

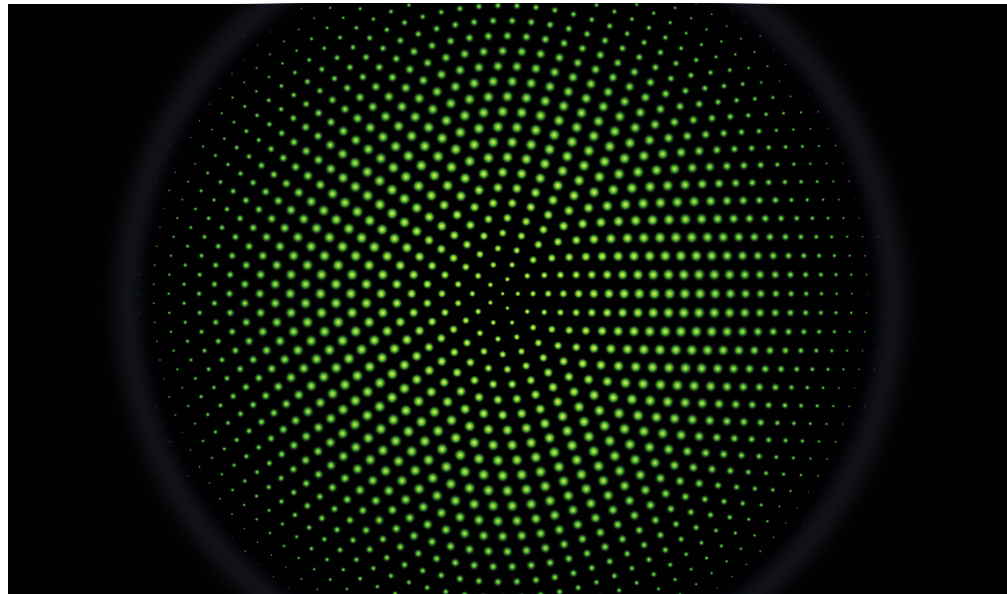
Global outsourcing trends and digital ITO

With the use of outsourcing growing, outsourcing models and methods are reinventing themselves to adapt to market forces and disruption. To track the ongoing journey of global outsourcing, Deloitte reached out to industry leaders from organizations of various sizes and operational footprints in the Americas, Europe, and Asia. The executives surveyed in our 2016 GOS represent various legacy functions—including IT, finance, and human resources—from more than 25 different sectors. Our analysis reveals a vibrant pathway for outsourcing to drive innovation into the enterprise.

In the area of digital ITO, responses indicate the market is looking to evolve outsourcing processes to go beyond the scope of the agreement to yield value-added benefits. For example, how can innovation act as an enabler of business function?

Outsourcing “done right” lies in measuring value. It is not only the key to hitting traditional cost and quality targets but also to delivering new capabilities, increasing revenue growth, and improving the user experience.

For detailed survey results, visit www.deloitte.com/us/2016GOS.



Global outsourcing perspectives

Zoom in on value

Information Technology Outsourcing (ITO)

From 30,000 feet

Digital innovation continues to disrupt the outsourcing industry. From robotic process automation to cognitive applications to cloud services, technology-driven innovations offer new ways for businesses to interact with customers, vendors, and internal stakeholders.

According to Deloitte’s 2016 Global Outsourcing Survey (GOS), the majority of surveyed companies have outsourced much of their IT core, creating cost advantages but also raising a dilemma: How can organizations take advantage of digital innovations while increasing or maintaining their level of ITO and how can those companies control, quantify, and create innovation? To solve this dilemma, digital innovation value must be encouraged, captured, and measured within the existing vendor portfolios.

Challenges and opportunities

The GOS indicates that 65% of the companies surveyed fail to measure the value of innovation delivered by their vendors. To hone in on innovation value,

it is important to define what “innovation” means. In this case, innovation can be defined as changes to an existing process or technology that result in a measurable benefit for the customer. Defining innovation may be the easy part. Extracting and measuring its value requires a multipronged approach with a keen focus on expectations, motivations, and governance.

Lens on innovation: Three areas of value

Organizations can examine innovation opportunities and outcomes at three key phases of the sourcing life cycle: strategy, contracting, and governance.

01

Strategy

- Assess innovation areas
- Set up innovation framework



02

Contracting

- Include innovation clauses
- Incentivize innovation



03

Governance

- Set up right-speed governance



Strategy: Define innovation expectations early

The first step in measuring innovation value in digital ITO is defining innovation goals and expectations. Identifying an innovation solution and quantifying its value at the outset of the strategy discussion allows organizations to focus on selecting the most appropriate service provider. It also helps to set the tone for the remaining phases of the sourcing process in several ways:

- Innovation expectations affect the pool of vendors on the request for proposal (RFP) short list.
- The evaluation framework informs vendor scoring and selection.
- Vendors and companies collaborate more closely to define service level agreements that measure value-driven outcomes, and develop SOWs to support the upcoming innovation and to align expectations over the duration of the sourcing process.
- Vendors develop their technical solution with more precision and clarity.

Building on common ground
 An organization going through a sourcing initiative is typically wrestling with conflicting objectives from its stakeholders. For example, a procurement officer may be focused on cost while a business stakeholder may be looking for the best solution first and cost second. Having conversations on cost, value, and expectations and achieving consensus early on enables organizations to build a common ground.

Quantifying innovation and including this as part of the business case is also essential, since innovation solutions and tools typically represent a significant investment for the organization. A strategy-driven innovation framework encourages all parties to discuss, deliver, and measure innovation value. Contractually incenting performance is the next step to quantifying ITO innovation.

Contracting: Defining and incenting innovation

To build upon the defined innovation goals, they must extend to the contract. There are several contractual clauses that have increased importance in today's digital environment. These innovation clauses should be included in the contract not only to encourage innovation but also to protect the company.

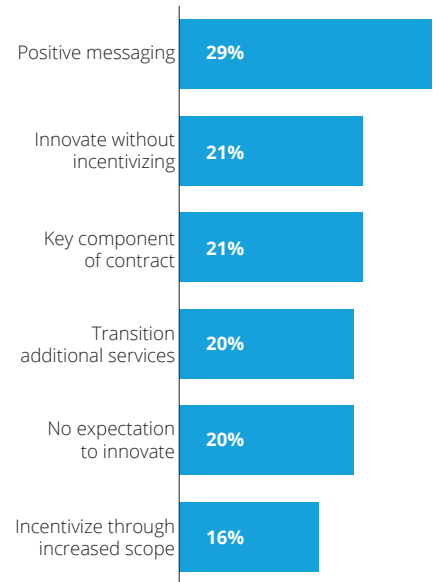
- **Key personnel.** Ensure that the service provider retains key thought leaders that were identified in the RFP process so that they can lead the desired innovation efforts.
- **Exit (disentanglement) and termination.** Ensure that the organization stays nimble as the sourcing cycle quickens and more innovation is sourced externally using termination clauses. Reasons for termination and exit should be agreed upon with the party responsible for paying termination costs.
- **Security.** Align security measures with the contract before an innovation project is pursued. The GOS survey showed that cyber security risks affect 73% of outsourcing decisions, with mitigation strategies primarily dependent on the contract to establish security protocols.
- **IP retention.** Discuss and contractually agree upon ownership of new Intellectual Property (IP) developed during the innovation process.

Incentives for innovation

Building a shared vision for innovation starts with the contract. Pricing agreements can and should be drafted in such a way that service providers are motivated to deliver innovative solutions. An innovation bonus can be written into the contract to reward positive performance, which can strengthen the partnership—often at a net-neutral business case cost.

Tailoring an incentive structure to the situation and the vendor relationship is valuable for organizations and their vendors. For example, a large agricultural

What methods does your organization use to incentivize outsources to innovate

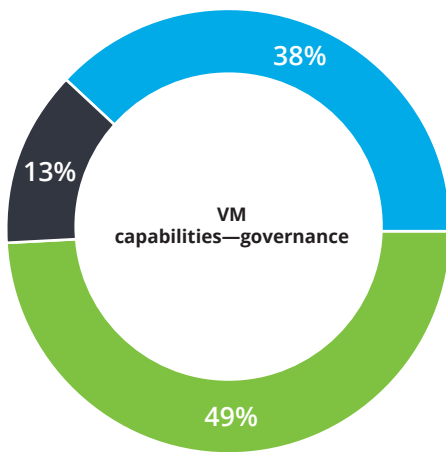


company funded an “innovation pool” with one of its vendors. The “pool” included a clause detailing a research session with thought leaders from both companies. The session ultimately solidified the partnership and demonstrated the effectiveness of the funding. Another company spurred innovation through a gain-sharing relationship. This structure motivated the vendor to pursue breakthrough innovation and was a win-win for both parties.

Defining and incenting innovation are important steps for realizing innovation value in ITO. To keep pace with the speed of innovation, however, organizations should also reimagine their approach to vendor governance.

Governance: Set up a right-speed model

As with business case development and contracting, vendor governance should adapt to encourage and measure innovation. Traditionally, vendor governance has been a rigid, slow-moving, and one-size-fits-all solution focused on incremental cost cutting rather than disruptive innovations. To take advantage of vendor innovations, the three-tiered governance framework should include



- Significantly above average
- Above average
- Average or below

an Innovation Council to coordinate and maximize cross-enterprise innovation and drive a culture of innovation at both organizations. The council should help ensure innovation-related activities are strategic aligned. A value-based investment approach should drive funding and prioritization.

As IT develops a “right-speed” approach to support its overall business, vendor governance within the business should be flexible enough to balance and support the business value, risks, and technical feasibility across many different projects with various development speeds.¹ Specifically, innovation governance requires a different speed than steady-state vendor governance and requires agile oversight and management from the vendor management (VM) and IT functions.

A look ahead

Outsourcing is a vital part of a company's evolving service delivery model and it is increasingly being used to capture market innovations, like robotics and cognitive technologies, to enhance a company's capabilities. Companies must be capable of adapting their sourcing cycle to capture value being created in the marketplace. By creating an innovation framework, and using that framework to select, contract, and govern vendor relationships, companies can capture new value and build an innovation advantage.

Deloitte's 2014 and 2016 GOS's examined the development of VM capabilities, identifying 13% improvement in VM's “governance management” capabilities over those two years. However, 49% of respondents still rate VM's “governance management” as average or below average. These findings demonstrate the need for a keener focus on appropriate governance models for innovation projects.

Governance models within digital ITO must support, rather than hinder, the speed of development. They should also be agile in terms of roles, attendance, and meeting frequency and capable of adapting to the changing flow and requirements of innovation projects.

Let's talk

It takes strategy, vision, and experience to tap into the potential of outsourcing innovation. If you're looking for ways to better navigate the evolving global outsourcing landscape, manage risks, and realize opportunities, we should talk.

¹ White, M., Pennington, J., Galizia, T., & Habeck, M. (2016). Right-Speed IT, Living between black and white. Deloitte University Press Tech Trends 2016. Retrieved April 10, 2016, from <http://dupress.com/periodical/trends/tech-trends/>

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