

An HfS Research Report

Desperately Seeking Innovation in Business Process Outsourcing: Enterprises Speak Out

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Executive Summary

Innovation is now the critical ingredient for most buyers of Business Process Outsourcing (BPO) services -unequivocally proven by a new HfS Research study. Most buyers of BPO services are initially delighted when they trimmed 30% of their costs on one process, and 50% on another, but once those costs disappear from the balance sheet, they are quickly looking at new initiatives to help them attain new thresholds of productivity or revenue growth: what HfS Research terms as “innovation”.

Moreover, while half of buyers are dissatisfied with the innovation they are currently achieving from their BPO endeavor, the majority are seeing significant potential to achieve it across certain processes within a two-year time-frame. Essentially, once they have out-tasked as much of the feasible routine administrative work to service providers, they quickly discover that next tranche of productivity is not nearly as straightforward as documenting standard processes and training an offshore team to replicate them effectively (commonly termed in the BPO industry as “lift and shift”). Those buyers realize they actually need to introduce new, creative methods to actually change the old way of managing processes to find improvement. This scenario continues to dominate the vast majority of large-scale BPO engagements today.

The answers lie with both BPO buyers and their service providers working together to achieve measureable business outcomes as part of organized and collaborative long-term partnerships. However, too many enterprise buyers jump into a service provider relationship polarized on the initial cost take-out from the “lift and shift”, and gloss-over the future initiatives they will need to implement in a couple of years, when they seek to find new value through better processes, talent and technology.

We believe buyers need to put the innovation track-record of service providers high up the decision-making tree when they select make selection decisions. As earlier [HfS Research](#) has demonstrated, service provision is commoditizing and leveling the playing field, with several BPO service providers today pushing services within a similar price-band, and sufficient track record of successful “operational” delivery. Most large enterprises have already experienced offshoring and outsourcing varying degrees of their operations for several years, and are smart enough to realize outsourcing provides an opportunity to deliver more than simply cost-savings through lower cost labor. Consequently, the ability to provide outcome-based solutions that encompass helping BPO buyers achieve innovation, is fast becoming a crucial differentiator.

This report dives into the experiences and expectations of today’s enterprise BPO buyers when it comes to achieving innovation, and offers actionable recommendations for devising a strategy to improve their innovation agenda with their BPO endeavor:

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Introducing a new HfS Research Study: Achieving Innovation in BPO

When it comes to BPO, Innovation is proving both a bane and a boon. Buyers want innovation as they recognize the significant value it can bring to their organizations but their expectations are falling short, in large part because they are not working effectively with their providers to achieve it.

To gain heretofore unattained insights and a much-needed dose of reality, HfS Research in May 2010 conducted a survey entitled “Are you Achieving Innovation in BPO” in conjunction with the Shared Services and Outsourcing Network’s (SSON) network of senior finance and operations executives. 588 senior decision makers within buy-side enterprises, BPO service provider executives and outsourcing advisors participated.

For the purposes of the study, the definition of “Innovation in BPO” used was, “the customer going beyond transactional/operational work to achieve new productivity gains and/or new revenue streams by implementing new practices through unique, creative methods.”

Analysis of the study results revealed that an increasing majority of buyers are aware they can achieve innovation, and know the potential is there to do exactly that. They also realize certain processes are extremely ripe for an injection of innovation. And in acknowledging that much of the blame for lack-luster innovation results fall squarely on their shoulders, buyers are increasingly understanding the need to craft clear, detailed and formalized innovation plans in partnership with their providers. While the present disappoints, hope for future innovation is abundant.

Key Study Findings

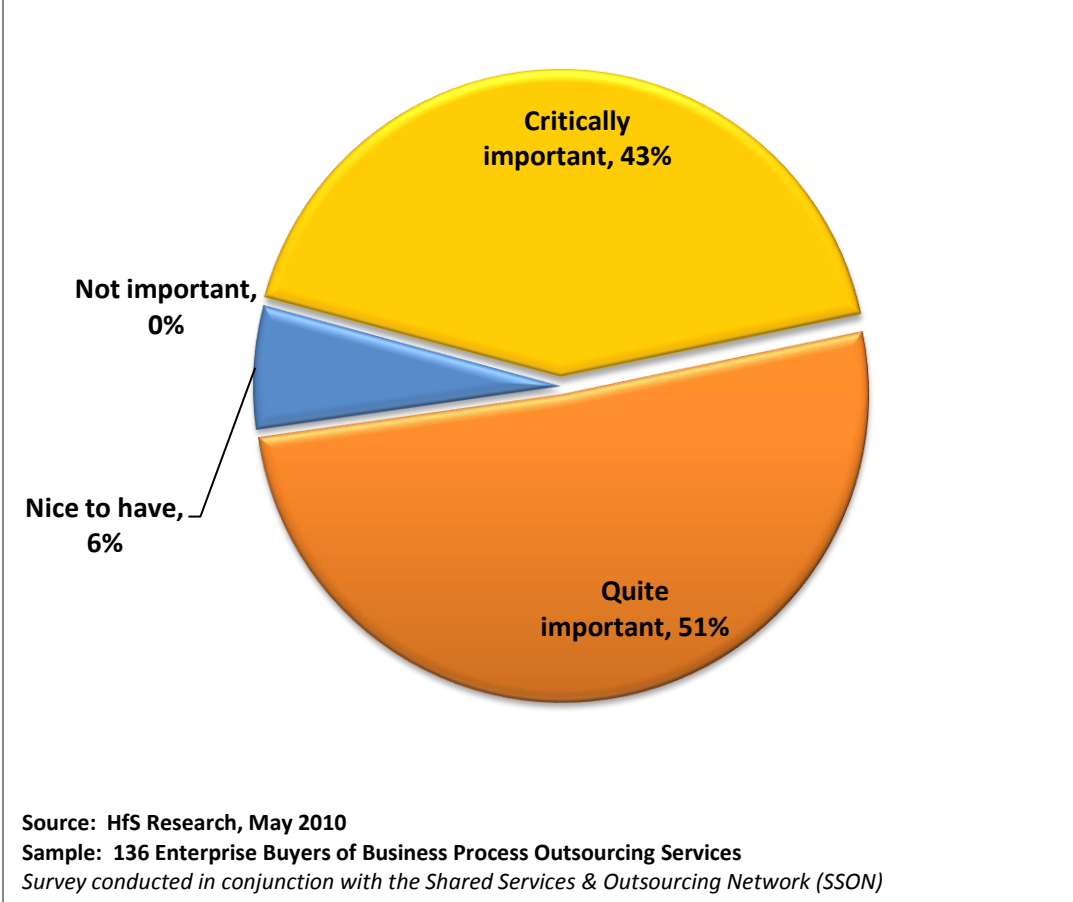
- 43 percent of buy-side decision makers now view innovation as a critical element of BPO
- Half of today’s enterprise buyers are disappointed with their current state of innovation
- Half of the BPO engagements today are having adequate talent and technology provisioned, from both the client and service provider sides, to help drive innovation.
- Customer care, recruitment, payroll and management reporting are noticeably failing to meet clients’ innovation expectations
- There is enormous medium-term potential to achieve innovation across industry-specific processes, analytics and several maturing BPO areas including procure-to-pay, supply chain and recruitment
- Major impediments to buyers achieving innovation include ineffective change management and communications, and unempowered internal governance teams

Innovation is Becoming a Critical Component of BPO

In the past, a significant number of buyers shied away from innovation due to their laser-focus on achieving operational stability within their BPO environment. Many claimed they would have to sacrifice meeting service levels if they tried to tinker with their processes to find new ways of achieving better outcomes. However, the importance of innovation in today's BPO engagements is abundantly clear, as shown in **Figure 1** below.

Figure 1: Importance of achieving innovation from Business Process Outsourcing endeavors

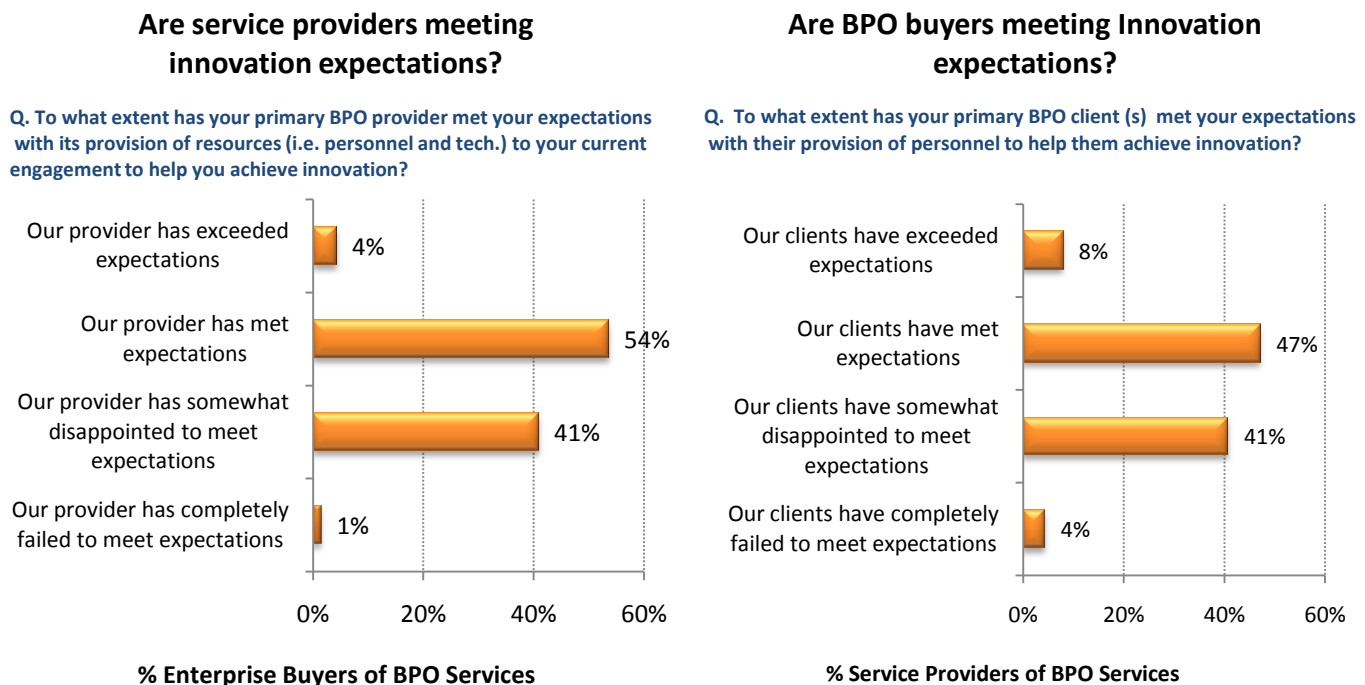
Q. How important is achieving innovation from your service provider in BPO engagements to your operational leadership?
(Buyers with significant influence only)



With 94 percent of respondents stating their operational leadership today view the achievement of innovation as a critical or quite important component of their BPO strategy, and with most providers now operating within a similar price band, innovation is clearly becoming the major differentiator in provider selection and a major contributor to BPO satisfaction.

Yet, as the following data illustrates, both BPO buyers and service providers are equally disappointed with each other's provision of resources and technology to meet innovation attainment expectations.

Figure 2: Enterprise BPO buyers and service providers fail to meet each other's expectations



Source: HfS Research, May 2010

Sample: 588 Shared Services & Outsourcing Executives

Survey conducted in conjunction with the Shared Services & Outsourcing Network (SSON)

Given how important innovation is to the operational leaders in buy-side enterprises, the fact that 41 percent of both BPO buyers and providers stated the other party “somewhat disappointed to meet expectations” spells a major concern for the future of BPO services. Only half of the BPO engagements today are having adequate talent and technology provisioned, from both the client and service provider sides, to help drive innovation.

Moreover, the fact that such a small proportion of today's engagements (less than ten percent) are surpassing expectations of innovation achievement, is a very telling sign that most of them today have failed to progress beyond the “lift and shift” phase, where buyers are merely focused on operational stability.

On the upside, while buyers are clearly not yet seeing much business value beyond operational delivery, they do see abundant potential for innovation in both generic processes and industry-specific domains. We'll discuss this later in this report.

Enterprise Buyers are Blaming Themselves for Innovation Failure

In days gone by, when a buyer was not getting optimum performance from an outsourcing endeavor, the blame quickly was targeted squarely at the service provider. However, our new research shows that most of today's buyers realize their failure to achieve innovation rests with primarily them.

In many of our client interactions at HfS, buyers acknowledge that they need to get their own house in order before they can truly call their provider to task for not providing them the resources they need to achieve innovation. Both parties need to work together to develop a well-crafted plan that not only introduces innovative goals and milestones over time, but also ensures against derailing meeting service levels that truly matter. This involves buyers developing more partnership-oriented relationships with their service providers, increasing IT-enablement of business processes, and developing gain-sharing metrics based on business outcomes.

Our question posed to executives with significant influence over BPO decisions (**Figure 3**) on their prime concerns for failing to achieve innovation in BPO, shows that today's BPO buyers actually recognize the blame lies a lot more in their camp than their provider's.

Figure 3: Buyers view change management and governance failures as the impediments to achieving innovation



If buyers were going to lay primary blame on their providers for lack of innovation prowess, far more than a fifth of buyers would have cited "the wrong composition of skills among their governance team and the provider's relationship team" as a major concern. Buyers' acknowledgement of the need to fix broken internal change management, communications and governance initiatives and start driving the innovation agenda, is encouraging. The future for innovation is bright, and many of today's enterprises are figuring out how to make some progress toward achieving it.

Identifying the Innovation Gaps is critical to developing an Innovation Roadmap

Innovation is about deploying creative and unique methods to drive new productivity, or top line growth, into the company. In reality, some processes have that potential to foster innovation, while others, frankly, only offer a means to an end. When it comes to achieving BPO innovation, buyers need to identify where real innovation is possible, and where they only really need operational efficiency.

Figure 4 shows key processes where senior BPO buyers are achieving significant innovation today, and where they view the potential to achieve significant innovation within a two-year timeframe:

Figure 4: The Innovation Gap shows huge potential for BPO buyers

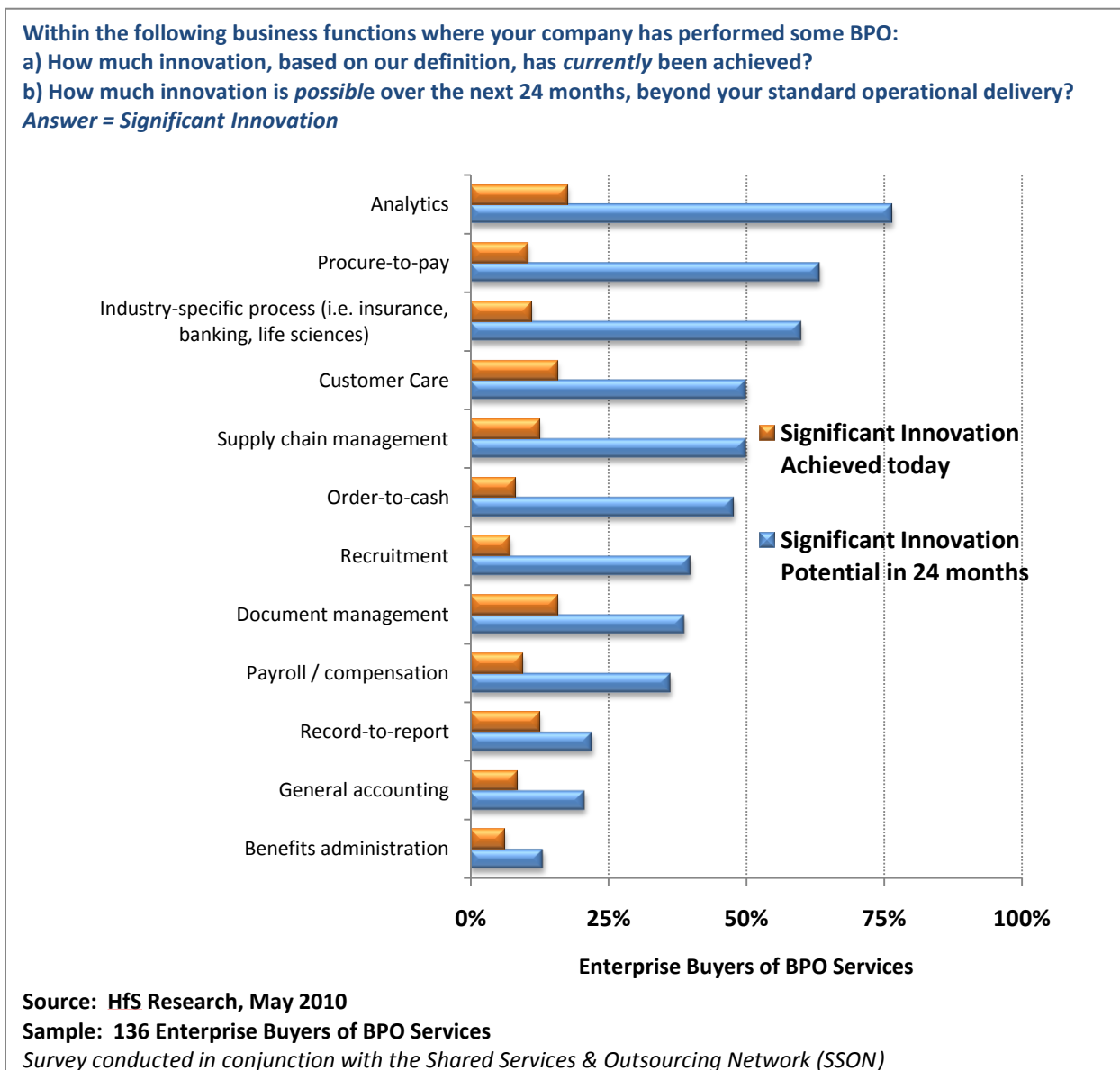


Figure 4 reveals volumes about buyers’ views of outsourcing today, in terms of where they currently are on their roadmap, and where they would like to get to in the future. Most outsourced business processes can be improved to a

certain extent, whether through better workflows, application of new technology or domain knowledge from experts. And most buyers today still feel most - or all - of their outsourced processes can benefit from further innovation.

However, some processes clearly have a *ceiling of attainable innovation value*. For example, once a benefits administration solution provides the required functionality, is delivered via a hosted/SaaS model, and the costs and service quality are performing to acceptable levels, little more can be done to deliver additional value in terms of increased productivity or new top-line growth. Although fine-tuning the Cloud Computing/SaaS model can help optimize delivery and further drive down operating costs, once the buyer is happy with the processes and the service delivery, that may be the limit of *future innovative value* that it can ever expect to attain.

Conversely, where there is significant room to improve process flows, add domain knowledge, creativity and technology into the mix to achieve impactful business outcomes, is where buyers have significant opportunity to achieve innovation. This is particularly prevalent with processes that are often a long way from standardization, and can benefit from a consultative business partnership to develop a specific innovation agenda.

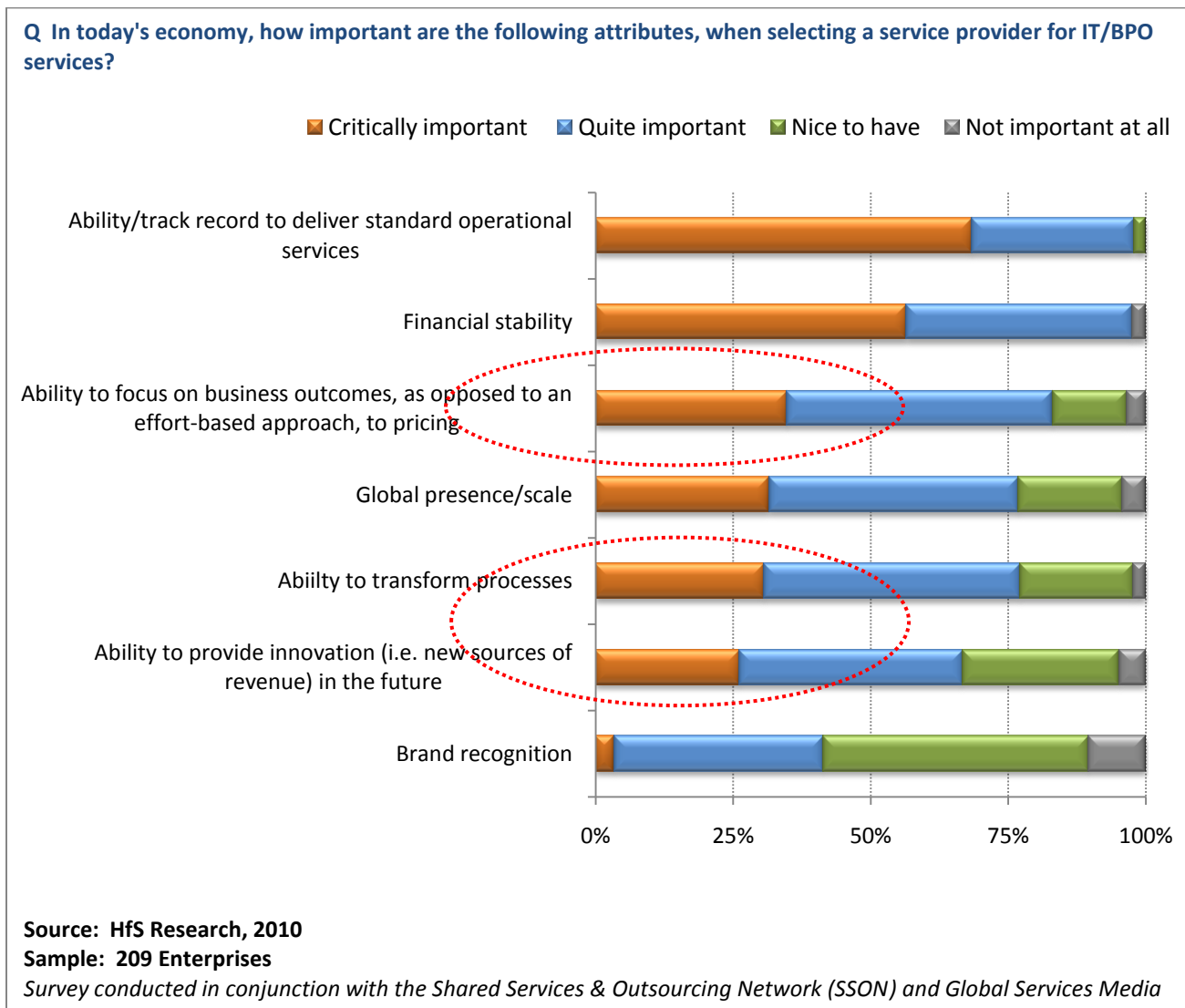
For example, analytics innovation clearly represents a major opportunity for providers and buyers to work together to make better use of information and drive results in a cost-efficient manner. It also requires a much greater need for consultative support from the provider. Other processes in which the innovation opportunity is significant, include P2P (massive productivity and cash flow), supply chain (driving product to market quicker), customer-care (driving new income) and recruiting (reducing time-to-hire and improving talent selection). Each innovation gap tells a story of where the future value lies.

When selecting Services Providers, Smart enterprises seek the right balance between Operational Efficiency and Innovative Value

When selecting BPO providers to drive new business value, buyers must focus on identifying which can genuinely help them innovate, in addition to keeping the machine cranking. Buyers are increasingly finding value in sourcing to multiple BPO and consulting partners - some to help them innovate in processes with real value potential, and others to keep costs down and operations functioning. And many of today's experienced BPO buyers are seriously considering - and many have already - adding more innovative expertise into their provider mix to obtain more creative value.

When HfS Research spoke more than 200 enterprise buyers earlier this year, we drilled into the criteria behind service provider selection decisions, with an eye on how these decisions will be made in the future (Figure 5).

Figure 5: When evaluating service providers, financial stability and operational excellence are table stakes; business transformation and innovation capabilities are the differentiators



Clearly, service providers need a proven operational delivery track-record, sufficient global scale and financial stability, simply to get to the table. The vast majority of buyers now see these criteria as table the stakes to start a

discussion. Moreover, with the market for operational work (e.g., transactional accounting, insurance claims processing, or even clinical data management) is now quickly maturing, and there are no more seats left at the table for room for service providers without proven customer successes and experience within the customer's industry.

Once at the table, buyers are asking "What else can you give me?" Quite simply, there are several service providers today pushing services within a similar price range and offering a sufficient track record of successful delivery. Furthermore, most large enterprises have already experienced offshoring and outsourcing in varying degrees in their operations for several years now, and are smart enough to realize outsourcing provides an opportunity to deliver more than simply those short-term cost savings we describe earlier. Consequently, the service provider's ability to provide outcome-based pricing is now a critical component among a third of buyers, and an important consideration for most of the rest.

Innovation and transformation are now becoming the major decision-swayers when buyers are making selection decisions. On the surface, it may appear that transformation and innovation are only secondary considerations (i.e., not a "deal-breaker" for three-quarters of customers). But considering that most vendors are offering similar solutions at similar prices, these categories are clearly becoming the game-changers, as our new survey validates (see **Figure 1**).

Brand is not nearly as much of a consideration. However, people rarely admit they are swayed by brand. Therefore, the fact that it is the least important selection criterion tells us that service delivery these days is much more about the realities of delivery excellence than the label under which it is provided. It is now considered as acceptable to engage with a second-tier offshore brand as with a household Western brand. The sheer number of customers that have engaged the new breed of offshore service providers in recent years has significantly leveled the playing field when it comes to brand.

Those service providers that fail to invest in helping clients achieve innovation will quickly get found out - and many already are. It is clear this business has reached a critical juncture where service providers are being judged on their ability to go beyond standard services and deliver real business value for their clients. Decisions are increasingly being based on which service providers have invested in talented, creative staff with industry domain skills, backed up by the table stakes of delivering bread-and-butter operational services at competitive prices.

Most the service providers are talking a big innovation game today, and it may even win them new business. But the real challenge is whether they can truly move clients up the value chain and help them find new avenues for productivity and growth. A lot of basic services contracts are being divvied out in this post-recessionary era. If today's winners fail to invest in increasing the value of their service provision by helping clients achieve innovation, they will find their clients seeking alternative service partners before long. Some service providers will always be happy delivering low-end operational services. However, if they see their business going to competitors with higher-value propositions and clients prepared to attest to genuine positive business outcomes being achieved, they will desperately seek out ways to remain competitive. The question is whether they have the appetite and culture to invest to find that next level of performance for their customers, because, if they do not, other services firms are eagerly stepping in to help buyers achieve innovation.

For example, several of the leading management consultants are bolstering practices to support buyers which have outsourced business processes and need real business transformation and governance expertise to move beyond the

“lift and shift” status quo. Simply put, not all the BPO providers have the capability, or financial inclination, to help their clients achieve innovation. In those instances, buyers have little choice but to bring other experts into their delivery mix to help them drive an innovation roadmap. In extreme circumstances, several buyers are looking to turn to other BPO providers to help them out of their current predicament where achieving innovation is simply unattainable with their current primary BPO provider.

On the flipside, providers need to determine where they add the most value. For example, as ADP has the lion's share of the managed payroll business, is it inherently necessary that it broadens into adjacent processes, such as procure-to-pay, that require greater innovative and consultative support? With Cognizant's robust portfolio of industry-specific offerings in verticals such as life sciences and banking, does it need to aggressively expand into horizontal processes such as finance and accounting, or procurement? And with Accenture's and IBM's strong offerings across many of these processes, where should they choose to invest more of their resources in a tightening market?

Moreover, while some buyers consider innovation a competitive requisite, others don't feel they require much. Similarly, while many providers base much of their value proposition on their innovation capabilities, some are happy delivering standard services with little innovation impetus beyond a few basic requirements. The fact is, there is room for both innovation and operation. The key is determining how much focus to place on each area. Buyers and providers need to work out a game plan wherein they together determine what innovation is desired and possible, and how to achieve it. The bottom line is that both buyers and providers need to be honest with themselves about whether they are truly prepared to invest in either achieving or delivering innovation. If the level of commitment and investment is not there, the best option is to stick with being operationally efficient, and stop talking about an innovation game plan that will never happen.

HfS Research Recommendations to BPO Buyers

- **Create an aggressive innovation agenda and a plan to keep that agenda fresh over time.** Buyers need to stipulate the need to explore new and creative ways to improve productivity and top-line growth as a core element of their BPO endeavor, and communicate this aggressively, on a repeated basis, to their entire retained operations organization.
- **Communicate this innovation agenda to both governance and provider teams.** Virtually all buyers beginning to achieve some innovation success with their BPO engagement will say the same thing: "We recognized what we needed to do internally, and communicated aggressively with our provider to start delivering it with us". Until buyers directly deal with the problem internally and communicate to their partners the new direction they are taking, they will never escape from innovation purgatory.
- **Create an innovative contract with their provider.** Buyers need to provide financial incentives to their providers in order to gain their assistance in achieving gains in both productivity and growth. Some of the recent BPO contracts exemplify this approach, with several in which the provider has demonstrated the confidence to insert productivity incentives as high as 20 percent. Providers will step up to the plate with the right approach, if they have the financial incentive to do so.
- **Stop playing providers off in a low-cost bake-off.** If a buyer simply squeezes the life out of its provider with a cost bake-off, it is unlikely to get much in return beyond operational delivery to meet the contracted service levels. Some of today's BPO providers are inserting gain-sharing elements into their deals in order to beat off price-dropping competitors, because they are desperate to win the deal. The better providers now have the advantage of knowing where they can offer innovation incentives to gain ground in tough pursuits. In any case, as most providers are now operating within a similar price band, the focus needs to move away from simply price and on to which providers are better prepared to drive innovative results, of course with the right financial incentives.
- **If your service provider fails to step up to the plate, seek alternative expertise.** Smart buyers quickly realize that the initial onus to drive an innovation agenda lies on their own doorstep. It is up to them to drive their expectations and requirements onto their service provider to foster a collaborative partnership where both parties can work towards common business outcomes for the buyer. However, in many cases, the buyer is discovering over the course of its first contract, that their provider is either unable, or unwilling, to commit the resources or talent needed to support its client's innovation roadmap, it is time to bring additional expertise into the delivery mix. This can be done to force more commitments during a contract re-negotiation, or, alternatively, can simply forge part of a strategy where the disappointing provider performs more of an operational role, and another provider or consulting firm can perform more of the innovation services. There is no reason why a single provider has to perform all the BPO-related duties, in this evolving marketplace.

About the Author

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Phil Fersht is Founder and Chief Executive Officer of HfS Research Limited, the leading boutique research analyst organization covering global outsourcing strategies. Launched in 2007, its famous blog “Horses for Sources” has more than 100,000 regular visitors across the global outsourcing industry, and is widely-recognized as the leading destination for collective opinion, research, analysis and coverage of industry developments. Its mission is to bring together the new world of social media with traditional research and analysis, to redefine the way in which advice, insight and knowledge is shared.



Phil is an acclaimed industry analyst, practitioner, advisor and strategist across Business Process Outsourcing and IT services worldwide, having worked extensively in Europe, North America and Asia. During this time, he has advised on more than 100 major outsourcing and offshoring engagements and consults regularly with senior operations and IT executives on their global sourcing strategies.

During his career, Phil has worked at AMR Research (Gartner Inc), leading the firm’s BPO and ITO practice. Previously, he served as market leader for Deloitte Consulting’s BPO Advisory Services, where he led numerous outsourcing and offshoring advisory engagements with Fortune 500 enterprises. He also worked for outsourcing advisor Everest Group leading the company’s BPO research practice. Phil began his career at IDC across its European and Asia/Pacific operations.

Phil is a frequent author and speaker on IT services, Finance, HR and Procurement Business Process Outsourcing trends and issues. He was named both an “FAO” and “HRO Superstar” by FAOToday and HROToday Magazines for 2005, 2006, 2007, 2008, 2009 and 2010 and was featured as the cover story for the December 2006 issue of FAOToday as one of the outsourcing industry’s most prominent advisors. He was also nominated for “Advisor of the Year” at the FAOSummit 2008. He speaks regularly at industry conferences, which have included The Conference Board, NASSCOM, IDC Directions, the Sourcing Interests Group and the Council of Supply Chain Management Professionals. He is also a regular columnist for several industry publications, including Global Services Media, SSON, FAOToday and Finance Director Europe.

Phil received a Bachelor of Science, with Honors in European Business & Technology from Coventry University, United Kingdom and a Diplôme Universitaire de Technologie in Business & Technology from the University of Grenoble, France.

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About Horses for Sources

Horses for Sources (HfS) is the foremost advisory analyst firm and social networking community, focused on helping enterprises make complex decisions with their global outsourcing strategies.

HfS provides the most impactful and frequently-visited collaborative community platform in the global services industry, providing rapid and insightful commentary, analysis and debate of enterprise outsourcing dynamics. The organization is unique in the fact that it integrates personable social networking with market research and advisory services.

HfS' mission provide a unique environment for collective research, opinion, experience and knowledge across the global outsourcing industry to help enterprises explore new performance thresholds. Led by industry expert Phil Fersht, the HfS team is a multi-disciplinary group of analysts across North America, Europe and Asia/Pacific regions, with deep domain knowledge in Business Process Outsourcing, Information Technology Services and Cloud Computing.

Launched in 2007, the HfS blog has more than 100,000 monthly visitors across the global outsourcing industry, and is widely recognized as the leading destination for collective insight, research and open debate of industry issues and developments. The HfS LinkedIn community is thriving with over 10,000 industry professionals sharing views and information daily. More information about Horses for Sources can be accessed at www.horsesforsources.com. The company can be followed on Twitter at www.twitter.com/horses4sources and LinkedIn by joining "The BPO and Offshoring Best Practices Forum group."

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