Teaching case

Building innovation into the outsourcing relationship: a case study

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Abstract

This teaching case has been developed for a global consumer products company. Interviews from several outsourcing managers and executives within the company have contributed to the case. This case focuses on how a company can build innovation into an outsourcing relationship when it has not been explicitly stated in the outsourcing agreement. The two fictitious companies in this case are Bentley & Brooks (B&B) (the client) and AlphaCorp (the provider). Both companies are based on, but are not accurate portrayals of, actual companies that are anonymous. The case is a composite of several actual outsourcing cases between the two companies. B&B has outsourced much of their human resource operations and IT support. They have been frustrated that their global outsource provider, AlphaCorp, has not been able to bring innovation to the relationship. In the outsourcing contract, innovation was not expressly identified, but was certainly discussed during the outsourcing proposal and negotiations. In addition, the ability of AlphaCorp to deliver consistent quality of service on a global basis has been uneven, particularly in Latin America. You will be asked to take on the role of a B&B employee who is part of a team looking into the innovation problem. The team has been asked to provide answers to three key questions and to present their recommendations to a panel of senior executives of B&B.
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Company profile: Bentley & Brooks (B&B)

B&B produces and supplies hundreds of consumer goods in food and household product categories. For most of their history, they have operated primarily in the Americas and Europe. In the past 10 years, they have broadened their reach to include Asia, Africa, Australia and New Zealand.

The company sells its products through its sales force, independent brokers, agents, and distributors to chain, wholesale, co-operative and independent grocery accounts, and food service distributors and institutions. It also distributes its products through a network of distribution centres, satellite warehouses, company-operated and public storage facilities, and depots.

B&B was established in Boston, Massachusetts in 1873 and has grown to become one of the world's 10 largest multinational consumer goods companies. The company is listed on most major stock exchanges.

The challenge

The challenge facing B&B is that while they are generally satisfied with their outsourcing arrangements from operational and service delivery perspectives, they are less happy about the level of innovation and continuous improvement (CI) that they are receiving from the more important arrangements.

The challenge was twofold:

(1) How to get an existing service provider to deliver innovation and CI in an arrangement where there is no predefined way in which to measure or manage the provider against it and where there are pockets of poor service levels.
(2) Determining what measures should be included in contracts for future outsourcing arrangements to ensure that innovation and CI gets the focus and importance B&B wants.

Outsourcing arrangements at B&B

B&B was no stranger to outsourcing arrangements. B&B's outsourcing strategy had been initiated by their CEO, Max Skinner, in 2004. He believed that outsourcing would not only reduce operating costs, but also help change the culture of the organization to one that would be more performance-driven. He also believed that regional and global outsourcing arrangements would help bring greater coherence to the organization through common processes and systems.

Over the past 7 years, B&B had implemented several major outsourcing arrangements:

- A Europe-wide IT infrastructure outsourcing with IBM
- A Europe-wide communications outsourcing with France Telecom
- A Europe-wide finance and accounting outsourcing with EDS
- An Americas outsourcing finance and accounting outsourcing with Accenture
- An Americas non-core procurement and logistics outsourcing with T&B, a specialty procurement and logistics service provider
- An Americas system development and maintenance outsourcing with Tata Consultancy Services
- A global human resource (HR) outsourcing with AlphaCorp, initially implemented in Europe and the Americas

These outsourcing contracts were 5–10 years in duration, and some of them have been extended for a second term, generally without competition, but with benchmarking to achieve fair pricing of the renewal contract.

Over the last 7 years, B&B had seen great progress in their ability to negotiate better deals with outsourcing providers and cut costs. Yet, B&B is now starting to question whether their overall outsourcing strategy is optimal, specifically considering questions such as: Should there be more or fewer outsourcing service providers? Should deals be more regional or global? Should deals be re-tendered at end of term as a matter of course to ensure competitive tension? Should the scope of outsourcing relationships continue to be focused round business functions, or should they be more process focused?

AlphaCorp outsourcing arrangement

Some of B&B's outsourcing arrangements had produced tangible and substantial benefits in a very short time frame. Others, such as that with AlphaCorp, had been challenging and difficult. B&B executives were most frustrated with the difficulty in bringing innovation from the outsource providers into the B&B environment.

AlphaCorp was one of B&B's most complex and important outsourcing relationships, due to its wide scope of services and geographies.

The scope of the AlphaCorp outsourcing relationship covered HR administration. The 10-year deal was signed in June 2006 and was implemented in Western Europe and the Americas by December 2007.
The services covered by the deal include:

- All HR data maintenance, including all employee information and information on benefit service providers, learning and education service providers, and other service providers
- Compensation and benefits administration
- Learning and education administration
- Recruiting of all administrative employees
- Management of the recruiting process for all other employees
- Management of talent and competencies data
- Travel and expense administration
- Procurement of all HR services
- Maintenance of the HR information system
- Management of employee assistance programmes
- Payroll and benefit payment processing
- Management of all HR regulatory issues in each country in scope

The objectives for the outsourcing were to:

- Achieve consistency in HR business processes
- Achieve consistency in HR data
- Increase the quality of recruiting, raising the level of skills acquired
- Give greater visibility into the skills and competencies in the organization
- Implement employee self-service
- Empower employees to upgrade their skills
- Achieve more effective relationships with HR service providers
- Reduce costs

Many of these objectives had been realized by the end of year 2012. However, achieving consistency in processes and data, and gaining greater access to talent and skill data was still far from being achieved. This was seen as largely due to lack of understanding by AlphaCorp of how to work in partnership with the B&B organization and of the cultural differences in the areas where B&B operates around the world.

In particular, a lack of understanding of the Latin American business culture had led to major problems in service provision across the region, and the relationship between B&B and AlphaCorp in Latin America had become quite strained.

AlphaCorp services are delivered from service centres in Porto, Portugal; Nashville, Tennessee; and Santiago, Chile. Governance is performed at three levels: national, regional and global. So far, both parties had found that communication between players within each of the parties' own organizations at these three levels had been poor, particularly on the B&B side, making regional and global governance difficult. Sharing of ideas between countries and regions had been particularly poor. It had been hoped that the governance process would result in sharing of good ideas across the regions and globally, but this had not yet been accomplished.

It had become apparent to B&B that AlphaCorp was not achieving their financial objectives from the relationship and that this was putting pressure on their ability to address the more challenging objectives of the deal requiring innovative approaches. B&B knew that AlphaCorp needed to make this deal work in light of its size and also because it was a 'marquee' transaction in the global outsourcing market that AlphaCorp needed to be successful for marketing purposes.

The scenario/situation

Carlos Vio is the B&B Service Management executive for the AlphaCorp relationship in Latin America. He had been hired specifically for this role from HP in Chile, having had significant experience in HR BPO deals with them. He has service managers for the AlphaCorp arrangement in each Latin American country reporting to him, and he reports two ways: to the head of HR Latin America and to the Global B&B Service Management leader for the AlphaCorp deal, resident in London.

Figure 1 depicts the reporting structure and the parallels between AlphaCorp and B&B.

The AlphaCorp arrangement while generally successful from a day-to-day operational level had been causing problems in two key areas:

1. The innovation and CI that was expected from Alpha-Corp had not been realized. Although the outsourcing contract did not explicitly define innovation and CI, B&B had been swayed during the proposal and negotiations by AlphaCorp's claims of thought leadership and intellectual capabilities that would be focused on improving B&B's outsourced business processes.
2. Service levels in Latin America had been exceptionally poor lately. Evidence of poor performance consisted of service outages, falling server level agreement (SLA) measures and generally poor customer satisfaction. For example, the online personnel update function used to change home address and other information had been unavailable for 2 weeks while a software malfunction was being resolved. A 2-week outage of a basic service function was well beyond the threshold of 3–5 days defined in the Service Level Agreement (SLA).

Carlos realized that innovation was a difficult factor to measure in outsourcing arrangements but was hoping that he and AlphaCorp could find a way to make it happen. The troublesome service levels in Latin America just made Carlos' situation more difficult, as he needed to decide if those had to be fixed before B&B could even start working on getting innovation from that region.

Senior executives were not happy about either situation and had given Carlos 12 months to fix the Latin American situation and to find ways to get real innovation discussions and processes underway. Carlos had assembled a team to work with him on this project.

Carlos and the team had spent some time talking to senior executives about their expectations and frustrations. They had also met with some of B&B's regional AlphaCorp account managers to find out what ideas they had that could be leveraged across the entire AlphaCorp arrangement.

Carlos was hoping that the information gathered through those discussions combined with industry best practices and research would be enough to set B&B back on the right course.

Extract of senior executive comments

Senior executives had expressed frustration that although B&B was able to apply innovation and CI to the development and improvement of products, they had not seen that spark of creativity from any of the major outsourcing providers that they had engaged. A number of B&B executives had agreed to be interviewed regarding innovation in outsourcing. The B&B senior executives interviewed came from both the business side and IT. They included:

- Vice President of Workplace Services
- Director, Finance Services NA & Europe
- Director, HR Services Supplier Performance
- Director of Outsourcing Services
- Director of IT User Services
- Director, Enterprise Computing Project Portfolio & Solutions

One executive had provided definitions of CI and innovation:

- 'CI involves ongoing incremental changes that are beneficial to the provider and to B&B. Usually these are cost reductions for the units delivered. Most outsourcers and B&B are very good at CI. For example, the outsourcing contract will identify year-over-year unit cost improvements in percentage terms that can be verified and are rewarded or penalized as well as benchmarked with outside firms. Great companies such as the global service providers and B&B have a culture of CI, constantly encouraging all of our people to think and act on unproven opportunities'.
- 'Innovation is a creative process that results in a step-function change in performance and costs. Innovation can be disruptive because it makes previous operating models for products and services obsolete. Innovation is unpredictable, and can be risky, but can deliver tremendous benefits when implemented successfully'.

Contract-related comments

- 'When the deal is being negotiated we see great innovation promises from the providers. However, once the deal is signed it very difficult to bring that innovation out of them'.
- 'If cost reduction measurements have been defined in the contract I am confident that the provider will meet those targets, because there are rewards and penalties attached
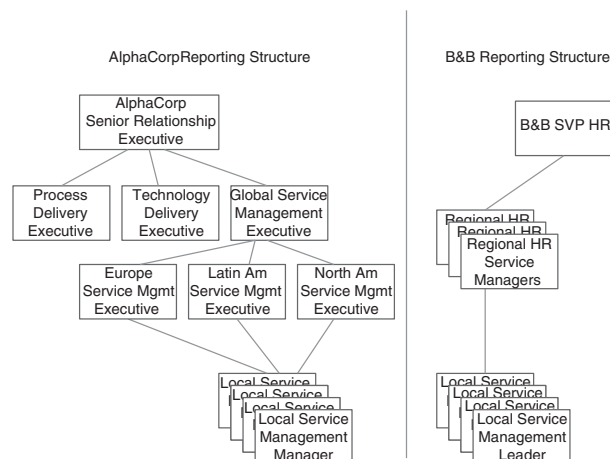

Figure 1 Organization charts.

to meeting those targets. However, when we asked for innovative ideas they sometimes come back and ask us for additional revenue or change requests to provide the funding for the innovation. We heard wonderful sales-speak prior to the contract but we have been disappointed with the lack of innovation during the contract'.

CI comments

- 'The providers are very good at meeting the CI goals, but we really do not see innovation from them'.
- 'Our providers have a tremendous level of operations understanding. Their facilities management and operational capabilities are superior. However, operational efficiency may bring CI but rarely does it foster innovation. Perhaps we expect too much from our outsource providers'.

Innovation comments

- 'Our global HR outsourcing brought us to understand that our first priority must be to have well understood consistent global practices that are executed efficiently. What may seem innovative in Europe or North America could be impossible to consider in other global locations. So innovation must be seen as something that is appropriate in the context of the local business process in the business unit'.
- 'The only innovation that has been seen from AlphaCorp is the HRA^2 initiative in Western Europe. That is an excellent example of what needs to be done more often and globally where possible. Perhaps if there was that kind of thinking in Latin America we would not have the service problems we have down there'.
- 'One example of a shared problem that created innovation was B&B's HP outsourcing relationship. B&B shook-up HP who came back with creative new ideas, reduced revenue from the existing outsourcing arrangement and created an opportunity for new revenue from the innovation'.
- 'The B&B Architecture Review Board meets quarterly to agree on operational and strategic projects. Our architects seem to identify more innovation than we see from the vendor'.
- 'When our providers discuss innovation they also ask about revenue growth, and they ask for exclusivity so that other competing vendors would not be involved in innovative new projects'.
- 'Where we see innovation from our providers is when they understand our business very well and bring a sophisticated understanding of our competition so that it brings a better competitive balance to B&B. This is especially true with our real estate and facilities management outsourcing providers'.
- 'We find that we often have to push our providers to bring innovation to us. In some areas such as IT, there is resistance to innovation'.
- 'Here are some of the better practices when innovation does work in our outsourcing arrangements:
  - We agree on specific areas of interest for B&B and competence for the provider
  - The provider brings market knowledge and intelligence far beyond what B&B could deliver
  - We look for quick-wins that monetize the value of the innovation in the near term
  - We define a longer-term path to realize larger strategic benefits
  - We share the benefits and the results of the innovation between B&B and the provider'.
- 'Innovation also comes from competition between providers where the best pragmatic and creative ideas win'.

General comments on outsourcing at B&B

- 'When we outsourced some of our business processes we learned that we did not fully understand details of our own business process. As we lifted-and-shifted both the process and the data to the provider we discovered gaps, redundancies and inconsistencies that we both had to fix. Innovation has been difficult as we have simply been working hard to stabilize and streamline the fundamental business processes'.
- 'When we have taken on major transformation projects we have underestimated the degree of change, especially when it occurs on a global scale. Our outsource providers are committed to managing the change, and they do expect to run a profitable business. We are just now starting to see an operating environment that may allow us to consider innovation, but the last 7 years have not been easy and have certainly been a learning experience for us and our providers'.
- 'B&B is now heavily dependent on its outsource providers. Although some innovation responsibility will come from the B&B architecture group, much of the thought leadership and implementation should happen through the outsource providers'.

Clearly, the B&B outsourcing executives had thought long and hard about the need and challenges of working with their outsourcing providers to create collaborative innovation. Carlos was thankful for their honest assessment of the situation.

Innovation initiative from Western Europe

Carlos had also spoken with a number of the regional account managers about the AlphaCorp arrangement and was particularly excited about what he had learned from Maria Andersson, the Service Management leader for the relationship in Western Europe.

Maria had told him about the implementation of an AlphaCorp service prototype for her region. Here, a group of young AlphaCorp engineers had developed a partnership arrangement with a large mobile phone company and two major communications carriers. Working with B&B HR users, the collective group had developed processes, software and mobile hardware, supported by the communications network, which would allow B&B employees to access and synch their HR information Anywhere at Any time (HRA^2). HRA^2 was a very attractive service capability to younger B&B employees who were very comfortable with portable media such as tablets and smartphones. The application was able to operate in 17 languages. AlphaCorp

had developed a prototype HRA^2 app for the iPhone that would be distributed to B&B employees after it had been thoroughly tested. A similar app for the Blackberry was in development.

The initiative for HRA^2 had been a local competition where university students employed in AlphaCorp's summer programme were asked to come up with ideas and suggestions to improve the HR process. Maria had sponsored the competition, which generated several ideas. The HRA^2 idea was intended to address the problem of B&B employees who constantly travelled and had limited office support. The current approach was to provide a 24×7 h HR telephone call centre service. The ability to accurately capture HR information from employees across many time zones, languages and cultures was problematic for Alpha-Corp. The AlphaCorp HR call centre was constantly trying to improve its performance, but often fell below industry benchmarks for timeliness and accuracy. In addition, with ongoing turnover in the call centre, AlphaCorp's operating costs were much higher than expected.

The HRA^2 innovation had not been part of the outsourcing contract, and had been initiated through collaboration at the regional level. Maria had proposed the HRA^2 to B&B HR executives, with joint funding from AlphaCorp and B&B (50:50). The HR executives agreed to try the concept. It was a huge success. B&B employees were delighted with the improved service and AlphaCorp saw reduced operating costs and improved accuracy and efficiency. The take-off caught the attention of other B&B executives who then asked AlphaCorp to study this model and replicate it in other areas of the outsourcing arrangement. This would not be easy, as the governance relationship lacked a formal mechanism for innovation and innovation was not identified in the outsourcing agreement.

The HRA^2 innovation concept also left many unanswered questions, such as:

- Who owned the concept, the intellectual property?
- Would HRA^2 be exclusive to B&B or could AlphaCorp offer it to other clients?
- Where was the responsibility for security and liability?
- What were the mechanisms for continuing the initial innovative concepts?

Carlos considered the HRA^2 concept for Latin America, where HR outsourcing had not been very successful. AlphaCorp was struggling to simply provide the basic HR services; accuracy and timeliness were well below benchmarks. B&B had filed a record number of service issue complaints to AlphaCorp, which needed to be resolved. AlphaCorp had not been able to live up to the innovation and CI promises made during the outsourcing proposal. He wondered if the collaborative innovation, which had benefited AlphaCorp in Europe could be replicated in Latin America. Indeed, because service levels have been so poor, trust between the two sides was very low and B&B had suggested imposing penalties if performance did not improve.

In search of best practices in innovation and CI
The team had read a lot about innovation and outsourcing and had come across a number of articles discussing

whether innovation in outsourcing was a pipedream. Carlos was very interested in two outsourcing models from academic experts in the field of outsourcing. The models focused on outsourcing relationship as being a prerequisite for innovation.

The first model is called the supplier competency model, described in Chapter 4 of the *Handbook of Global Outsourcing and Offshoring* by Oshri *et al.* (2011). The model suggests that outsource suppliers should have strong capabilities in technology exploitation and process improvement in order to help customers transform their businesses (97–103).

The second model is from Kern and Willcocks (2000). They identified trust between the buyer and provider as being an important capability in the outsourcing relationship and a key to building innovation in outsourcing arrangement. Figure 2 depicts the role of trust in outsourcing.

Kern and Willcocks identify requirements for a smooth outsourcing working relationship to be 'largely a task of communications, cooperation and developing trust in the counterpart'. They discuss the role of social and personal bonds between individuals as being important to the relationship, and note the importance of shared cultural beliefs and values: 'the development of the relationship depends on social and personal bonds, so much so that alleviation of conflicts, achieving satisfaction and continuing to adapt all depend to a certain extent on the closeness of the bonds between individuals' (331).

Other researchers agree with Kern and Willcocks. Lewicki and Bunker (1996) defined a three-level trust model, which consists of calculus-based trust, knowledge-based trust and identification-based trust.

Calculus-based trust 'is based on assuring consistency of behaviour; that is, individuals will do what they say because they fear the consequences of not doing what they say'. Knowledge-based trust 'is grounded in behavioural predictability – knowing the other sufficiently well so that the other's behaviour is anticipatable'. Knowledge-based trust occurs when one has enough information about others to understand them and accurately predict their likely behaviour. Identification-based trust 'is based on a complete empathy with the other party's desires and intentions' (119–120).
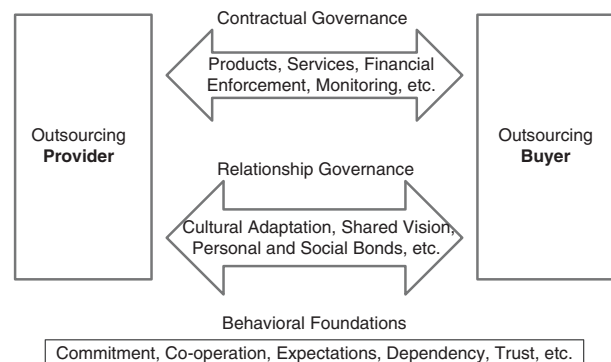
Figure 2 The role of trust in outsourcing.
Source: Kern and Willcocks (2000).

'At this third level trust exists because each party effectively understands, agrees with, empathizes with and takes the other's values because of the emotional connection between them and thus can act for each other'. It is this third level of trust that buyers and providers strive to achieve in the outsourcing relationship because of the value it will create.

The case requirements

You are the team working with Carlos. On the basis of the information found in this case and current articles blogs[1] and from your own experiences, prepare a response, to be presented to senior executives, to the following three questions:

1. What approach would you recommend to get AlphaCorp to bring innovation to the table within this current arrangement in general? Consider some of the following issues:

    1.1. How should innovation be built into the governance process so that it gets proper attention alongside monitoring of cost and service level performance?
    1.2. How should AlphaCorp and B&B distinguish between innovation and CI?
    1.3. Where should be focus of innovation: Current operations? New areas? Existing or new regions? Why?

2. Would that approach be different for Latin America in the short term, while B&B is resolving service level issues? Explain why it would or would not be different. Consider some of the following issues:

    2.1. How could innovation be used to improve performance and the outsourcing relationship in Latin America?
    2.2. Would innovation be an unwanted complication to the current relationship? Why?

3. What would you recommend incorporating into any future outsourcing arrangements with other service providers to ensure B&B would get innovation and CI where it is needed?

    3.1. Would a single model across all outsourcing arrangements work? Why or why not?
    3.2. How should ownership of intellectual property (such as patents, methodologies etc.) be handled when multiple organizations contribute to innovation?
    3.3. When should innovation and CI be discouraged, or not expected as part of the outsourcing arrangement?
    3.4. Should B&B adopt different models for innovation in outsourcing? Describe two or three alternative innovation models. Should penalties or incentives be implemented in arrangements to encourage providers to be more innovative?
    3.5. What would be the role of B&B in enhancing innovation in outsourcing? How would B&B work more cooperatively with outsource providers to achieve innovation? What would be respective roles and responsibilities?

Notes

1 This case study was prepared with support from the Centre for Outsourcing Research and Education (CORE).
2 You may wish to read a blog on innovation and outsourcing at http://blogs.computerworlduk.com/hart-of-outsourcing/2012/05/innovation-and-transformation-do-it-for-the-right-reasons/index.htm.

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