

# Outsourcing : The Innovator's Secret

Why companies in pursuit of innovation  
and advantage outsource



Transforming applications into business advantage

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# Executive Summary

Most companies have historically viewed IT outsourcing as a cost-reduction play<sup>1</sup>, simply a matter of transferring assets over to a provider who has the scale to deliver the service cheaper. Though justified by this cost reduction, this has often been at the expense of flexibility. The most innovative companies, however, have historically regarded outsourcing as a way to focus on their core business and differentiation, and as an enabler to growth<sup>2</sup>. The ongoing shift from IT as business cost to IT as business value<sup>1</sup> means that more companies need to learn the lesson of effective outsourcing. Treating outsourcing as merely a cost-reduction mechanism can prevent innovation and slow down business growth. The objective, therefore, is to use Outsourcing as a platform for innovation; this means shifting away from seeing IT outsourcing as responsible for just the operation of systems and towards a full lifecycle view of outsourcing based on the IT and business services that are being provided.

The next generation of IT Outsourcing is about providing full lifecycle support for business services, not about keeping the lights on in application operation.

# Innovation isn't about technology

**“The big challenge with the Information Communication Technology (ICT) trends is that they are about technology flexibility, not necessarily about business flexibility”<sup>8</sup>**

There has been considerable research<sup>3</sup> on how IT spending impacts with some commentators claiming that IT makes no impact on business<sup>4</sup>. The reality, however, is that it is not how much money is spent but on what the money is spent<sup>5</sup> and that smart use of money in IT is what drives business improvement and competitive advantage<sup>6</sup>.

Innovation is not simply about using new technologies. It is about the effective application of new, and old, technologies to deliver new value to the business. It is not sufficient to seek to adopt new technologies simply because they are new as this is unlikely to deliver innovation and potentially causes more problems.

# Understanding how innovation matters

**“The challenge for businesses is:**

**How do I understand that complexity?**

**Where should I be flexible?**

**Where should I be compliant?**

**These questions are posed because flexibility isn’t something that applies everywhere.”<sup>7</sup>**

Innovation means different things in different areas of a business. For example, if an area is tasked on managing costs, then an innovation could be a switch towards a standardized operating environment. If driving top-line growth is the focus, innovation could be a new way of selling to the customer. There is no single answer within a business on how innovation should be applied. Instead, the aim is to understand the various different models and what type of innovation and structure should be applied.

The consistent factor is that innovation needs to be focused on the business; technology is simply the mode of innovation delivery.

## **The benefits of outsourcing for innovation**

Outsourcing for innovation does not mean the outsourcing of innovation. Instead, it relates to how companies use outsourcing to free up the time and resources of retained IT and create a coherent ecosystem that enables a greater focus and engagement with the business. It is this that will drive innovation<sup>2</sup>. To enable this focus, outsourcing must move away from being simply about cost and towards being an integrated part of a company’s strategy.

It appears as if companies that view outsourcing in a broader strategic context, and implement it systematically with proper financial analysis, governance, and methodologies, can gain greater business value. This, potentially, could provide a competitive edge over those that take a more traditional procurement-oriented view.<sup>9</sup>

This is the approach to outsourcing that drives innovation. This approach begins with an understanding of the business and its strategic context and then leverages outsourcing to achieve those objectives. This also enables the retained IT department and the business to focus on driving the strategic differentiation that the company needs either directly or via its outsourcing partners. This represents a moving away from Outsourcing as IT cost and towards Outsourcing as part of business strategy<sup>10</sup>. One third of businesses have already obtained transformation or innovation through outsourcing<sup>9</sup> and around half stated that if they consider outsourcing again they will make it better aligned to the business goals<sup>9</sup>. The question then, is how can these companies achieve said alignment while still ensuring transformation and innovation?

# Making the change

## Understanding the Business

In any evolution towards an IT environment that better reflects the business it supports and where innovation is targeted at the business benefits, the first stage is to understand the business. By undertaking a value network<sup>8</sup> or business-service<sup>9</sup> approach, it is possible to understand how IT should be developed and managed to deliver the business advantage and to understand where IT should focus its innovation to deliver the maximum benefit<sup>10</sup>.

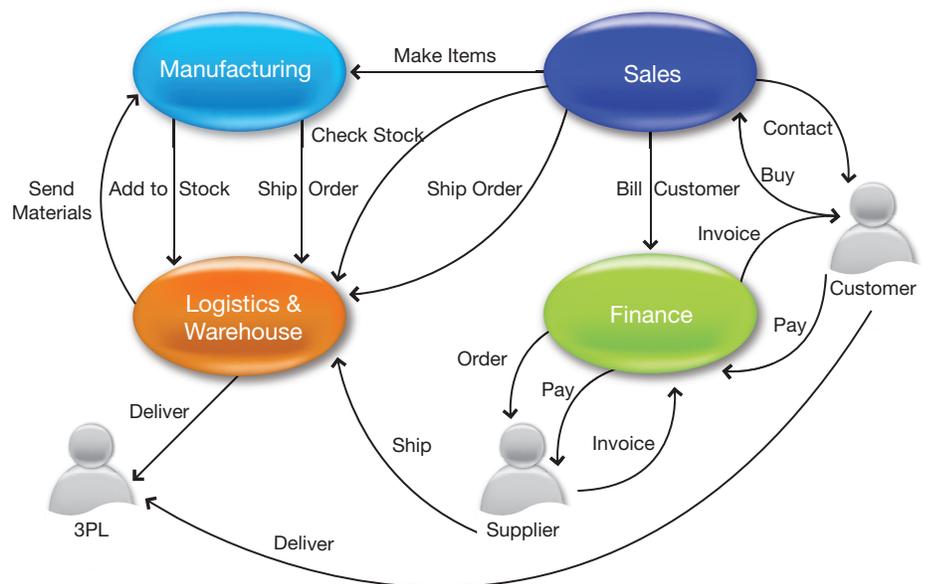


Figure 1. Manufacturing Level 0 Service Model

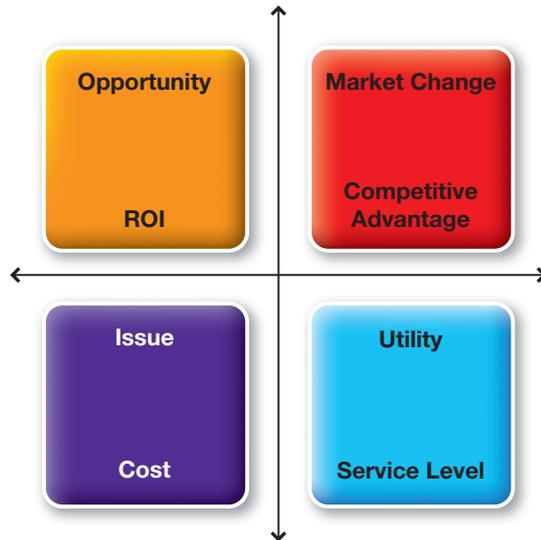


Figure 2. Value Clasification Matrix

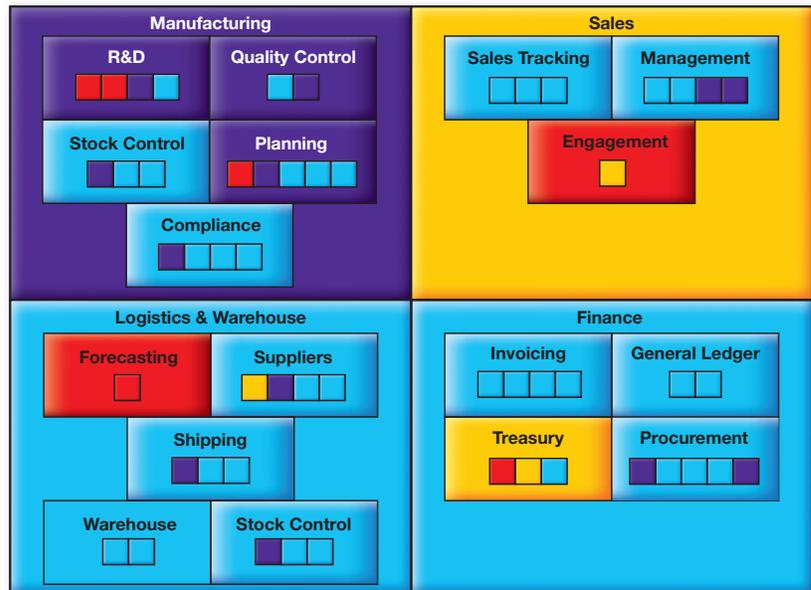


Figure 3. Sample heatmap

Shifting the focus of IT away from applications and towards business services represents the first stage in transforming the IT estate. This establishes the structure and context for the change but will not in itself deliver the change. Change itself requires the contracts and measures of the internal IT and its Outsourcing partners to be aligned to the business value and not the technical SLAs.

## Understanding the Business

The current focus for most organizations for IT Outsourcing is on the delivery of technology applications at a reduced cost. This reflects how most IT organizations deal with the business; the role of IT is to be told by the business what it wants and to then work out the best, i.e. cheapest, internal or outsourced way to deliver a solution. With the general change in IT focus away from technology cost and towards business value<sup>1</sup>, Outsourcing also has to change and become the platform for innovation.

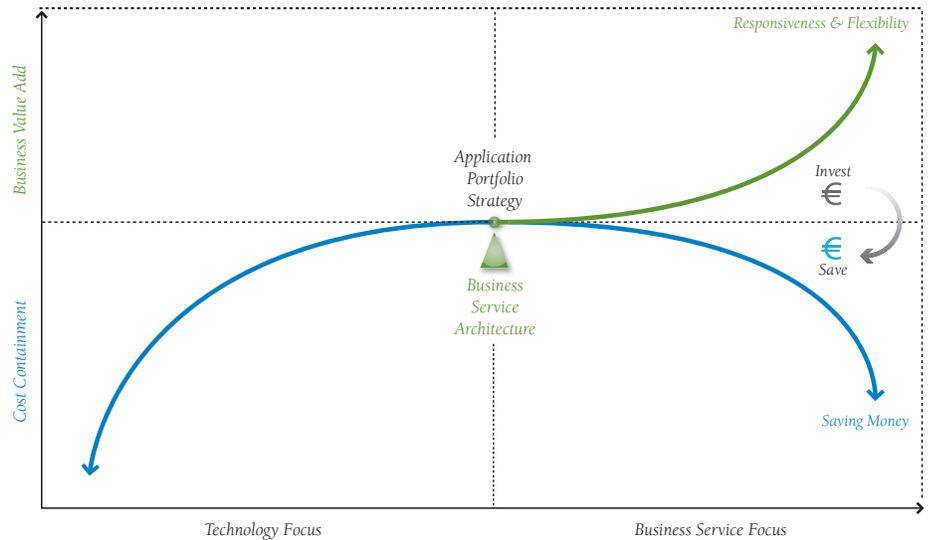


Figure 4. IT delivery quadrant<sup>10</sup>

This, in turn, requires shifting the focus of IT and Outsourcing towards the business. Figure 4 illustrates the quadrant and focus for understanding how Outsourcing needs to be focused and targeted. This is split into three core quadrants

1. Technology Focus/Cost Containment – this is where traditional Outsourcing of maintenance, management and development sits. The contracts here are about the technology and the question is primarily “what is the cheapest way of doing the IT delivery”.
2. Business Service Focus/Cost Containment – This is where the next generation of cost based outsourcing services sits. Here the focus is on the delivery of the service to the business and in reducing the business cost of delivering the service.
3. Business Service Focus/Business Value Add – This is where the internal IT department and outsourcing partners are able to understand where business value can be added and can then apply new approaches to deliver the advantages and flexibility that the business needs.

It is important to note that there is no path in the top left quadrant (Technology Focus/Business Value Add). The reason for this is twofold. Firstly, because any solutions that are purely technology focused but deliver business value add tend to be point solutions rather than part of a coherent landscape (e.g. High Performance Computing). Also, these unusual elements where true technology focus delivers business add tend to be a case of being able to do something physically quicker than the competition. Secondly technology innovation only has a point when it is applied to a business problem. For the vast majority of technology innovations (Web 2.0, SOA, BPM) this means having a business-service focus first and applying the technology to deliver the business service.

# Changing the outsourcing imperative

The objective of most outsourcing decisions is to enable a company to focus on their core business. Traditionally, these decisions are predominately focused around the technology costs and the reality that outsourcing companies have the required scale to industrialize the delivery of these technologies and therefore can do so at a cheaper price. “Bottom Left”<sup>4</sup> outsourcing will continue to exist and will continue to be dedicated to the industrialization of technology delivery. This, however, will not be the dominant way of outsourcing for companies that wish to focus on their core and drive innovation and value. The future is to outsource on the right, specifically to outsource by business service and managed via Business Level Agreements<sup>11</sup>.

## **Business Services at Business Cost**

Freeing up money for investment by focusing on technology can deliver significant savings. However, it is through focusing on delivering a business service and specifically delivering that service as a utility, that it becomes possible to free another level of cost savings and link the cost of IT to the business scale and to the business metric that determines that scale. Undertaking this transformation requires the consideration of the service as a utility and constructing a cost model that is based around specific business metrics, whether these be users, transactions, miles or anything else that makes sense from a business-cost perspective.

This approach, however, most often requires a significant transformation of the existing estate to move it from an application-centric view towards a more standardized utility model<sup>12</sup>. The responsibility for this transformation should be placed upon the outsourcing provider via a “Run-Build-Run” contract that ensures not only provision of the technological shift, but also the support for the business change that is required to make the change.

## **Business Advantage at Business Speed**

The other shift is for outsourcing to become an integral part of the innovation and differentiation delivery. The broader industry changes such as Web 2.0 and the shift towards collaborative systems<sup>13</sup> means that for an outsourcer to help a business, it must commit to delivering the business advantage required. In this model, the outsourcer must move away from the traditional IT estate and into the line of business and Shadow IT applications which have previously sat outside the domain of all IT, not just outsourced applications.

The goal of an outsourcer in delivering business advantage is the commitment to change and to enter into a collaborative partnership with both the retained IT and the business users of these applications. This requires a new approach to working and thinking that unifies IT in new ways that are focused on investing for competitive advantage on a standardized base. By industrializing shadow IT applications<sup>14</sup>, the outsourcer can provide a business with the platform for innovation that will enable it to succeed and grow.

# Summary

Effective Outsourcing has always been an approach employed by the most innovative companies and these companies and their partners are becoming more sophisticated. IT Outsourcing is moving from technology-focused cost reduction towards delivering the business services at business cost and to providing the industrialized platforms that enable organizations to drive business advantage. The key to this change is the understanding of the business and the alignment of the outsourcing partners KPIs to the business success criteria. This moves outsourcing from being something that successful companies do in order to concentrate on their differentiation to being the solid base on which that differentiation is built.

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