

Innovation Sourcing

Increasing business value within outsourcing relationships

ON DEMAND BUSINESS



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The leaders in tomorrow's outsourcing market will be those who can deliver the greatest business value. Excellence in low cost service delivery will be taken for granted – the winners in the market will be those with the capability and vision to help clients innovate in terms of business and technology to exploit market opportunities and overcome competitive challenges. A client entering a strategic outsourcing relationship places great trust in its supplier. Innovation Sourcing is one approach IBM uses which recognises this investment and ensures that the client can leverage the complete IBM equation: its world-leading research and development capability, industry thought-leadership and product/services portfolio. Successful Innovation Sourcing programmes with many IBM clients have harnessed the best capabilities on both sides of the outsourcing relationship to deliver business value and drive revenue growth.

Outsourcing – a changing market

Over recent years, sluggish economic conditions and challenged IT budgets have ensured that outsourcing has been the principal driver of growth within the IT services market. It has allowed organisations to drive out costs, access specialist expertise and technologies and to refocus management skills away from non-core IT functions towards those challenges driving competitive differentiation. Outsourcing has also become widely recognised as a financial engineering instrument¹ to smooth out IT spending peaks and create savings; these either fall directly to the bottom line or, increasingly, fund new business solutions.

Over the same period, the global outsourcing market has matured significantly and the number of service providers has increased. Whilst there remains a continuing stream of \$1B+ mega-deals, the stronger growth in more modest contracts has provided opportunities for smaller service providers. In addition, various IT companies have turned to outsourcing either to diversify away from hardware/software portfolios or to replace the higher margin consulting and project services which suffered a significant downturn in 2002-3.

Innovation Sourcing is the term IBM uses to collectively describe the assets, processes, and techniques which it uses in its outsourcing contracts to drive innovation.

“Our clients often tell me that their ‘battle is won above the line and not below it’. They are searching for solutions that will impact the revenue line and not only the cost line. They want more than just IT service from their relationship with IBM. Through Innovation Sourcing we leverage the entire ‘TEAM IBM’ to deliver greater value and assure better long-term client relationships.”

*Joe Benaroya, General Manager,
Strategic Outsourcing, IBM EMEA*

Whilst some elements of IT service have commoditised and created pricing pressure, the basic outsourcing proposition remains one where long-term relationship and business value delivered are critical. Indeed, it is a sign of the maturity of this market that both suppliers and clients have developed a much keener sense of what it takes to ensure that an outsourcing contract succeeds as a relationship rather than a simple provision of services. Gone are the days where compliance with service levels alone was sufficient to maintain high customer satisfaction and market leadership. Strong relationship governance, business value, innovation and win-win scenarios are the current touchstones.

Innovation to improve business value

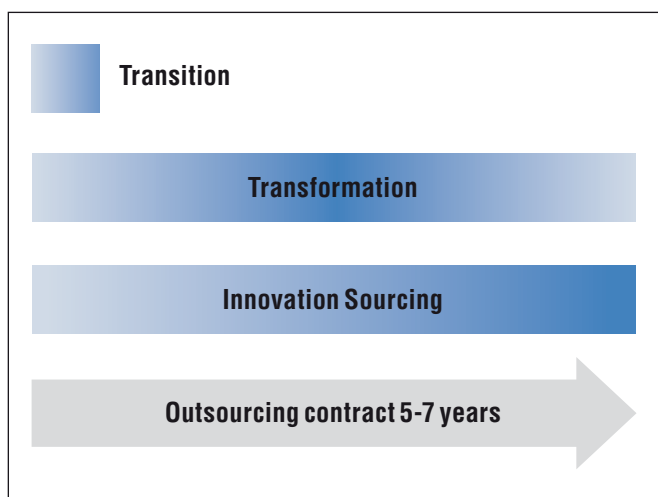
The level of mutual commitment and implied trust makes strategic outsourcing relationships unlike any other in the IT industry. Beyond service excellence however, what sources of value can a service provider leverage to enrich the relationship? One answer is to ensure that the client benefits from privileged access to its wider capability – not just that part which is providing the contracted IT services. By bringing together complementary capabilities plus the best business and technical minds from both sides of the relationship, joint projects can drive innovation to improve the base IT services and address the client’s broader business growth challenges.

In a company the size and diversity of IBM with capabilities and intellectual assets spread across its research laboratories, hardware, software, IT services and business consulting practices, there is huge potential for engaging with clients in innovative projects. Quite rightly, IBM’s size and capability raises high expectations within its outsourcing client base – the challenge is to meet these in a manner which is cost effective for both parties and builds upon, but does not distract from, the baseline services.

Innovation Sourcing is the term IBM uses to collectively describe the assets, processes, and techniques which it uses in its outsourcing contracts to drive innovation. Not only does Innovation Sourcing provide the environment to foster the necessary collaboration but it also puts in place joint governance structures to ensure that priorities are assigned to innovative ideas, scarce resources are deployed efficiently to explore them and that, where possible, they can be folded into the base contract scope at the appropriate stage with minimal risk.

Innovation Sourcing can be positioned as the third of three routes for developing the in-scope services during an outsourcing relationship:

- **Transition** is the initial phase of an outsourcing contract whereby a client's staff and assets transfer to IBM – this is where quick-win cost take-out actions will occur although the main focus is on establishing a seamless handover.
- **Transformation** is the longer-term process of developing the IT service through technology refresh, consolidation, process redesign and new systems implementation; the transformation plan underpins the long-term cost model and services vision.
- **Innovation Sourcing** is the on-going process of identifying and pursuing technical and business innovations jointly with the client. These may directly impact the baseline services (for example, driving additional cost reductions) or might benefit the client's business in some other manner.



Innovation Sourcing is the third of three mechanisms for developing the services within an outsourcing relationship.

Making innovation happen

No-one would suggest that innovation can be merely purchased – it is a creative process with unpredictable outcomes – the trick lies in putting the right multi-disciplinary teams within a suitable environment. Metrics need to reward creative, ‘out-of-the-box’ thinking and the portfolio of ideas must be managed and prioritised based on a balance of short-term and long-term benefits.

Innovation does not occur purely at the technical level – it can focus upon novel business or organisational models. For this reason, a critical part of IBM's Innovation Sourcing process is the deep industry and process knowledge from the client's own business specialists and IBM's Business Consulting Services (BCS).

With Innovation Sourcing, there is no ‘one-size-fits-all’ approach. How to tap into IBM's broader capability will depend upon the client's size, skills, business strategy, partnerships and resources. From a practical viewpoint, clients may also wish to run an Innovation Sourcing programme for a limited period to match personnel and resource availability. For these reasons, IBM's Innovation Sourcing approach is tailored to accommodate different models of interaction.

A particular concept IBM has developed successfully is that of the innovation team, ‘i-team’ or value creation centre. Here, IBM and the client form a joint unit and drive brainstorming and workshop sessions to identify and develop innovative solutions which create business value. Based upon priorities developed with senior management, the team then define detailed solutions, commission prototypes and carry-out risk-reduction investigations leading to full business case development. IBM can support the complete lifecycle, including subsequent implementation, drawing upon specialist capabilities as required through its Business Partners.

Innovation Sourcing and on demand

The innovation process needs triggers to fuel the intellectual and creative juices. Whilst the immediate business challenges of the client will be a crucial starting-point and specific technologies may be able to provide quick wins, it is helpful that the IBM/client team shares a longer-term vision of how successful businesses will operate in the future and how they will exploit technology to deliver business value. Many clients will already possess a view of future business scenarios and the role of IT. However, to supplement or indeed challenge these, IBM's on demand strategy plays a central role.

"An on demand enterprise is one whose business processes – integrated end-to-end across the company and with key partners, suppliers and customers, can respond with speed to any customer demand, market opportunity or external threat."

This vision underpins the value proposition of IBM's products, services and solutions and has guided the company's own investments with its aim of becoming an on demand business itself. We have found our industry-specific on demand roadmaps an essential tool in creating a vision of the client's future operation.

The innovation team concept has had great success with many clients like those described below and is a highly productive way to leverage IBM's research experts and solution thought-leaders. This approach is also powerful in that it provides a focus and identity for the joint innovation activity within the client's organisation. The team might be a virtual one or located at a physical 'innovation centre'.

As an alternative model, clients may wish IBM to operate in 'push mode' where the IBM team meets with the client business specialists then develops a portfolio of candidate projects for presentation and appraisal by the client.

Scope and impact need also to be considered: does the client want to focus on innovations with more direct impact on the existing outsourced services (for example, new capabilities or additional cost take-out) or is a wider remit preferred? Does the client have a very specific challenge which might benefit from fresh outside thinking?

What is under the bonnet?

So what are these IBM assets which are brought to the table to facilitate and energise Innovation Sourcing? Leading the programme from the IBM side will generally be a consultant from IBM BCS who will be able to draw upon deep industry knowledge as well as expertise across the range of BCS practice areas:

- *Strategy and Change*
- *Human Capital Management*
- *Customer Relationship Management (CRM)*
- *Supply Chain Management*
- *Financial Management*
- *Application Innovation.*

For additional industry insight, the programme can also leverage the IBM Institute for Business Value (IBV). Accessible to all IBM clients, IBV is a focus for industry thought leadership and research with a mission to highlight and anticipate industry trends, understand the emerging technology landscape and assess strategic options for the alignment of IT with business needs.

Working closely with the BCS focal-point will be IBM researchers specialising in Innovation Sourcing; they will provide the necessary window into the largest corporate IT research organisation in the world. They are the client's guide to IBM Research's intellectual assets ranging from subject matter experts and current research focus areas through to IBM's patent portfolio, laboratory capabilities and collaborator networks (for example, academia, venture capitalists).

To ensure that the fruits of IBM Research make the transition to its main business, IBM operates a portfolio of Emerging Business Opportunity (EBO) projects. EBO groups work with the main IBM business lines to develop prototypes and support projects with early-adopter, flagship clients. Recent EBO subjects include radio frequency identification and advanced digital media solutions.

Other assets which can be leveraged within Innovation Sourcing are of course IBM's hardware and software divisions together with architects experienced in bringing together both hardware, software and services to build industry-specific solutions.

IBM Business Partners can also be called upon for specialist skills and capabilities.

The Innovation Sourcing process, like any significant investment, requires buy-in from the client's executive management team. To assist this process, IBM is able to leverage its Advanced Business Institute (ABI) in New York as a forum for engaging senior client executives on the role of innovation within their organisations. These events are part of a wider syllabus covering both leadership and IT effectiveness². With many outsourcing clients, IBM has leveraged the ABI to drive 'value infusion' workshops as a time-boxed method of exploring innovation strategies.

IBM Research

IBM has the world's largest IT research organisation with about 3000 scientists and engineers (including five Nobel Laureates) working at eight laboratories in six countries. Since 1996, IBM has invested approximately \$5 billion per year in research, development and engineering and its current portfolio of 40,000 patents is the result of 12 years where IBM has consistently been awarded more patents than any other company. Its specialists from multiple disciplines are engaged in a diverse range of fields:

- *Communications technologies*
- *Deep computing*
- *Display technologies*
- *E-commerce*
- *Personal systems*
- *Semiconductor technology*
- *Servers and embedded systems*
- *Storage*
- *VLSI design.*

Most recently, it has dedicated significant resources to On Demand Innovation Services (ODIS) where IBM researchers team with IBM clients to tackle business challenges in innovative ways.



Finnair exploiting maths to drive revenues

Finnair is one of the world's oldest operating airlines and carries approximately seven million passengers per year. IBM's long-term relationship with the company was extended in 2002 through an outsourcing contract; with technological leadership and innovation high priorities for Finnair, the outsourcing agreement included provision for an Innovation Sourcing programme.

One of the early tasks tackled was to address Finnair's vast and growing database covering customer travel and purchase histories. How could this hitherto unused asset be exploited to gain a better understanding of customer types and their historic buying patterns? Taking it further, if you could predict future patterns and also understand the eventual value a customer represented, this insight could be integrated into marketing programmes and processes. CRM would then become customer equity management – a whole new way to run an airline.

Working closely with Finnair's marketing group, IBM brought in a team from its Zurich research laboratory who were able to develop and refine mathematical modelling and optimisation algorithms to investigate the data.

Success here, and collaboration with an IBM partner, led to the development of a prototype for IBM's customer equity management solution, which already has an 80 percent accuracy rate for predicting the eventual value a customer represents.

The implications are far-reaching for the Finnair business: this approach can reduce marketing costs by up to 20 percent through better targeted campaigns whilst improving campaign response rates to boost revenues. In addition, by forecasting future travel decisions, the IBM solution will improve the airline's customer satisfaction.

Critical to the success of this programme were the mutual commitment to pursue an innovative agenda, sharing of the client's business challenges with the IBM team and a joint approach to problem solving covering both business and IT. Other areas of joint investigation with Finnair have included flight logistics analysis as well as exploitation of broadband, digital TV and radio frequency identification technologies. The Innovation Sourcing programme at Finnair drew upon several IBM Research laboratories, the IBM IBV and IBM Business Partners as well as Innovation Sourcing programmes with other IBM clients.

Banking leadership in technical innovation

One of IBM's key clients in the finance sector in Europe is a large, multi-national banking and insurance group with assets in excess of €200 billion, approximate ten million personal customers and one million corporate clients. Having grown inorganically in the past four years, its strategy is founded on strength and innovation. IBM was therefore a natural partner when the group was looking for an outsourcing relationship to help it consolidate and transform IT support to the business. The outsourcing agreement between the parties was one of the largest ever concluded in the finance sector.

The Innovation Sourcing model centred on a Transformation and Innovation Team jointly staffed and managed by the client and IBM with the remit to:

- *Provide access to IBM's investment in research and development (R&D) and expertise with other world-wide finance sector clients*
- *Support the client's decision-making with technology and market insight*
- *Propose projects and programmes to improve the client's cost-income ratio within three years.*

Since its inception, the Transformation and Innovation Team has focussed on a wide range of initiatives, for example:

- *Optimisation of enterprise resource planning (ERP) solutions to drive cost reductions of 20 percent*
- *Assessment and development of the group's on-line banking architecture by specialists from IBM's Haifa laboratories*
- *Assessment of its enterprise content management projects – again drawing upon specialists from IBM's Haifa laboratories*
- *Integration of the multiple legacy systems from the various banks brought together within the group.*

Review and direction of the Transformation and Innovation Team ensures that it continues to deliver value by focussing on joint research interests, technology exploitation and quick wins together with knowledge transfer to the client in critical areas such as e-banking.





Summary

The outsourcing market has evolved significantly in recent years. The competitive environment has been transformed and there are more providers able to deliver the basics of IT service. As a consequence, client purchasing and satisfaction criteria have shifted. The customer dialogue is increasingly about relationships, business value, innovation delivered and leverage outsourcing partnerships to drive revenue growth.

IBM's experience with clients reinforces the importance of innovation in raising customer satisfaction. Innovation Sourcing is the route through which IBM leverages its world-class capability in research, products, services and business solutions to deliver more business value to its outsourcing clients. However, a single approach does not fit all cases and a range of models are available ranging from physical to virtual innovation centres and directed innovation versus more 'blue-sky' approaches.

Innovation is a creative and necessarily unpredictable phenomenon but provided the appropriate technical, commercial and organisational environment is established, the pay-off can be substantial. IBM's outsourcing clients have benefited in tangible business terms from Innovation Sourcing programmes.



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¹ Morgan Chambers, 'Outsourcing in the FTSE 100: Episode 2 – Impact on Financial Performance', 2001.

² IBM Advanced Business Institute syllabus, **ibm.com**/ibm/palisades/abi/index.html

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