Designing a Pricing Model for Innovation. – 13.6 Step 6: Measuring Innovation Performance.

1 Executive Summary

Italy is known for bringing to the world some of the greatest inventions and arts. Indeed, creativity and innovation are not strange phrases in many Italian sectors such as fashion, automotive and leather. But challenges to achieve innovation in the Italian service outsourcing sector still lay ahead. Recent reports have highlighted the complexity involved in fostering collaborative innovation between a client firm and a supplier, often resolving in unsatisfactory results. Hence, in this report, we seek to unveil whether the long innovative tradition plays a role in its local service outsourcing industry. A study of 150 British and Italian Service Outsourcing executives was carried out to examine their comparative innovation performance and the mechanisms that support innovation in each country. The results show that:

- Italian client firms reported more satisfaction with the quality, frequency and impact of innovation delivered by suppliers than their British counterparts;
- In outsourcing engagements where innovation is sought, Italian client firms' strategic intent has been revolving around the objective

to increase the pace of innovation within the firm while their British counterparts have been focusing on cost reduction;

- Italian client firms have mainly been using outcome base pricing model while British client firms have mainly been using fixed-price model.
- Italian client firms have been using advisory firms to a far more extent than their British counterparts;
- Italian client firms have reported higher degrees of collaborative mode of working with their suppliers than their British counterparts.

The results of this study suggest that a systematic approach to foster collaborative innovation is needed in which both relational and contractual aspects are integrated as part of the planning and delivery of value added services. We propose the Innovation Ladder framework as best practice to achieve such collaborative innovation.¹ The framework is made of six steps that guide executives in their quest for innovation in outsourcing. The uniqueness of this framework is that it corresponds to commonly-applied outsourcing lifecycle frameworks. These are the key steps:

- Step One: *Strategizing innovation*, in which executives need to consider what type of innovation is expected and what the expected impact of this innovation is at the operational and strategic level;
- Step Two: *Designing measurement instruments*, in which executives are required to develop the instruments for assessing improvements achieved through innovation;
- Step Three: *Assessing supplier's innovative capability*, in which executives are required to develop a methodology which guides them to consider the innovativeness of the supplier as part of other supplier selection criteria;
- Step Four: *Designing a relational contract for innovation*, in which the contract should be crafted to include a partnership platform for innovation;
- Step Five: *Designing a pricing model for innovation*, in which the parties should select the most appropriate pricing model to motivate and reward the supplier to innovate while safeguarding the client's objectives and interests;
- Step Six: *Measuring innovation*, in which the client firm monitors and verifies meeting performance targets.

The journey to achieving innovation in outsourcing is challenging for both client firm and supplier and as such it needs attention and nur-

1 Oshri I., Kotlarsky J.; Willcocks L.P. (2015). *The Handbook of Global Outsourcing and Offshoring*. London: Palgrave.

turing from the parties involved. The case of the Italian outsourcing sector demonstrates that innovation can be achieved when contractual and relational are properly integrated with the intention to transform transactional outsourcing engagements into collaborative partnerships.

2 Trends in Outsourcing

Recent years have witnessed an unprecedented growth of the outsourcing industry. By the end of 2014, the market has exceeded US\$700 billion. Recent estimates predict that the market will see 4.8% compound annual growth through the end of 2018. Interestingly, in 2014 growth in Europe has exceeded growth in the US for the first time ever. Further, nearly 120 offshore locations are now competing for IT outsourcing and business process services around the globe. As firms become more savvy consumers of outsourcing services, they apply various sourcing models varying from multi-supplier sourcing arrangements to the setting up of offshore captive centres where skills are available at the right cost.

There is now strong evidence that client firms have been focusing on getting value adding services from their third party supplier in addition to cost savings. In the quest for value adding services, client firms need to develop a systematic approach of working together with their third party suppliers to ensure the delivery of innovative solutions as part of their outsourcing engagements.

3 Innovation in Outsourcing: Background

In management terms, innovation can take the form of a *new product* or *service* offered to clients or a *new process* through which an organisation develops products or delivers services. Innovation can also be anything that is state-of-the-art and also anything which is new to the organization.

Innovation does not come easy, whether as an in-house process or through external partners. When in-house, inertia forces often obstruct attempts to innovate and break away from old ways. And when sought through relationships with partners, innovative efforts face additional challenges, for example having to agree and monitor how each party contributes to the partnership as well as benefits from the value created.

The outsourcing context poses additional challenges to achieving innovation between a client firm and a supplier. One of the main reasons often cited by CIOs for failing to achieve innovation in outsourcing is the difficulty to find the sweet spot between the collaborative attitude and the transactional approach, both needed in joint innovation projects. Further, client firms struggle to use pricing models that motivate the

supplier to engage in high risk innovation projects while safeguarding the parties' benefits.

So how can companies achieve innovation through outsourcing engagements? In this study, we answer this question by comparing innovation performance of Italian and British client firms.

4 About this Research

This research was conducted by Prof. Ilan Oshri, Director of the Research Centre for Global Sourcing and Services at Loughborough University, Prof. Giovanni Vaia (Ca' Foscari University Venice, Italy) and Engineering, an Italian firm.

The results of this study are based on a cross-industry survey carried out in 2015 with 150 client firms in Italy (75 firms) and the UK (75 firms) at the executive level who were directly involved in achieving innovation through outsourcing.

Forty five (45%) per cent of Italian executives interviewed for this study work in firms that employ less than 1000 employees from various sectors such as manufacturing (25%), retail (25%), finance (9%) and public sector (12%). Fifty three (53%) per cent of them work in the information technology department within the business with 34% of them having more than 5 years outsourcing experience.

Seventy one (71%) of British executives in this study work in firms that employ more than 1000 employees, representing similar spread of sectors such as manufacturing (23%), retail (23%), finance (16%) and public sector (13%). Fifty-three (53%) per cent of them work in the IT area and 55% of them have more than 5 years experience.

5 The Nature of Innovation: UK and Italy

Innovation comes in various forms and may have differing levels of impact. Some innovations are at the functional level while others are strategic. Innovations can be incremental, gradually affecting the business while other initiatives can be transformative, radically changing the way business is conducted in a short time. Traditionally, suppliers have been viewed as mainly capable of improving operations with little involvement in strategic challenges faced by their clients. Our results confirm this observation with respondents from the UK (85%) and Italy (88%) reporting that innovation achieved was mainly operational with the most common example cited as moving a system (e.g. email or procurement) to the Cloud. The few examples at the strategic level of innovation reported in this study were 'the development of a customer-focused platform to manage customer re-

relationship’ (Italy) and ‘[supplier] tailored a low-level solution for the Asian markets’ (UK). Our results suggest that there is little difference in how innovation is perceived in the Italian and British outsourcing sector. It is also evident that the adoption of Cloud Services by many organisations is perceived as an innovation initiative, though the focus is still on the technological solution rather than the impact on the business.

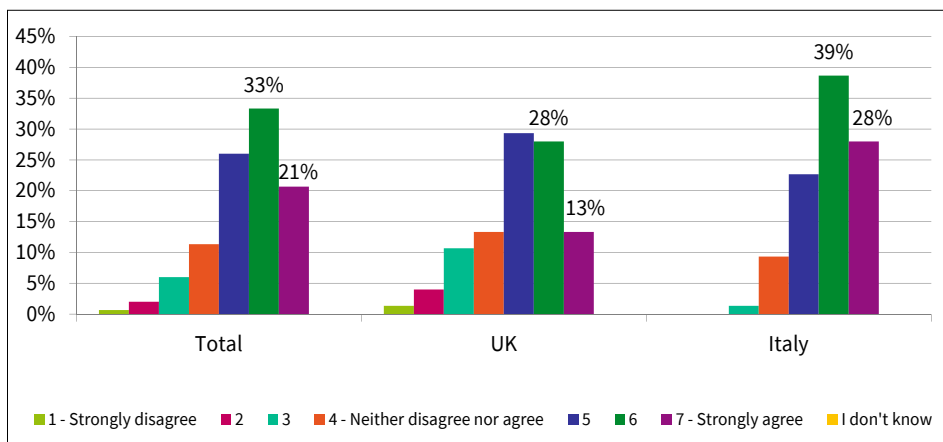
6 Achieved Benefits from Innovation: UK and Italy

Innovation can deliver various benefits to the client firm. Strategic innovation is expected to positively affect the way the client firm competes and penetrates new markets while operational innovation is likely to reduce operating costs and improve efficiencies. Our study reveals a significant difference in 6 areas of benefits from innovation between the Italian and British outsourcing sector.

6.1 Cost Saving Benefits

Sixty seven (67%) per cent of Italian executives reported that they strongly agree or agree with the statement that innovation contributed to a decrease in running costs compared with only 41% of the British executives (see Figure 1). These results may suggest the following: (i) innovation in Italy delivers a reduction in running costs more broadly than in the UK, and/or (ii) Italian executives are more content with the level of costs reduction deliver through innovative solutions by their suppliers than their British counterparts.

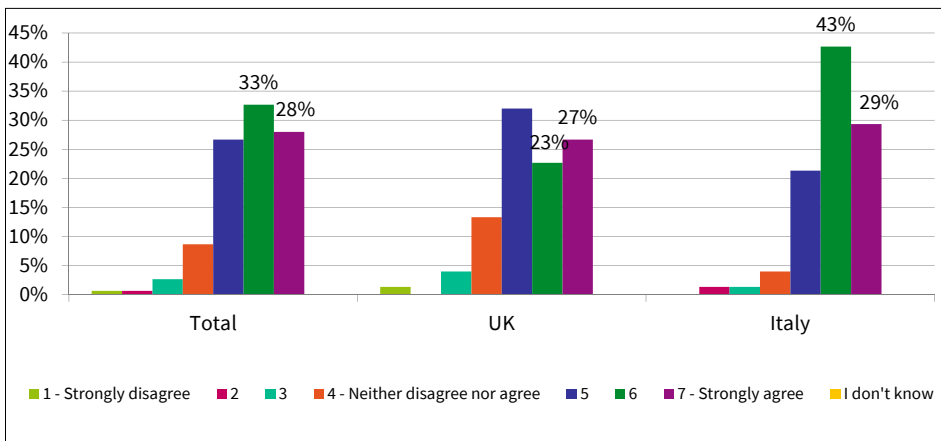
Figure 1. The innovation contributed to a decrease in our running costs



6.2 Improve Service Offering

Seventy two (72%) per cent of Italian executives reported that they either agree or strongly agree with the statement that innovation delivered by suppliers improved their service offering compared with only 49% of British executives. These results suggest that (i) innovation delivered in Italy is achieving a broader strategic impact on the business than in the UK and that (ii) Italian executives are more satisfied than British executives with the impact on service offering achieved by their suppliers through innovation.

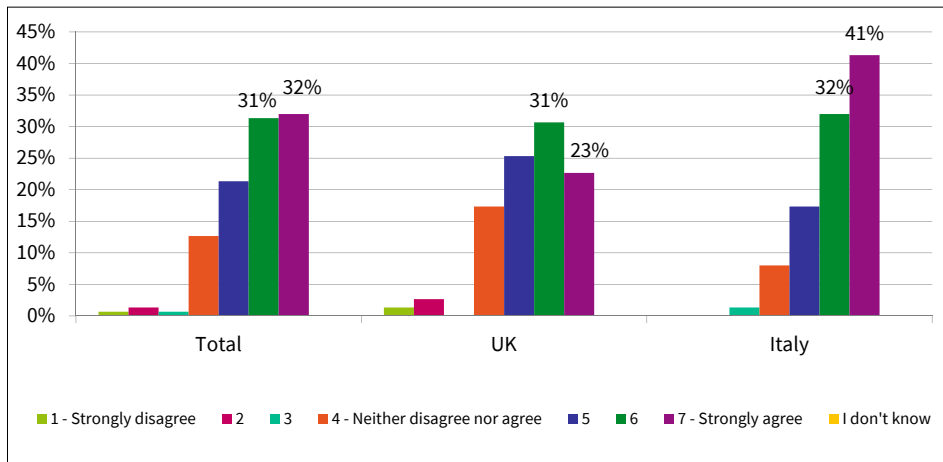
Figure 2. The innovation improved our service/product offering



6.3 Process Transformation Effect

Seventy three (73%) of Italian executives reported that they agree or strongly agree with the statement that innovation has led to transformation in processes compared with only 54% of their British counterparts. The results suggest that innovation in the Italian outsourcing sector delivers process transformation more broadly than in the UK and that Italian executive report satisfaction with the transformation delivered by their suppliers.

Figure 3. Innovation led to beneficial transformations in our processes

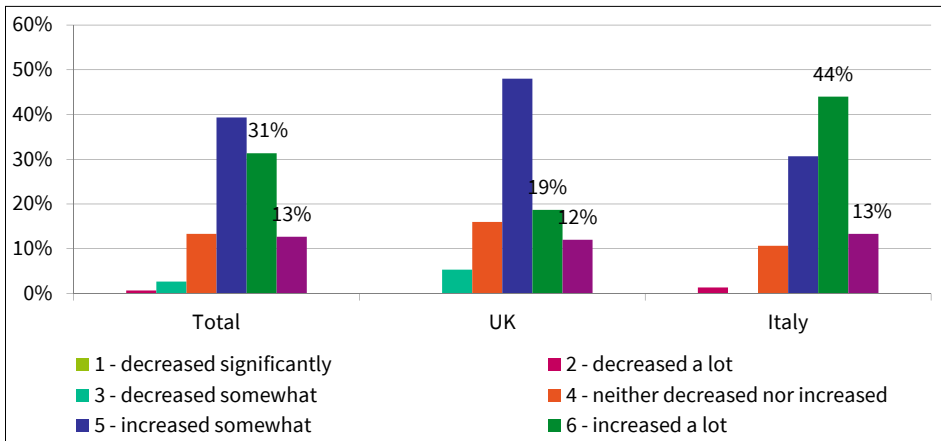


6.4 Number of Innovation Solutions Delivered by Supplier

Another indicator of innovation performance is the number of actual innovative solutions delivered by suppliers. An increase in solutions delivered by suppliers can be seen as a healthy indicator while a decrease in numbers may suggest that the parties have lost interest in pursuing innovation.

In our study, 57% of Italian respondents indicated that the actual number of innovation solutions has either ‘increased a lot’ or ‘significantly increased’ compared with only 31% of their British counterparts.

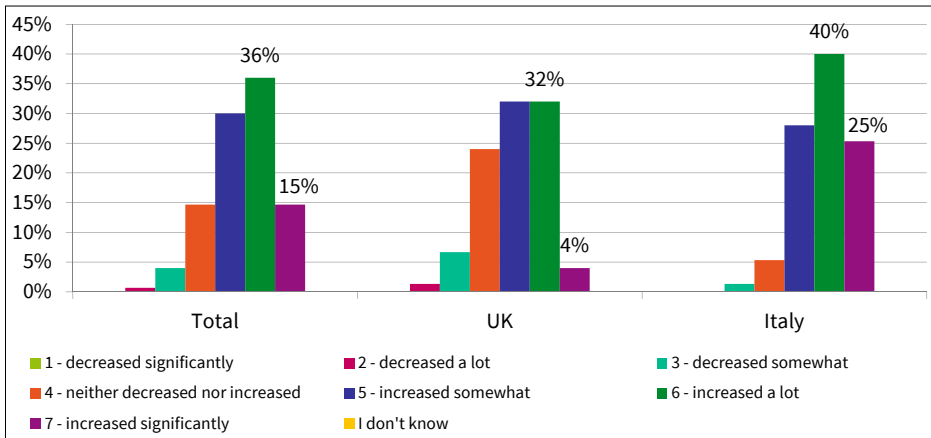
Figure 4. Actual number of innovative solutions delivered by our third party suppliers has...



6.5 The Quality of Innovation Delivered

We have also examined comparative perceptions of the quality of innovation solutions delivered by supplier. Sixty five (65%) of Italian executives reported that the quality of innovation solutions delivered by supplier has either ‘increased a lot’ or ‘significantly increased’ as compared with only 36% of the British executives.

Figure 5. The quality of innovations delivered through outsourcing has...



6.6 Interval Between Innovation Solutions Delivered by Suppliers

The rate that suppliers deliver innovative solutions is another health check of innovation performance in outsourcing engagements. Forty four (44%) of the Italian executives indicated that the frequency of delivering innovation solutions has either ‘increased a lot’ or ‘significantly increased’ as compared with only 19% of British respondents.

To sum, it is evident from the six areas of benefits examined here that Italian executives hold a much more positive view on their gains from innovation delivered by suppliers than their British counterparts. It is therefore intriguing to understand why Italian executives either gain or believe that they gain more than their British counterparts in terms of the number and quality of innovative solutions delivered by their suppliers.

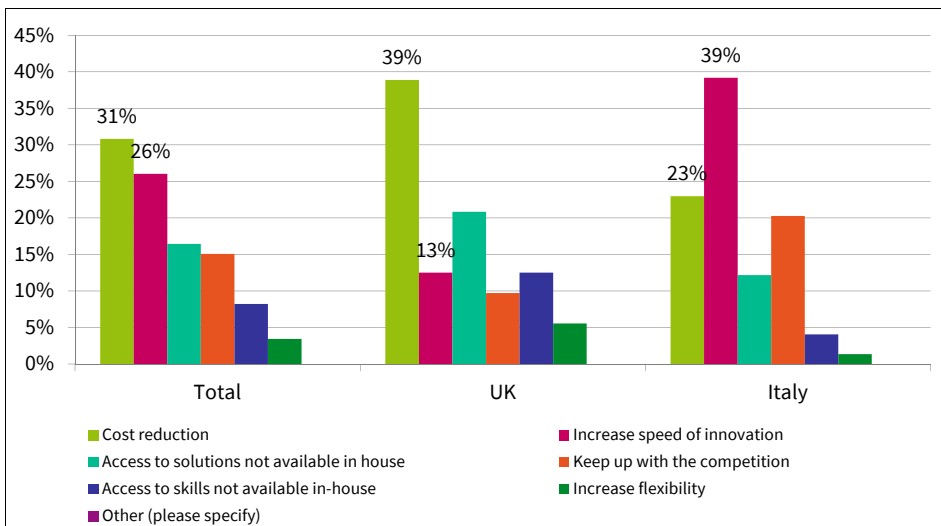
7 Differences and Similarities: The UK and Italy Outsourcing Sectors

We start investigating the sources of the differences in benefits from innovation by examining the characteristics of the outsourcing sectors in Italy and the UK.

We found three fundamental differences between the Italian and British outsourcing sector. First, the percentage of large firms (bigger than 1000 employees) participating in this study was higher in the UK (71%) than in Italy (55%). Indeed, the Italian economy is characterised by the relatively higher population of smaller firms as compared with most Western-European economies. The implications of this difference in terms of the firm size is that smaller firms are more likely to work with smaller suppliers thus more capable of maintaining close relationships with their suppliers that often lead to successful innovation.

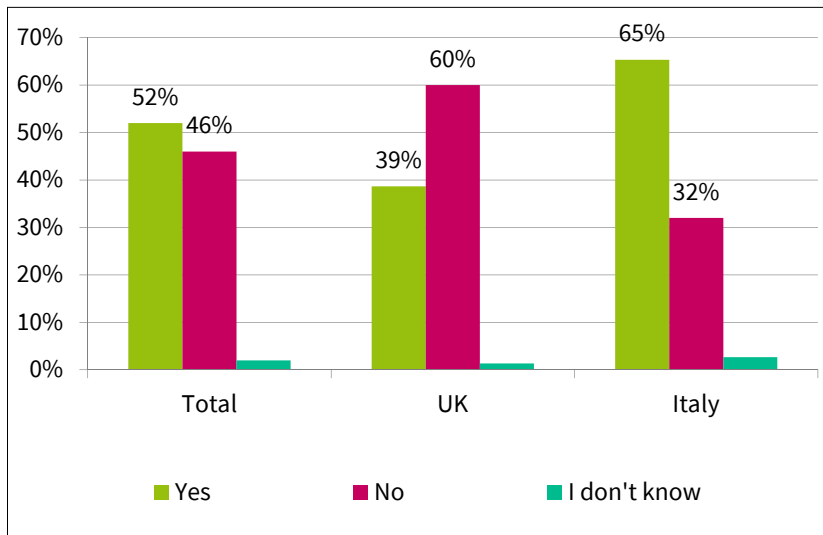
Second, the strategic intent for outsourcing the functions in which innovation was sought in Italy and the UK is different. In Italy, the main reason for seeking innovation was to speed up the rate of innovation within the client firm (39%) while in the UK the main driver was to reduce costs (39%). Indeed, most studies have persistently showed that the vast majority of the client firms' drive to outsource is cost reduction. In this regard, the Italian case presents a new motivator in the outsourcing literature that is purely focusing on innovation as an outcome of the outsourcing engagement.

Figure 6. What was your organisation's strategic intent behind outsourcing the areas for which innovation was important?



Last but not least, the vast majority of Italian client firms (65%) have used advisory firms to help them achieve innovation in their outsourcing engagements compared with only 39% of their British counterparts. This approach by Italian firms may have helped them use best practices and advance methodologies leading to high innovation performance.

Figure 7. Did your organisation use an advisory firm to help you get innovation from your third party suppliers?



Other parameters examined in this study did not show significant differences between Italian and British outsourcing sector. Respondents from the UK and Italy were predominately from the IT area within the organisation (see Figure 8) with an average of 5 (Italy) or 7 (UK) years experience in outsourcing. Similarly, both Italian and British client firms have had 6 years of outsourcing experience on average. The distribution of functions outsourced by Italian and British firms is very similar with IT infrastructure as the most popular and legal as the least popular functions (see Figure 9).

Digital Innovation and Design 1

Figure 8. Which area of your organisation do you work in?

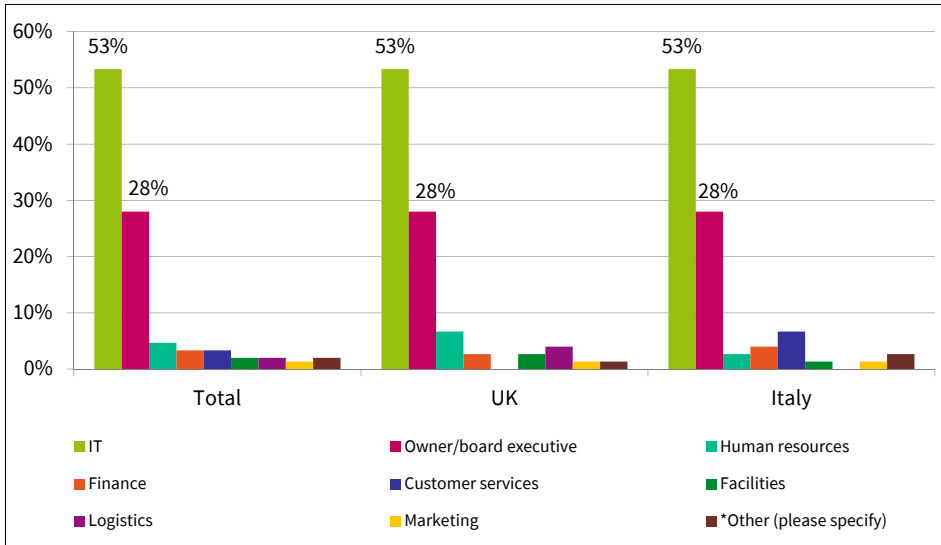


Figure 9. Which of these areas does your organisation currently outsource to third party suppliers?

Base: all respondents	Total	UK	Italy
IT infrastructure	71%	65%	77%
Application development	57%	57%	57%
Software testing	49%	49%	48%
Application maintenance	47%	49%	45%
Finance and accounting	35%	28%	43%
Data warehousing	32%	36%	28%
Procurement	29%	20%	37%
Human resource management	23%	17%	28%
Contact centres	23%	24%	21%
*Other (please specify)	2%	4%	0%
Base	150	75	75

8 Pricing Models for Innovation: The UK and Italy

Selecting a pricing model that may facilitate innovation is imperative. The professional and academic literature has traditionally focused on two pricing models: fixed-price and time and materials. Recently, an outcome-based pricing model has been applied more frequently in outsourcing settings though it is still not as popular as the other two. The common assumption in the academic literature is that these pricing models can play different roles in supporting innovation. At the basis of this claim is the postulation that innovation bears some degree of uncertainty for the supplier. Therefore, a fixed price model, which presents little tolerance of uncertainty, is unlikely to support innovation. Time and materials may accommodate the supplier's risk mitigation strategy as the supplier can recover any investment made; however, the client might be exposed to on-going payments which may negatively affect the relationships with the supplier if the innovation is not well defined. Last but not least, an outcome-based model may reduce the client's risk and may serve the supplier's agenda to pursue well-defined innovation targets. As such, an outcome-based model may support innovation. Recently we reported that the combination of incentive-based clauses with either fixed-price or time and materials is also likely to promote innovation.

In this study we observed a significant difference between the pricing model used by Italian and British firms in outsourcing engagements where innovation was sought. While fixed-price was the leading pricing model in the UK (45%), Italian firms have adopted an outcome-based pricing model (40%) (see Figure 10). These results confirm our observation that outcome-based pricing models are more likely to result in higher degrees of innovation while fixed-price contracts are more challenging to deliver innovation. Our results also show incentive-based models such as gain-sharing or risk sharing are hardly used in the UK and Italy, though executives from both sectors hold the perception that such pricing models are likely to deliver innovation (total 60%) (see Figure 11).

Digital Innovation and Design 1

Figure 10. What was the pricing model used in the project in which your organisation achieved or tried to achieve innovation?

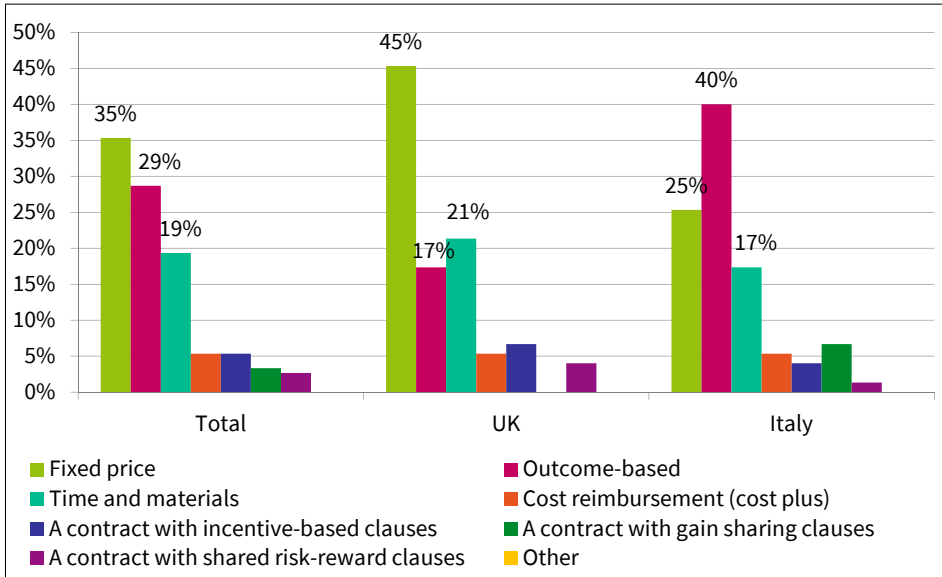
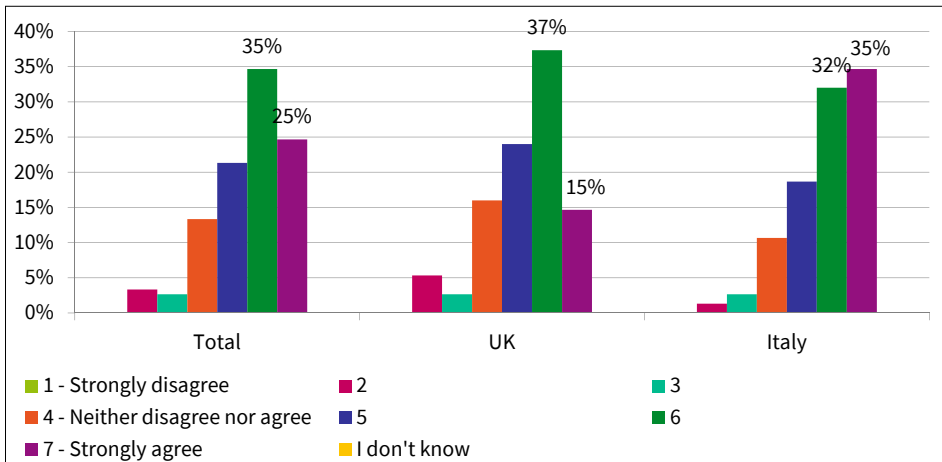


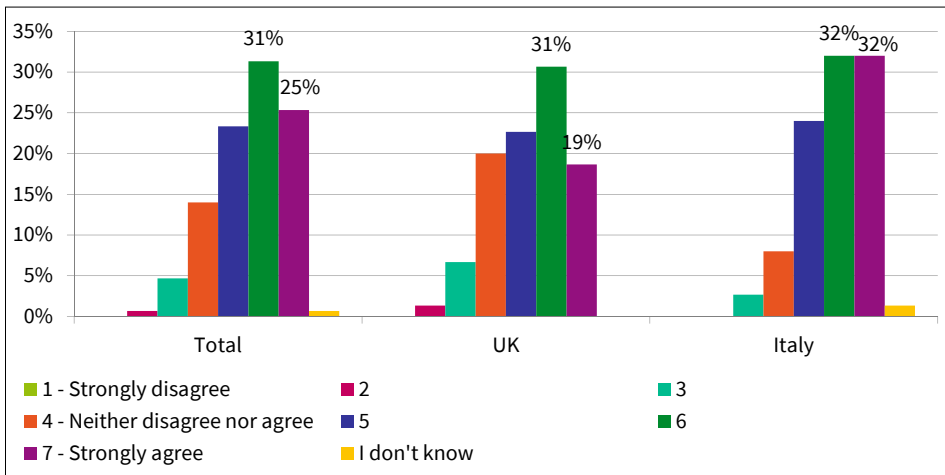
Figure 11. A contract with gain-sharing clauses provides incentives for third party suppliers to deliver innovation in outsourcing engagements



9 The Content of the Contract and Innovation: The UK and Italy

While the pricing model signals whether innovation can be accommodated, there are elements captured in the contract that may inhibit or promote innovation. We have examined 5 aspects namely, mandatory targets, measures for innovation, flexibility about delivery scopes, penalty schemes, flexibility regarding service costs and service quality, and their effect on innovation according to the views hold by Italian and British executives. Our analysis shows that Italian executives supported penalty schemes (51% versus 40%), flexibility in terms of service costs (57% versus 43%) and preferred to focus on service quality rather than costs (64% versus 50%), which in their opinion led to innovation.

Figure 12. In order to achieving innovation through outsourcing, the contractual agreement between the client and third party supplier needs to focus on service quality rather than costs

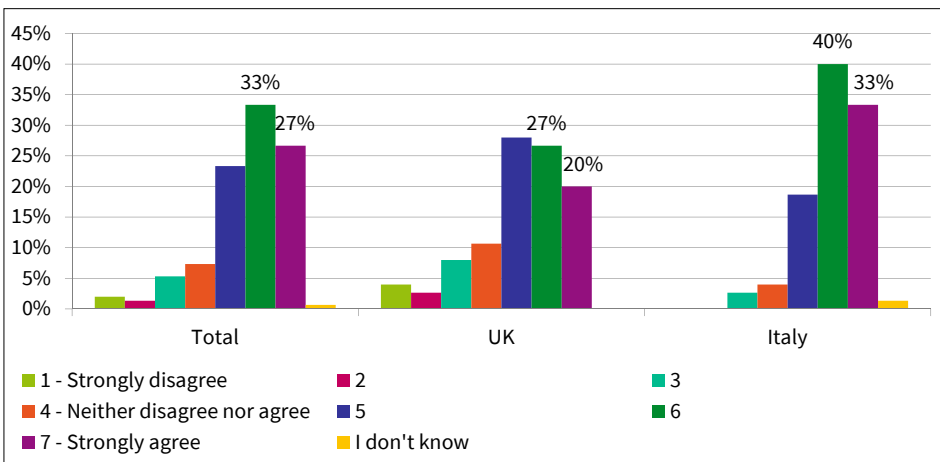


10 Knowledge Exchange and Capabilities: The UK and Italy

Innovation is enabled by the innovator’s ability to understand the challenge, apply knowledge to search and develop solutions, tap into resources and capabilities in order to implement a solution and measure the impact of the innovation. Firms that have outsourced functions may have lost specific domain knowledge that may hamper their innovation efforts. Therefore, it is imperative to understand the role that knowledge and capabilities play in supporting innovation in outsourcing.

In our study, 77% of the Italian executives agree or strongly agree that suppliers have had in-depth knowledge of the particular service where innovation was achieved as compared with 56% of their British counterparts. Similarly, 71% of Italian executives agree or strongly agree that suppliers understood processes relating to this particular service as compared with only 56% of the British executives. The most striking difference was found with regard to the statement that third party suppliers understood processes relating to this particular service, where 73% of the Italians strongly supported it compared with only 43% of the British respondents.

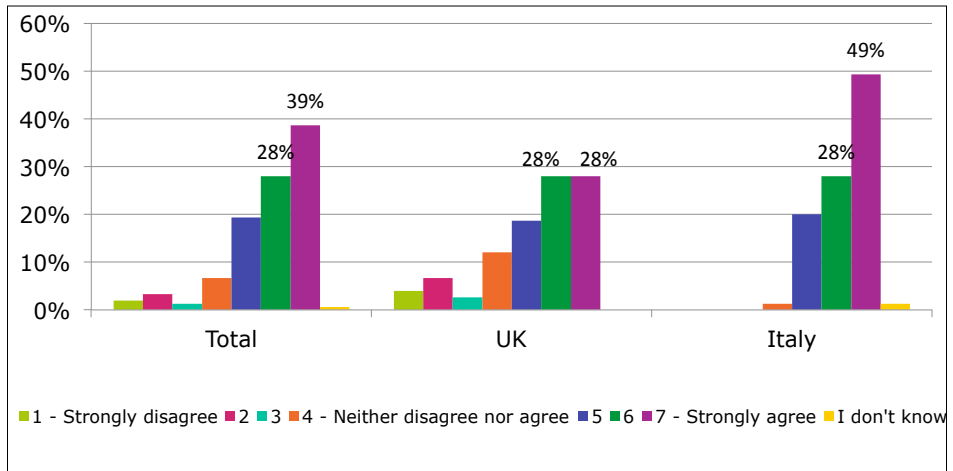
Figure 13. How much you agree or disagree with the statement – third party supplier understood the strategic roadmap of this particular service



While it is imperative for successful joint innovation projects that the supplier possesses domain and strategic knowledge about the client’s systems and services, it is no less important that the client firm understands the supplier’s capabilities and its strategic goal. In our study, 76% of Italian

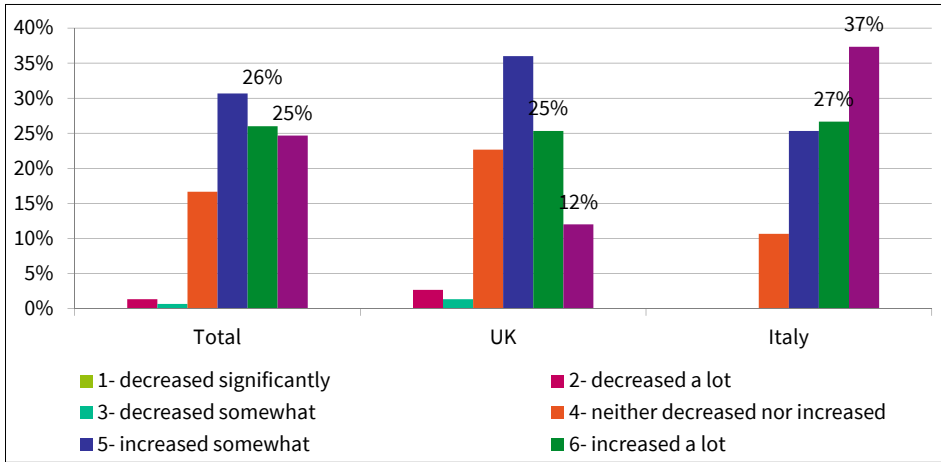
executives agree or strongly agree that they possessed sufficient understanding of the supplier’s capabilities and understand the supplier’s strategic goal for this particular service (75%) compared with 52% and 56% of the British respondents respectively.

Figure 14. We understood the supplier's strategic goal for this particular service



When examining the on-going trend towards exchanging knowledge between the client and supplier, we found that 61% of Italian executives hold to the view that suppliers’ knowledge of their business challenge has either increased a lot or significantly increased in the last 5 years as compared with only 45% of their British counterparts. Further, 59% of Italian executives claim that their efforts to educate suppliers about business challenges has increased a lot or significantly increased as compared with only 33% of the British respondents. Last but not least, 64% of Italian respondents hold to the view that in the last 5 years their ability to assess suppliers’ capabilities to innovation has increased a lot or significantly increased compared with only 33% of the British executives in this study.

Figure 15. My organisation's ability to assess the third party suppliers' capability to innovate has...



To sum, this study shows that the Italian outsourcing sector is expressing confidence in its ability to exchange knowledge between the client and supplier, educate the supplier about business challenges and develop tools to assess the supplier’s ability to innovate. The British outsourcing sector holds a positive view on these matters; however, far more reserved about its ability to exchange knowledge with its suppliers.

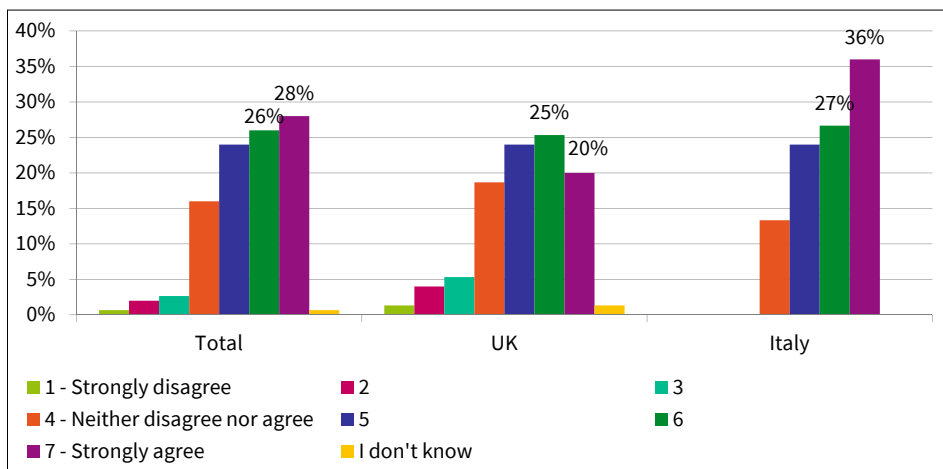
11 The Relational Aspect: The UK and Italy

Close collaboration between client and supplier is imperative for innovation through outsourcing. It is not easy to develop a collaborative mode, as client firms often find it easier to resort to a transactional approach, in particular when cost reduction is the primary objective. A collaborative approach often means that the client and supplier need to align their goals and objectives, develop shared understanding and continue to motivate each other to pursue innovation. There has to be a high degree of trust and open communication between the parties as well as high commitment to implement innovative ideas.

Our results show that both Italian (59%) and British (57%) executives agree or strongly agree that their suppliers are part of the team that works on innovation and hold a similar view about the level of trust between the parties (63% of Italian and 61% of British). However, when examining the way they collaborate with their suppliers, certain differences have emerged between Italian and British executives.

Sixty four (64%) of Italian executives reported that they either agree or strongly agree that they and the supplier work as one team in developing innovative solutions compared with 55% of British respondents. Further, 52% of the Italian executives (compared with 37% of their British counterparts) reported that supplier employees involved in innovative work were (at least temporarily) located at our organisation’s site. Co-location of employees is critical for the joint development of innovative solutions, such as business solutions. Finally, 63% of Italian respondents expressed that they treated supplier employees as their employees compared with only 45% of their British counterparts.

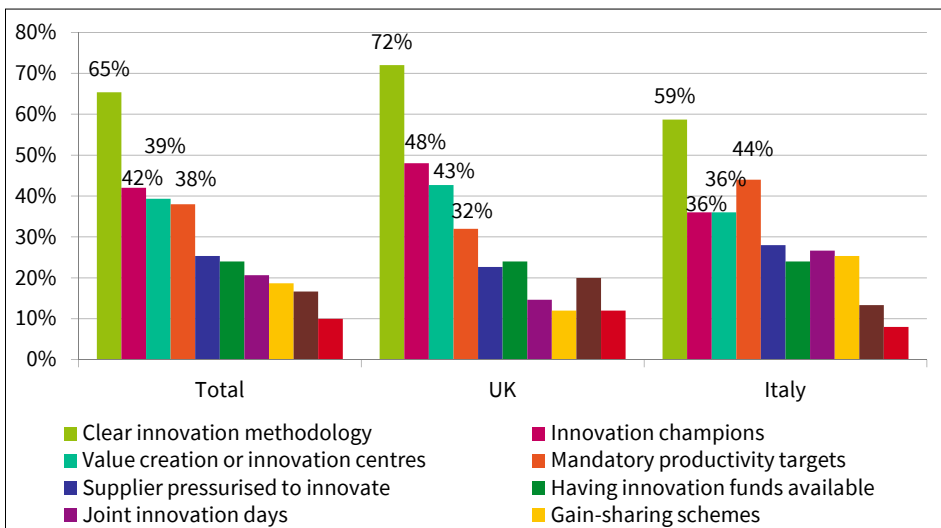
Figure 16. We treated the key third party supplier employees like our own employees



12 Innovation Mechanisms: The UK and Italy

Respondents were asked to rank the mechanisms that led to innovation in their projects. Our results show that British and Italian executives are in agreement that ‘clear innovation methodology’ is the most important mechanism, followed by ‘innovation champions’ (2nd for British, 3rd for Italians), and ‘value creation centres’ (3rd for Italians and 3rd for British). Italian respondents ranked ‘mandatory productivity targets’ as second in importance, giving this mechanism higher weight in driving innovation in their projects.

Figure 17. The mechanisms leading to innovation



13 How to Achieve Innovation in Outsourcing: The Innovation Ladder

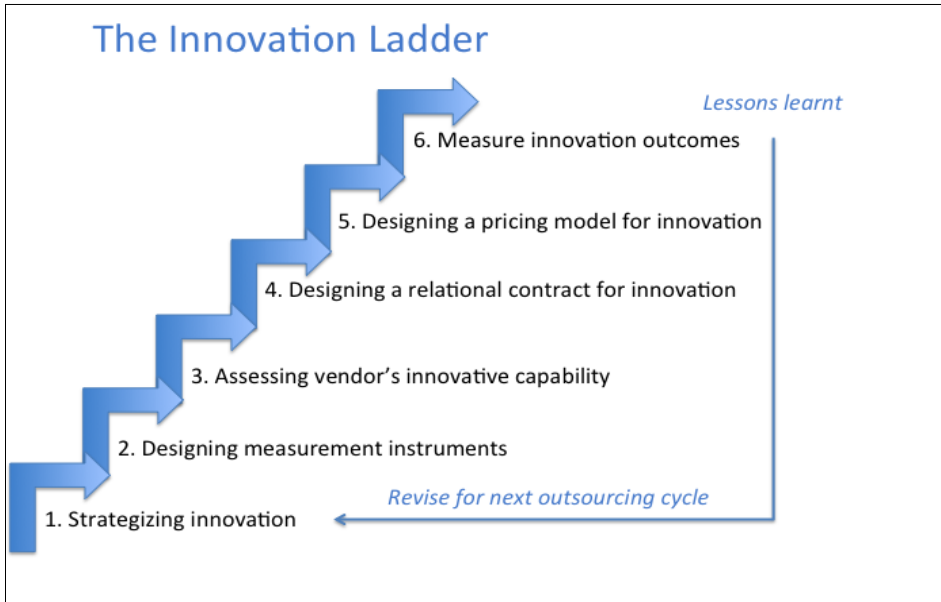
The data and analysis presented in this report offers a rare opportunity to examine why Italian client firms report higher levels of satisfaction with innovation delivered through outsourcing. At the heart of the analysis, we see an interaction between relational and contractual elements that create a far more accommodating collaborative platform for Italian client firms to motivate their suppliers to engage in higher risk innovative projects. Creating the conditions for innovation starts by having a strategic intent that is about improving innovation performance within the firm, as the Italian executives indicated, opposed to the cost reduction focus by British firms. However, client firms need to back-up their intentions with appropriate and relevant actions. Indeed, Italian executives reported higher commitment levels to pursue a relational approach through co-location and knowledge exchange tactics and a one-team approach as well as applied an outcome-based pricing model that is more likely to deliver innovative solutions. Further, though Italian firms were smaller in size, they reported a much more dependence on advisory than British firms, an approach that has led to higher degree of satisfaction from innovation delivered by their suppliers. Last but not least, Italian firms have persistently reported in this study that the quality of the service matters more than any other objective, a strong signal to suppliers that such a partnership is about searching for the best solution rather than the cheapest. Such an approach nurtures a culture of innovation within the client firm and its suppliers.

While our comparative analysis sheds some light about innovation in outsourcing, one pestering question remains: can client firms achieve innovation from suppliers in a systematic manner?

We developed a framework that we call The Innovation Ladder² (Figure 18) to help client companies incorporate innovation in their outsourcing strategy. The emphasis in our approach, as opposed to some other studies we have seen, is that we believe that the innovation strategy should be integrated into the outsourcing strategy of the client firm. The Innovation Ladder is a full cycle approach from the beginning of the outsourcing relationship until the delivery of innovation. Yet, client firms can pick and choose some steps depending on the breadth of innovation sought and on the nature of the relationship they establish with their suppliers.

2 Adapted from Oshri I., Kotlarsky J.; Willcocks L.P. (2015). *The Handbook of Global Outsourcing and Offshoring*. London: Palgrave.

Figure 18. The Innovation Ladder in Outsourcing



13.1 Step 1: Strategizing Innovation

A journey into innovation in outsourcing should start at the early stages of strategizing the outsourcing project. These early stages of the outsourcing life-cycle often involve the identification of objectives and the potential areas for improvement derived from the outsourcing engagement. At that point in time, it is imperative that executives will define what innovation means in the context of the outsourcing engagement.

In principle, executives should define three areas of improvements when strategizing innovation in outsourcing: information technology operational innovation, business process innovation and strategic innovation.

IT operational innovation is when the supplier introduces technology changes not impacting firm-specific business processes. Business process innovation is about changes in the way the business operates in some important way and strategic innovation focus on transforming business performance or enabling the firm to enter new markets³.

By bringing together these three aspects of innovation in outsourcing

3 Cfr. Weeks, Feeny 2008.

during the early stages of the planning, clearly defining each area, the client firm will be able to devise an approach to realizing the innovation potential from each setting. Below we describe in depth each of the following steps.

13.2 Step 2: Designing Measurement Instruments

As a second step, client firms need to develop a framework within which innovation will be pursued. Within this framework, client firms should outline specific areas of innovations expected in the outsourcing engagement. These innovations should be labelled as IT operation innovation, business process innovation and strategic innovation and the strategic intent behind each area should be clearly outlined. Client firms should also develop the measurement instrument per each area of innovation (e.g., % of cost reduction, % of improvement in time-to-market or a % reduction in process duration). In the case of strategic innovation, client firms should also relate targets to Key Performance Indicators (KPI) and Key Success Factors (KSF) at the industry level. The contract should also have a clear reference to how the supplier will be rewarded if it improves the measurements further (e.g., bonus as % of additional cost savings that result from process improvement). As part of the design of measurement instruments, the client firm should assess its internal innovation and change capabilities and the mechanisms available to collaborate with its supplier network.

13.3 Step 3: Assessing Supplier's Innovation Capability

Having carefully crafted the measurement requirements for the desired innovation, it is now the time to develop a set of criteria upon which the innovativeness of the bidding suppliers will be assessed. While our research suggests that many client firms consider the innovativeness of their suppliers as one of the selection criteria, to our knowledge, no study has so far revealed what these criteria were, as well as how they should be applied in the context of innovation.

There are various ways to seek proven evidence of innovativeness from a supplier. Some of the examples we have come across are in the form of referral letters from existing and past clients, supplier's case studies about innovation delivered and evidence of the supplier methodology to deliver innovation. There is also a need to understand the supplier's relationship capabilities as an indicator of its collaborative approach and commitment. These inputs will allow the client firm to systematically compare between bidders when selecting an innovative supplier.

13.4 Step 4: Designing a Relational Contract for Innovation

Once the supplier selection phase has been concluded, the attention of the parties involved should shift to the design of a relational contract. Our results clearly suggest a collaborative approach is the best basis for developing a contract that facilitates innovation. Firstly, in order to define a win-win situation, supplier and client firms need to allow sufficient time prior to signing the contract to reach a shared understanding of each other business goals and objectives, and to discuss their potential shared interests in innovation. Apart from such an alignment of goals and objectives, trust and open communication obviously help in laying open the innovation needs and potential cost saving on both sides. These early negotiations should also include securities for the supplier for the case that they suggest innovations. By building flexibility into the agreement, deliverables can be modified following innovative ideas, without requiring a renegotiation of terms and clauses. Such securities in turn facilitate the necessary openness and proactivity on the side of the supplier. However, not only the supplier but also the client needs to be open about their needs. Similarly, significant proactivity and effort are required not only by the supplier but also the client to follow up and implement innovative ideas. This effort is somewhat alleviated through a well-defined innovation methodology than can be part of the contract. For example, the steps, timing, and responsibilities for piloting and implementing an innovation, and certain times for innovation days can be defined in the contracting phase.

13.5 Step 5: Designing a Pricing Model for Innovation

One very clear result from this study is that the pricing model chosen for an outsourcing engagement in which innovation is sought should be carefully considered. It appears that a stand-alone fixed-price or time and materials pricing model is unlikely to deliver innovation mainly because these pricing models offer little incentives for the supplier to engage in a higher risk, and sometimes ill-defined innovation projects. On the other hand, an outcome-based pricing model offers clarity with regard to the expected results thus motivating the supplier to consider engaging in innovation. Further, gain-sharing clauses in any pricing model are also likely to motivate the supplier to engage in innovation, as the returns on the investment are clear. The challenge for most client firms lies in moving away from the traditional pricing models that currently rely heavily on fixed-price and time and materials models, and consider more complex pricing models that combine some degree of flexibility within the traditional well defined clauses.

13.6 Step 6: Measuring Innovation Performance

There is a general belief that innovation improves business performance; however, in the context of outsourcing it appears that many firms do not measure its impact. Client firms, therefore, should invest more in understanding the impact of innovation delivered on the firm's operations and strategic positioning. We believe that most firms can, in fact, measure the return on the outsourcing investment, in a quantifiable form, should they follow steps 1 and 2 of the Innovation Ladder in which the objectives and measurement instruments have been defined. Measurement instruments may have to be revisited during the project lifecycle, however, their impact can still be assessed.

Measuring strategic innovation is more challenging to measure; however, the client firm should seek both qualitative and quantitative inputs regarding performance. In terms of qualitative feedback, the client firm should seek input regarding the quality of the network created to arrive in strategic innovation. Periodical surveys among members of the joint effort regarding the quality of collaboration, motivation to contribute, assessment of each partner's contribution and intention for future collaboration can provide an indication regarding the 'health' of the relationships and the will to innovate. Quantifiable measurement tools to assess the impact of the strategic innovation on business performance should be in the form of benchmarks against industry performance. In particular, as strategic innovation was sought to improve the competitiveness of the firm either through operational excellence or strategic positioning, the client firm should judge the impact of this innovation through industry-wide performance indicators. For example, the quality of service provided, represented through various measurable indicators such as customer satisfaction, is one performance indicator that can be used by service firms.

Step 6 is not the last step in the innovation ladder. If anything, it is a step that calls for reflection and a stage that offers an opportunity redesign the innovation framework. Feedback collected during these six steps should serve the client firm in its journey to achieve innovation in outsourcing.

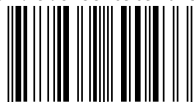
Stampato per conto di Edizioni Ca' Foscari - Digital publishing, Venezia
nel mese di novembre del 2015
da Logo srl, Borgoricco (PD)

The results of this study are based on a cross-industry survey carried out in 2015 with 150 client firms in Italy (75 firms) and the UK (75 firms) at the executive level who were directly involved in achieving innovation through outsourcing. The researchers answer this question by comparing innovation performance of Italian and British client firms: how can companies achieve innovation through outsourcing engagements?



Università
Ca'Foscari
Venezia

ISBN 978-88-6969-043-3



9 788869 690433 >

EDIZIONE NON VENALE