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Whitepaper

In association with the
London School of Economics
Information Systems and Innovation Group

The Outsourcing Enterprise

Step-Change: Collaborating To Innovate

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Logica, collaboration, innovation and outsourcing

I passionately believe that the most successful business organisations of the future will be those that have taken advantage of the benefits of outsourcing and have made a step change in the relationships with their suppliers, to achieve innovation through collaboration. I am therefore very pleased to write the introduction to this report - which focuses on this subject - and is the fifth in Logica's series of Outsourcing Enterprise white papers.

The white papers are produced in collaboration with the London School of Economics, and are authored by Professor Leslie Willcocks and Andrew Craig. Logica's objective in publishing these reports is to provide customers of outsourcing services with an insight into best practice for maximising business value from outsourcing relationships. They are based on fresh research and analysis, conducted by globally recognised experts, and are widely respected in the outsourcing marketplace.

The subject for this latest report - "Step change: Collaborating to Innovate" - reflects the development of the outsourcing marketplace from the early days of arm's length contracts to today's much more sophisticated contract relationships involving collaborative leadership. The report provides examples of outsourcing customers who have made the step change to using outsourcing as a key part of building an efficient and innovative long term business, rather than just as a short term expedient to save cost.

The recommendations contained in the report are very relevant to the economic challenges faced by many organisations at the time of publication (Summer 2009). We hope that the report will provide you with useful insights which can be used for the benefit of your business.

This report also relates to Logica's business strategy that builds on our distinctive strengths with the objective of making Logica our customers' most trusted innovation partner. These strengths are a strong presence in our European markets - enabling us to work closely with our customers - backed by a powerful global delivery capability.

The customer examples in this report are drawn from Logica's portfolio of outsourcing clients, including Michelin (France), KPN (Netherlands), Statoil Hydro (Norway) and Spring Global Mail (Netherlands). They also cover the full spectrum of outsourcing services that Logica provides – namely Applications Management, Infrastructure Management and Business Process Outsourcing.

I would like to thank the authors of this report for producing a well structured, thought provoking analysis, and most importantly our clients across the world who have agreed to share their experiences on collaborative innovation.

Jean-Marc Lazzari
CEO of Logica Outsourcing Services

Collaborating To Innovate:
Lessons from The Outsourcing Enterprise

Through analysis of our new research and our existing research bases, representing 17 years of combined research into over 1600 organizations, we see eight key lessons emerge:

1. **Innovation is even more important in economic recessions. Innovations can be changes in IT operations, business processes or in products and services offered or in the business model of how the firm competes. To survive and thrive through a recession requires sustainable change. A focus on cost-cutting alone, or even cost-efficiency solves short-term problems, at the expense of building the future business.**

2. **Innovation using the external services market is increasingly realistic as both clients and suppliers are maturing their ability to go beyond traditional outsourcing relationships and build the collaborative arrangements necessary for innovating. This means clients can move from contract administration and outsourcing management to a new phase of collaborative leadership. They can also develop a new performance agenda.**

3. **Innovation with large-scale, long term impact requires deep collaboration within clients, and with and across their external suppliers. Without this, innovation, and the consequent high performance, cannot be delivered.**

4. **Collaborating to innovate requires a step-change in objectives pursued, relationships with suppliers, and how work and innovation is conducted. Our study of effective practitioners suggests distinctive practices for success. These can be classified into a fourfold framework - Leading, Contracting, Organizing and Behaving.**

5. **Leadership shapes the context for collaboration, innovation and high performance and is primary. Leadership deals with adaptive challenges, and must be at all levels in each of the collaborating parties. Leadership also changes the approach to risk in order to share and manage down risk and manage in opportunity.**

6. **New forms of contracting are required for collaborative innovation to succeed. Such contracts share risk and reward in ways that incent innovation, collaboration and high performance to achieve common goals.**

7. **Organizing for innovation requires more co-managed governance structures and greater multi-functional teaming across those organizations and people responsible for delivering results. Teaming now requires the ability to collaborate within a client organisation, between client and supplier and between suppliers in multi-vendor environments.**

8. **Leading, contracting, and organising in these ways incents behaviour and enables collective delivery of superior business performance. Collaborative innovation is most effective when it generates high personal, competence-based and motivational trust amongst the parties. High trust is a key component and shaper of the collaborative, open, learning, adaptive, flexible and interdependent behaviours required.**

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Step-Change: Collaborating To Innovate

Introduction: Moving To The Next Phase

Our previous four papers in this series provide the foundational lessons and practices that make for effective sourcing strategy and delivery. This paper asks: what next? The future can be glimpsed in the relatively few organizations that have matured their strategic ability to handle global sourcing. They have converted outsourcing's weak spots – variable quality in relationships, and little innovation experienced - into opportunities and strengths[2].

In practice, outsourcing so far has been contract management or at best supplier management (see Figure 1). Client and supplier organizations need now to consider how to make a step-change in their ability to lead outsourcing for strategic business purpose by collaborating to innovate. The present economic recession makes this need more urgent, not less, especially if organizations are to be fit for purpose both for the downswing and the subsequent upswing. Figure 1 captures the four phases we have observed client organizations pass through in their outsourcing management evolution.

> "The future is already here – it is just unevenly distributed"
>
> – William Gibson[1], writer.

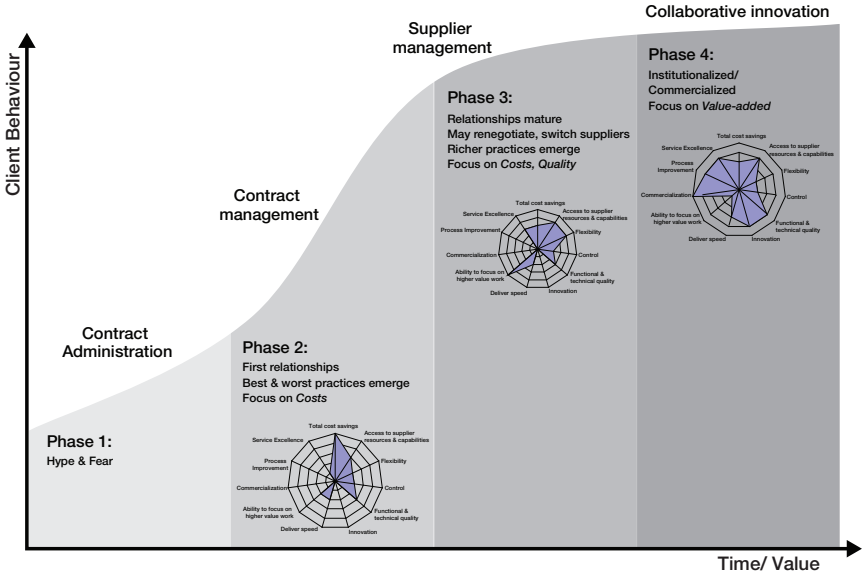

Figure 1: The Global Sourcing Learning Curve 1989-2009

We can distinguish four sorts of client behaviour through the phases:

- Contract administration or negativity
- Contract management
- Supplier management
- Collaborative innovation

1 - William Gibson wrote Neuromancer in 1984, a novel in which the concept of cyberspace was first introduced.

2 - This emerges from our work collected in Lacity, M. and Willcocks, L. (2009) Information Systems and Outsourcing: Studies in Theory and Practice. (Palgrave, London) and Willcocks, L. and Lacity, M. (2009) The Practice of Outsourcing: From IT to BPO and Offshoring (Palgrave, London). See also Ross, J. and Beath, C. (2005) Sustainable Value From Outsourcing: Finding The Sweet Spot. Centre for Information Systems Research paper vol. 5, 1a, MIT, Boston.

In looking at Figure 1, undue optimism in the earliest stage often results in a debased form of contract management we call 'contract administration'. In Phase 2 clients tend to get their act together on managing the contract, but it is only in Phase 3 that they really begin to focus on how to leverage the supplier beyond the contract. This process culminates in Phase 4 where close collaboration occurs.

How does being in these different phases **feel** to clients? They report to us the following growth path:

- Phase 1 – Undue optimism or panic
- Phase 2 – Learning
- Phase 3 – Maturing relationship
- Phase 4 – Collaborative leadership

The rest of this paper focuses on the lessons learned to get into the fourth phase. By 2009 a critical mass of organizations had reached, or were reaching for, Phase 3, at least in their management of information technology outsourcing (ITO). The shorter learning curve, really from 1999-2009, means they lag behind this in their business process and offshore outsourcing practices. All these organizations stand on a cusp of an outsourcing decision – whether to drive down a traditional cost cutting route under recessionary conditions, with limited payoffs, or to make a step-change and go for sustainable cost reduction and business-focussed innovation.

Based on research from September 2008 to February 2009, as economic downturn moved to global recession, we report the findings from studying how organizations can make this step-change towards what we call 'collaborative innovation,' and the practices on which it needs to be based. In the first section we show how levels of collaboration determine types of innovation and performance impacts achievable from using the external services market. Then we use Michelin as an example of an organization that has moved to the new performance agenda. The paper then provides a framework for the process of collaborative innovation that needs to be adopted if superior performance is to be aimed for and accomplished.

Developing The New Performance Agenda

The management world abounds with buzz words and fashions, so it is important to be clear that what we are dealing with here is an evolution of sourcing practices that have been in the making for some twenty years. Collaborating to innovate builds on the solid foundations detailed in previous papers in the **Outsourcing Enterprise** series and takes them to a new level. The problem is that familiar ideas have all too often **not** converted into new practices.

Collaboration

Collaboration is a cooperative arrangement in which two or more parties work jointly in a common enterprise towards a shared goal. In the context of business relationships the word collaboration signals close partnering behaviours developed over and for the long term, distinguished by the high trust, flexibility, reciprocity risk sharing, and investment of resources and time essential if high performance on individual and shared goals is to be achieved[3].

3 - Our definition, but backed by a significant literature in the strategy, but not in the outsourcing literature. See Kern, T. and Willcocks, L. (2000) *The Relationship Advantage: Information Technologies. Sourcing and Management.* Oxford University Press, Oxford.

“ Leadership is key in making progress in collaboration… ”

All outsourcing requires a relationship to succeed. But what kind of relationship works? This depends on the activities being outsourced. Commodity services such as accounts payable processing, mainframe processing, or specialized repeatable processes like credit checks, unique technology services – these can be accomplished with relatively hands-off, contract-based relationships between a client and its supplier(s). But deeper, more trust-based relationships are required if external resources are to be used for more sophisticated, risk bearing and critical services including large-scale IT development projects, business process changes, and technology innovations. Consider Suncorp’s move into agile methods and the change required in client and supplier behaviours:

“ The standard behaviour in an organization is everybody does their job, they deliver it and then somebody else goes and creates the same thing over and over again; but with collaboration comes leverage. In collaboration, you will be welcoming an advance from me to be able to find out how you did it and to share it with me. Partnering is an ongoing relationship where you are leveraging the skills that your partner has, and learn from them. Leadership is key in making progress in collaboration. ”

- Senior executive, Suncorp insurance company.

“ Collaboration only happens if there is a higher level goal for everyone ”

Collaboration also has to stretch across suppliers, as Han Wijns, Senior Vice President for Innovation, at Dutch-based KPN, makes clear:

“ What we need is collaboration from our suppliers. If they are competitive then we have a very special meeting and say this behaviour is unacceptable; you have to work together. Collaboration only happens if there is a higher level goal for everyone. We put in the necessary incentives for them to put their best people on it and they can’t succeed without the help of the other suppliers. ”

As we shall see in the cases below, collaboration requires a different mind-set towards other parties, underpinned by different forms of contracting and behaviours.

The Role of Suppliers

Clients see suppliers as having an integral pro-active role in collaborating to innovate:

“ A pro-active partner is aligned in thinking with you and comes up with new ideas and innovation. They think for me. They say we can do it like this and it will cost you that and we can do it with these people in this time. They make a whole business case and I just have to say, okay, we do it or we don’t do it. That’s being very pro-active. ”

- Senior Manager, Insurance Company

“ They think for me… ”

Rune Aase, VP and Head of Service Delivery at StatoilHydro, pointed out to us how innovation requires new ways of working together:

“ We have established a road map to become world class within shared services. But of course, when we do that, we need to have sourcing partners that are on the same road map and are willing and able to change and to be innovative. ”

While innovation executives from Logica gave us a supplier perspective:

> For us innovation is really the sum of technology, creativity and organization. The trick is to be creative with existing technology and look for value added services or products, rather than just applying state of the art technology, without any link to where the value is for the end user. Creativity… has to do with cross industry experience and expertise, knowing what you are doing. But innovation will only succeed if you are able to organise the whole process of innovation, knowing what the pitfalls are, and being able to really serve all the stakeholders in the value chain touched by innovation.
>
> – Gerben Mak, NL Director for Innovation, Logica

In earlier Outsourcing Enterprise papers we commented on the observable trend towards relationships becoming increasingly managed and leveraged as strategic assets. The indicators of this can be seen in our most recent research: more rigorous relationship planning and measurement, more contracting based on values and behaviour, and, on client demand, suppliers becoming more embedded in their client's business – including supporting the client's mainline services, becoming a client of the client, and identifying new sales opportunities. Collaboration sees added-value relationships as a norm, with clients looking for business ideas, innovation and environmental scanning from their suppliers, and a much greater focus on business, not just technical outcomes. Collaboration in a strategic sourcing context, then, is pro-active working together and risk sharing, in flexible integrated ways, to achieve high performance on larger, mutually rewarding commercial goals.

So the challenging role for suppliers is to:

- Ensure they have the **key capabilities for collaboration**. This means that their planning and contracting, organizational design, governance, leadership, program management and customer development capabilities must be strong[4]. But **collaborative thinking and action** must be in the DNA of all managers and delivery staff.
- **Invest** significantly in innovation resources and capability.
- Be very **pro-active with clients** on how things can be done differently to joint advantage.
- Be capable of **working with and across other suppliers**, together with the client where there are adaptive challenges and innovation is required. As we shall see in cases like Michelin, and KPN, multi-vendor environments are typical rather than unusual and this is where collaborative innovation takes place.

Types of Innovation

As will emerge, collaboration is the foundation for effective innovation. But what does innovation mean to clients; what sort of innovation do they care about? For one executive:

> Innovation, for me is, twofold. One is the ability to wake up one morning and realize there is a different and better way of doing something. Secondly, combining that with an ability to deliver.

4 - See Willcocks, L, Cullen, S. and Lacity, M. (2006) The Outsourcing Enterprise: *The CEO Guide To Selecting Effective Suppliers.* Logica, London

For Wouter Hijzen CFO at Spring Global Mail:

> “Innovation to me is really simple. It doesn’t have to be a product or a new service. It’s doing things differently for the better, that’s innovation.”

Clearly innovation does not have to be one big thing, and it is also in the eye of the beholder:

> “Although it might be the twentieth time that we implement some sort of system or product or whatever, for our client, it’s usually the first time, a one-off. For them it might be really innovative, while for us, it’s just business as usual.”
>
> - Supplier innovation executive.

Essentially innovation is the introduction of something new which creates value for the organization that adopts it[5]. For our purposes we use client-focused definitions more suited to what is trying to be achieved in their collaborative arrangements with business and IT service companies[6]. On this schema there are three types of innovation:

> “Innovation is… doing things differently for the better..”

IT operational – technology and IT organizational, work and personnel changes that do not impact firm-specific business processes e.g. new email platforms, new operating systems, IT infrastructure remodelling, new IT staffing arrangements. These could lead to better business use of IT, for example, introducing agile systems development at Suncorp in 2008 led to IT being in place quicker to support the business. According to one executive:

> “There are no sacred cows, they’ve all got slaughtered.”

Business process – by contrast, this innovation changes the way the business operates in some important ways. For example in insurance two key processes are underwriting and claims. Simplifying and technologising these processes, often by outsourcing, can and has improved business performance[7]. In his study of the BAe Systems-CSC deal Michael Weeks found one such successful implementation – the development of a Product Data Management System for the Astute submarine programme. This helped to implement computer aided technology into the production process by documenting all of the parts and essential manufacturing information (weld placements, wiring diagrams etc) used in the design and production of the final submarine[8]. He also notes a successful vendor-supported SAP implementation at Rolls Royce which helped the firm ride the 2000-3 downturn more effectively through better financial management and inventory control.

5 - The definition was developed for use at Intel. See Westerman G. and Curley, M. (2008) Building IT-enabled Capabilities at Intel. MIS Quarterly Executive, 7, 1, 33-48

6 - Adapted from Weeks, M. and Feeny, D. (2008) Outsourcing: From Cost Management to Innovation and Business Value. California Management Review, 50, 4, 127-147

7 - See for example Willcocks, L. and Lacity, M. (2009) The Practice of Outsourcing op. cit. ch. 13.

8 - Weeks, M. (2004) Information Technology Outsourcing and Business Innovation: An Exploratory Study of a Conceptual Framework. PHD thesis, Oxford University, Oxford.

Business product and service – these innovations significantly enhance the firm's product/service offerings for existing target customers, or enable the firm to enter new markets. Such innovations can change a firm's business strategy and competitive positioning. In Asia Pacific we found Crown Casino introducing technology to automate (and thus speed up) roulette, and also to increase revenues from high rollers. Similarly, the CFO of Repco, a car parts distribution company commented:

> "One of the things that we came down to very rapidly was, we wanted IT to be a competitive advantage. That sort of changes the focus from being reactive to being proactive. It's about delivering a business product that's new and innovative rather than just keep going with what you've got."

In 2009 Repco, with the aid of suppliers, operationalized remote computerised car monitoring to pre-empt mechanical breakdown and provide positive response in terms of spares and repair:

> "For us, it's a different strain of business, but the key thing is, we can actually say, your car is due for service and these are the parts you need. Here's a suggested place to go and service it."

Given these definitions, our research points to a new performance agenda for outsourcing practitioners to aim at over the next five years. Essentially, superior performance through innovation is now feasible in a maturing industry, but requires a step-change in objectives, relationships and behaviours. The messages of our findings are present in Figure 2, and can be summarised as:

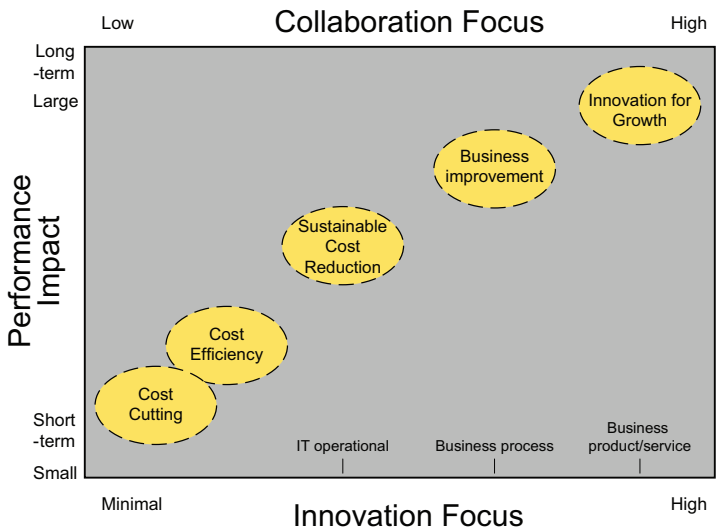

Figure 2: The New Performance Agenda

- In outsourcing, the collaborative capabilities of all parties determine the type and degree of innovation possible. Only **deep collaboration** makes large business process and strategic innovations feasible.
- Without an **innovation focus**, outsourcing can achieve cost-cutting mostly of a one-off kind, or at best cost efficiency – similar service at lower cost.
- Focusing on **innovations in IT operations** can and does achieve larger, sustainable cost reductions.
- The real performance impacts over time come from business process and business product/service innovations. **Business process innovations** create sustainable business improvements in areas much bigger than IT operations alone – a bigger target, a more impactful innovation. **Business product/service innovations** can, and do, support firms' revenue and profit growth targets.
- Innovation is risky. **Collaborative innovation finds ways of sharing and offsetting risk**. It also galvanises behaviour towards lessening risk and achieving shared goals. Collaborative innovation definitely supports superior performance more realistically than more traditional outsourcing relationships.

This paper discusses many examples of organizations that have successfully got on to the new performance agenda. For ease of reading we have placed four such detailed cases in the Appendices. As one further detailed illustration, in the next section we look at Michelin's initiatives. From studying these and many other organizations, we then provide a fourfold framework for success on how to make the step-change to collaborative innovation. And as Michelin illustrates, in the future such collaborative innovation will usually take place in a multi-vendor environment.

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Michelin – The Future Is Already Here…….

Background

Michelin is the leader in the world tyre market with a 17.2% market share. The Group operates in more than 170 countries. It manufactures and sells tyres for all kinds of vehicles, publishes maps and guides and operates a number of digital services. It has 71 plants in 19 countries producing 197 million tyres and 20 million maps and guides each year. Its staff is highly qualified with over 121,000 employees, including 4000 research engineers, in Europe, the United States and Asia. It has an extensive brand portfolio for all market segments. The Group's portfolio is one of the richest and well balanced in the tyre industry with two world class brands, Michelin and BF Goodrich, and strong regional brands and well positioned private brands. Before being an equipment supplier for vehicle manufacturers, Michelin is primarily a player on the consumer market for passenger cars and motorcycles and on the professional consumer goods market for light and heavy utility vehicles.

IT and Outsourcing

The Group spends 15-20% less on IT than comparable companies. In 2004, Michelin's world wide IT function consisted of 2,200 staff. That year the group outsourced all its IT infrastructure and transferred 800 people to IBM. This left the company with 800 on Applications and 600 dealing with external suppliers. In 2008 IT accounted for about 1% of the workforce and the IT spend was only 2–3% of the total group spend.

The Group's growth plan has been to retain Michelin as a leader of the tyres market with four business goals of increasing capacities for growth, developing new services, harmonizing world wide best in class processes and reducing costs. The group looked for partners able to commit to the same goals, bringing the right skills and delivery model within a collaborative governance model. Michelin's strategy for the Application activities has been to use external services differently, with an approach they, call 'co-management'.

Co-management involves the selection of a single global partner per functional area in order to support all the IT activities with Michelin in co-managed entities. Eight functional areas were identified (CRM, SCM, FAR, FAO, OTC, MFG, RDI, GS) and two stand-alone zones – South America and Asia. In each entity the Michelin and supplier managers work together on a basis of trust and transparency to deliver on KPIs, achieve the entity's "business case", jointly drive change and monitor the transformation plan in a collaborative way. The co-managers are also responsible for planning resources and staffing management. Most importantly, Michelin look to suppliers to provide innovative ideas to achieve the entities' objectives. A co-managed entity has shared client-supplier objectives with a risk-reward mechanism based on project performance, entity performance, supplier cooperation and group performance metrics. It also has common activities in the form of upstream studies, business requirements and acceptance and roll-out. The supplier is responsible for applications development, maintenance and support, using offshore capacities. Finally, co-management is characterised by top level commitment, on both sides, to achieve Michelin objectives.

How did Michelin get there? In 2004 Michelin and Logica showed leadership by prototyping a new way of working. A major CRM project was undertaken in the fleet management area. Client and supplier decided on a joint way of delivering the system. They both provided managers and staff. Effort and focus were aligned by all workers, whether Michelin or Logica, sharing common objectives and key performance indicators. The success of the project demonstrated to the rest of Michelin that co-management could work. Michelin showed leadership in its sourcing strategy by deciding on a multiple vendor, but co-managed, route forward. Michelin was clear that it wanted the sort of innovation it got from its 2004-6 CRM project Michelin stipulated four suppliers

as the maximum with contract duration of three plus three years. The selection process began in early 2006 and transition began in July 2008.

But in the process Michelin showed further leadership and collaborative intent by involving their suppliers in shaping how that would be accomplished. How should the work be divided up – by zone, by technology, by business function, or by a mix of these? These were difficult questions. Michelin signalled and gained from collaborating, receiving highly constructive advice from its four supplier groups. Finally Michelin shaped the future by deciding that R&D and Manufacturing went to Accenture-Atos, F&A went to IBM-Sopra, South America went to IBM, and HR and Asia went to Wipro. Logica was chosen for the Supply Chain Management, Corporate Finance, Customer Relationship Management and Order to Cash domains. The organization and governance structure for the Logica piece is shown in Figure 3, representing an aligned, co-managed structure. Delivery had onshore, nearshore and offshore elements, with the plan being to move a greater percentage of service provision, development and testing offshore to Logica's service centre in Bangalore through 2009-10.

“ Create a polar star... ”

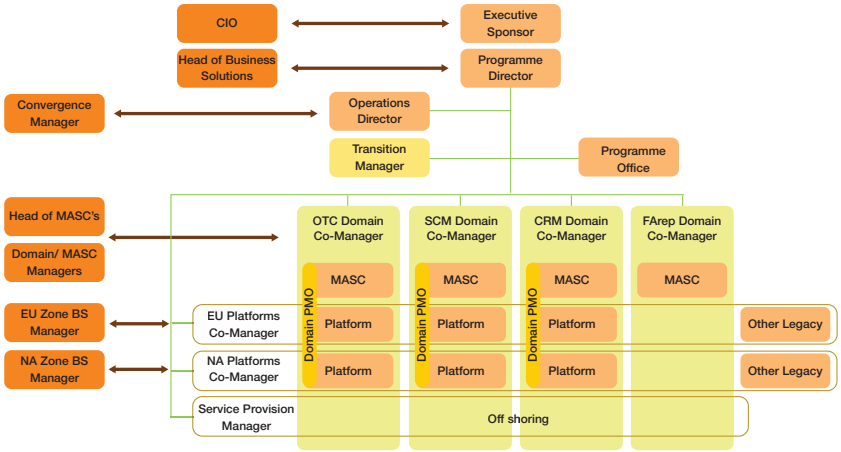


Figure 3: Michelin – Organization and Governance Structure (source: Michelin/Logica)

Pascal Zammit, in 2008 Michelin's Head of Business Solutions, neatly summed up the co-management approach by saying:

“ We want our suppliers to jointly create a 'polar star' with us. ”

In a wide-ranging interview he went on to say that Michelin is a highly competitive business and it looks to its suppliers to maintain its competitive edge:

“ At Michelin, we seek to collaborate with our suppliers, and relationships are built on trust and behaviour. Trust is built up over time and is about experience. As an example, Logica exhibits the right behaviour from the project team to Andy Green, the CEO of Logica. ”

Pascal Zammit saw governance as one key (see Figure 3), but also the alignment of suppliers. Michelin set the environment for collaboration and as a mature organization regarded itself as innovative but also continually looking for new ideas:

> “Up until now, our innovation has been more about products and services rather than process. So we know that we can make more progress on process innovation than perhaps we have done in the past. We look to our new co-managed approach to achieve this process innovation through collaboration.”

Co-management is itself, operationally, a strong example of collaborative leadership. Logica’s programme director, Pierre-Dominique Martin, gave us one example. In Figure 3 a domain such as supply chain management (SCM) is co-managed by a Michelin manager and a Logica manager. They have the same KPIs and objectives. The Logica manager will tend to focus on the fixed price delivery and maintenance work, while the Michelin co-manager will be involved more in design, policy and upstream business-focussed activities. But they constantly challenge each other, in practice to innovate further, move work offshore and take the right risks. This style of collaborative working is repeated throughout - at very senior as well as at all operational levels. Operationally Michelin and Logica people work alongside each other in teams on a day-to-day basis dealing with common problems against common objectives, demonstrating how a different form of leadership and contracting leads to new ways of organising and teaming, leading to greater performance possibilities.

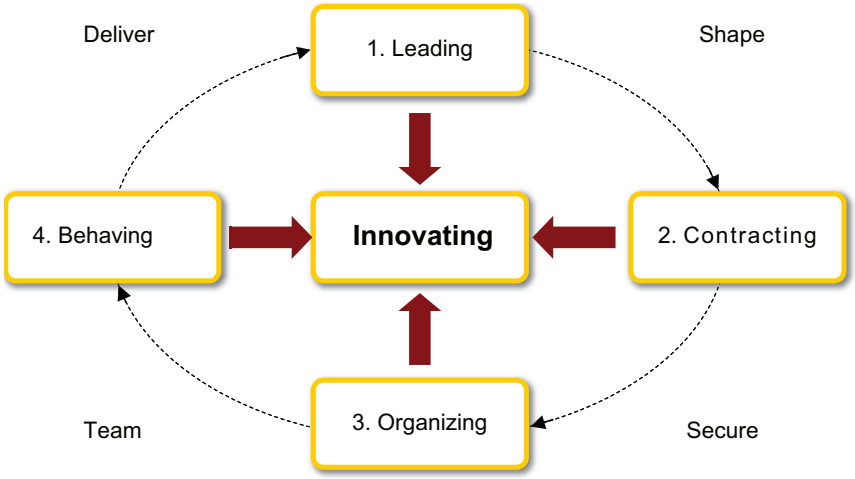
Lessons

We can draw out the following lessons:

- **Create a polar star.** Companies outsourcing need to create a common goal with their suppliers. In this context the right metrics are important.
- Suppliers need to **understand the business first** and then be able to bring complementary skills within a collaborative governance model.
- **Co-management by entities or domains** is a powerful governance model which sets the framework for innovation.
- **Top level commitment is necessary to set the environment** for collaboration and innovation.
- A co-managed entity needs **shared client-supplier objectives with a risk-reward mechanism** based on project performance, entity performance, supplier cooperation and group performance metrics.

Collaborative Innovation: The Framework For Success

Our case studies make very clear the critical success factors that drive collaborating to innovate. In the rest of this paper we consolidate our learning into four fundamental shapers and components of effective collaborative innovation. These are **Leading, Contracting, Organizing** and **Behaving**. Of these, Leadership is primary (see Figure 4). Leadership shapes and conditions the environment in which requisite contracting, organizing and behaving can occur. The right kind of contract supports collaborating and is an incentive for the right behaviour. The right kind of organization supports teaming amongst the parties and enables high performance. Let us look at this process in its four phases.



Source: Willcocks and Craig 2009

Figure 4: The Process of Collaborative Innovation

Phase 1 - Innovation's Open Secret: Leadership For Collaboration

In ***Leadership Without Easy Answers***[9] Ronald Heifetz makes an important distinction between technical and adaptive work. Technical problems are rarely trivial but what makes them technical is that the solution, in the form of specialist know-how, techniques, and routine processes, already exists within the organization's (or a supplier's) repertoire. Managers can delegate such work to specialists and monitor the outcomes.

By contrast, leadership deals with adaptive challenges. In fact, Heifetz defines leadership as shaping and mobilizing adaptive work, that is, engaging people to make progress on the adaptive problems they face. He suggests five strategic principles of leadership:

- Identify the adaptive challenge
- Keep the level of distress within a tolerable range for doing adaptive work
- Focus attention on ripening issues and not on stress-reducing distractions
- Give the work back to the people, but at a rate they can stand
- Protect voices of leadership without authority

9 - Heifetz, R. (1994) *Leadership Without Easy Answers.* The Belknap Press, Cambridge, MA

10 - Adapted from Heifetz, R. and Linsky, M. (2002) *Leadership On The Line.* (Harvard Business Press, Boston)

Challenge	Type of Work	Done By
Technical	Apply current know-how techniques, processes	Specialists
Adaptive	Learn new ways	The people with the problem

Figure 5: The Leadership Challenge - Technical versus Adaptive Work[10]

For him, the hardest and most valuable task of leadership is advancing goals and designing strategy that promote adaptive work. An adaptive challenge is a particular problem, often difficult to specify precisely, where the gap between values and aspirations on the one hand, and circumstances on the other, cannot be closed by the application of current technical know-how and routine behaviour. **Adaptive challenges** require experiments, discoveries and adjustments from many parts of an organization. When is it an adaptive challenge? When peoples' hearts and minds have to change; when all technical fixes fail; when conflict persists despite all remedial action; when a crisis arises, indicating that an adaptive challenge has been festering.

Modern outsourcing is full of adaptive challenges and work that cry out for leadership and learning strategies. Innovation itself is essentially an adaptive challenge. When one adds into the mix typical modern developments - large-scale, multiple suppliers, offshoring, the outsourcing of IT-enabled back offices like HR, procurement, finance and accounting, and transformation outsourcing, and supplier involvement in business transformation projects - it becomes very clear that, in modern outsourcing adaptive challenges far outweigh technical ones. Thus leadership – the ability to shape the context for and mobilise adaptive work - becomes key.

Consider the major adaptive challenges in the 1999-2006 $US 600 million HR outsourcing deal between BP and Exult. Here the complexity of taking over an 'As-Is' HR function covering 56,000 employees, and centralising and standardising the service, was greatly underestimated. Moreover, the supplier was a start-up, and the premise that its superior technical web expertise would take BP's HR to a new level greatly underplayed the risks and adaptive challenges. Much leadership at all levels within BP and the supplier was needed over four years to put this deal on an even keel[11].

In our experience, leadership begins in the Boardroom with the CEO and key executives. In their study, Earl and Feeny[12] found that the CEOs who leveraged IT the best had a vision that IT could transform their business, and demonstrated their belief by their own behaviours. This CEO transformation agenda is also what is needed to achieve innovation with outsourcing collaborators. It also needs a top management team process designed to achieve new things, the relevant CXO (whether IT, HR, procurement, finance, accounting) as a member of the top team, and a CXO tied and capable of delivering on an innovation agenda. Gooding's work on CIO innovators[13]

11 - Detailed accounts appear in Willcocks, L. and Lacity, M. (2006) *Global Sourcing of Business and IT Services* (Palgrave, London)

12 - Earl, M. and Feeny, D. (2000) How To Be A CEO In An Information Age. *Sloan Management Review,* Winter, 11-23

13 - Gooding, G. (2002) *The Contribution of the CIO To Business Innovation.* PHD Thesis, Oxford University, Oxford.

applies to other CXOs. He found the major attributes being business visionary, member of the 'inner circle', communicator of direction, external and internal networker, purposeful change agent, holistic implementation champion and creator of agile IT.

Our illustrative case studies of collaborative innovation – of Michelin, the Heathrow Terminal 5 project (Appendix 1), and of KPN, StatoilHydro, and Spring Global Mail (see Appendix 2) are saturated with leadership challenges and responses. In Michelin we see the leadership shaping how contracts are let, and implementing the new co-management approach to facilitate risk management, behaviour change and innovation. In the Heathrow Terminal 5 project, Sir John Egan, CEO of the British Airport Authority, was clear that the role of the client had to be fundamentally different. BAA needed to think differently about risk management and about long-term relationships with suppliers. A new sort of agreement was needed (see Figure 6).

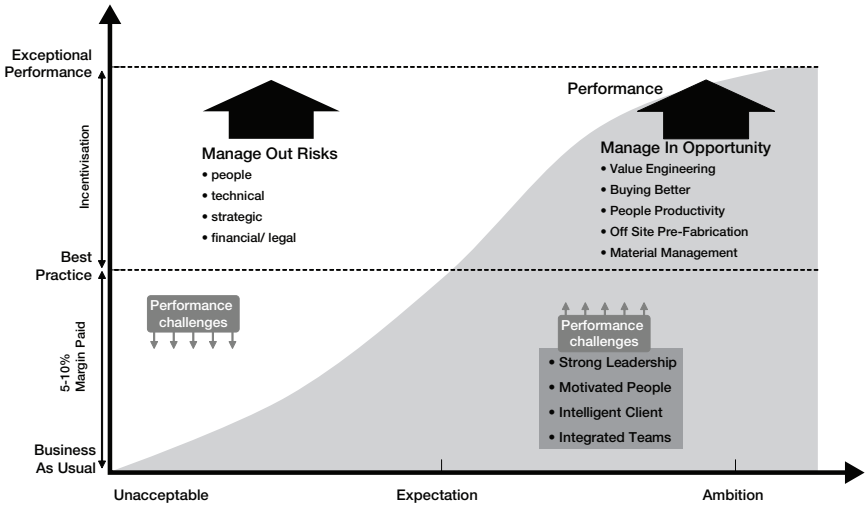


Figure 6: Heathrow Terminal 5 Agreement Approach (Adapted from Doherty 2008)

Egan was clear that, given the long-term spend on construction, BAA needed to find the best suppliers, and work with them to try to develop best-in-class approaches to buying and building so that all organizations could create more value together over time. The objective was to 'manage out risks' and 'manage in opportunity' (see Figure 6). Leaders had a great belief in the ability of the T5 team to solve any problem thrown at them and this was continually reinforced. Their belief spread into the teams, motivating them and encouraging every individual that they could personally make a difference. This leadership culture was meticulously implemented throughout the various management and governance fora. As Tony Douglas, T5 Managing Director said:

> "Leadership made the difference on T5. The judgement, passion, determination with which we got the best out of the integrated teams and influenced the key stakeholders was second to none."

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According to Andrew Wolstenholme, the T5 Construction Director, those leaders who made a difference on and around T5 had five characteristics: thinking big picture, engendering and operating with vigilant trust, driving for success despite the odds, keeping stakeholders onside and aligned with objectives, and getting the best out of the integrated teams. Moreover, he notes that:

> “At different phases of that project, it was right for different people to lead it.”

At KPN, based in the Netherlands and provider of telephone, internet and television services, we found Han Wijns, the senior VP for Innovation achieving major innovations in its networks with key outsourcing partners. He saw his leadership role as visioning, architecting and facilitating innovation but also driving collaboration:

> “We have to challenge the suppliers for innovation…. I think that we have to co-create.”

At a multinational mobile telecommunications company some senior executives were very clear that collaborative behaviours were fundamental in the effective use of suppliers and that those behaviours must be demonstrated from the top and throughout the leadership spine of the companies involved. This is backed by another senior exectutive:

> “We have to co-create...”

> “My job is to get into supplier organizations and make sure that my company has a higher percentage of their innovators’ and decision-makers’ time than other companies.”

Meanwhile at international mail services company Spring Global Mail, the Chief Finance Officer Wouter Hijzen told us that leadership had a fundamental role not only in creating the climate for collaboration and trust, but also in dealing with issues when difficulties occurred:

> “You establish trust through delivery but when it goes wrong you have to show leadership. Taking responsibility is the beginning of leadership. If you keep telling people what to do they will never become leaders.”

The payoff from leadership is indicated by Andrew Wolstenholme, the T5 construction director:

> “We set up an environment within which innovation could flourish; I didn’t come up with all the clever ideas. We created a place where people could innovate and that’s the act of good leadership; making it safe for people to stick their necks out.”

Phase 2 - Contracting For Collaborative Innovation: Making The Game Change

Leadership, then, creates the environment for innovation. In earlier IT outsourcing deals, especially the long-term 'strategic alliances' signed in the 1990s – for example EDS-Xerox, IBM-Lend Lease, BAE-CSC, UBS-Perot Systems – invariably innovation was cited as something the customer expected, and the 'world class' supplier could and would deliver. In study after study we found such innovation not forthcoming.

For example, even in what is considered a relatively successful finance and accounting outsourcing deal at an oil major, an IT executive reported:

> "We are not getting dynamic innovation, to say the least, on a continuing basis. After the initial burst of creativity, it went flat."

One response is to create an innovation fund for suppliers to bid for. According to one public sector IT manager:

> "In the previous contract we never asked for their strategic view, so that was half our fault. But equally, they didn't come up with a lot of innovation. Lesson learned: for the 2008 round we are putting in a formal mechanism to encourage innovation."

Our experience is that even large innovation funds have rarely produced lasting, important innovations. The same applies to many joint venture and equity share initiatives designed partly to stimulate innovation. They disappoint invariably because they are mere add-ons in mainly fee-for service deals where, in practice, both clients and/or suppliers prioritise service and cost issues well above innovation issues. Let us pursue this issue further.

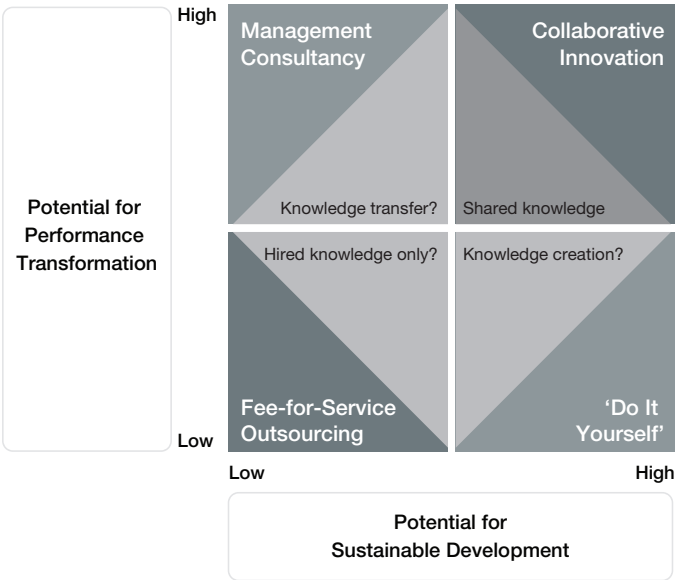

Figure 7: Options for Back-Office Innovation

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In practice, senior executives' organizations have available four main approaches to achieving innovation, each with a distinctive knowledge objective and approach.

In Figure 7 we summarize our research findings on the suitability, benefits, and risks of each innovation option[14]. **'Do-It-Yourself'** scores highly on retaining control and keeping the value of transformation within the company. But to succeed, it requires both funding and appropriate skills which may be lacking. It is also the option most likely to encounter internal resistance if senior management does not give a clear signal of its importance. An example of success is Commonwealth Bank Australia. Despite having two major outsourcing deals, between 2003-5 it achieved a major CRM implementation largely through using internal resources, and has further extended its internal development capability since[15]. The **'Management Consultancy'** route brings in external energy, gives a clear signal of commitment to major change by bringing in outsiders, and reduces political resistance. The most significant risks we have seen are cost escalation, lack of sustainability and little knowledge transfer.

> "Innovation..can be lots of little things.."

'Fee-For-Service Outsourcing' - whether ITO or BPO – can see limited, usually 'one-off', innovations through reforming inherited back-office management practices, streamlining business processes, and fresh investment in new technology, but even where these are forthcoming, our research shows that the innovation zeal is rarely sustained. The contract is structured around cost/service issues and does not incent the supplier to innovate. There is an over-reliance on the supplier to innovate in business areas where innovation should be primarily an in-house concern. The supplier gets focused on selling extra services to make further margins, and also gets imbedded in solving today's pressing crises and operational problems. The employer does not develop or employ people capable of innovating. The customer loses interest in joint boards and often downplays the in-house responsibility to leverage the relationship further. As one energy company IT executive put it:

> "The relationship gets stale, and an outcome is lack of innovation and creative thinking."

Some form of 'Collaborative Innovation' is required if sustained, significant IT or back-office and business innovations are to be achieved. The greater the innovation ambition the more this is likely to have a risk-reward component in the contracting arrangement - as we saw in the T5 and Michelin cases. Collaborative innovation may also take the form of a formal joint venture as in the case of Xchanging's back-office deal the London Insurance Market (2001 and on-going). In that case a jointly resourced and owned third entity was created to deliver service and innovation to the client. The third entity had the competencies detailed in the Outsourcing Enteprise paper: "The CEO Guide To Selecting effective Suppliers" including the transformational capabilities of reengineering, technology exploitation, leadership, customer development, program management, sourcing and behaviour management[16]. However the approach to innovation has been incremental rather than 'big bang'. As one executive we talked to put it:

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14 - These findings are based on the present research and earlier studies detailed in Willcocks and Lacity (2006) and (2009) ops. cit.

15 - See Reynolds, P. and Willcocks, L. (2007) *Building Core IS Capabilities for Business Change: The Commonwealth Bank Case.* Proceedings of the ICIS Conference, Montreal, December.

16 - Another methodology to assess outsourcing service providers is the eSCM framework developed by Carnegie Mellon. Our own twelve capabilities framework is detailed in Willcocks, L., Cullen, S. and Lacity, M. (2007). The Outsourcing Enterprise – The CEO Guide To Selecting effective Suppliers. Logica, London.

> Innovation does not need to be a big idea – it can be lots of little things.

But there are real dangers in relying overmuch on the supplier for technical and business innovation, even where this has been explicitly contracted for. This can be most dramatically observed in examples of transformation outsourcing. The problem here is when transformation is treated largely as a supplier responsibility. Transformation, as the word suggests, can rarely be merely a technical matter, and invariably involves behavioural, organizational, social and political issues. Nor is it easy to define precisely the outcomes, what work is to be carried out, by whom and how. This means transformation is about learning, experimentation and bringing many different forms of know-how together to deal with adaptive challenges. This immediately means it requires primary leadership and learning by the client organization. These considerations probably help to explain some of the extreme difficulties UK-based Sainsburys experienced with its IT and logistics transformation outsourcing programme between 2000-5.

In terms of contracting for innovation, it is salutary to reflect upon the different contracting assumptions underlying the Heathrow Terminal 5 project, and shown in Figure 8.

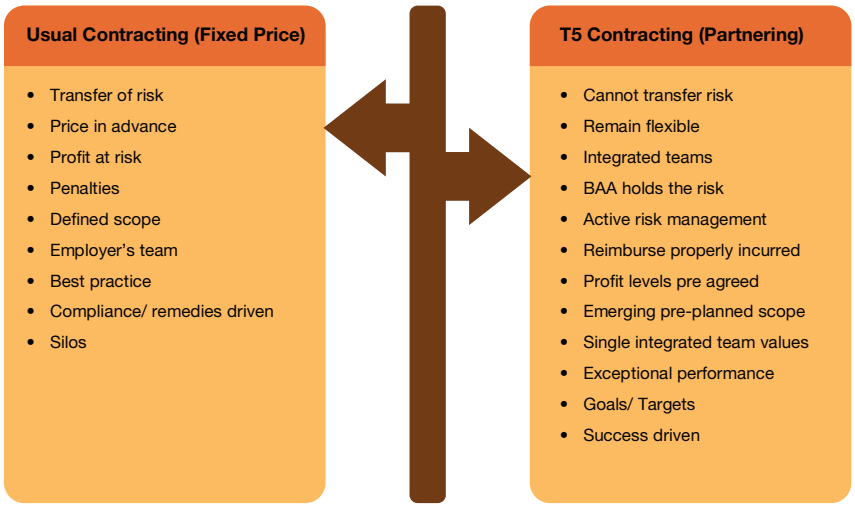

Figure 8: Heathrow T5 Contracting Assumptions

Adrian Wolstenholme, T5 construction director said:

> We did not simply rely on a contract that identifies culpability when something goes wrong, but a contract that encourages people to get it right before it goes wrong.

What is also particularly interesting in Figure 8 is the approach to risk. Traditionally both clients and suppliers look to transfer as much risk as possible to the other party. The actual distribution of risk depends on negotiating power, but, if skewed to the detriment of one party, can damage both the relationship and performance and curtail severely innovation. The T5 contract was a cost-plus contract, with a contractor receiving actual cost, plus a fixed fee, overheads and profit. Additional incentivisation existed for exceptional performance (see also Figure 6). Here, operational risk is shared, but the client, BAA, holds the main risk, and together with its suppliers actively manages risk. A range of practices and behaviours surrounded cost-plus contracting to convert performance into partnering and collaborative innovation.

Phase 3 - Organizing For Innovation

Let us distill from this study the learning on organizing and teaming. Our framework is shown in Figure 9. Technical work requiring the application of existing specialist know-how and techniques can be outsourced relatively safely, assuming competent specialists can be hired. The more work becomes adaptive the more leadership is required and the more multiple stakeholders need to be engaged with defining the problem, and working together on arriving at and implementing a solution. The role of leadership is to maintain direction and shape the context and process by which this can happen. Moreover, the more radical and business focussed the innovation required, the more that leadership should be primarily by the client.

In practice, in-house leadership is vital to large-scale IT and back-office innovation and transformation because these inherently comprise predominantly adaptive challenges for the organization. But, as described above, even fee-for-service outsourcing has some adaptive challenges mixed in with, and often mistaken for technical challenges. For example, tried and tested technology introduced into a new client environment impacts on existing technical and social systems and presents adaptive challenges. The specialist will need to collaborate with business users and in-house IT people to get it to work. We have found this time and again with implementing ERP and HR systems, for example[17].

	APPROACH		
ISSUE	**Technical**	**Techno/ Adaptive**	**Adaptive/ Innovation**
Problem Definition	Clear	Clear	Unclear; Requires learning
Solution and Implementation	Clear	Requires learning	Requires much all-party learning
Primary Responsibility	Specialists	Specialists and User; Participatory	User with specialists; Multi-functional teams
Type of Problem-solving	Technical	Technical-adaptive	Adaptive-innovative
Contract with External Services	Outsource	Time/ materials Resource-based	Shared Risk-reward Outcomes-based
Objective	Efficient use of existing technical know-how	Effective implementation of existing solution in new setting	Effective business solution
Primary Leadership	Specialist	Collaboration	Business Sponsor/ Champion

Figure 9: Technical, Adaptive and Innovative Work in Outsourcing

17 - Examples appear in Willcocks, L. Petherbridge, P. and Olson, N. (2003) *Making IT Count: Strategy, Delivery and Infrastructure.* Butterworth, Oxford)

Figure 9 makes clear that teaming across organizational boundaries and functional silos is vital for adaptive-innovative work. All our respondent organizations looking for innovation had this understanding and were actively putting it into practice. It can be clearly seen in Michelin's co-management governance structure. KPN see the client as responsible for making the innovation plan, but feel that KPN has to find trans-sector innovation in the future (see Appendix 2). Requirements had to be very clear and this started at Board level. But in building the architecture and achieving delivery multiple suppliers were needed. As one example, to achieve one innovation they put the designing teams from the several suppliers together in one building and in five months they built the new IT solution. Designing, building, and testing their own part were the responsibilities of each supplier; KPN kept the integration function. KPN use a lot of innovation power from their network of (not just IT) suppliers.

As three further examples:

> "We always thought that, together, we would be more cost effective as a whole – that was active collaboration. In Spring we always say it's a team. It's not a family. You have to work together, but you don't have to sleep together."
>
> – Wouter Hijzen, CFO, Spring Global Mail.

> "We got sufficient leverage and sufficient buy-in and understanding from all the senior executives in the supply chain to say, we are prepared to sign up to this. This is about behaviours. This is about how we work together in this unit that we call integrated teams and it appears that you are going to take off our shoulders the traditional commercial risk that we'd otherwise be carrying. In response to that, we need to give you our best people and we need to make sure their reputation is high. This is a very different sort of commercial leverage."
>
> – Andrew Wolstenholme, Construction Director, Heathrow T5

Tom Lamming is the Vice-President of Transformation at the major telecoms company Telstra and oversees the IT-enabling component of its $A20 billion transformation programme. He commented:

> "We have twelve strategic technology suppliers… I think a lot about the people and the chemistry and it's not about uniformity and unilateral decision making. We have multiple suppliers, and it's about the ability to team and work together for the outcome."

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Phase 4 - Behaviour Change: Key To Innovation Payoff

Leadership, creative contracting and organizing and teaming in new ways build the fundamental behaviour changes needed to undertake collaborative innovation. The partnering behaviours required for innovation are summarised in Figure 10.

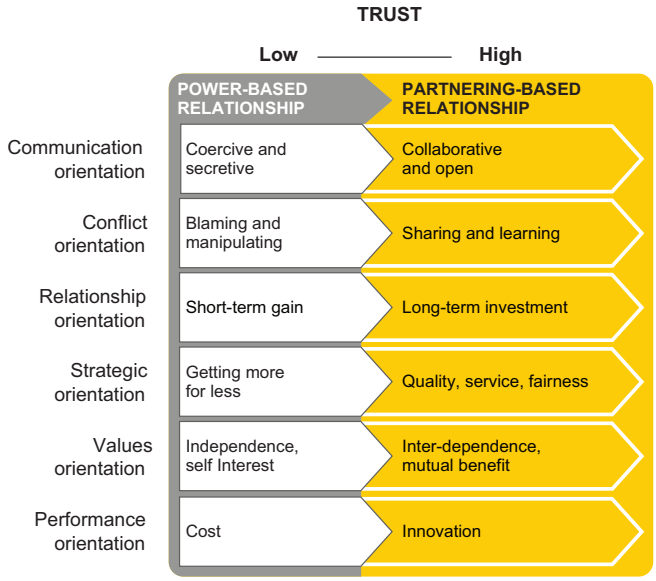

Figure 10: Power and Partnering-Based Relationships

> "You build trust by spending time together.."

The behaviours represented on the left side of Figure 10 are very limiting in terms of what can be achieved by either client or supplier. They are essentially tied to an adversarial game, with no 'third corner' to move to. Unfortunately recessionary conditions often pressure organizations to regress to this default position. But as Max McKeown suggests, a crisis is a terrible thing to waste, and the best way to deal with a recession may just well be to innovate your way out of it[18]. Behaviour change can come about as a result of a crisis, but lasting collaborative innovation is shaped in the context of prior work on leadership, contracting and organizing, which creates rising levels of trust, teaming and performance:

> "There was a mindset change at the centre of T5. It was not a perfect project, but one where people woke up in the morning thinking, I know what the directives are and I'm part of a single team and I'm going to make this work. I think we'd worked with each other for sufficiently long enough that we had a level of trust. We actually had to spend a lot of time and investment in people and in understanding relationships."
>
> - Andrew Wolstenholme, Construction Director, Heathrow T5

As Figure 10 illustrates, trust is a key component in partnering. As we have noted in other studies there is no such thing as instant trust in outsourcing. It is built over time through demonstrable performance:

18 - McKeown (2008) op. cit.

> You build trust by spending time together. You need to have capacity within the organization to do that and to build competence and business understanding. You can't just outsource things and then think that everything is going to go well; you need to invest in the relationship.
>
> – Rune Aase, VP and Head of Service Delivery, StatoilHydro

Weekes and Feeny have developed a useful three-pronged model of trust that reflected the complexities of the outsourcing environment. Personal trust refers to the confidence one has that another person will work for the good of the relationship based on their integrity and adherence to moral norms. The high uncertainty associated with innovation adds another dimension to this, but one can see through all our case histories how high personal trust means that all parties will accept responsibility for risks that do not work out, rather than pointing fingers or deflecting blame. Competence-based trust exists when one party has confidence that the other will successfully deliver their allocated tasks and responsibilities. This may well include innovation. Successful completion of projects and achievement of joint goals enhances competence-based trust, while operational failures will degrade it. Motivational trust refers to where both parties believe the rewards and penalties they experience are geared towards the achievement of joint goals - a 'win-win' situation. As we have seen in our cases, bonus structures and risk-reward sharing mechanisms are elements used to build this type of trust in collaborative innovation efforts. Ultimately all three types of trust have to be present across all parties for success. Our evidence suggests that that is true whether the goal is IT operational, business process, or strategic innovation.

In the Michelin case and the four cases detailed in Appendices 1 and 2 it was clear to us that all these organizations experienced high personal, competence-based trust and motivational trust, together with superior business performance and increased innovation. Behaviour and trust appear to be fundamental but collaborative behaviours also need to be developed over time and must be demonstrated from the top and throughout the leadership spine of the company. Development is experiential and the right behaviours must be demonstrated all the time: it is about developing and embedding new behaviours in their own people and their suppliers.

Finally, organizations do not deliver collaboration and innovation, people do. The importance of the behaviour change exhibited in Figure 10 becoming part of the DNA of individual actions is captured well by one of our interviewees:

> Being a strategic partner, as a supplier, means that if I tell you to come and visit me because I've got a problem, you will come and visit me. I always make sure I get more of the time of both decision makers and the innovators in those supplier organizations. It's only the people in that company that can be innovative, and innovative (as opposed to inventive) people back up words with actions.

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Conclusion: Towards Third Corner Thinking

Successful collaboration and innovation share what we call 'third corner thinking.' In traditional outsourcing, problems are dealt with largely as a contest between the two parties with different vested interests to protect. For example, the client wants more service at lower cost, while the supplier wants to make margins and lower the costs it bears on service delivery. Third corner thinking sees both parties finding a larger, overriding mutual objective they can aim at.

Relatedly, innovation is at its best when it overcomes some contradiction between conflicting objectives. The most successful products deliver two benefits that contradict each other – for example Linux challenges Windows because it is free and open. Such innovation attempts to reconcile the irreconcilable. Third corner thinking is unwilling to accept the compromise between two opposing characteristics, or the adversarial needs of two opposing parties.

In effect, our overall research has documented the 20 year rise to globalism of IT and business services outsourcing. The key quest for clients has been how to leverage the ever expanding services market for significant business advantage. The common denominator in the findings: we have uncovered no quick fix. Most have learned the hard way, by making mistakes, finding out what works, and what does not, across two or three generations of outsourcing. The wise ones have been 'smart in their ignorance,' taking an incremental route into more and more outsourcing, learning as they go, limiting their risk exposure, building up their understanding and also their retained capability to run a sourcing regime aligned with their business strategy and imperatives. Suppliers have also faced learning curves in their attempts to differentiate their services, find new markets, and deal with new competition from potentially anywhere in the world. The 2008/9 economic recession makes their capabilities and suppliers' abilities to leverage them ever more critical.

Clients and suppliers both now need to consider carefully the role of third corner thinking and leadership for their sourcing strategies. Leadership is about shaping the context and mobilizing resources to deal with the adaptive challenges organizations face. Leadership is also about transforming how things are done, and leveraging techniques and capabilities in new ways. Leadership therefore, is essentially about third corner thinking, innovation and its delivery. The present study makes clear that changing business needs, recession, the globalizing and technologizing of the supply of business services, and the much greater use of outsourcing, will provide challenges that will require many more organizations to make a step-change from outsourcing management to collaborative leadership – if governance, control, flexibility, innovation and superior business outcomes are to be outsourcing's consequences.

Appendices

Appendix 1
Collaborating: Learning From Heathrow Terminal 5

Background

The construction industry went through a number of crises in the 1990s, which the IT and business services industry can learn much from[21]. The Latham Report of 1994 was sponsored by the Government and the Construction Industry following several poorly performing construction projects. The 1998 Egan Report, "Rethinking Construction", looked outside construction for lessons from other sectors like automotive, aerospace and retail. It was distinguished by its higher level thinking, identifying five drivers of change:

- Committed leadership
- Focus on the customers
- Integrated process and team around the product
- A quality driven agenda
- Commitment to people

In 2002 the Strategic Forum for Construction, under Sir John Egan, published "Accelerating Change." In 2003 Constructing Excellence was formed to bring together all the government initiatives to provide a single interface with the industry.

The reviews by Latham and Egan both emphasized the significant potential to increase the performance of the construction industry. But this would only be achieved if the industry and its clients changed their approaches and practices; clients they stressed, had a personal stake in this. Even so, the industry still has many clients, consultants and constructors who see close collaboration as an alien or threatening process. As Egan said: "they could usefully reflect on how poorly they have been served by traditional methods." Sir John Egan led the Heathrow Terminal 5 project, completed in 2008. The project embodied a collaborative approach to innovation and high performance, and is one the outsourcing industry can learn much from.

Building Terminal 5: What Really Happened

Media focus on the fraught opening of Heathrow Terminal 5 (T5) in March 2008 and the Transport Select Committee's findings in November 2008 has deflected attention from the subsequent turnaround, but, more seriously, from the project's real long-term achievements. The building of Terminal 5 is a good example of how the new initiatives in the Construction Industry were put into practice[22]. Sir John Egan was the CEO at British Airport Authority (BAA) from 1991 to 1999 and it was clear to him that the role of the client had to be fundamentally different. BAA needed to think differently about risk management and about long term relationships with profitable suppliers. Together they worked to change the approach to the use of computer-based design for manufacture, supply change management and safe and efficient processes, thus getting the best out of a well-trained workforce. The commitment to a ground-breaking contract – the T5 Agreement in which BAA held most of the risk – set a principle for the way of working. The right leadership, ongoing client involvement and a focus on getting integrated teams to perform to a world-class standard has meant that the UK construction industry delivered a success story.

21 - Our thanks to Jonathan Snowball of Logica for bringing this history to our attention.

22 - A good account up to mid-2008 is provided by Doherty, S. (2008) Heathrow's T5 – *History In The Making. Wiley,* Chichester.

BAA managed risk differently through the T5 Agreement (see Figure 2, page 10). This context allowed leaders to drive for success and trust differently while working with stakeholders and integrated teams. BAA was a committed, highly involved, intelligent client who over the years pioneered new thinking and different ways of operating in partnership with their supply chain:

> "Understanding where value came from the supply chain was key and I guess understanding, ultimately the outsourcing model. Egan's mindset was, let's get to know our suppliers and let's work alongside them and let's understand how we get best value for everybody."
>
> – Andrew Wolstenholme, Construction Director, Heathrow T5

The T5 Agreement was a legally binding agreement that confirmed that, on a £4.3 billion programme, the client BAA held most of the risk, with supplier exposure being loss of profit or insurance excess payments. Suppliers would receive a guaranteed margin that ranged from 5–10% depending on trade for delivering at least industry best practice, and a team incentive plan was put in place, so that all the suppliers would have to succeed for additional bonuses to be paid where exceptional performance was achieved. Egan was clear that, given the long-term spend on construction, BAA needed to find the best suppliers, and work with them to try to develop best-in-class approaches to buying and building so that all organizations could create more value together over time.

The objective was to 'manage out risks' and 'manage in opportunity' (see Figure 6, page 17). The approach used at T5 focused on; empowering the project team to deliver and make their own decisions; enabling tradeoffs across projects; understanding the impact of one project on another; and accurately tracking the progress of each project within a consistent programme framework. Leaders had a great belief in the ability of the T5 team to solve any problem thrown at them and this was continually reinforced. Their belief spread into the teams, motivating them and encouraging every individual that they could personally make a difference. This leadership culture was meticulously implemented throughout the various management and governance forums. As Tony Douglas, T5 Managing Director said:

> "Leadership made the difference on T5. The judgement, passion, determination with which we got the best out of the integrated teams and influenced the key stakeholders was second to none."

According to Andrew Wolstenholme, the T5 Construction Director, those leaders who made a difference on and around T5 had five characteristics: thinking big picture, engendering and operating with vigilant trust, driving for success despite the odds, keeping stakeholders onside and aligned with objectives, and getting the best out of the integrated teams. Moreover, he notes that: 'at different phases of that project, it was right for different people to lead it'.

Working in integrated teams was one of the cornerstones of the T5 Agreement, and was a fundamental ingredient in the success of T5. Consultants and suppliers, in return for a guaranteed margin and access to an incentive scheme, committed to working in integrated teams alongside BAA. In practical terms the integrated teams approach included co-locating teams, and ensuring that they had the 'best person for the job'. This meant having people work in the spirit of problem solving, not protecting their company interest, as they tried to deliver, at a minimum, industry best practice whilst striving to achieve exceptional performance. The T5 Agreement was at the heart of the culture. This large document was digested and turned into a few simple pages, with teamwork, commitment and trust as the values all needed to live by. T5 by no means got it right all the time in every team. What was critical was that leaders and the client understood that it was important to do everything possible to try to get teams working together and delivering.

Lessons

The Heathrow T5 experience would suggest a number of learning points for the outsourcing industry:

- Focus on the **customer's innovation needs.**
- The client role has to be fundamentally different. **Leadership makes the difference.**
- **Think differently** about risk management and about long term relationships.
- **Partnering and collaborating** turns the process around; it assumes a win-win scenario for all parties.
- **Integrated teams** enable partnering and collaboration to lead to superior performance.

Appendix 2
Emerging Blueprints: KPN, StatoilHydro and Spring Global Mail

In addition to Michelin, we noted in our research many other organizations pioneering the way towards collaborative leadership. In this section we focus on three of the more notable examples we found – KPN, StatoilHydro and Spring Global Mail - and the blueprints they were working on.

KPN – 'Challenging Vendors For Innovation'

KPN provides high-quality telephone, Internet and television services and products and is an all-round provider of ICT services. Consumers in the Netherlands take fixed and mobile telephony, Internet and TV from KPN. Business customers use an entire array of innovative and reliable services which include everything from telephony, Internet and data traffic/management all the way through to the management of ICT services. In Germany, Belgium and elsewhere in Western Europe, the services of the KPN group consist mainly of mobile telephony. KPN made a profit of €2.5 billion in 2007 on annual sales of €12.6 billion.

Between 2009-10 the Netherlands business will undergo a radical transformation. The All-IP network announced in March 2005 will move into its final phase with the implementation of a new access network. In addition, KPN will pursue a radical simplification of its business, both at the front-end in retail segments and at the back-end in network operations. The significant cost reductions that will be generated by this simplification will be used firstly for re-investment in revenue growth and secondly, will lead to margins improving. As part of this transformation, Logica is one of KPN's outsourcing partners[23].

Of nearly 60 interviews that we conducted for this paper, only one client executive had innovation in their title. That person was Han Wijns, the senior VP for Innovation at KPN. For Wijns, the maturing of the global outsourcing services market has now made it possible to do very large jobs and make large steps in innovation:

> "You can't outsource innovation. Our responsibility is for time to market, for business development for innovation; we must have the architects. We don't outsource our vision. But we really do believe that innovation can only be done if we use a lot of capacity outside of the company. I really believe that we have to use the knowledge and the power from places like India."

Han Wijns saw the client as responsible for making the innovation plan for the next few years. He felt that a lot of sector-based innovation doesn't succeed any more and that KPN would have to find trans-sector innovation in the future. Requirements had to be very clear and this started at Board level. The first step is the strategy to market, and the next is the architecture:

> "As an example, we put the designing teams from the several suppliers together in one building and in five months together they built the new IT solution. Designing, building, and testing their own part are the responsibilities of each supplier; we have the integration function and the architecture."

23 - Logica has a five year applications management contract for legacy and new network information systems being responsible for more than fifty IT applications for network administration and geographical information on network elements in the domain IT4W&O (IT for Wholesale & Operations) of KPN. It also has three HR outsourcing contracts with KPN, which has multiple suppliers.

KPN use a lot of innovation power from their network of suppliers and not just IT:

> “We are only the facilitator. We bring together those technologies in IT and in our network and take the products to the customers. We are not the most innovative party. We have to challenge the suppliers for innovation.”

The sourcing strategy is long term relationships with several partners focused on quality and delivery. KPN did not want to outsource all to one party and say, ‘okay, we are not involved any more’. The Board wanted to be involved in its own destiny: ‘I think that we have to co-create.’

For KPN innovation is related to what it brings in for the business. In outsourcing the network, cost cutting is not the main goal:

> “We are looking to suppliers that can help us in transformation and not only in the existing network. It has to be a combination of cutting costs and innovation together.”

Lessons

- **Trans-sector innovation** will be the way forward.
- Use the **innovation power** from your **network of suppliers.**
- **Suppliers** need to **collaborate with each other.**
- Collaboration only happens if there is a **higher level goal** for everyone.
- ‘We have to **co-create**’.

StatoylHydro – “Surprise Me!”

StatoilHydro is an integrated oil and gas company based in Norway, the leading operator on the Norwegian continental shelf, and an expanding international company. It focuses on innovation in exploration and production to recover valuable resources that were previously thought unreachable. StatoilHydro's oil and gas portfolio ranges from development projects to mature fields. The group is the second biggest gas supplier in Europe and the sixth biggest in the world. StatoilHydro trades in petroleum products, methanol, power and emission allowances and ranks as the world's third largest net seller of crude oil.

StatoilHydro is a mature organization, especially in ITO, with high value, multi-functional shared services since 1993. Its IT is divided into two - infrastructure and applications. It uses sourcing first of all to close capacity gaps and then to get additional competence into the organization. Perhaps surprisingly, costs have never been the driving mechanism for sourcing. Of course, cost is important but the capacity issue is their first priority. For IT outsourcing they do not have a single sourcing solution but look for, and expect, extra value from each supplier. One of those suppliers, Logica, has provided the Service Desk for IT since 2003. This supports IT and SAP in all geographies, is based in StatoilHydro premises and on their Service Management processes (ITIL-based) and is also integrated with other suppliers’ processes. StatoilHydro is now looking at BPO concepts, on which, compared to ITO, they are immature.

In an extensive interview Rune Aase, VP and Head of Service Delivery, described StatoilHydro's approach to sourcing. He said first of all, to be a sourcing partner you need to understand my business, which takes time, and you need to have competence within each area you are serving. Of course, relationships are also key in any partnership. If you go into partnership with an external supplier, you have to have a partner that is flexible and is looking for ways to improve both systems and processes throughout the contract period.

StatoilHydro has established a road map to become world class within shared services. But of course, in doing that, they need to have sourcing partners that are on the same road map and are willing and able to change and to be innovative:

> "What we often see is that the way you establish your contracts with sourcing companies can be so stringent that it does not give them or you any flexibility. If you don't have flexibility and there are no gains for suppliers in doing innovation then you have a problem."

Rune Aase stressed the importance of a partner that has the same culture and has the same understanding of where you are going. Partners need to be flexible and solution orientated. Moreover:

> "We expect our sourcing partners to be innovative. I want partners that are able to surprise me with new ideas and are able to advice me on how to improve our performance. My job is to advise my customers and give them what they need, and I expect the same from my sourcing partners."

Lessons

- **Understand** my business and **bring competence/capability** to each area.
- Establish and **get on the same road map** – understand where we are going.
- **Don't make the contract too stringent** and squeeze out any chance of innovation.
- **Be flexible** and continually look at ways to improve systems and processes.
- **Surprise me!** Do it before I ask – be innovative.

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Spring Global Mail – 'Outsourcing To Make Ourselves Better'

Spring Global Mail is a world leader in the provision of international mail services to businesses. It is a joint venture company, formed in 2001 by three of the world's most dynamic and respected postal organizations: TNT of the Netherlands, Royal Mail of the United Kingdom and Singapore Post. It employs 1,100 people in 25 countries and its headquarters are located in Amsterdam, the Netherlands. Spring Global Mail has become the world's largest independent cross-border mail distribution company. It uses its creativity and experience to find solutions to the most complex of cross border mail requirements. Their customers include some of the world's largest senders of cross border mail.

We interviewed the CFO, Wouter Hijzen, who gave us his views on outsourcing and innovation. He started by saying that Spring Global Mail is an outsourcing company!

It takes over all the mail and postal responsibility from its customers. It's a technical thing. Spring buy and sell mail. Clients choose Spring to operate their businesses more efficiently and cost effectively. Its role as an outsourcer has given Spring major insights into its expectations about suppliers.

In its own outsourcing, it used to do the Finance function in-house but outsourced it in September 2008. Spring has also outsourced all its IT services across the world to a TNT company. For finance it has a nine year contract with Logica. All back offices with APAR credit control to certain countries are outsourced to Logica:

> "When we were contracting for this we explicitly said, we are not going to outsource to a company that's only based in India. We want to outsource to a local company, local meaning European. This is because of language, time difference and mentality issues. We don't outsource credit control to India; it remains in the Netherlands, somewhere close."

For Wouter Hijzen innovation is just looking at, and doing things differently. It doesn't have to be a product or a new service. On the finance side the fact that this is the core business of Logica and the fact that Spring's IT is the core business of the people they outsource to for IT makes a huge difference:

> "We have outsourced to make ourselves better; that's the main thing that triggers innovation. As an example, we didn't have an electronic system to approve invoices. We couldn't afford it. It was just too expensive to build it for ourselves, Logica had one. We now make use of Logica's. I don't think it's innovation for them but it is for us."

For Wouter, trust is most important; without it there can be no innovation. Trust is built by letting some things go. Once you go back to the contract you are in a fight and trust is lost. That's why the general outline of the contract is more important because Spring knows that suppliers can't make money if they don't innovate. So it is not important to have innovation explicitly in the contract, because he knows his suppliers will seek innovation. He has suppliers that are really good in the contract and that's why he trusts them. They write down what they will do and then they deliver. Trust is clearly

established through delivery but it also needs strong leadership, especially if things go wrong.

Spring had already squeezed out all the money from their back office functions. The big reason for outsourcing was because they couldn't make it better. Outsourcing wasn't about cost savings or making it more efficient, but to make IT and finance better and to make the people better. Like at KPN, Spring see themselves as having a facilitator role with outsourcing:

> "If my company wants to continue to make the same kind of money now we need to innovate. We don't do anything ourselves. We are just are the brains and not the hands. We need suppliers for everything we do. We only put together suppliers and customers and hopefully, we can make money out of it."

Lessons

- Innovation is really simple, it's about **doing things differently.**
- It may not be innovation for the supplier but it is for us.
- Without **trust** there can be no innovation.
- You establish **trust through delivery.**
- When things go wrong you have to show **leadership**.

End Note

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Leslie Willcocks has a global reputation for his research and advisory work on outsourcing, information and communications technologies and organizational change. He is Professor of Technology Work and Globalization, Director of the Outsourcing Unit, and Head of the Information Systems and Innovation Group, Department of Management at the London School of Economics and Political Science UK, he is also Associate Fellow at Templeton College, Oxford, Visiting Professor at Erasmus and Melbourne Universities, and Editor-in-Chief of the Journal of Information Technology. He is co-author of 32 books and over 170 papers in journals such as Harvard Business Review, Sloan Management Review, California Management Review, MIS Quarterly, MISQ Executive, and Journal of Management Studies.

In February 2001 he won the PriceWaterhouseCoopers/Michael Corbett Associates World Outsourcing Achievement Award for his contribution to this field. He is a regular keynote speaker at international practitioner and academic conferences, has extensive consulting experience, and is regularly retained as adviser by major corporations and government institutions.

Andrew S. Craig

Andrew S. Craig heads the IT leadership and governance stream of Carig Ltd and is also a director of Board Coaching Ltd. He is a visiting Senior Research Fellow at the LSE working in the Outsourcing Unit. He has coached executives, teams and boards in the Defence Procurement Agency, the UK Border Agency, the leisure industry, Balfour Beatty, HSBC and finance and fund management companies.

In his professional Army career, as Brigadier, he directed the recruiting operation- an annual requirement of 16,000 people- and was responsible for Human Resource planning for a workforce of 120,000. He commanded engineering operations worldwide, including in the first Gulf War and Bosnia, and led the UK's planned military response to nuclear, biological and chemical terrorism. He was awarded an OBE in 1998.

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The Research Bases

This paper draws upon new research conducted by the authors in the 2008-9 period. We studied 26 client organizations and their collaborative innovation practices, and interviewed 15 suppliers concerning their experiences of innovation with clients. In total we interviewed 56 executives. Additionally we draw upon our long-standing research on global sourcing, collected in the following research bases.

The first research base consists of 112 sourcing case histories (mainly in the area of IT) studied longitudinally from 1990 to 2001. These are described in Lacity, M. and Willcocks, L. (2001) Global IT Outsourcing: In Search Of Business Advantage (Wiley).

The second is a study of relationships through seven case histories. This appears in Kern, T. and Willcocks, L. (2001) The Relationship Advantage (OUP, Oxford). The third is a 2001-2005 longitudinal study of business process outsourcing practices, with a particular focus on four cases in aerospace and insurance. See Willcocks, L. and Lacity M. (2006) Global Sourcing of Business and IT Services (Palgrave, London). We also draw upon a fourth research stream consisting of ten cases of application service provision, published in Kern, T., Lacity, M. and Willcocks, L. (2002) Netsourcing (Prentice Hall, New York).

A further research stream analysed vendor capabilities, including innovation, and is represented in Feeny, D., Lacity, M. and Willcocks, L. (2005) Taking the Measure of Outsourcing Providers. Sloan Management Review 46, 3. We also draw upon five outsourcing surveys carried out in USA, Europe, and Australasia in 1993, 1997 2000, 2001 and 2002 covering multiple sectors and over 900 organizations. A further research stream, by Sara Cullen, assessed 100 ITO/BPO initiatives of a variety of business functions during the decade from 1994 to 2003 to determine what worked and what did not work, what drove the various degrees of success and failure, and the emerging lessons. The research is represented in Cullen, S. and Willcocks, L. (2004) Intelligent IT Outsourcing (Butterworth) and Cullen, S., Seddon, P. and Willcocks, L. (2005). Managing Outsourcing: The Lifecycle Imperative MISQ Executive, 4, 1.

We also draw upon 2006-8 research into innovation in the contexts of offshoring and business process outsourcing. This covers ten case studies and is represented in Lacity, M. and Willcocks, L. (2009) Information Systems and Outsourcing: Studies in Theory and Practice (Palgrave), Oshri, I. et al. (2008) Outsourcing Global Services (Palgrave) and Willcocks, I. and Lacity, M. (2009) The Practice of Outsourcing: From ITO to BPO and Offshoring (Palgrave, forthcoming).

Combined, this work forms an unrivalled 680 plus case research base held by the researchers at LSE, Melbourne and Missouri, St. Louis Universities. (Including survey work the research base represents data from 1,600 plus organizations) The research base covers all major economic and government sectors, including financial services, energy and utilities, defence/aerospace, retail, telecoms and IT, oil, transportation, central, state and local government, health care, industrial products and chemicals, and is drawn from medium, large and multinational organisations based in Europe, USA and Asia Pacific.

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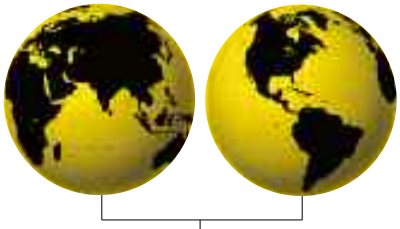

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