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Contracting for Innovation

By Alexander J. Hamilton

It's not that customers forget to include the "standard" innovation clauses in their outsourcing contracts. So why is the constant refrain from customers that suppliers can not (or will not) innovate in practice? Why, in other words, are the following standard clauses not enough: the supplier will evolve the services so that they keep up with developments in industry best practices; the supplier will regularly propose new ways to improve the services, including applying improvements developed on other accounts; and the customer will have regular access to the supplier's consultancy and research arms?

Supplier delivery teams, meanwhile, may be wondering quite why delivering better services at lower cost is not sufficient in itself. But the sales teams that went before will no doubt have raised customers' hopes of a promised land of constant innovation. Shouldn't something be seen to be happening to meet these expectations?

Some customers have decided that innovation is not outsourceable, it remains the responsibility of the customer team and that references to innovation in RFP bids are only so much sales puff. But it is not

unreasonable to expect the leading HR outsourcing suppliers, whose businesses are focussed on HR services, to be seen to deliver innovation.

To have any hope of creating commercial arrangements that encourage innovation, we need to be a bit more precise about what innovation looks like and why it is desirable. After all, innovation is more art than science, dependent as much on luck and inspiration as R&D dollars – it's a tricky concept to deliver on tap.

Rather than just focussing in your outsourcing contract on innovation per se, I suggest that emphasis should be placed in the contract on the outcomes produced by innovation and the operational and governance dynamics that encourage innovation. The following are some areas for customers to consider:

Focus on Outcomes

To the extent you know what the outcome of the innovation looks like, lock it down in your contract. Focus on both the initial transformation as well as on going improvements over the term.

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For cost improvements don't expect, whatever you put in the contract, that the supplier will volunteer suggestions on how to cut the charges without any gain for the supplier! Instead, actually build in at the beginning contracted ongoing reductions in the charges and let the supplier get on with figuring out how to deliver them through managing its costs. Similarly, lock-in ongoing improvements in service levels if these are required, rather than hoping that improvements will be suggested later on.

Don't worry, though, about requiring the supplier to offer new services that will create new revenue streams. The supplier will be quite capable of coming to you with suggestions without any help from the contract!

Nurture the Right Behaviour

The contract can be used to set up the rights governance framework and forums, but how the customer reacts in practice to supplier suggestions is most important.

Rather than spending valuable negotiating time worrying about complex gain-share clauses in the contract (which rarely, if ever, are actually used), instead create an operating environment that supports good supplier behaviour in practice.

Reward supplier suggestions that benefit just the customer and react positively to suggestions that require joint investment to produce joint benefits. And don't sit on a supplier idea for ages, then insist that it be bid out in a process involving the supplier's competitors!

Customers also need to make sure that their retained organisations are willing to make the changes and investments needed on their side of the services to improve the overall processes.

Take Advantage of Standardisation

Where possible, buy the standard service offered by the supplier. The more the supplier has the opportunity to offer multiple customers the same service, the easier it is to leverage innovative ideas across accounts. It will also encourage supplier investment in standard tools and processes.

Finally, if you really want an innovative supplier, do your due diligence and speak to existing customers about what they receive in practice, rather than what they were promised.

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