

Contracting for Success in Services

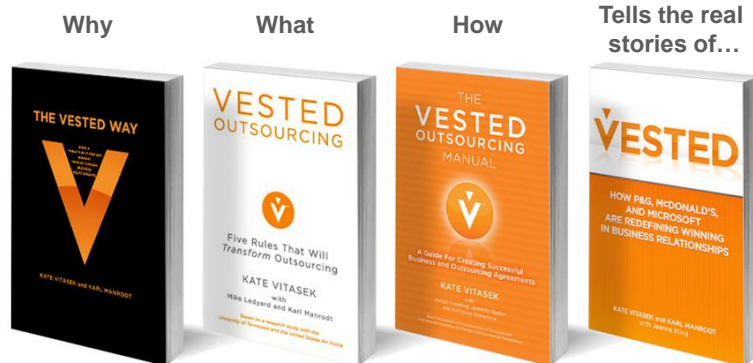
THE UNIVERSITY of TENNESSEE 
KNOXVILLE
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Kate Vitasek
ISM Services Conference Dec 6, 2012

Based on research with.....

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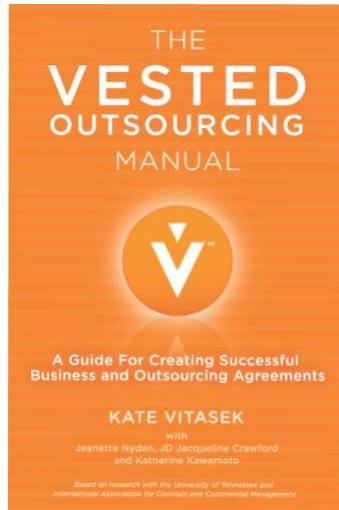


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Solve Vested Outsourcing

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2

10 Elements of a Successful Services Contract



10 Elements of a Vested Agreement	
Rule 1: Outcome-Based vs. Transaction-Based Business Model	
Element 1	Business Model
Element 2	Shared Vision Statement and Statement of Intent
Rule 2: Focus on the WHAT, not the HOW	
Element 3	Statement of Objectives/Workload Allocation
Rule 3: Clearly Defined and Measurable Desired Outcomes	
Element 4	Performance Metrics for Desired Outcomes
Element 5	Performance Management
Rule 4: Pricing Model Incentives are Optimized for Cost/Service Tradeoffs	
Element 6	Pricing Model (Margin Matching / Incentives Framework)
Rule 5: Insight vs. Oversight Governance Structure	
Element 7	Relationship Management Framework
Element 8	Transformation Management
Element 9	Exit Management Plan
Element 10	Special Concerns and External Requirements

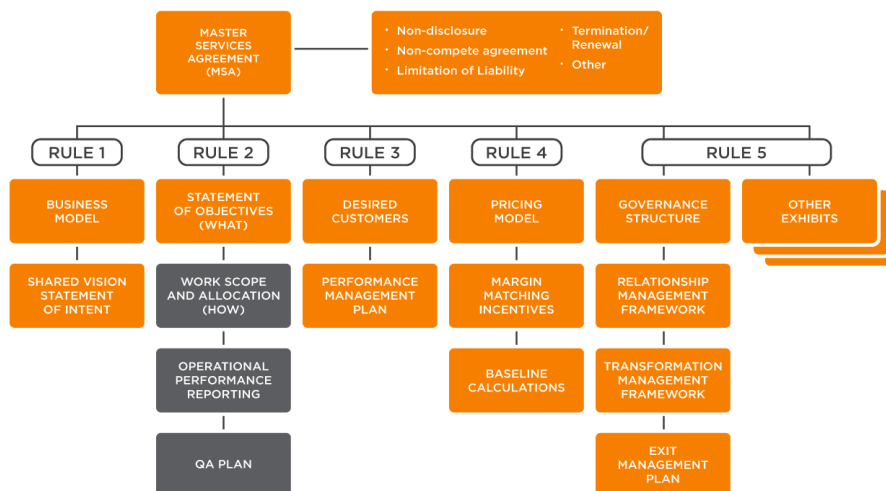


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Building a Vested Agreement

VESTED OUTSOURCING AGREEMENT STRUCTURE



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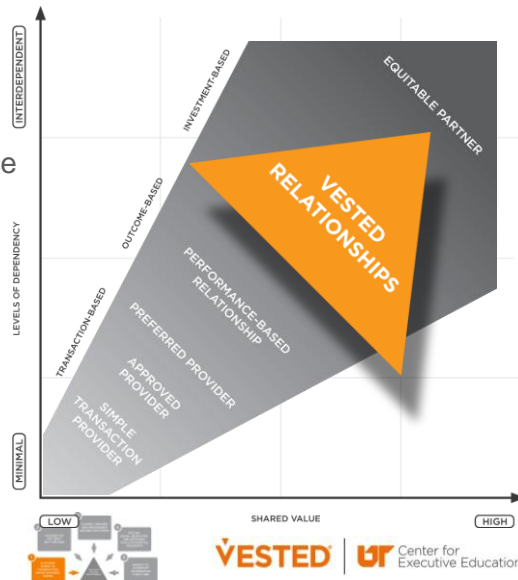
1.

Outcome Based vs. Transaction Based Model



Element 1: Business Model

- Vested Outsourcing
 - **focuses attention on outcomes** and not *transactions*
 - encourages the service provider to innovate
 - ensures that the selected business model **rewards positive outcomes**
 - carefully crafts **collaborative agreements**
- Shares Value!



Element 2: Shared Vision & Statement of Intent

- A joint vision guides you for the duration of your Vested journey
- The vision form the basis of a Statement of Intent drafted by the outsourcing teams
- Establishing intensions set the right dynamics for the relationship
 - Cooperative and collaborative
 - Integrity, respect and trust



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2.
Focus
on the
WHAT
not the
HOW



8

Element 3: Statement of Objectives/Workload Allocation

- Focus on the “What” not the “How”
- Describes intended results and accountabilities, not tasks
- Enables the parties in the Vested partnership to do what they do best
- Buyer develops a Statement of Objectives (SOO); Supplier defines a Performance Work Statement (PWS)
- Less is more.



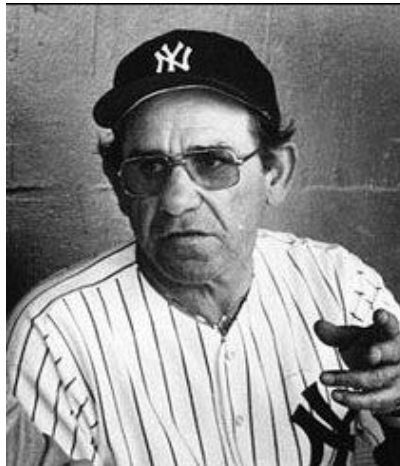
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3.

Clearly
defined and
measurable
outcomes



You got to be very careful if you
don't know where you're going,
because you might not get there.

- Yogi Berra

10

Element 4: Performance Metrics for Desired Outcomes

- Work together to define and quantify Desired Outcomes
- Outcomes must be expressed in terms of a limited set of high-level metrics
- Jointly and collaboratively define exactly how relationship success will be measured
- The service provider will propose a solution that will achieve the Desired Outcomes and deliver the required level of performance at a predetermined price

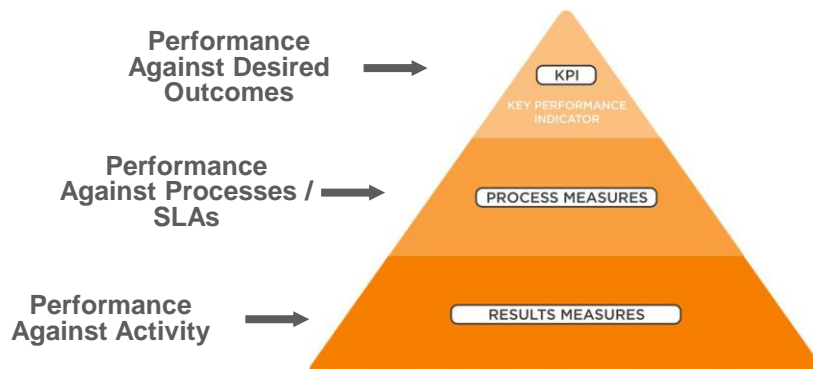


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Metrics Hierarchy



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Element 5: Performance Management

- Measure performance to determine if the Desired Outcomes are being met
- Include high-level performance management measures that are easily understood by business stakeholders and all parties involved in the process
- The metrics will help align performance to strategy



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4.

Pricing
Model
Incentives
Optimize
Cost-
Service
Tradeoffs



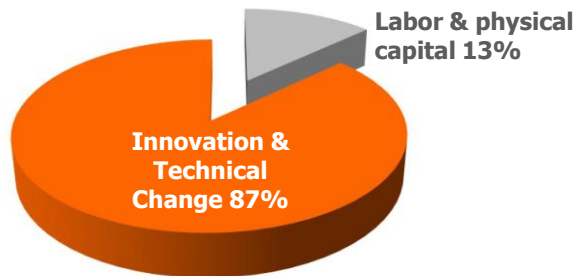
14

14

Solow's Law

- Named for Robert Solow, Nobel Prize Winning Economist

Economic growth is driven by “technical change” which is driven by improvements in business process or technical improvements in products.



Solow's Findings

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Element 6: Pricing Model

- A Vested pricing model incorporates incentives for the best cost and service trade-off
- The strategic bet—and paradigm shift—of Vested Outsourcing is that the service provider's profitability is directly tied to meeting the mutually agreed upon Desired Outcomes
- Inherent in this model is a reward for service providers to invest in process, service, or associated products that will generate returns in excess of agreement requirements



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12 Steps to Fair Pricing

12 Steps	Vested Pricing Model
Step 1	Form the Team
Step 2	Establish Guardrails / Share Assumptions
Step 3	Document Assumptions (input assumptions)
Step 4	Develop Total Cost Buildup and Best Value Assessment
Step 5	Perform Risk Assessment and Allocate Risks
Step 6	Agree on Compensation Model
Step 7	Determine Target Agreement Duration
Step 8	Complete Pricing Model and Establish Prices
Step 9	Test the Model and Agree on Baseline
Step 10	Define Margin Matching Triggers and Techniques
Step 11	Agree on Incentives
Step 12	Document Deployment Processes

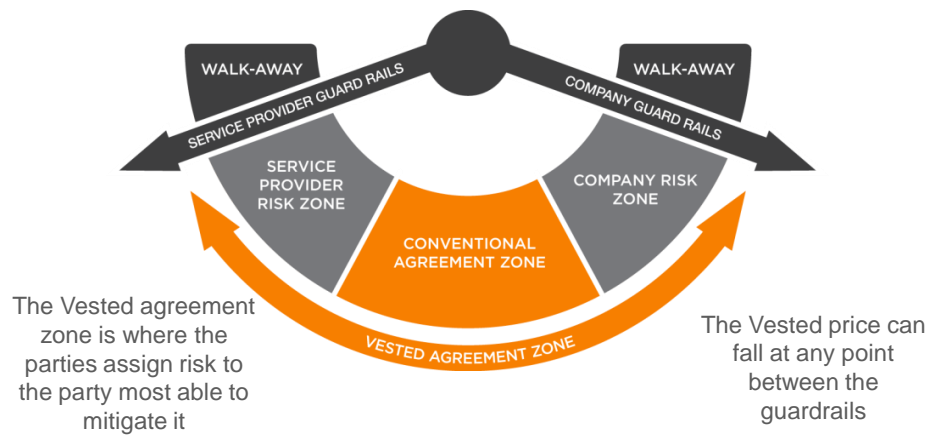
Vested Pricing Model
A pricing model that is designed to reward the outsourcing company and the service provider for achieving mutually agreed Desired Outcomes.

Conventional Pricing Approach



The actual agreement price is the "compromise" price—because both parties had to settle for something less than they had hoped for.

The Vested Pricing Approach



The much larger "Vested Agreement Zone" represents the opportunity for greater gains by expanding the pie for both parties.

5.

Insight
vs Oversight
Governance
Structure



Element 7: Relationship Management Framework

From ME

- Getting the supplier to meet my needs
- It's in the contract, now it's the supplier's problem
- Blame and punish the supplier
- Unpleasant surprises

BECOMES

To WE

- Finding a way to meet both our needs
- Work together to achieve the performance and compensation goals
- Communicate the issues, jointly find solutions
- Integrated planning and communications

Vested thinking manages the business, not just the supplier.



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Shifting From ME to WE

ME

- Getting the supplier to meet my needs
- It's in the contract, now it's the supplier's problem
- Blame and punish the supplier
- Unpleasant surprises

BECOMES

WE

- Finding a way to meet both our needs
- Work together to achieve the performance and compensation goals
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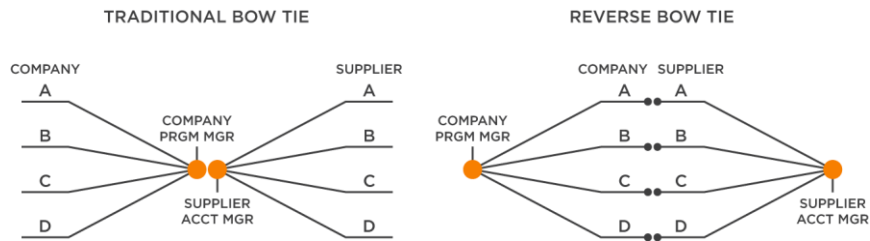
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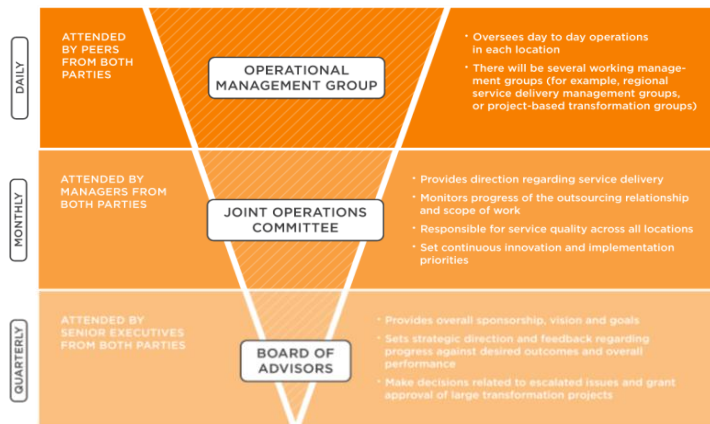
22

Relationship Management Framework



- Moving from the traditional hierarchical communication to direct functional communication improves the flow of information
 - This should be established in the beginning with the Supplier
 - Resist the temptation (and/or supplier pressure) to revert at the first “breakdown”
 - It is essential that the managers hear about problems from their teams FIRST!

Tiered Governance Structure



The Vested governance structure is tiered... each layer is accountable for examining the relationship and business success

Element 8: Transformation Management

- Transformation management element of your agreement should contain four key components, each targeted for different types of transformation:
 - A common understanding on how the initial transition of work is managed
 - Include philosophies for driving overall transformation initiatives
 - Contain a process for managing day-to-day continuous improvement efforts or business problems that arise
 - Include a process for updating and managing any changes to the actual agreement



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Element 9: Exit Management Plan

- Business happens, and companies should have a plan when assumptions change
- An exit management strategy can provide a template to handle future unknowns
 - Termination notice
 - Exit transition period
 - Exit transition plan
 - Exit governance and reporting
- The goal is to establish a fair plan and to keep the parties whole in the event of a separation that is not a result of poor performance



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Element 10: Special Concerns and External Regulations

- Governance frameworks are not one-size-fits-all, especially in more technical or complex relationships
- Pay attention to all the things that are unique to your Vested deal to help make it work more smoothly over its term
- With regulatory and compliance issues point to the regulation and assign ownership to monitor the regulation



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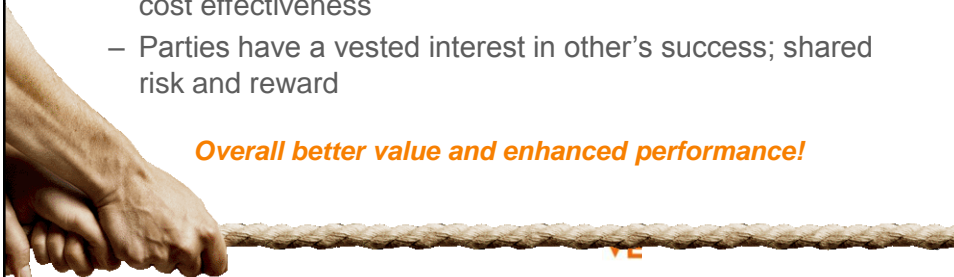
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27

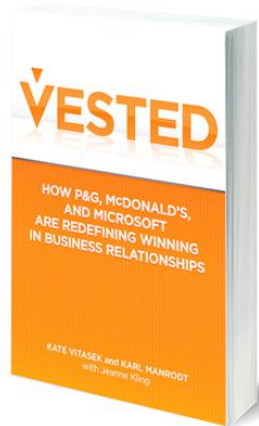
Benefits of a Vested Outsourcing Approach

- Better competition: not just suppliers, but solutions
 - Supplier buy-in and shared interests
 - Variety of solutions from which to choose
 - Supplier flexibility in proposing solutions
- Focus on intended results, not activities
 - Increased likelihood of meeting corporate goals and objectives
 - Mutually beneficial, shared incentives drive innovation and cost effectiveness
 - Parties have a vested interest in other's success; shared risk and reward

Overall better value and enhanced performance!



Real Results from Real Companies



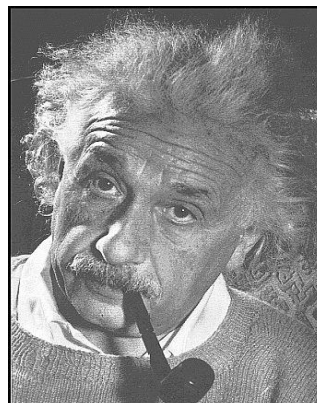
- P&G (Real Estate/Facilities Management)
- Microsoft (BPO)
- McDonald's (Supply Chain)
- U.S. Dept. of Energy (Environmental Services)
- State of Minnesota Dept. of Transportation (Construction)
- Integrated Management Services (Staffing)
- Diversey (IT)
- Water for People (non-profit NGO support in developing countries)

Getting your outsourcing agreement right can be a game changer!

“Any intelligent fool can make things bigger and more complex...

It takes a touch of genius - and a lot of courage to move in the opposite direction.”

- Albert Einstein



Contact Us

- Visit the University of Tennessee's dedicated Vested Outsourcing website at www.vestedoutsourcing.com
- Contact Kate Vitasek – the lead researcher and faculty for Vested Outsourcing at kvitasek@utk.edu
- Register for one of the University of Tennessee's open enrollment classes at <http://vo.utk.edu> or contact [Bric Wheeler](mailto:BricWheeler@utk.edu) for a private, custom event at bwheeler@utk.edu

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