VESTED OUTSOURCING

Five Rules That Will *Transform* Outsourcing

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with

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Based on a research study with the University of Tennessee and the United States Air Force

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About the Authors – Kate Vitasek

Kate Vitasek is a thought leader in the area of Supply Chain Management and is a well-recognized authority on performance management and performance-based logistics. Kate's approaches to performance management have been widely published; she has authored over 75 articles which have appeared in publications such as *Journal of Business Logistics*, *Supply Chain Management Review*, *Aviation Week and World Trade Magazine*. Kate has been recognized for her leadership in the profession. Most recently she was selected as a "Woman on the Move in Trade and Transportation" by the Journal of Commerce and was also recognized as a "Rainmaker" by DC Velocity Magazine for her efforts in helping to build the logistics and supply chain profession.

Ms. Vitasek has been the lead researcher and faculty for the University of Tennessee's Performance-based Logistics efforts for the last 4 years. She developed and teaches a four day course on Performance-based Logistics for the University of Tennessee's Aerospace and Defense program and is one of the university's lean implementation coaches as part of their Center for Executive Education. Kate is currently leading two comprehensive PBL research projects funded by the U.S. Department of Defense. She is also developing and piloting a "Service Acquisition Workshop" that will be rolled out across the U.S Air Force in conjunction with the Air Force's Installation Acquisition Transformation efforts.

Kate has strong practitioner background, having worked for P&G, Kroger, Microsoft and Modus Media International, a global 3PL. As a practitioner, Kate has served in marketing, operations, and general management roles - including Director of Marketing, Director of Supply Chain, Vice President of Operations Services, and Vice President and General Manager for Global Accounts. She acquired exceptional consulting skills while with Accenture's Logistics Strategy Practice.

In 2002, Kate founded Supply Chain Visions, a small consulting practice that specializes in supply chain strategy and education. Supply Chain Visions' philosophy is to "teach a company to fish," bringing a customized mix of teaching, coaching and hands-on consulting that goes beyond the stereotypical "Vinyl Binder" studies that traditionally wind up on the shelf. This blend of skills ensures that solutions are practical and cost-effective and get a higher degree of penetration and adoption within a firm.

Ms. Vitasek also finds time to support the supply chain profession as a popular speaker at industry events and as a columnist for Supply Chain Digest. She has served on the Board of Directors for the Council of Supply Chain Management Professionals and for the Supply Chain Council's Deliver Committee. She is a reviewer for the Journal of Business Logistics is on Auburn University's Supply Chain Program's Board of Directors.

Ms. Vitasek graduated from the University of Tennessee with an MBA in logistics and a BS in marketing, receiving high honors for both her undergraduate and graduate work.

About the Authors – Mike Ledyard

Mike Ledyard has exceptional credentials in business process design and the management of planning, manufacturing, distribution, product development, and engineering in high volume consumer goods and food industries. Mike is a veteran of international sourcing, manufacture and importation of product and tooling, especially from China and Eastern Asia. He is a skilled communicator, and is able to concisely explain complex supply chain concepts in understandable form to audiences ranging from boardroom executives to shop floor personnel. He is also an author and frequent speaker on performance-based acquisition of services, process assessment and measurement, and was selected as one of the Top 20 Logistics & Supply Chain Executives of 2001-2002.

Mike has worked with clients large and small to analyze current process, determine opportunities, and implement process improvements. These projects have included:

- Assessing planning and forecasting functions, and developing a sales and operations planning structure to improve on-time commitment and delivery
- Changing assembly scheduling to a demand driven model supported by Kanban cells to improve on-time performance to 99+% while reducing WIP
- Assessing off-shore procurement and import supply chain, and developing the improvements needed to reduce variability and improve service levels
- Driving performance-based acquisition of services, and developing performance standards for suppliers
- Guiding collaborative process redesign and implementation of revised roles, responsibilities and control systems.
- Developing global end-to-end business processes with focus on opportunity distribution and management
- Mentoring the development of business requirements for improvements to partner facing processes and tools

Mike served as the project manager for a joint CSC/University of Tennessee team that conducted a study on supply chain measurement for the Council of Logistics Management (now CSCMP). He is a co-author of the book resulting from that study, entitled ***Keeping Score: Measuring the Business Value of Logistics in the Supply Chain***. Mike is also part of a research project for UT on performance-based acquisition of services, and has helped to create and teach on the topic for the Air Force. He has authored several articles, and spoken frequently on the effects of measurement on supply chain performance and optimization, and on the design and implementation of measures.

Mike has a Bachelor of Science in Industrial Design from the University of Cincinnati, and has done post-graduate work in Business Management. He is a member of the Council of Supply Chain Management Professionals, and served on the Deliver technical sub-committee of the Supply Chain Council.

In Search of a Better Way to Outsource

Several decades ago, EDS was the first to use the term outsourcing to describe their work maintaining large mainframe computers and data centers for other firms. Today, the term outsourcing is used to describe a full range of service arrangements. Although outsourcing in some circumstances has generated controversy, when properly deployed, outsourcing can be a strategic weapon that will significantly improve operational and financial performance, as well as increase shareholder value. While there are more successes than failures, almost all companies are struggling with how to improve their outsourcing efforts.

For the past two years, the authors participated in a University of Tennessee research program funded by the Air Force to formally study companies that were employing performance-based approaches for outsourcing. A key part of our research was to distill our observations into courseware for the Defense Acquisition University, and to work with real programs in their implementation efforts to ensure a deep understanding of how to develop a solid outsourcing agreement (known as a service acquisition in the government sector). In this handbook, we explore the world of performance partnerships as a unique approach to outsourcing.

This handbook is based on our research and hands on experience working with organizations that have adopted mutual symbiotic performance partnerships that truly unlock win-win solutions. While many believe win-win is a simple buzzword that is theoretical in nature, our research has uncovered there is indeed a set of unwritten rules companies can use to develop performance partnerships where both parties in the outsourcing relationship go the distance to achieve much higher levels of performance and cost savings than previously thought possible.   We have distilled our lessons and approach into what we call Vested Outsourcing – because it is typified by an outsourcing relationship where both parties have a stake in maintaining the arrangement and work together to create a performance partnership which takes both the company outsourcing and the service provider to new levels of cost, service and profitability levels not realized before.

This handbook is designed to be a resource for companies (both companies that outsource and outsource providers) who want or need practical guidance on the fundamentals of a performance partnership as outlined by our Vested Outsourcing philosophies. ***This handbook is an excerpt of our upcoming book being published by Macmillan and is being provided for free. The University of Tennessee and the authors believe that the concepts codified by Vested Outsourcing is such a powerful approach that any company wanting to improve their outsourcing relationships should be able to have a sound guidebook helping them.***

If after reading this book, companies would like further help, we invite them to attend the University of Tennessee's Performance-Based Outsourcing: Buying Results, Not Activities! course offered as a three day open enrollment class at the University of Tennessee's Center for Executive Education. (See www.thecenter/PBO.utk.edu). You can also pre-register to reserve your copy of the complete book when it comes out in November – which is being published by Macmillan.

Ten Ailments of Outsource Relationships

No matter why a firm outsources, almost all outsource arrangements have room for improvement. Outsourcing as a large-scale business practice simply has not been around long enough to work out all the kinks. Many companies jumped in without a full understanding of how to do it right. The result? Outsourcing deals have been structured with fundamental flaws in the business model and the relationship.

The flaws result in perverse incentives: direct negative behaviors or unconscious behaviors that drive unintended consequences. A classic example of perverse incentives was the French program in Hanoi that paid people a bounty for each rat pelt handed in. The program was intended to exterminate rats. Instead it led to the farming of rats![1]

Our research has identified ten of the most common flaws we have seen afflicting outsourcing relationships. We can think of these as ailments— illnesses or, bad habits— that weaken an outsourcing relationship. A few are obvious. Most are not. One characteristic these ailments share is they drive perverse behaviors, leading to uncomfortable relationships and wasted opportunities for gains in efficiency.

In some cases, the ailments simply causes mild symptoms, so the companies or outsource providers never bother treating the condition. They suffer the symptoms, thinking they can learn to live with them, but the symptoms soon become so debilitating that they must be treated. Or they may have no visible symptoms, like a person with high cholesterol; but if they avoid regular healthcare and never get diagnosed, their ailment will weaken or harm them. In the worst case, the ailment becomes an outright disease that is so severe that it eventually causes the death of the relationship, causing the company to either bring the outsourced services back in house or switch vendors.

Read on to find if your outsource relationship is afflicted by one of these ailments — and then keep reading to find out how to prevent and treat them.

1. Penny Wise and Pound Foolish

Let’s start with the easiest ailment to identify: when a company outsources based purely on costs. We’ve all heard the warning to not be penny wise and pound foolish. Unfortunately, many procurement professionals are still in the dark ages. Too many companies profess to have an outsource “partnership” but behind the scenes they focus solely on beating up their service providers on price.

When outsourcing, you need to think beyond the short-term bottom line. The danger in focusing on the cheapest offer is like anything else -- you make tradeoffs in quality and/or service. Unfortunately, many executives view outsourcing as a "quick fix" solution to resolving balance sheet problems. Often companies suffering from a case of Penny Wise and Pound Foolish fall into a loop of frequent bidding of their work to the lowest price provider and transitioning to that supplier. This can lead to a vicious cycle of bid and transition, bid and transition, bid and transition. When a company gets caught in this cycle they often end up with one or more of the following unintended consequences.

- Outsource providers that work with the company over time will refuse to work with the company again. They get tired of getting beat up on price only to have their efforts rewarded by losing the work the next time around and ultimately choose to pursue revenue from more productive outsourcing relationships. In one extreme example we witnessed a company re-bid their transportation services every three months. In this extreme case the company had churned through nearly all of the top 20 suppliers over 5 years and was forced to work with suppliers of lesser quality.

- Outsource providers bid such low prices in order to work with a company that they go out of business and put the company in a jam to find a new outsource provider. One company, as an example, was referred to by their suppliers as the "800 Pound Gorilla." This company dabbled with outsourcing their manufacturing and had some successes. They decided to outsource all of their manufacturing to allow them to focus on their core competencies (which is usually a smart move). The book of business was worth roughly $100 million in revenue for the winner. In this case there were three contract manufacturers that had the experience and scale to manage the work volume. The 800 Pound Gorilla went through several rounds of extreme negotiations to save the last possible dime on the multimillion dollar outsourcing deal. They awarded the work to a $1 billion outsource provider – an estimated 10% increase in revenue for the outsource provider. The problem? The outsource provider "bought" the business, and eventually could not sustain the losses of profit. They gave the 800 Pound Gorilla a 30-day notice they would no longer manufacture their products and went into bankruptcy – eventually tanking what was once a successful and profitable $1 billion firm.

Organizations with this ailment give outsourcing a bad name– and should not be outsourcing in the first place. Their myopic focus might pay off in the short term, but this approach has proved time and time again that it does not pay to be Penny Wise and Pound Foolish.

2. The Outsourcing Paradox

The first symptom manifested by sufferers of this disease is the development of the "perfect" set of tasks, frequencies and measures. The "experts" within the company attempt to develop the "perfect" Statement of Work. The goal is to tightly define the expected results. After all – we are all taught that we need to clearly define expectations, right? The result is an impressive document containing all the possible details on ***how*** the work is to be done. At last, the perfect system! However, this "perfect system" is often the first reason that the company will fail in its outsourcing effort. That's because it's the company's perfect system, not one designed by the provider of the services. We call this disease the Outsourcing Paradox.

Thought leaders in performance-based concepts warn that an ill written task-frequency specification can sometimes create a harmful and insurmountable obstacle to a successful contract. A too-tightly written statement of work makes outsource providers responsible for the work without giving them authority to exercise their own initiative in carrying out the work.[2]

We found a classic real world example of the Outsourcing Paradox at work in a third party logistics provider (3PL) that runs a warehouse of spare parts. During our site visit we saw approximately 8 people servicing a facility that on average had less than 75 orders for spare parts per day. We asked why all the resources. We were told, “That is what the company that is outsourcing requires per our statement of work—so I have staffing at that level to meet the contract requirements.”

We are continually amazed to find that companies have chosen to outsource to the “experts” – yet then define the requirements and work scope so tightly the outsource provider winds up executing the same old inefficient processes! This disease can be exacerbated when coupled with another condition we call the Junkyard Dog Factor, Disease #4 below.

3. The Activity Trap

Many companies that suffer from the Outsourcing Paradox often suffer from the Activity Trap. Traditionally, companies that purchase outsourced services use a ***transaction-based*** model. Under a transaction-based model, the service provider is paid for every transaction—regardless of whether or not it is needed. Businesses are in the business to make money – and outsource providers are no different. The more transactions performed, the more money for the outsource provider. There is simply no incentive for the outsource provider to reduce the number of non-value-added transactions, because a reduction of transactions would result in a reduction of revenue.

The Activity Trap can manifest itself in a variety of transaction-based outsource arrangements. When the contract structure is cost reimbursement, the outsource provider has no incentive to reduce costs because profit is typically a percentage of direct costs. Even if the outsource provider’s profit is a fixed amount, the typical outsource provider will be penalized for investing in process efficiencies to drive costs down. In a nutshell, the more inefficient the entire support process, the more money the service provider can make. Perverse incentives play a major factor in the Activity Trap as well. Nineteenth century paleontologists traveling to China used to pay peasants for each fragment of dinosaur bone (dinosaur fossils) that they produced. They later discovered that peasants dug up the bones and then smashed them into multiple pieces to maximize their payments.[3] Or think of the farmed Hanoi rats: how many rats can you find in your outsourced processes?

The table on the next page outlines characteristics of companies suffering from the Activity Trap in their efforts to outsource 3rd party logistics services.

Company outsourcing for Services	Service providers' typical reaction under a Transaction-Based Model
I forecast over.	We charge you to store and count your product monthly… the more you have the more we make.
I forecast under.	We charge rush fees to expedite your products to market
I manage my suppliers poorly.	Your suppliers caused us to rework your product into new packaging. We have to charge you more money to rework.
Inventory working capital is killing me.	We don't own your inventory…we just provide services to you. Actually, we like when you have too much because we charge to hold it.
I specified the wrong shipping requirements.	We ship as we are told. You didn't tell us about the special label.

Source: Supply Chain Visions

Inherent in the Activity Trap is a disincentive to try to drive down transactions (another symptom seen in the Zero-Sum Game, Ailment #6, below). But does this really happen? Unfortunately, it does.

On one recent site visit, we asked the General Manager of a 3PL what the large area full of "orange tagged" pallets was for. She replied, "That's some of our customer's old inventory I need to move to an outside storage facility." When we dug further we found out it was product that was well over 5 years old—and at the rate it was moving would last 123 years (that is not a typo). When we pressed further, asking why they didn't work with the customer to scrap the material, the answer was "Why? I charge $18 a pallet per month to store it. I'd lose revenue if I did that!"

Another victim of the Activity Trap, a large technology company, was transferring sales support activities from one outsourced provider to another. They found that the data required to run certain reports was no longer current, and the new data was being stored in a new format in a different location. This had not been made known to the current provider, so the reports the provider had produced for the past five months were in fact wrong. In a damage control drill, the team learned good news and as well as bad news – the sales manager who had requested this reporting had been transferred, and the new sales manager did not use this (now inaccurate) report. But it was still a required activity, and the technology company was being charged each month to generate the report.

A third example of the Activity Trap comes from outsourced manufacturing. A contract manufacturer performed final kitting and assembly "pack-out" as a value added service for their customer. The customer had given the contract manufacturer the Bill of Materials with detailed instructions to use a specified finished goods "pretty box" for the product. Each "kit" had multiple parts organized in a box. The contractor needed to assemble the box and then insert the parts in an organized manner. To build the box required the contractor to have 12 "touches." The contractor charged a flat fee per touch to assemble the box carton, plus a fee of one “touch” for each item placed in the kit. The contract manufacturer knew that the particular box design was not efficient, but simply did what they were told rather than proactively offering solutions for an improved box design, which could eliminate touches.

If you are outsourcing, is the agreement based on pushing the cash register button every time a specified activity is performed?

4. The Junkyard Dog Factor

When the decision to outsource comes down, it means jobs will likely be lost as the work and jobs transition to the outsource provider. The result? Often employees will go to great lengths to hunker down and stake their territorial claim to certain processes that simply “must” stay in house. We call this disease the Junkyard Dog Factor. Even if the majority of the jobs are outsourced, many companies choose to have their “best” employees stay on board to manage the new outsource provider. These same “best” employees are often the ones who were asked to help write the Statement of Work. Is it any wonder why the SOWs become basically rigid documents of the often less than optimal ways the company was performing the tasks that are now being outsourced?

Over time this ailment affects the outsource provider as well. Under a transaction-based model the service provider is rewarded for work associated with the volume of the transactions. Unless otherwise compensated, the last thing an outsource provider wants to do is develop process efficiencies that eliminate their own work! So a company who might have set out on an outsourcing path to find an efficient and low cost *total solution* instead achieves the lowest cost for an activity without really achieving their desired outcomes.

This discourages innovation, first at the company outsourcing and then at the outsource provider. The Junkyard Dog Factor often results in inefficient and overbuilt infrastructure, because each touch point in the process has tried to optimize their individual part to either keep jobs or earn revenue associated with tasks. The result: misaligned desired outcomes. The company gets what they contracted for—but it is not really what they wanted.

5. The Honeymoon Effect

At the beginning of any relationship, both parties go through the honeymoon stage. The Honeymoon Effect was studied by the Stamford, Connecticut, research firm Gartner, Inc. Their research found that overall attitudes toward an outsourcing contract tend to be positive at the outset, but satisfaction levels drop as the project progresses.[4] Outsource providers will often jump through hoops as they ramp up (and begin to collect revenue) for their new client. While remaining conscientious about meeting the company’s expectations and associated service levels outlined in the contract, the service provider does not have an inherent incentive to raise service levels (or decrease the price) under typical arrangements, even if the industry service levels are improving. Over time, the downside of the Honeymoon Effect can lead directly to the Seven-Year Itch: the supplier's productivity levels may begin to decline if they are not investing in their people and technology. Then the outsourcing company, feeling dissatisfied with their supplier's service levels and productivity, will want to switch to a new supplier. However, suppliers can make it costly and disruptive for owners to exercise this right.[5]

6. Sandbagging

To prevent the Honeymoon Effect, some companies have adopted approaches to encourage outsource providers to perform better over time by establishing bonus payments for them to achieve certain levels of performance. This can work – unfortunately, and all too often, it creates perverse incentives for the outsource provider, whereby the outsource provider achieves only the amount of improvement in order to get the incentive. Consider Ukrainian pole vaulter Sergey Bubka. Mr. Bubka was a world class pole vaulter who earned $50,000 every time he set a new world record. From 1983 to 1998 he set world records 35 times… never by more than a quarter of an inch![6]

Let's look at a typical outsourcing example of Sandbagging. Many times during contract negotiation, someone on the company side, frequently senior management, will ask "Just how much CAN I save?" Rather than establish the highest level of savings achievable as early as possible (which would be most beneficial to the company outsourcing), the outsource provider will Sandbag and offer up the savings in smaller increments over time. The same is true with service improvements. Why deliver it all up front when your hardnosed customer is just going to hammer you for more next quarter or next year? Companies know that the savings are made of up "low hanging fruit" and long term savings. They often hold back some of their short term improvements in an effort to manufacture savings opportunities down the line, in case they don't perform in future quarters or years.

7. The Zero-Sum Game

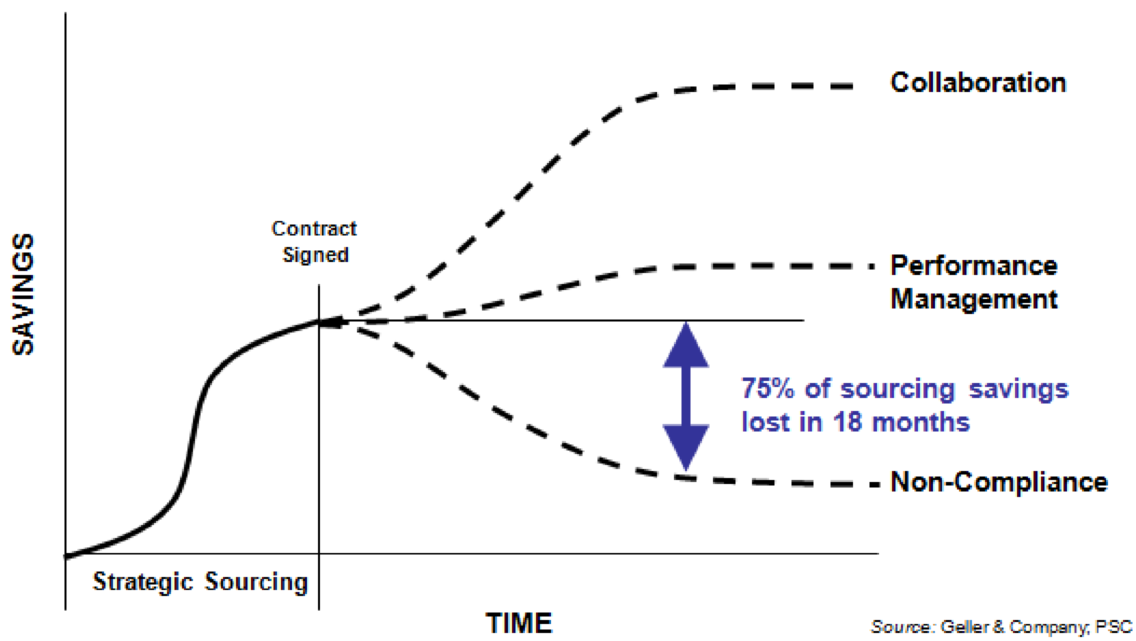
One of the most common ailments afflicting outsourcing arrangements is the Zero-Sum Game; outsourcing companies play this game when they believe, mistakenly, that if something is good for the outsource provider, then it's automatically bad for them (and outsource providers play the game, too). Companies who play this game fail to understand that the sum or the parts CAN actually be better when they are combined effectively, which was proven by John Nash's Nobel Prize winning research, commonly referred to as game theory. The basic premise of game theory is that when individuals or organizations play a game together (work together to solve a problem) the results are always better than if they had worked separately (played against each other).

We have all played games in business school and simulations that prove this concept (e.g., the supply chain Beer Game, the Astronaut on the Moon game, etc.). The first step in overcoming this ailment is to recognize that an outsourcing relationship should actively seek win-win solutions. Unfortunately, many outsource providers that try to cure this condition often have customers that suffering from the Activity Trap or the Outsource Paradox. They want to be proactive – but they are forced into business relationships where the contract's pricing model provides incentives to perform non-value added activities or their customers do not allow them to bring proactive solutions to the table.

8. Driving Blind Disease

Another ailment that bedevils many outsourcing agreements is Driving Blind Disease: the lack of a formal governance process to monitor the performance of the relationship. When we started working with companies over 20 years ago, most outsourcing arrangements fell into this trap. They would develop arrangements but then not outline how they would measure the success. Typically the companies would track costs, but not measure the various aspects of performance. The result was that early outsourcing agreements often failed because of unclear definition of success.

According to the Aberdeen Groups, assuring that negotiated savings are actually realized on the bottom line is one of the biggest challenges in organizations today. The term “savings leakage” is used to refer to the difference between the savings that were identified, and the actual savings that were achieved, as illustrated in the graphic below.



Proper measurement and follow-up of the key cost drivers is critical to preventing this “leakage.” In addition, identified leaders in this area have linked incentives to total cost savings *achieved* versus initial savings negotiated. Other companies have “secured support from company leadership to align sourcing and spend compliance with corporate goals and incentives.”[7]

The good news is in the past 5 years we have seen many firms – both companies that outsource and outsource providers – putting in place scorecards or dashboards to “keep score” of how the outsource provider is performing. Dashboards provide a feedback loop which helps the organization involved get data on how they are doing. If you don’t have one – think about getting one now! However, do keep in mind that using a dashboard improperly can result in one or two of the final ailments, outlined below.

9. Measurement Minutiae

Most of us probably remember being warned by Mom that too much of a good thing can be bad for you (perhaps while you were gobbling up your Halloween candy). The same concept applies to measurement of outsource providers. The hallmark of Measurement Minutiae is trying to measure everything. It is simply remarkable the Measurement Minutiae that some organizations are able to create. We have found spreadsheets with 50 to 100 metrics on them. Measurement Minutiae is often associated with companies that are suffering from the Junkyard Dog Factor and agreements that are typified by the Activity Trap.

One technology provider we visited actually had so many metrics that they needed a formal “binder” to keep track of everything on a monthly basis. They were embarrassed to tell us the total person hours across all the organizations that were required to contribute to these spreadsheets. Now, this isn’t a wasted effort if the company is getting positive results from the efforts based on the improvements they are making. Unfortunately our experience shows that few companies have the diligence to actively manage all of the metrics they have created.

10. The Power of Not Doing

The saddest of all ailments is the one we call the Power of Not Doing. We recently observed a case of it at a Fortune 50 company. A senior manager was demonstrating what a great job her company had done on establishing measures. They signed up for a seminar to learn how to apply the Balanced Scorecard and had hired a consulting firm to help them create a world-class scorecard. They had invested over $1 million in an automated scorecard solution to capture and graph performance. Each of the supplier scorecards were posted on an internal website. One could quickly click through to look at the current measures and performance.

As she pulled up a scorecard, we randomly pointed to a measure and said, “This metric seems to be the in the red (*their scorecards were color coded to indicated red was poor performance*). When was the last time your team discussed this performance with the outsource provider?” The response? She looked us straight in the eye and answered honestly that she had no idea. She knew they had quarterly business reviews with their “top” suppliers, but the dashboard in question was not for one of these suppliers. We went on to ask, “How rigorously do you adhere to quarterly business reviews?” She was embarrassed to say that they were lucky if they met with their suppliers once or twice a year.

This case of the Power of Not Doing is not unusual – many companies have fallen into the trap of establishing measures for the sake of measures, and have not thought through how they will be used to manage the business. We’ve all heard the old adage that “you can’t manage what you don’t measure” but if you don’t use the measures you have to make improvements – you should not expect results!

A variation on this ailment—harking back to Penny Wise and Pound Foolish—involves activities that the service provider does not perform, usually linked to common perverse incentives. For example, consider that fire departments are often funded according to the number of fire calls made. Obviously, this is intended to reward the fire departments that do the most work. However, it may discourage them from fire-prevention activities, which are not measured or compensated.[8] Or, the practice of paying medical professionals and reimbursing insured patients for treatment but not for prevention—which discourages early discovery and increases total costs.[9]

A Better Approach: The Rise of Vested Outsourcing

Now that you have a better appreciation for the typical ailments that plague outsourcing relationships, you might be asking yourself “Is there a better way?” The good news is that thought leading companies have been challenging conventional outsourcing models over the past 10 years. The result has been an evolution to a “next generation” outsourcing model we call Vested Outsourcing.

In the familiar terms of Strategic Sourcing, there are basically three types of suppliers:

- Transactional – the supplier is effectively kept at “arm’s length”, and a PO is issued for every order
- Preferred Supplier – this supplier is pre-qualified, either by certification or years of experience. The Preferred Supplier is often exempted from certain procedures, given releases against blanket PO’s, etc.
- Strategic Alliances – this is characterized by a “C” level relationship between the companies, with shared intelligence and operational tie-ins. The two companies often develop working relationships that more closely resemble divisions of the same company.

Vested Outsourcing creates a new level in between Preferred Suppliers and Strategic Alliances. The relationship is more focused than a Strategic Alliance, and does not require as much operational infrastructure. But it takes the Preferred Supplier relationship to a whole new level.

While no two Vested Outsourcing partnerships are alike, all good ones achieve a performance partnership based on optimizing for innovation and improved service, reduced cost to company outsourcing, and improved profits to outsource provider (see the figure at right). The trend towards performance partnerships has evolved where companies that outsource and service providers work together to develop a performance-based solutions where both parties interests are aligned—and both parties receive tangible benefits (either through tangible or intangible incentives).

The heart of Vested Outsourcing contract is an agreement on desired outcomes, which explicitly state the results on which both companies will base their outsource contract. A Vested Outsourcing agreement clearly defines financial penalties or rewards for not meeting or exceeding agreed upon desired outcomes. In an agreement, regardless of what is being outsourced, the outsourcing partner has the ability to earn additional financial value (e.g., more profit) by contractually committing to achieve the desired outcomes. Simply stated: if the outsource provider achieves the desired outcomes (achieves results), they receive a bonus. It is important to understand Vested Outsourcing is NOT gainsharing. The manner in which Vested Outsourcing agreements work is outlined in more detail later.

Under this dynamic the outsource provider is challenged to apply “brain power” and/or investments to solve the company’s problem. They also take on risk to do it, in essence putting “skin in the game.” The outsource provider looks at how they can best apply world-class processes, technologies, and capabilities that will drive value to the company that is outsourcing. This commitment to deliver against projected value for the company outsourcing (such as a commitment to reduce costs or improve service or both) shifts risk to the outsource provider. In exchange, the company outsourcing commits to allow the outsource provider to earn additional profit (above and beyond industry average profits for their service area) for achieving this incremental value. The result is a win-win Vested Outsourcing partnership—a paradigm shift we explore in the next section.

Changing the Game: Going The Whole Nine Yards with Your Outsource Relationship

It's important to understand that Vested Outsourcing is much more than delivering a higher level of service on a given activity. For example, it is

NOT about achieving 99% fill rate for your warehouse provider vs. 95%
NOT about answering 95% of all calls in 20 seconds versus 30 seconds
NOT about achieving quality defects from 3000 DPPM to 3.4 (six sigma) DPPMs from your contract manufacturer
NOT about ensuring that janitorial service provider cleans the toilets every 2 hours
….and the list can go on and on.

Unfortunately, many people on both sides of an outsourcing relationship simply do not understand the fundamental business model concepts behind Vested Outsourcing. A common mistake occurs when an organization THINKS they have a Vested Outsourcing agreement because they have taken their existing contract and simply added if a service provider achieves the metrics they are paid a bonus. This completely misses the mark. **Vested Outsourcing is a fundamental business model paradigm shift in how the outsourcing company and their service providers do business.**

At the heart of a Vested Outsourcing agreement is a true win-win mentality between the company outsourcing and it's outsource provider. Deeply wedded to this philosophy are the following five major rules:

1. Outcome-Based vs. Transaction-Based Business Model
2. Focuses on the WHAT not the HOW
3. Clearly Defined and Measurable Desired Outcomes
4. Pricing Model Incentives are Optimized for Cost/Service Tradeoffs
5. Insight, vs. Oversight governance structure

WIIFWe vs. WIIFMe

While many organization tout they have "partnerships" – our experience and research found that most organizations have an internal desire to optimize their own self interests. This is often known as a WIIFMe approach (What's in it for Me). How could they when we are ingrained with "winning" from early childhood and most business schools and law schools focus on "winning". Procurement and sales professionals are trained in the art of negations to help them "win".

The very word partner implies that there are two sides. The progression towards a Vested Outsourcing agreement should focus on creating a culture where parties are working together to ensure the ultimate success of each other. The mentality should shift from an "us vs. them" to a "we" philosophy, as we discussed earlier in avoiding the Zero-Sum Game. This is what we call a What's in it For We (WIIFWe) philosophy.

Companies that embark on a Vested Outsourcing agreement should approach it as a symbiotic relationship. Only by working together can they succeed. Consider the cartoon below.

The goal of a Vested Outsourcing partnership is to focus on first identifying and then aligning the interests of both players. The relationship becomes more collaborative and expands beyond simply meeting requirements.

<u>A WIIFWe philosophy strives to increase the size of the entire pie (unlock a greater opportunity than is currently realized by either party) versus maximize the size for any one player (e.g. lower costs at the expense of the outsource provider's profits).</u> WIIFWe challenges the conventional win/lose mentality and tosses it out the window. A company that is trying to maximize their piece of the pie instead of grow the whole pie is not playing under Vested Outsourcing rules and will most likely craft an outsourcing agreement that is structured with one or more of the ailments.

Many of you might be thinking "win-win is so fluffy. Is it really possible?" Remember the contract manufacturer from the Activity Trap that had to "touch" the box 12 times to assemble it? Under a performance partnership, that supplier would have substantial incentives to help the customer redesign the packaging to reduce the total cost. Let's say that the supplier helped design a box that cost two cents more to manufacture, but reduced the "touches" from 12 to 7. If the "touches" cost 2 cents each, and the annual quantity was 5M pieces, the annual net savings would be $400K. Wouldn't you as the customer be willing to share that with your supplier?

Following WIIFWe prevents:

- The Activity Trap
- The Junkyard Dog Factor
- The Honeymoon Effect
- The Zero-Sum Game

Developing a WIIFWe relationship is easier to describe than it is to do. Evolving from a culture of oversight and control to mutual respect is not an easy transition for most companies that outsource. Adversarial relationships often persist, and getting to a true win-win relationship will likely take practice. We frequently suggest assigning a neutral party to the team to act as the "win-lose cop" to point out when organizations slip into conventional win-lose thinking.

The first place to watch for potential adversaries is at the executive leadership level. Vested Outsourcing is not for the faint of heart; it demands committed executive leadership from both organizations, willing to transcend the traditional "win-lose" approaches most companies take when it comes to procuring goods and services. Unfortunately, some executives often feel they are too senior to be coached by the win-lose cop and have a strong conviction they have to do what they think is right for the company, not what will further the objectives of the Vested Outsourcing partnership.

In such a case, we recommend that both organizations simply agree to disagree – and realize both organizations will compromise on their ability to achieve the best possible outsourcing agreement. You don't necessarily have to abort your efforts – but you should recognize your agreement could end up as a pig with lipstick. The good news? At least the outsourcing agreement and your partnership will likely be better than a strictly conventional approach and you might be able to avoid at least some of the typical outsource ailments.

Even when there is commitment at the most senior levels in both organizations, individuals at the lower levels can succumb to the Junkyard Dog Factor. In fact, we have seen this ailment afflict some companies so severely that one or more of the organizations had to fire some of their existing employees to remove "baggage" or get beyond conventional win-lose thinking.

One common place all companies should watch out for adversaries is with contracting professionals and lawyers at both organizations. Contracting professionals and lawyers can be the kiss of death for Vested Outsourcing because their entire profession is built around the philosophy of "getting the best deal" for their company. Much of our society's business culture and history has been hard-wired to play win-lose. The win-lose cop can come in handy to keep the contracts and legal departments in check. If their behavior presents an obstacle, whenever possible, the individuals responsible should be removed and replaced with different mindsets.

True win-win requires effort and commitment by both parties. Outsourcing does not mean abdication: it must be a partnership with regular, frequent communication to manage the expectations as well as the work. Although the most pernicious problems that affect outsource arrangements are brought on by micromanagement, a different set of problems can emerge when a company hands over a process completely to the outsource provider, washes their hands and walks away.

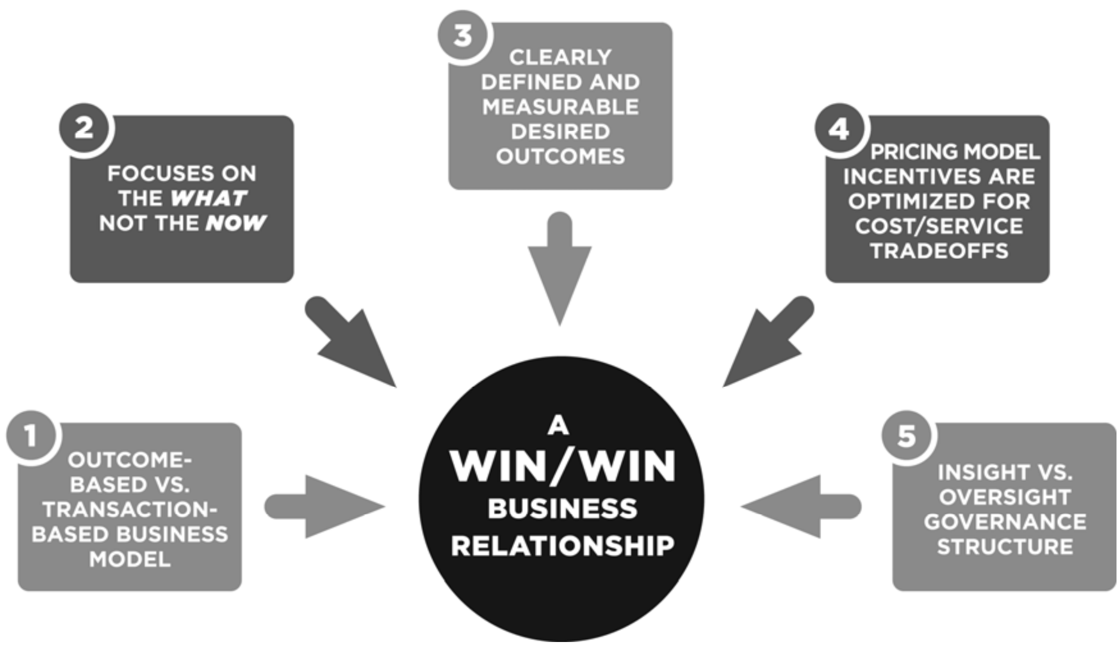
True partnerships must often evolve over time as both parties learn to work under a win-win philosophy. For many companies a win-win approach is a learned behavior, and they have to unlearn their conventional approaches and ways of thinking. Human relationships are fundamental to successful Vested Outsourcing. Absent of mutual trust, any attempt to implement Vested Outsourcing will become mired in terms and conditions. In addition, both the company outsourcing and the outsource provider need to make sure they are comfortable in their associated roles. The company outsourcing needs to feel comfortable describing the "what" and delegating the "how" to the outsource provider. The outsource provider must be comfortable signing up to take the risk to deliver the "how." Both organizations must constantly seek to overcome roadblocks in the processes, infrastructure, technology and people that prevent the mutual success.

Most companies that use Vested Outsourcing as an approach for outsourcing do not spend a lot of time talking about how it gives their service providers the opportunity to make more money. They prefer to focus on how it delivers better value or better performance at the same or lower total cost. Nevertheless, service providers who work under Vested Outsourcing partnerships often focus on the higher profit potential of Vested Outsourcing and point to the fact that successfully designed Vested Outsourcing partnerships create happier clients. Because both organizations are working together to achieve their goals, Vested Outsourcing works as a true win-win relationship, which is what partnership is all about.

In our experience, only those organizations that truly challenged the WIIFMe mentality are able to achieve true Vested Outsourcing partnerships that delivered outstanding results.   In our opinion, adopting anything less that WIIFWe philosophy will result in less than optimal results.

Deeply wedded to the WIIFWe philosophy are the following five major rules.

1. Outcome-Based vs. Transaction-Based Business Model
2. Focuses on the WHAT not the HOW
3. Clearly Defined and Measurable Desired Outcomes
4. Pricing Model Incentives are Optimized for Cost/Service Tradeoffs
5. Insight, vs. Oversight governance structure



Rule #1: Outcome-Based vs. Transaction-Based Business Model

Traditionally, many outsource arrangements are built around a transactional model (see the Activity Trap mentioned earlier). Most often this transaction based model is coupled with a cost-plus or a competitively bid fixed price per transaction pricing model to ensure the company buying the services is getting the lowest cost *per transaction*. Under this conventional method, the service provider is paid for every transaction—regardless of whether or not it is needed. The more inefficient the entire process, the more money the service provider can make.

Following Rule #1 prevents:

- The Activity Trap
- The Power of Not Doing

This transaction-based business model achieves the lowest cost for transactions for the company outsourcing —but often does not help the company achieve what they really want or need. Why? The company that has outsourced gets what they contracted, but it is not really what they want. Vested Outsourcing operates with an outcome-based model, with the emphasis on having the outsource provider align their interests to what the company really wants: an efficient and low-cost total support solution.

A performance-based business model fundamentally shifts how a company buys services. The concept of Vested Outsourcing is fairly straightforward; instead of paying a outsource provider for unit transactions for various services activities such as warehousing, transportation, spare parts, repairs, or hours of technical support, feet of grass mowed, or number of toilets cleaned, the company and its service provider agree upon desired performance outcomes. Desired outcomes are still quantifiable, but take a different form: they can be set availability, reliability, cost, revenue generation, employee or customer satisfaction, or even asset investment targets. In essence, *Vested Outsourcing buys outcomes, not individual transactions*.

Rule #2: Focuses on the WHAT not the HOW

Adopting a Vested Outsourcing business model does not change the nature of the work to be performed. At the operational level, there is still a need for lines of code to be written, bathrooms to be cleaned, orders to be fulfilled, spares and repairs to be managed, calls to be answered, and meals to be cooked. What does change is the way in which the company that is outsourcing purchases the services.

Under Vested Outsourcing, the company outsourcing specifies “what” they want and moves the responsibility of determining “how” the “what” gets delivered to the outsource provider. Why? Remember the Outsourcing Paradox? Your company has decided to outsource for a reason: your in-house operations are either too expensive, ineffective, or both. You outsource to get someone who can do the job better than you can do it. Succumbing to the Outsourcing Paradox is foolish when you have a competent outsource provider to rely on.

The most effective Vested Outsourcing partnerships include minimal discussion of the processes the service providers must follow to meet the requirements; they focus instead on system performance expectations. It's up to the service providers to figure out how to put the supporting pieces together to achieve the goals.

Consider IT outsourcing arrangements. Under a conventional contract, the company outsourcing would specify the hardware to use and possibly even the number of help desk personnel. But the job of an outsource provider is to be expert in their field. They are constantly in the marketplace, keeping tabs on the latest developments. IT experts will certainly know of the most appropriate hardware for a given task, and they may even know of process or system efficiencies that allow them to do the task with less labor than non-IT firms. Performance partnerships let each firm do what they do best. Unless the company that is outsourcing has both the skills and the resources to keep up with the latest innovations in the service they are outsourcing, they should leave the details to the experts.

Following Rule #2 prevents:

- The Junkyard Dog Factor
- Outsource Paradox

Depending upon the scope of the Vested Outsourcing partnership, some or all of the activities that need to be performed to achieve the desired outcome are transferred from the company that is outsourcing to the service provider. For example, when outsourcing cleaning services, a company could outsource all aspects of maintaining restroom facilities—which might expand the outsource provider's scope to include managing plumbing needs or procuring supplies.

Collaboration lies at the heart of Vested Outsourcing because often a service provider becomes responsible for more services and has to work with other service providers to be successful. In a properly constructed Vested Outsourcing partnership, the service provider no longer has the option to throw up their hands and say "not my fault!". Rule #4 below (*Incentives that Drive Optimize for Cost/Service Tradeoffs)* works in conjunction with this rule to create the positive forces to prevent this.

Rule #3: Clearly Defined and Measurable Desired Outcomes

The third hallmark of a good Vested Outsourcing partnership is clearly defined and measurable desired outcomes, which are essential to avoid Driving Blind. Both parties must be explicit in defining the desired outcomes. These defined outcomes are expressed in terms of a limited set—ideally, no more than five—high level metrics. Both organizations should spend the time, collaboratively, during the outsourcing process, and especially during contract negotiations, to establish explicit definitions for how the success of the relationship will be measured. Investing time upfront in the process is critical to ensure that neither of the companies involved in the effort spend time after implementation investing time or resources focused on achieving the wrong things.

Once the desired outcomes are agreed upon and explicitly expressed, the service provider can propose a solution that will deliver the required level of performance at a pre-determined price—often in terms of cost per unit usage. This fundamentally shifts the business model, shifting risk from the company that is outsourcing to the service providers. Under the purest form of Vested Outsourcing, the company that is outsourcing only pays for results, not transactions; rather than being paid for the activity performed, service providers are paid for the value delivered by their overall solution.

Following Rule #3 prevents:

- Driving Blind Disease
- Measurement Minutiae

We cannot stress enough the criticality in getting this right. Getting it wrong will result in potentially hundreds of thousands (if not millions) of dollars wasted in an outsource solution that is plagued by the ailments we have observed. The company will have procured a solution that gets what they ask for, but may not necessarily be what they want. And be careful to avoid Measurement Minutiae. Too much of a good thing is still bad!

Rule #4: Pricing Model Incentives are Optimized for Cost/Service Tradeoffs

The fourth hallmark of a Vested Outsourcing partnership is a properly structured pricing model that incentivizes the optimal cost/service tradeoff, which is essential to avoid being the Penny Wise and Pound Foolish. The pricing model is based on the type of contract (fixed price or cost reimbursement) that will be used to reward the outsource provider.

When establishing the pricing model, businesses need to apply two principles. *First*, the pricing model must balance risk and reward for both organizations. The agreement should be structured to ensure that the outsource provider assumes risk only for decisions within their control. For example, a transportation service provider should never be penalized for the rising costs of fuel, and a property management service provider should never be penalized for an increase in energy prices. *Second*, the agreement needs to require the service provider to deliver solutions, not just activities. When properly constructed, Vested Outsourcing will incentivize the service provider to solve their customer's problems proactively. The better the service provider is at solving the company's problems, the more incentives (or profits) the company can make. This encourages outsource providers to develop and institute innovative and cost-effective methods of performing work to drive down total cost while maintaining or improving service.

The essence of Vested Outsourcing is a strategic bet by the outsource provider that they can meet the service levels at the set price. Inherent in the business model is reward for the service provider to make investments in process, service, or associated product that will generate returns in excess of their contract requirements. Performance Partnerships are usually based around achieving the desired tradeoff stated by either achieving

- higher service levels at the same cost
- the same service levels at lower costs
- higher service levels AND lower costs

If the service provider does a good job, they will reap the rewards of greater profitability.

Vested Outsourcing does NOT guarantee service providers with higher profits, but it does provide service providers with the authority and autonomy to make strategic investments in their processes and product reliability that can generate a greater return on investment than a conventional cost-plus or fixed price per transaction contract would yield. Vested Outsourcing also typically seeks to encourage service providers to meet the desired performance levels at a flat or decreasing cost over time. Therefore the service provider has to leverage their unique skills and capabilities to make the processes much more efficient—to the point at which the service providers can generate increased profit. In addition, the outsource provider may earn intangible benefits such as contract extensions or the willingness of their customer to provide references.

Vested Outsourcing needs to be open to reducing the total cost of the process being outsourced, both in the company doing the outsourcing and in the outsource provider. The interwoven dependencies of outsourcing relationships require the establishment of an environment that encourages the service provider to push the company outsourcing to change their internal processes, if their processes are inhibiting the success of Vested Outsourcing.

Following Rule #4 prevents:

- Penny Wise and Pound Foolish
- Sandbagging

The right pricing model supports the business and provides appropriate embedded incentives. It is important to explicitly understand the outsource provider is a profit maximizer. This is reasonable, since few businesses are designed to be otherwise. Therefore, explore what the company can do to encourage outsource provider performance to its own benefit, and reward that performance with additional profits.

Is this a risky bet for a company and their service providers? Most thought leaders on both sides think not. Is it easy? No. It is especially difficult in that both organizations have to build a dynamic relationship that challenges the status quo in existing processes. But properly structured Vested Outsourcing partnerships can (and do!) create win-win paybacks for both parties.

Rule #5: Insight vs. Oversight Governance Structure

In the early days of outsourcing many companies made the mistake of simply throwing the work over the fence to their outsource provider, having poorly defined requirements and often no performance metrics or SLAs (service level agreements). As scary as it may seem, we have witnessed some companies with a high percentage of their outsource agreements not under a formal contract and operating without any real "agreement" in place. Fortunately, most companies that jumped into outsourcing have fixed that problem. The downside is that many have gone to the other extreme as witnessed by companies experiencing the Measurement Minutiae aliment. Today's outsource providers often have a small army of people often referred to as "program managers" who micro manage the outsource provider.

An effective Vested Outsourcing partnership outsources to service providers that are real experts. The partnerships should be managed to create a culture of insight versus oversight. Let's look at the meaning of both words to get a better understanding for the difference.

> ***Insight.*** Power of acute observation and deduction; penetration, discernment, perception
>
> ***Oversight:*** Watchful care; superintendence; general supervision. Escape from an overlooked peril.

If you have done a good job picking the right outsource provider that is an expert in their field and you trust them, why do you need a small army providing “general supervision” to manage them? Our experience has shown that companies tend to go overboard and have a tendency to micromanage their outsource providers. This is probably due to the Junkyard Dog Factor.

Following Rule #5 prevents:

- Outsource Paradox
- Measurement Minutiae

A properly structured governance structure should establish good insight – not provide layers of supervisory oversight.

How Vested Outsourcing Rules Work Together

In Vested Outsourcing, the organizations work together upon a foundation of trust where there is mutual accountability for achieving the outcomes. Through the careful alignment of performance objectives, accountability, and control, the service provider, while absorbing additional risk, is empowered to pursue improvements that will deliver improved performance, higher profits, and lower total ownership cost. ***Vested Outsourcing uses the power of free market innovation to improve the outsourcing relationship.*** This can be challenging to achieve, but the Vested Outsourcing journey should always strive to arrive at this idealized end state to achieve the performance pyramid where both the company outsourcing and the outsource provider are consistently applying a WIIFWe foundation and applying all five of the Vested Outsourcing rules.

For the service providers, Vested Outsourcing is an opportunity to exercise greater flexibility in deciding how support is provided, to ensure cash flow stability through long-term contracts, and to increase revenue by rewarding the service provider's investment in improving processes. For the company that is outsourcing, it is a chance to obtain improved performance while decreasing costs and assets by partnering with a highly competent and properly motivated firm.

To say that Vested Outsourcing represents a departure from conventional outsourcing practice would be to seriously understate the case. Vested Outsourcing changes the fundamental business constructs of the typical outsourcing approach.

Companies wanting to embark on a Vested Outsourcing partnership will need to deeply understand both the central core of WIIFWe approach and the five rules. They will need to treat them as rules to live by, as described below. In our opinion, a Vested Outsourcing partnership that does not strictly adhere to the entire WIIFWe core and all of the 5 rules can easily fall victim to one or more of the outsourcing ailments outlined above. We like to think of a Vested Outsourcing partnership that does not adhering to the rules as a pig with lipstick. You can’t simply pretty up something that is essentially ugly!

Success Stories (It Really Does Work!)

The one downside to working with an organization who adopted a successful Vested Outsourcing partnership philosophy is that they often view it as a competitive weapon. We have found it very difficult to get companies to share their success stories. Service providers want to go public – but the customers are keeping them at bay. In fact, in a recent research study that we conducted with the University of Tennessee looking at Vested Outsourcing partnerships with 20 companies, all but one strictly forbade us from associating their names with their successes.

The good news is Vested Outsourcing partnerships are starting to get more airtime in the popular press. A literature review of Vested Outsourcing partnerships in both trade and academic journals shows the benefits have been espoused over the last 10 years. However, the amount of coverage has been minimal when compared to the number of organizations implementing Vested Outsourcing partnerships. We have seen articles in the popular trade press promoting partnerships in IT, facilities/property management, and construction services. Most recently, Vested Outsourcing partnerships were referenced for the first time in the mainstream press when Forbes ran an article on next generation outsourcing and espoused the benefits of “outcome based” outsourcing.[10]

One area that has published success stories is the Aerospace and Aviation service sectors. The U.S Department of Defense (DoD) is probably one of the most active in promoting the application of Vested Outsourcing partnerships (known as Performance-Based Logistics (PBL) in the DoD), with over 200 current and planned arrangements in place.[11] In the DoD, where PBL has been implemented since 1998, documented case studies prove that performance-based agreements works at increasing performance while optimizing costs[12]. The results are not limited to simple incremental improvements in performance—it is not uncommon for performance-based programs to report improvements between 40 and 70 percent. Performance-based approaches have such a high potential that the Office of Management and Budget is mandating that the DoD increase its adoption of the approach so that 45 percent of all services they acquire be procured with performance-based agreements.

To Go the Whole Nine Yards or Not

It is important to keep in mind that just because you CAN use a Vested Outsourcing approach for just about anything you outsource, it does not mean you should. Some things still should be conventionally outsourced. Vested Outsourcing is hard and it takes time… it should really only be done for the areas that will have a big bang for the buck. Evaluate opportunities to outsource using the chart in the graphic below – if there is high value and expertise to continue to manage a process within the company, don't outsource those activities. However, if there is low expertise but high value then that activity would be a good target for Vested Outsourcing. Conventional outsourcing is best used when contracts do not add strategic value to operations. Look for opportunities to decrease cost, increase availability and thus increase customer satisfaction.

If Vested Outsourcing looks promising for the activity you have identified, you must then ask yourself not "What's in it for me", but rather "What's in it for **we**" if you are going to be successful.

What's In It For We? Identifying the Pony

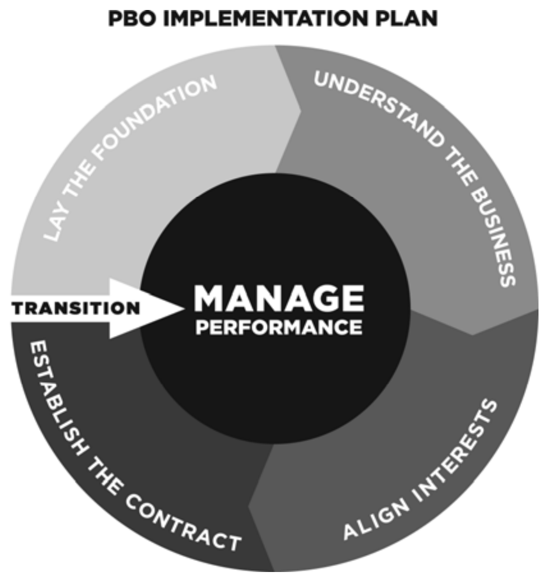
Before you decide to investigate Vested Outsourcing, you should validate the opportunity. If you hope to save $1 million dollars over the next 3 years by outsourcing, is that reasonable given the current spend for this service? What is the current spend? Are there other alternatives to this service that should be considered as a part of the project? There are many questions that need to have been thought through before proceeding. The answers may not all be available yet, at least not in complete form, but the direction and magnitude should be understood. A high percentage of projects fail as a result of being poorly conceived, or misunderstood, by the people executing them.

A critical component of a successful Vested Outsourcing is to conduct a baseline assessment and to identify what we call "The Pony". The Pony is the difference between the value of the current solution and the potential optimized solution. The Pony represents something the outsourcing company wants, but was not able to get on their own or with existing service providers. Remember the $400K that could be saved annually by redesigning the package? That $400K is the Pony.

Baselining is key because it identifies the value of the Pony, which helps determine the combination of service level improvements and cost savings potential. Both the service provider and company outsourcing should use the Pony to help them derive the appropriate incentive levels to be provided to the service provider. The bigger the Pony, the bigger the incentives the service provider should have the chance to earn.

If the outsource provider can capture the Pony (i.e., achieve service level and cost targets), everyone will be happy because the outsourcing company finally gets what they want. The catch: the company has to share the value of the Pony with the outsource provider who helped achieve it. The value of the Pony is used as the resource to fund the incentives for the outsource provider.

Getting Started: An Implementation Framework



So just how can you get started transforming your outsourcing efforts to enable it to go the whole nine yards? Companies should start by reviewing the 10 common ailments outlined in this eBook and seeing which ailments they are currently experiencing and begin to ask themselves HOW they got there. Once you fully understand you have a problem, you can then begin to explore the 5 Rules of Vested Outsourcing and how they can help you. Some of the key questions to begin asking yourself are:

- What is the desired outcome? (not what are the activities you will outsource!)
- Who will be impacted?
- What is the Pony?
- What is the outsourcing business model that will best capture the Pony?
- How can the contract be structured to support the business model in order to prevent perverse incentives?

If you cannot answer these questions clearly and confidently, you should not proceed further until you can, as everything is dependent on them.

Once you determine that you are ready to explore Vested Outsourcing, we recommend using a structured framework to help you transform your existing outsourcing relationship to a more productive performance-based approach. The University of Tennessee's research has led to the development of an implementation framework wrapped around the five Rules as illustrated in the Vested Outsourcing Implementation Plan diagram to the right. (Read clockwise starting with Lay the Foundation). We have been piloting the framework with the Air Force and will be working with Intel on transforming their outsourced logistics and transportation to more productive performance-based approaches. We are actively soliciting other companies to help pilot our implementation framework.

In Conclusion…

While the ailments many outsourcing arrangements suffer from occur as frequently as the common cold, they share a common cure: Vested Outsourcing can and does create an outsourced business model where both the company outsourcing and the service provider give it their all to go the whole nine yards. And the risk of catching one of these ailments through outsourcing is more than made up for by the Pony: the achievement through a productive Vested Outsourcing partnership of lower costs by the outsourcing company and higher profits by the service provider, neither of which can be attained by each organization working alone.

Our upcoming book, published by Macmillan, will offer a comprehensive guide for developing successful Vested Outsourcing partnerships. It is designed to help all companies begin their effort to take their outsourcing relationships to the next level. For companies with immediate desires to explore Vested Outsourcing further, we offer three resources:

- The University of Tennessee offers a three-day open enrollment class at the University of Tennessee's Center for Executive Education ***Performance-Based Outsourcing: Buying Results, Not Activities!*** (See http://PBO.utk.edu) You can contact Bric Wheeler at the University of Tennessee for customized, in house training on PBO for your company. These can be ***individual companies or a combination of a company outsourcing*** and their service provider(s). BWheeler@utk.edu

- You can visit our Blog at www.vestedoutsourcing.com and receive additional resources, success stories, and insights offered by the authors (anyone signing up to receive this eBook will automatically be subscribed to our Blog)

- You can follow us on Twitter at http://Twitter.com/VestedOutsource

- You can contact the authors directly at Kate@VestedOutsourcing.com or Mike@VestedOutsourcing.com

Endnotes

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