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3PL (third-party logistics). An outsourced provider that performs logistics services on behalf of its clients. A 3PL typically facilitates the movement of parts and materials from suppliers to manufacturers and finished products from manufacturers to distributors and retailers. Among the services 3PLs provide are transportation, warehousing, cross-docking, inventory management, packaging, and freight forwarding.

Behavioral economics. The study of the quantified impact of the behavior of individuals (or organizations). The study of behavioral economics is evolving more broadly into the concept of relational economics, which espouses that economic value can be expanded through positive relationship (win-win) thinking rather than adversarial relationships (win-lose or lose-lose). In short, entities can work together to expand the pie.

Best value assessment. An assessment that bases pricing decisions *on the value associated with the benefits received, not on the actual prices or cost*. It uses decision criteria that go beyond costs and include decisions on work scope and pricing based on intangibles such as market risks, social responsibility, responsiveness, and flexibility.

Business model-mapping analysis. An exercise that helps a company determine the appropriate business model to use for its sourcing relationship. The exercise also can help service providers consider how to offer added value to customers more closely related to the outcomes their clients desire.

Change management. The process of managing and monitoring all changes to products and processes. A formal change management process typically is instituted to avoid risks associated with ad hoc change and to document any changes to the agreement. A Vested agreement always includes a change management process.

Company. The organization that is outsourcing the process or function.

Continuous improvement. A structured, measurement-driven process with the goal to review performance and make improvements on a frequent basis.

Cost-reimbursement agreement. An agreement in which the company pays its service provider the actual costs to perform a service. By definition, cost reimbursement is a variable price agreement, with fees dependent on the amount of service provided over a given time period. A cost-reimbursement approach is appropriate when it is too difficult to estimate a fixed price with sufficient accuracy and when the service provider will not agree to assume the risks associated with unknowns. Cost-reimbursement agreements often are used to develop a new product or service, because the work cannot be clearly specified.

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Desired Outcome(s). A description of results a company strongly wants to achieve. Typically, Desired Outcomes include system-wide, high-level results for items such as lowered cost structures, higher service levels, higher market share, faster speed to market, reduced cycle time, more loyal customers, or others.

EBITDA. Earnings before interest, taxes, depreciation, and amortization. EBITDA is a common accounting term to measure profit.

Exit management plan. A plan that facilitates a smooth, effective transition of services delivery, minimum disruption of ongoing delivery, and efficient completion of all agreement obligations. The plan is invoked with the issuance of a formal termination notice under the agreement, specifying: (1) the portion of services included in the scope of termination; (2) the estimated exit transition period and vendor delivery centers affected; and (3) the period of time following a termination notice that the parties will have to agree on the specific scope of transition services provided by the vendor.

Five Rules of Vested Outsourcing. The name given by the University of Tennessee to the five key rules it has identified to employ when crafting business-to-business agreements that require more than basic market-based exchanges. Although these rules originally were created for outsourcing deals, they are applicable to any business agreement where the parties want to create a shared value relationship to jointly leverage capabilities to innovate, lower costs, and improve service to compete. When applied to an outsourcing relationship, the rules will move the relationship from a conventional relationship to a Vested relationship. The Five Rules are:

1. Focus on outcomes, not transactions.
2. Focus on the *what*, not the *how*.
3. Agree on clearly defined and measureable outcomes.
4. Pricing model and incentives optimized for cost/service trade-offs.
5. Governance structure that provides insight, not merely oversight.

Fixed-price agreement. An approach in which the service provider's price is agreed in advance and typically is not subject to adjustment. The parties agree on the fixed price, which includes the service provider's costs and profit. A fixed-price agreement eliminates budgeting variation for the company. Because the total fee for the products and services is fixed, the service provider, not the company, absorbs the peaks and valleys.

Gainshare. A monetary incentive where the service provider shares in costs savings. The focus is on driving out costs that are of limited value and sharing the costs savings.

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Governance/Vested governance framework. A governance framework that provides consistent management and cohesive policies, processes, and decision rights that enable the parties to work together effectively and collaboratively to manage performance that achieves transformational results throughout the life of the Vested agreement. Vested governance encompasses a joint process and flexible framework that over time defines and structures an enterprise/agreement that in theory and practice works for the mutual benefit of all the parties by ensuring that they act ethically, employ best practices, and adhere to formal laws. (Also see *Vested governance structure*.)

Guardrails. Agreement boundaries or structured parameters that can block the parties from developing a formalized agreement to frame their Vested business relationship. Guardrails provide the team that is drafting the agreement with the authority to develop a deal within the clearly stated boundaries. If the parties establish an agreement within the guardrails, no last minute surprises will occur because, by design, the agreement is within boundaries already established.

Incentive. A type of award for the company or the service provider. Incentives can be monetary or nonmonetary. In a Vested pricing model, incentives should be based on achievement of incremental performance of the desired outcome. In a Vested Outsourcing agreement, incentives motivate service providers to make decisions that ultimately will meet the company's Desired Outcomes.

Incentives framework. The mechanism that the parties use to measure incremental performance and establish incentive payments. Typically this is a mathematical formula. The simpler the formula is, the better.

Investment-based model. An equity partnership in which the parties form a single balance sheet entity, also known as a merged in-source solution. This model can take different legal forms, from buying a service provider, to becoming a subsidiary, to equity-sharing joint ventures. Equity-based partnerships often are born out of a company's need to acquire mission-critical goods and services. Also, these partnerships often require the strategic interweaving of infrastructure and heavy co-investment. Most equity partnerships are in place on a continuing basis and often conflict with the desires of many organizations to create more variable and flexible cost structures on a company's balance sheet.

Joint statement of Intent. A document in a Vested agreement that is a working guideline of principles under which the parties commit to operate. (See *Statement of Intent*.)

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Key performance indicator (KPI). A critical metric in the outsourcing agreement that reflects performance against the overall Desired Outcomes. In most cases, the company and the service provider must work together to achieve the KPIs.

Lean. A production practice that considers the expenditure of resources for any goal other than the creation of value for the end customer to be wasteful and thus a target for elimination. Working from the perspective of the customer who consumes a product or service, "value" is defined as any action or process that a customer would be willing to pay for.

Logistics. The management of business operations, such as the acquisition, storage, transportation, and delivery of goods along the supply chain.

Margin matching. A technique used to fairly adjust actual prices to be paid. Margin matching includes establishing a trigger point that activates to reset prices when the point is met. For example, the inflation rate might be a trigger point for resetting inventory carrying cost charges. The goal of using a margin matching technique is to establish pricing fairness, which ultimately builds trust and a better working environment

Master services agreement (MSA). A legally binding contract entered into by two or more parties. The agreement, which is usually service-oriented, goes into great detail regarding all its components. Because the parties intend to enter into future agreements with one another, they document terms that will govern future agreements in one place, the MSA. The same terms need not be negotiated again. Thus, the parties are freed up to negotiate deal-specific terms.

Operational metrics. The lowest level in the metrics hierarchy. These measure results at the task level.

Organizational alignment. Creating relationship and communications mechanisms that enable a company and the service provider in a Vested agreement to work together effectively to achieve the mutually defined Desired Outcomes.

Outcome-based business model. A model in which a service provider is paid for the realization of a defined set of business outcomes, business results, or agreed-on key performance indicators. An outcome-based business model typically shifts risk to the service provider for achieving the outcome. A well-structured agreement compensates a service provider's higher risk with a higher reward.

Outsource/Outsourcing. The transfer of a process or function to an external provider.

Performance management. A process and culture that drives performance and accountability to delivery performance against key performance indicators. A performance management program goes beyond just having performance metrics in place. Metrics are aligned to

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strategy and linked to the shop-floor or line-level workers. Tools/technology are in place to support easy data collection and use. This often includes the use of a dashboard or scorecard to allow for ease of understanding and reporting against key performance indicators.

Performance-based outsourcing. A simple outcome-based sourcing relationship. It typically pays a service provider for the achievement of agreed-on key performance indicators. This model typically rewards the service provider for achieving or maintaining performance. It also sometimes includes a gain-share incentive but does not include a value-share incentive. A well-structured performance-based outsourcing deal that follows the Vested Outsourcing's rules is a Vested deal.

Performance-based logistics (PBL). A term used primarily in the aerospace and defense sector to describe the purchase of assets with a complete array of services and support in an integrated, affordable, performance package. This approach is designed to optimize system readiness and meet performance goals for a weapon system through long-term support arrangements with clear lines of authority and responsibility. PBLs use an outcome-based business model but are not Vested deals.

Performance work statement (PWS). Resides between a statement of objectives and a statement of work in terms of specificity. The company defines the expected results in the statement of objectives and solicits solutions from service providers. The service provider then develops a performance work statement. A PWS still expects the service provider to drive innovation to fulfill the company's statement of objectives —but it goes into more detail than a statement of objectives. A PWS allows for input and innovation from the service provider in *how* it meets the Desired Outcomes and associated statement of objectives. It is important to note that using a PWS is *not* a requirement in a Vested agreement. If it is used, it is not part of the formal agreement but an additional resource that helps the companies establish trust as they learn to work together effectively.

Pricing model. The mechanism companies use to establish the price(s) between a company and its supplier. In most cases, the pricing model consists of a spreadsheet. We use the term *model* because in many cases prices change for various business reasons. A good pricing model enables the parties to manipulate the assumptions of the various pricing model components. The pricing model components are:

The compensation method (e.g. fixed price, cost plus, hybrid)

Assumptions

Total costs and best value assessment

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Risk allocations

Margin matching

Contract duration

Pony. In Vested Outsourcing, the difference between the value of the current solution and the potential optimized solution. It represents something the outsourcing company wants but was not able to get on its own or with existing service providers.

Process metric. Measures the success of a process.

Relational economics. The study of the quantified impact of the behavior of individuals in a contractual relationship and the direct impact that their collective behavior has on achievement of the Desired Outcomes and realization of mutual gain.

Relationship management. The practice of establishing joint policies and processes that emphasize the importance of building collaborative working relationships, attitudes, and behaviors. The structure by necessity will be flexible and will provide top-to-bottom insights about what is happening with the Desired Outcomes and, just as important, the relationship between the parties. Relationship management is a comprehensive approach to managing an enterprise's interactions with the organizations that supply the goods and services it uses. The goal of relationship management is to streamline and make more effective the processes between an enterprise and its suppliers. This is most definitely not a whose-throat-to-choke exercise; rather, it is the establishment of processes for communication, reporting, and improvement.

Relationship rules of conduct. A firm commitment to constructive working relationships, attitudes, and behaviors. A Vested relationship is, after all, about people working together in new ways to achieve a common goal; it is not about filling seats at the lowest common denominator and bean counting. It must be recognized at the outset that behavior modification is likely necessary for success.

Risk mitigation. The active practice of avoiding predicted events that could cause harm to a business and its operation.

Risk premium. The value (typically in term of a fee) paid to a party that knowingly and willingly bears a risk and is rewarded for doing so in some form or another.

Root cause analysis. A problem-solving method that aims to identify the source of problems or incidents. The focus is to solve problems by attempting to correct or eliminate their basic origins rather than merely addressing their symptoms.

Shared value. A mutual commitment to establish economic benefits for all parties. In essence, shared value thinking involves entities working together to bring innovations that benefit

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them through a conscious effort to gain (or share) in the rewards. This shared value thinking is what the University of Tennessee researchers have named "what's in it for we" (WIIFWe).

Shared vision statement. The statement that sets forth the larger, guiding principles for the business relationship and the purposes for going on the Vested journey together.

Service-level agreement (SLA). Specific metrics that a service provider must meet. Often there are incentives for exceeding SLA targets or penalties associated with missing SLA targets.

Service provider. The external company that provides the outsourced process or function.

Standing Neutral. A trusted neutral expert selected by the parties at the beginning of their relationship who is readily available throughout the life of the relationship to assist in the prompt resolution of any disputes.

Statement of intent. A statement that builds the foundation for the agreement by setting out how the parties will work together to achieve it; it establishes how the parties will behave once the agreement is documented in a written contract. Each party must align its intentions with the shared vision.

Statement of Objectives (SOO). A statement that establishes the required objectives that the parties will strive to accomplish under the agreement. Under a Vested agreement, the company outsourcing must be willing to allow and enable the service provider to make significant changes to improve overall processes and flow within the scope of work it is assigned.

Statement of Work (SOW). The tool usually used by outsource practitioners to document business requirements. Typically, a company defines and documents the tasks it wants the service provider to accomplish. SOWs are best suited for transaction-based models and not for outcome-based or Vested Outsourcing business models. In Vested Outsourcing, SOWs should be avoided in favor of a statement of objectives.

Supplier relationship management (SRM). The practice of creating mechanisms to increase the efficiency and effectiveness of how a company works with its service providers. The goal of SRM is to create effective processes for working together, which in turn yields lower costs of doing business. Some SRM efforts are designed to build deeper relationships that foster improved collaboration efforts and innovation. A benefit of SRM is that it provides a common frame of reference for companies and services providers, thus establishing unified business practices and terminology for how the organizations work together.

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Ten Ailments. University of Tennessee research and experience have defined the 10 most common problems seen with outsourcing agreements, which drive perverse behaviors and lead to severe strains in the relationship—or worse, to the failure of vendors or outsourcing companies. The ailments are listed in Appendix A.

Ten Elements. The foundation of Vested agreements. These elements set out how the parties will work together to achieve the agreement and how the parties will behave once the agreement is documented in a written contract. The Ten Elements document the business aspects of an outsourcing contract.

Total cost of ownership (TCO). The foundation for any Best Value decisions that need to be made. A TCO analysis includes determining the direct and indirect cost of an acquisition and operational costs. The purpose of determining the TCO is to help make clear decisions when it comes to pricing.

Transaction-based business model. The business model typically used by companies for all of their commercial agreements when they make buy decisions. Conventional approaches to transaction-based models keep service providers at arm's length. Three types of transaction-based sourcing relationships have evolved over time as businesses wrestle with how to create service provider relationships that are better suited for more complex business requirements: simple transaction providers, approved providers, and preferred providers.

Transaction-based pricing model. An outsourcing model where payments to the service provider are based on the number of transactions executed.

Transaction cost economics (TCE). In its simplest form, the study of the economics of all of the hidden costs associated with the transactions that companies perform, based on research by Oliver Williamson underscoring that businesses should collaborate for mutual interest or face hidden transaction costs. The University of Tennessee's applied research augments their research with evidence of hidden transaction costs in the form of the Ten Ailments of outsourcing.

Transformation management. Management that supports the transition from the old to the new as well as improvement of end-to-end business processes. The focus is on mutual accountability for attaining desired outcomes and the creation of an ecosystem that rewards innovation and a culture of continuous improvement.

WIIFMe (what's-in-it-for-me). A relationship approach in which the parties act in their own self-interest with a focus on winning.

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WIIFWe (what's-in-it-for-we). A relationship approach in which the parties move toward a partnership that focuses on identifying desired outcomes and then aligns the interests of all parties so that all benefit if those outcomes are reached.

Win-win. Negotiation philosophy in which all parties to an agreement or deal stand to realize their fair share (not 100 percent) of the benefits or profit.

Value-share. The practice of allocating a share of the total value that is derived from an improvement or innovation to the parties. The savings are based on the entire value to all stakeholders, not just the company. Value-sharing encourages service provider innovation for total overall value.

Vested. The use of the common word vested which respects and conveys all the foundational principles of Vested Outsourcing: shared value, behavioral economics, mutual success, and where the size of the pie is not predetermined.

Vested agreement. An agreement between two or more companies whereby the beginning foundation of the agreement determines its future success—shared value. The Vested Outsourcing Five Rules and Ten Elements provide the flexible, customizable framework for the agreement to enable both parties to "contract" for mutual success.

Vested governance. A framework that uses a relationship management structure and joint processes as a controlling mechanism to encourage organizations to make proactive changes for the mutual benefit of all parties

Vested Outsourcing. An outsourcing relationship where companies and service providers become Vested in each other's success, creating the true win-win solution.

Vested Outsourcing business model. A business model that is a hybrid of outcome-based, shared value, and relational economics approaches. It is best used when a company wants service providers to move beyond just performing a set of directed tasks and instead develop solutions to achieve the company's Desired Outcomes.

Vested pricing model. A pricing model designed to reward both the company outsourcing and the service provider for achieving the Desired Outcomes. When properly structured, the pricing model should generate returns in excess of target margins for both parties when the parties achieve the Desired Outcomes.

Vested principles. Principles describing the Vested approach, in which a balanced partnership based on trust, collaboration, transparency, and value delivery. Companies and service providers establish joint and flexible processes that allow for timely decisions while providing proper controls for ensuring ethical decisions.

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Thank you for helping educate students and the business community on Vested!

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