VESTED® For Success Case Study

Facility Management Outsourcing:
From Performance-Based to a Vested Agreement

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EXECUTIVE SUMMARY 2
PART 1: INTRODUCTION 3
History of The Relationship 3
PART 2: 5
THE ORIGINAL AGREEMENT AND WHY THE SHIFT TO VESTED 5
High-Level Overview of the Agreement 5
- Business Model 5
- Statement of Work 5
- Performance Measurement 5
- Pricing 6
- Governance 6
- From Decentralized to Centralized 6

Why the Shift to Vested? 7
Structural Flaws in the Existing Contract 9
10 Ailments of Outsourcing 10
Compatibility and Trust Assessment 11
Readiness Assessment 12
PART 3 – FACILITATED "VESTED RESET" 13
From Concept to Contract 13
Reflecting on the Process 15
Living into the Agreement 16
PART 4 - THE VESTED REFRESH AGREEMENT 17
How Buyer-Supplier Follow the Vested Five Rules 18
Rule 1: Focus on Outcomes, Not Transactions 18
Rule 2: Focus on the What, Not the How 18
Rule 3: Clearly Defined and Measurable Outcomes 18
Rule 4: Pricing Model with Incentives 19
Rule 5: Insight versus Oversight Governance 19
PART 5: CONCLUSION 21
The Journey Drives the Change 23
ACKNOWLEDGMENTS 24
FOR MORE INFORMATION 25
ABOUT THE AUTHORS 26

EXECUTIVE SUMMARY

Sometimes the journey to success is not a straight line. The same can be said for the journey to Vested. Often there are bumps along the way, some pauses to retool or refuel.

This Buyer-Supplier journey to a Vested Agreement began in June 2013, when the two parties decided to pursue the Vested model and process for an extension of their existing performance-based agreement, which they had signed in 2010.

By December, 2015 the two companies made a commitment to transform their performance-based facilities management (FM) agreement into a highly collaborative Vested relationship designed to strategically focus on outcomes. No one said it would be easy. And, of course, there were some roadblocks. A major one was that the Buyer, a pharmaceutical giant, announced it would be going through a major organizational restructuring, with procurement shifting under a newly formed shared services group, called Business Services.

But the Vested process, anchored by a mutually defined shared vision and five simple "rules," kept everyone on track.

This case study is divided into five parts that profile the Buyer-Supplier Facility Management agreement all the way to the completion of a fully Vested Agreement in these sections:

- **Part 1** briefly introduces the history of the relationship
- **Part 2** examines the **original agreement** and discusses **why** the parties felt a **Vested** agreement was a better fit
- **Part 3** highlights the **"Vested Reset" process** the parties used to lay the foundation of their Vested agreement
- **Part 4** shares how the parties continued on their journey to what they coined a "**Vested Refresh,**" which led to the parties fully following the Vested Five Rules
- **Part 5** summarizes **learnings and next steps** for the relationship

This case study is produced by the University of Tennessee with the cooperation of the parties and The Forefront Group, the Vested Center of Excellence that supported the parties' Vested journey. It is based on extensive interviews conducted in the summer and fall of 2015 and in early 2016.

We hope this case study will inspire you to challenge your own outsourcing relationships and explore if the Vested process is the right approach for you.

PART 1: INTRODUCTION

The Buyer and Supplier are two dominant, global players in their respective industries.

The Buyer is a multinational pharmaceutical company. With roots that date back over 150 years, it provides healthcare solutions that address the evolving needs of patients and societies worldwide.

Their products are available in over 180 countries worldwide, and those products reached over 1 billion people globally with over 130,000 people comprising 150 nationalities.

Innovation and sustainability are watchwords throughout the organization, driven directly from the top by the CEO: "I really believe that innovation not only rests with our R&D teams. We each have a responsibility to look for ways to innovate to better serve those who are counting on us. How are you innovating in your area?"

The Supplier is a professional services and investment management company specializing in real estate and FM. It is one of the largest real estate and FM firms in the world with 230 corporate offices spanning over 80 countries.

The Supplier also has a long history of innovation. It began as an auctioneer in the late 18th century. Over its development, the firm has tackled new frontiers, expanding from documenting boundaries and ownership of thousands of land parcels to being the leading global commercial real estate services and investment management firm.

History of The Relationship

The relationship dates back to 2010 when the Buyer outsourced its real estate and FM operations across 24 sites in North America. The Buyer was seeking to shift to an Integrated Facilities Management (IFM) agreement where they could integrate maintenance & repair, site operations, and workplace services under a single supplier contract. This was a significant strategic shift in the way they managed their real estate and FM functions. Under the IFM model, services would be standardized throughout sites and the chosen suppliers would be held accountable to Service Level Agreements (SLAs).

When the Buyer started its outsourcing initiative, FM operations were decentralized across each of the seven business divisions within the company. Each division had its own objectives, own budgets, and own needs. There were over 5000 suppliers, which were ultimately reduced to four strategic suppliers. The Supplier was chosen to be the company to manage the facilities.

A key objective of the IFM initiative was to drive down costs. Leveraging the Buyer's purchasing power across significantly fewer suppliers gave it significant negotiating power during the bid process. As such, it made sense that their procurement organization played the lead role in developing a contract. The Managing Director, Life Sciences Business for the Supplier, explained that during the procurement process the Supplier worked hard to develop a relationship with the Buyer's procurement organization. "It was great to have such a good relationship with the procurement folks. But the downside was procurement handed the contract over to operations, who were responsible for facilities. Because their FM operations group was not engaged in the process from the beginning, most of their divisions were not on board with outsourcing."

It was particularly frustrating for the Supplier's Vice President and Site Lead for the account, who was part of the implementation team. "Some of the sites viewed the relationship as a threat; it was a rough beginning. There was quite a bit of resistance. I would say maybe not overt resistance; nonetheless it was difficult to overcome."

The transition challenges were exacerbated by the fact that the Buyer was new to outsourcing. Often referred to as a "first-generation" outsourcing relationship, a large number of the Buyer's employees' jobs were transitioned (i.e., outsourced) to the Supplier. The Supplier's MD noted, "Any time you're involved in a first-generation outsourcing, there's a huge cultural change for folks that are transferring from the internal company, and the Buyer was no different. It was hard for people to accept that their jobs were being outsourced."

Last, it is also important to note that when the Buyer started the outsourcing initiative, its FM operations were decentralized. While there was one overarching contract with Supplier across all 24 sites, there were still challenges. The Supplier's MD talked about the impact of this on the Supplier. "Working under the agreement meant we had to establish seven different relationships and seven different savings glidepath targets for each division. Often the goal and contractual commitments were completely at odds with what the Buyer people at the sites wanted."

This further complicated agreement transition issues. Reflecting on the beginning year of the relationship, Supplier's VP & Site Lead said, "A lot of promises had been made as part of the negotiations with procurement that were difficult to keep. Fortunately, both Buyer and Supplier were committed to the relationship and we were able to work through the bumps in the road."

PART 2:

THE ORIGINAL AGREEMENT AND WHY THE SHIFT TO VESTED

The original contract between the Buyer & Supplier was a performance-based agreement. Performance-based agreements are not a new concept: they date back to the 1960s. However, they got traction for FM deals only in the early 2000's when consulting firms began advising clients on the merits of performance-based agreements. Under a performance-based agreement, the buyer typically shifts risks to the supplier by negotiating for guaranteed costs savings and guaranteed Service Level Agreements. If the supplier cannot meet these commitments, they face penalties. Thus, the term "performance-based" agreement, as the supplier's payments are tied to performance.

Highlighted below are some of the key features of the original Buyer-Supplier performance-based agreement.

High-Level Overview of the Agreement

Business Model

When the Buyer set out to craft the agreement, it did so intending to receive value through reduced risk, with guaranteed performance against predefined outputs. In exchange for these guarantees, the Supplier would be rewarded with higher margins when it achieved outputs (e.g., they would not be subject to a performance penalty.) This meant that the Supplier's management fee was directly tied to its ability to perform, rather than triggered by payments associated with completing transactions.

Statement of Work

As is common with performance-based agreements, the Buyer took a broader view of the scope of work by bundling the various workscope components under one integrated FM workscope. This was essential because it enabled the Supplier to expand its span of control across the Buyer's entire North America portfolio. By doing so, the Supplier could drive improvements efforts and best practices across all 24 sites. This also meant creating a statement of work that is less prescriptive than traditional statements of work where the Buyer would focus on the what – but not specify the how. However, letting go did not mean losing control. The Supplier still had detailed work instructions and reporting requirements.

Performance Measurement

A key component of any performance-based agreement is to have clearly defined output-based measures – often called Service Level Agreements or SLAs. Output-based SLAs shift thinking from measuring a functional activity to measuring the results of a process. For example, the Buyer would not measure how often the bathroom was cleaned, but rather would measure success with an audit to check for cleanliness. In addition, the Buyer & Supplier agreed to put in satisfaction measures that would extend measurement beyond just operational metrics – but to overall satisfaction measures as well.

Pricing

A performance-based model uses a price with incentives and/or penalties (also called service credits or malice payments). The Buyer-Supplier pricing model used a hybrid approach based on cost pass-through with a guaranteed maximum price. As is typical in a performance-based agreement, the Buyer's pricing model included the Supplier placing a significant amount of their fees at risk against SLAs and the cost savings glidepath.

One of the key challenges that the parties faced was in setting a clear and accurate baseline. This caused a great deal of frustration and led to poor performance out of the gate. The Supplier's MD explained, "We were understaffed in certain situations, did not do a good job validating baseline in other situations, and there were some underperforming sites. The upshot was that at the end of year one we gave back a chunk of our management fees because of missed guarantees to Buyer. Not a very good first year by any measurement."

Governance

As a supplier relationship shifts along the sourcing continuum, so too does the need for additional governance. As such, the Buyer-Supplier contract included provisions for a formal governance structure. For example, the contract required the parties to participate in Quarterly Business Reviews. In addition, the contract had detailed provisions about how the parties would manage compliance requirements. This was very important to Buyer as much of its operations expand beyond simple office buildings to include labs that fall under strict government regulations.

While the contract outlined a governance structure, it was never fully supported by the Buyer because of the decentralized nature of the contract, the overall lack of site/field support with outsourcing, and the initial disconnect between purchasing and site leadership business goals. This also contributed to the rough first year.

From Decentralized to Centralized

When the original contract was written there was no centralized facility management or real estate function. While there was one overarching contract with the Supplier across 24 Buyer sites, the Supplier still had to establish seven different relationships and seven different savings glidepath targets for each division.

Beginning in the 2013-2014 timeframe, the Buyer began a companywide restructuring. In 2015 it completed a major portfolio restructuring. In addition, the Buyer made a strategic decision to create what the company called Business Services (BS). BS was created to manage Buyer's shared service resources more effectively. In short, the Buyer began the process to shift from decentralized control to centralized control of many functions – including real estate and FM. The Buyer's BS initiative ultimately had a major influence and impact on the move to the Vested reset and later the Vested refresh.

Why the Shift to Vested?

By the end of the second year, the Buyer & Supplier had worked through many bugs. The Supplier MD noted, "We had pretty much settled in; our reporting was solid, our governance meeting cadences were good. We had consciously replaced some underperforming staff and our processes around finance, work orders, safety – day-to-day stuff – had become much more solid." In short, the Supplier was achieving a green scorecard.

On the financial front things had improved as well, with the Supplier hitting the marks financially and achieving the savings commitment that year. The Supplier MD was pleased to see the Supplier was even earning incentive fees after year two.

The performance-based agreement was now working as it was designed to work. The Buyer was getting operational stability with a green scorecard and was achieving financial targets per the glidepath. This set the stage for year three of the relationship.

During the third year of the relationship both the Buyer and Supplier began to think about the future of outsourcing for the Buyer. The Buyer had historically had a corporate policy that all contracts were put out to bid every three years.

With the original transition pains in the not-so-distant past, the Buyer's Business Services Facilities Management Category Manager was not too excited about going out to bid. "Facilities management relationships are relatively difficult to unwind and they're expensive to go out to tender on," he explained. "We knew if we went out to tender it would likely take a year to go through the exercise. We also knew it would take a year to a year and a half to stabilize the relationship if we were to switch suppliers."

The BS FM Category Manager knew that on at least one occasion the Buyer's procurement organization had waived the three-year bid policy. As he researched this, he learned that in Canada, the Buyer had been piloting a new Vested Outsourcing approach with a third-party logistics provider. Exploring what his Canadian counterparts had done, he thought it might be a viable option for the Buyer FM agreement with Supplier. He was especially pleased to discover that the Supplier already had experience with the Vested model, having over a decade of experience operating under a Vested Agreement with another client.

As the parties started to talk about the opportunity to extend the agreement, both began to explore their options. Of course, the easiest option would have been to simply extend the existing agreement. However, they had concerns about continuing with the performance-based agreement. The Supplier MD shared his perspective: "There's a natural life cycle to any business relationship, especially a first-generation outsourcing relationship. For example, when we wrote the original contract there was no centralized facility management or real estate function. Also, we had found that often the Buyer's goals and our contractual commitments were completely at odds with what the people at the sites wanted."

The BS FM Category Manager reflects on how Buyer had traditionally approached outsourcing: "We have a strong focus on productivity numbers and measures, and a complex process for getting things approved. We felt a lot of the easy things had been done as part of the first-generation outsourcing, and if we were really going to do take our outsourcing relationship to the next level, we had to start shifting the way we were working and identifying things that could have a higher value to the company. We began to ask ourselves what other levers were available for reducing costs that enhance the value proposition that may not be coming from the things we focused on. To me it was important we start to recognize those value streams as opposed to productivity and cost reduction. We had talked about things like value creation and innovation, but nobody wanted to stick their neck out to say we need to do something different."

As the BS FM Category Manager and the Supplier MD discussed the pros and cons of a performance-based agreement versus a Vested Agreement, they challenged the underlying constructs of not only their existing contract, but a performance-based model in general. One of the things that concerned the BS FM Category Manager was the sustainability of the performance-based business model. The BS FM Category Manager explained, "You can't completely decouple the business model from financial performance. If you have poor operational performance there's likely going to be an impact financially as well. We were now hitting year-over-year glidepath savings, but we wondered if this was sustainable."

This ultimately led to both parties having discussions around the viability of moving to a Vested business model. The BS FM Category Manager was introduced to The Forefront Group's Bonnie Keith and Donna Massari in the middle of 2012 by the individual that had led the Buyer's Canada Vested pilot. He suggested that BS FM Category Manager and Supplier MD consider having The Forefront Group do a formal "Deal Review" to assess the existing relationship and contract between the Buyer and Supplier.

A Deal Review is a neutral third-party assessment of an outsourcing agreement that reviews all aspects of an outsourcing agreement. A key feature of a Deal Review is to review the contract to determine if there are structural flaws in the agreement that are creating perverse incentives and behaviors – referred to by University of Tennessee researchers as “Ailments in Outsourcing”.

The Forefront Group’s Donna Massari was the Certified Deal Architect who conducted the Deal Review starting in August 2013. Massari recalls, “The Buyer and Supplier were looking for something different; both wanted something more. The results of the Deal Review were clear. The Buyer and Supplier had definitely outgrown their existing performance-based contract. The anonymous interviews revealed that the contract was constricting the path forward. Most divisional leadership found the value that the Supplier brought to the table, but were struggling with ‘letting go’ in some cases. Both parties wanted much more than just year-over-year glide path results, but to get to the next level it was clear the contract and existing behaviors needed to change from a performance-based agreement buying contractual outputs to a highly collaborative Vested Agreement that could help them drive mutual value against bigger picture business outcomes.”

A Vested Agreement would allow them to shift to an outcomes-based agreement and incentivize Buyer to invest in much-needed innovation that would be essential if Buyer was going to sustain year-over-year cost savings and continued value-add services.

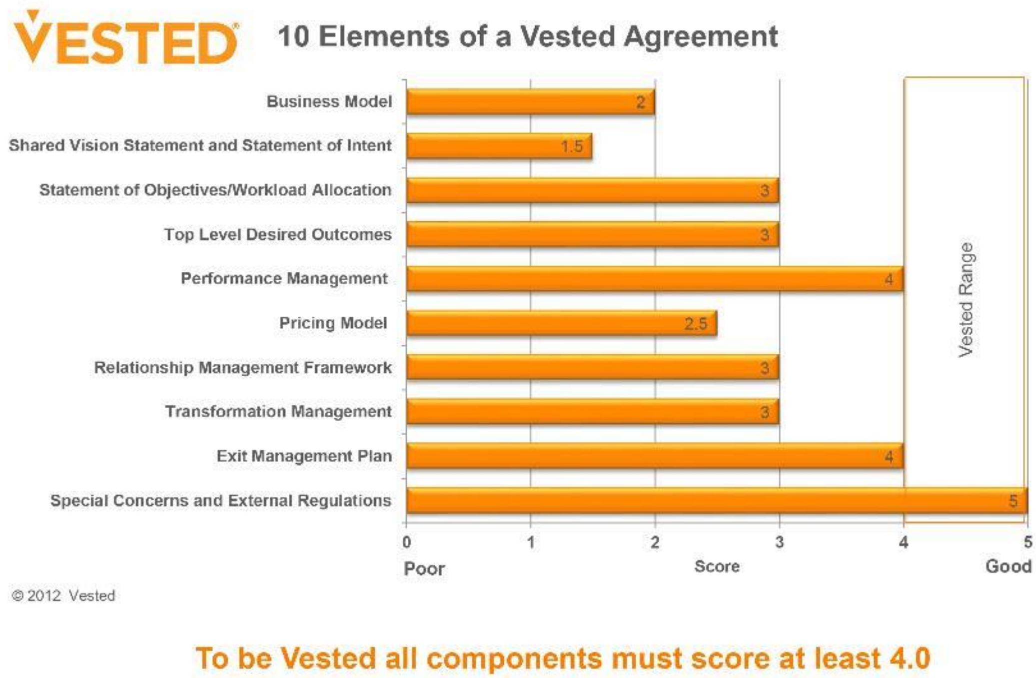
The high-level findings from the Deal Review follow.

Structural Flaws in the Existing Contract

A key part of the Deal Review was to do an analysis of the contract with the goal to see how well the existing contract supported the Vested Five Rules and 10 contractual elements. To be Vested, each of the 10 Elements had to score at least 4 on a 5-point scale.

The Deal Review findings regarding the first-generation contract focused on the parties’ scores on four crucial parts of the Vested process: the 10 Elements, the 10 Ailments, Readiness, and the Compatibility and Trust Assessment (CaT).

Figure 1: Assessment of 10 Contractual Elements (August 2013)



As Figure 1 shows, the first-generation agreement was not Vested.

With respect to the contract structure and the 10 Elements, the parties scored 3.0. (For reference, a Vested Agreement scores a minimum of 4 on all 10 elements). Furthermore, the parties were not 100% living into the intentions of the contract language; that is behaving to the governance guidelines and with teamwork. This dynamic also caused a lower score on the overall assessment. Shifting to a Vested Agreement would mean the Buyer & Supplier would need to close gaps in 9 of the 10 elements of a Vested Agreement.

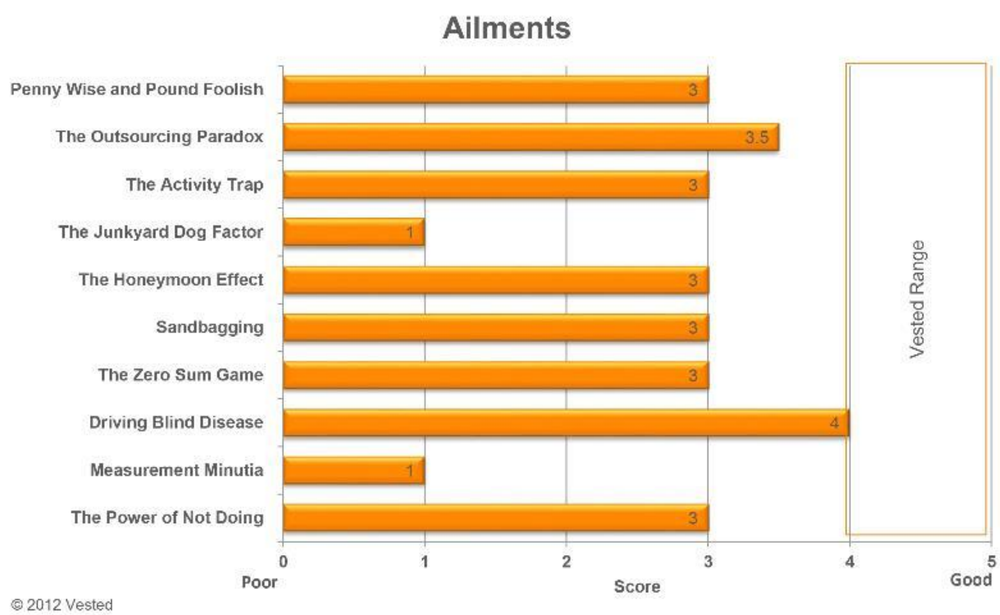
10 Ailments of Outsourcing

When an organization has structural flaws in its contract, it almost always leads to one or more of the 10 Outsourcing Ailments. University of Tennessee researchers describe Outsourcing Ailments as perverse incentives that drive behaviors that create tension in the relationship. The more an organization is afflicted with Outsourcing Ailments, the more costly and unproductive the relationship. In severe cases, Outsourcing Ailments can lead to the desire of one or both parties to exit the relationship.

The assessment made sense to the BS FM Category Manager. "The Buyer and Supplier had a pretty good performance-based contract in place, but it was definitively generating some unhealthy behaviors on both sides. For example, we were experiencing perverse incentives associated with complicated year-end closures. The Deal Review really highlighted what we were thinking – but put things in context in how we could restructure the contract to drive the right behaviors."

Overall, the Buyer and Supplier scored 2.7 with regard to the Outsourcing Ailments. (Figure 2). The review indicated the parties were suffering most from "Measurement Minutia" and the "Junkyard Dog Factor".

Figure 2 – Buyer-Supplier Scores on the Ailments



Compatibility and Trust Assessment

Moving to a Vested Agreement signals the desire to create a more strategic relationship. With this comes a longer-term contract where the supplier agrees to make investments in innovations that create mutual value for both parties. This requires a trusting relationship. Thus, a key part of the Deal Review was a Compatibility and Trust Assessment® (CaT). A broad base of team members from each organization participated in an anonymous survey designed to identify gaps in compatibility and trust.

The CaT confirmed what the BS FM Category Manager and the Supplier MD had believed – the relationship was strong enough to warrant moving to a Vested Agreement.

The CaT found that both organizations had similar behaviors and cultures, and that their relationship was developing in a positive way. This was a very strong result, indicating that the companies were "definitely ready for a Vested relationship."

Readiness Assessment

The last part of the Deal Review was the Readiness Assessment. Moving to a Vested Agreement requires that the parties know exactly what they are getting into, and are "ready." There are five components of the Readiness Assessment: a stakeholder analysis, Vested knowledge base, champions for Vested from each organization, organizational alignment and understanding of corporate guardrails.

The Readiness Assessment confirmed both parties had the needed level of readiness to continue to create a Vested Agreement.

PART 3 – FACILITATED "VESTED RESET"

With the Deal Review findings in hand, the Buyer & Supplier decided to proceed with what the parties came to call a "Vested reset," in which they would work through the Vested methodology to close the gaps in their agreement (e.g., getting scores on all 10 elements up to at least a score of 4). The Buyer & Supplier set out with a six-month plan involving 24 people from both companies to help the companies move from discussing Vested as a concept to creating a Vested contract.

From Concept to Contract

The companies started by establishing a small "Core Team" who led the initiative to restructure their contract. The Core Team was augmented with an "Extended Team" of resources who worked through specific areas where they were subject matter experts (e.g., finance folks worked on Element 6 – Pricing Model). The entire process included 24 people from both Buyer and Supplier that were teamed in a "two-in-a-box" fashion. For example: The Buyer has a finance person paired with a Supplier finance person who worked on developing the pricing model. The Buyer had a procurement person paired with the Supplier account executive. Each role was mirrored so the companies could have the right subject-matter experts work on the appropriate contractual elements.

While both the Buyer and Supplier had team members with some experience in Vested Agreements, no one on this Buyer-Supplier team had ever created or worked under a Vested Agreement. Thus, the companies decided to use a Vested Certified Deal Architect to coach them through the process. The companies once again turned to The Forefront Group – but this time tapping Donna Massari as a neutral third-party coach to help them work through each of the Rules/Elements and architect a Vested agreement.

The companies used a combination of the University of Tennessee's ***Creating a Vested Agreement*** online course, facilitated workshops, and offsite coaching support to help them architect their agreement. The online course provided the backbone of the methodology, allowing team members located in different cities to learn by doing. Team members took an online course module, and then set out with their "Two-in-a-Box" teammates to work through their assigned deliverables. The group came together for four facilitated workshops where about a dozen of the team members met face to face to finalize key deliverables. For example, one of the first deliverables the team created was to work jointly to develop a Statement of Intent, which included a Shared Vision, Guiding Principles, and Statement of Intended Behaviors.

The team made great progress until they got to **Rule 4 – Pricing Model with Incentives to Optimize the Business**. A key component of the pricing model is to create incentives for the supplier that are paid when the supplier achieves mutually defined Desired Outcomes. This is essential because under a Vested agreement the supplier invests in innovations. Pricing models should ideally contain incentives that are aligned to the

Desired Outcomes. The more successful the supplier is at achieving the Desired Outcomes, the more incentives they earn.

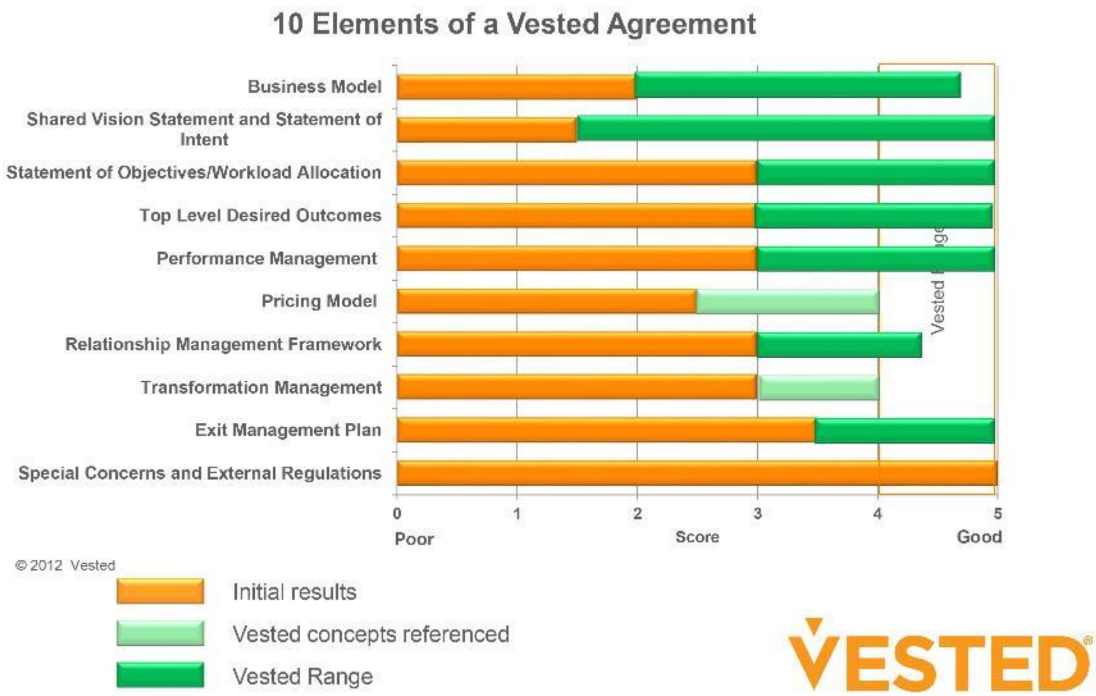
Unfortunately, developing the pricing model became a major stumbling block for the joint team when they reviewed the model with Buyer executives who ultimately signed off on the contract. The BS FM Category Manager explained, "We got hung up on some of the financial parts of the review and that set us back about three months. Basically, we had not done a good job in educating our senior procurement executives who had to sign off on the deal and they did not understand that incentives were essential to a Vested Agreement."

The Supplier MD added: "The Buyer's procurement organization felt that the process was creating too many incentives for Supplier and the economics were too favorable for Supplier. While most of the Vested elements were added to the agreement, when it came to the economics, we simply went back to renegotiating the terms – extending and enhancing what we already had in place for the economics."

While progress was made in all of the 10 elements, Supplier MD noted, "We never really got to a fully Vested Agreement that complied to all 10 of the Vested Elements. We definitely fell short on the pricing model and as a supplier that was disappointing. In our company, we believe that we can have a tremendous impact in driving innovations for clients. But we also have a fiduciary responsibility to our investors and we need to have pricing models that allow us to recoup investments in innovations. We like the Vested approach because if we can deliver value through innovations, we are rewarded with incentives that make our investments worthwhile."

The team finalized the agreement on Jan. 1, 2015. It was a five-year agreement that included two 12-month extension options. As part of the process, The Forefront Group "scored" the final agreement, with both the pricing model and the transformation management components falling short of being deemed Vested.

Figure 3 -- Final Deal Review, February 2015



In the end, the Vested reset helped Buyer and Supplier redirect their approach to outsourcing, enabling them to shift a key objective to move to an outcome-based model.

Reflecting on the Process

While the parties did not reach a fully Vested Agreement, the Vested methodology brought great value by helping Buyer-Supplier shift their thinking and structure to a much more effective agreement that was more aligned with Buyer's business needs. The BS FM Category Manager said Buyer was happy, stating, "The Vested methodology enabled the Buyer & Supplier to get aligned on really what they were trying to get out of the relationship."

The Supplier MD added his perspective: "The Vested online course of working through the different sections of the contract provides fantastic structure. I knew that we needed that type of structure. We also really valued having a neutral third-party Certified Deal Architect to provide program management and to frame the different sections of the agreement that we needed and coach us through the process. I don't think we would have gotten to a renewed contract without it, honestly."

Both companies stated the weak point in going from concept to contract was that the Buyer's senior executives had not been fully educated on what it really meant to have a

Vested agreement. According to the BS FM Category Manager, "While our senior management in procurement had chartered the conversion to a Vested deal, it became apparent we did not give them enough background and education when we shared the pricing model with them. It was a setback, but a good lesson that we used in the next phase – our Vested Refresh."

Living into the Agreement

Both Buyer and Supplier knew that it was one thing to define what they wanted in the contract, but they would need to operationalize the changes. The companies describe the first few months post-contract signing as a "learning curve." The Supplier Account Executive explains, "We stumbled a little bit out of the gate for the first few months in the first quarter of 2015. Getting people to wrap their heads around outcomes-based objectives as opposed to more tactical objectives was a little bit tough."

One of the key factors slowing progress was that some sites had difficulty following the governance structure of the agreement. Much of the problem with governance stemmed from implementing the new BS unit and its impact on the agreement. The Supplier Account Manager says, "What Buyer and Supplier had on paper from a governance standpoint was good, and looked very much like what a Vested Agreement should look like, but in practice, it was not quite hitting the marks in all locations. With the advent of BS, there was a new layer of governance that had not existed in the original agreement." He continued, "We didn't think about when we were building this, that there could be a whole new global governance model that would come into play."

The Buyer-Supplier team began to get the wind under their sails by the second quarter of 2015. The BS FM Category Manager was pleased to see the great progress being made on shifting from a 'what's in it for me' mindset to Vested's highly collaborative 'what's in it for we' mindset. "By the summer of 2015, the Vested mindset had started to click. You could really tell from a tone and collaboration perspective that the Vested process had made a tremendous impact overall. The agreement really does have the parties collaborating and talking more and when problems come up, people are really working together to get to the outcomes we have defined. While I think perhaps there was a bit of reluctance and skepticism moving into the process a year and a half ago, I think now people are starting to understand exactly where that is taking us." He added, "It's very clear to people and to managers in the (Buyer) organization that if the Supplier is failing everybody should consider themselves to be failing."

"This is a remarkable shift," he continued, "Because it's pretty easy with a contractor to say it's not my fault, they did it, they screwed up. The viewpoint now is that there is still a management fee at risk, so if we are taking away any of that fee at risk for anything other than some egregious screw-up, we've screwed up. Both parties have responsibilities back to the end-users."

PART 4 - THE VESTED REFRESH AGREEMENT

Just as the relationship was clicking into full speed, so too were the mindsets of the Buyer executives. It was during this time period (Summer/Fall 2015) that the Buyer senior executives began to see the promise of what Vested could bring. Even though the “reset” contract was less than a year old, the decision was made to reopen the entire agreement to address the outstanding pricing and governance issues – key areas that now were becoming apparent were going to hold the Buyer and Supplier back if they did not have them in place.

Once the BS FM Category Manager and the Supplier MD got approval to reopen the contract and close the remaining gaps, things moved very quickly. The Supplier MD and the BS FM Category Manager found themselves once again at the helm of leading the organizations to a Vested Agreement. But this time the goal was a truly Vested Agreement. The duo referred to this phase of their Vested journey as the “Vested Refresh,” because their objective was to quickly refresh the agreement and close the remaining gaps that were preventing Buyer-Supplier from having a truly Vested relationship.

The BS FM Category Manager described it as a "very productive, if not frenetic summer. We were now able to address the problems that Buyer-Supplier had in the last iteration of the agreement.”

Between August 2015 and December 2015 Buyer and Supplier went back to the drawing board. But this time it was more about tweaks that would complete the restructuring. In addition, the Buyer decided to give a big vote of confidence to the Supplier – bringing their Latin America sites into agreement’s scope. This allowed the parties to leverage the relationship and solid performance. In addition, management of baseload construction projects and expanded Health Safety and Environmental activities were added to the scope.

The parties signed the fully Vested Agreement on Jan. 1, 2016. It is a five-year agreement with provisions for two one-year extensions. The contract now covers about 35 facilities spanning North America and South America. However, as with any good Vested Agreement, it is structured as a flexible framework and allows Buyer with an easy option to add other regions, such as Southeast Asia.

Let’s consider how the parties are conceptually following the Vested Five Rules. (Note: the details of the contract are confidential and the following section provides a high-level understanding of how Buyer and Supplier follow the rules.)

How Buyer-Supplier Follow the Vested Five Rules

Rule 1: Focus on Outcomes, Not Transactions

Vested Rule 1 – Focus on Outcomes, Not Transactions – means radical alignment around a handful of big goals rather than long lists of activities to be performed.

The reset and refresh agreements moved Buyer and Supplier to outcomes-based thinking. “Getting people to wrap their heads around outcomes-based objectives as opposed to more tactical objectives was a little bit tough,” the Supplier Account Manager acknowledged. The Supplier VP & Site Lead added, “For the most part the movement to outcomes has been fairly expeditious. Of course, it is expected that some sites move slower than others. This is to be expected when you think about it. After all, some people have done something a certain way for 20 years, and even though everyone agrees that this is an outcome-based agreement they're still likely to measure tasks.”

Rule 2: Focus on the What, Not the How

The purpose of Vested Rule 2—Focus on the What, not the How—is to make sure the supplier is not constrained by pre-described mandates. This allows a supplier to explore innovative solutions that will meet the mutually defined Desired Outcomes.

The first-generation performance-based contract was based on very prescriptive service level provisions and the Supplier VP & Site Lead was pleased to see the shift in thinking. “We made excellent progress on focusing on the what. Part of that was the trust we developed as part of the process. While we had built trust in the first two years, the Vested methodology helped us at the managerial level to understand that essential to this relationship is the Buyer defining the outcome and giving us the latitude to arrive at that outcome the way we see most fit and not to micromanage us.”

Rule 3: Clearly Defined and Measurable Outcomes

Alignment is a key Vested concept. Vested Rule 3, “Clearly Defined and Measurable Desired Outcomes,” ensures the right set of measurement criteria.

Rethinking Rule 3 led to the tightening up of and getting more alignment on metrics to the Desired Outcomes. The BS FM Category Manager explains, "We realized what the Vested coaches were saying in that we really could reduce the number of metrics." As such, the team further streamlined the number of KPIs used, reducing overlap, and eliminating metrics that were not being used. "We are now down to eight KPIs for compliance," The BS FM Category Manager said.

Not only did the team streamline the metrics, but they also focused on better alignment. “Now our performance measures are tied to our Desired Outcomes. This is a huge win because now – truly – Buyer and Supplier are literally pulling on the rope in the same direction." The BS FM Category Manager emphasizes, "If Supplier is failing, we're failing; this will now show up on the customer satisfaction score." Both parties see this as a great step in the right direction.

Last, the Supplier VP & Site Lead reports that revisiting Rule 3 also helped them realize they needed to streamline reporting. "We've scaled back the amount of reporting we are doing – it's more reporting by exception. We also agreed to streamline the administrative process between us. We still have more work to do in that regard, but we'll get there."

Rule 4: Pricing Model with Incentives

In Vested, buyers and suppliers develop a pricing model with incentives that rewards the supplier when mutually defined outcomes are achieved. In short, the supplier is Vested in the buyer's success – and vice versa.

As mentioned in Part 3, establishing a pricing model with incentives was a big stumbling block for Buyer "Under the Reset agreement Supplier was not incentivized to make significant investments in the terms of financial investment and the success of the partnership," the Supplier VP & Site Lead said. But the parties addressed this gap in the Refresh agreement.

A key addition was to include the incentives that had been originally cut in the first contract extension. In addition, a fair amount of scope that was in "uncontrollables" was moved over into the baseline. The BS FM Category Manager explained, "This gives Supplier more budget to work with and there are more deliverables out of that. I think the direction is extremely positive; getting this performance model into this format is going to do a lot for everybody."

Rule 5: Insight versus Oversight Governance

A Vested Agreement creates a highly collaborative governance structure based on insight, not oversight. For the buyer, this means learning how to manage the business *with* the supplier, not simply manage (or micromanage) the supplier.

The Vested methodology challenged the Buyer-Supplier team to scrutinize their governance processes. For example, the agreement now purposefully incorporates the Buyer's new global Business Services organization.

But equally important was the commitment to shift the mindset to how the parties approached governance. "We had to reenergize the governance structure we had on paper," the Supplier VP & Site Lead said. "We didn't have the level of senior involvement that we needed to make it work, and there were a couple of trouble sites where a stronger governance structure was needed. Vested helped us not only redesign our governance structure, but to reinvigorate it."

For instance, the dispute escalation process in the first-generation agreement "was a disaster." The Supplier VP & Site Lead explains, "In the past, if one of the sites did not agree with a decision coming out of the governance process, it would go into a 'do-loop' for months and appeals were all over the place and made as ugly as possible. That was creating a lot of relationship issues, because the intent with an escalation is to get things done in a relatively rapid fashion so you find what sucks and then move on as opposed to something where people just didn't want to take any responsibility for something."

The team set out to rethink disputes with the focus that it was OK to disagree, but there needed to be a fair, easy, and expeditious process for getting to a resolution. A key part of this was working with legal to get buy-in on having accountability and responsibility.

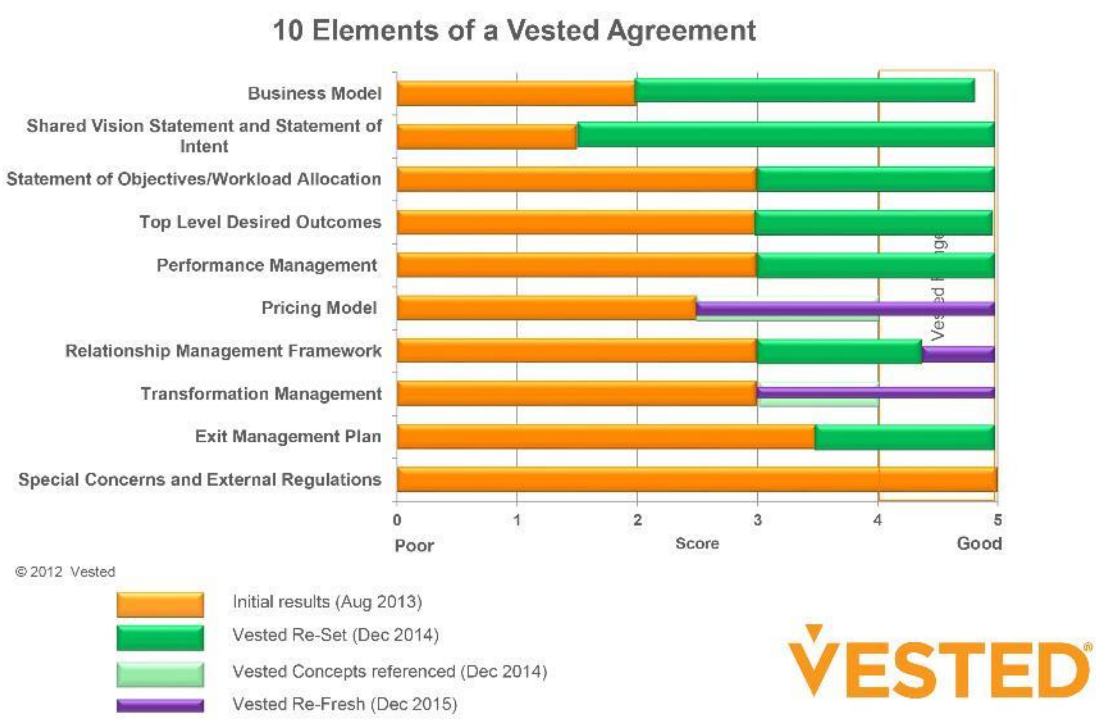
PART 5: CONCLUSION

As we stated in the Executive Summary, sometimes the journey to a Vested Agreement is not a straight path. By acknowledging that concept, the parties were able to use stepping stones along their journey that ultimately culminated in a fully Vested Agreement where the Buyer & Supplier are working in a highly collaborative manner with both a win-win spirit and win-win economics.

Today, both parties feel they are winners. The deal is architected so that the Buyer gets additional cost savings and the Supplier gets additional scope and incentives for achieving mutually defined Desired Outcomes. And both get alignment with better governance, better KPIs, better outcomes, and performance metrics that truly align the Buyer and their Supplier counterparts.

The Forefront Group once again reviewed the agreement, this time seeing if they were able to close the remaining gaps. Figure 4 shares the complete progress of the Buyer-Supplier Vested journey. The companies were proud to learn their deal has now passed the full criteria for a Vested Agreement established by the University of Tennessee.

Figure 4 -- "Re-fresh" Deal Review -- Jan. 2016



The Buyer-Supplier case study demonstrates the commitment of both parties to relentlessly pursue a true win-win relationship. The BS FM Category Manager beams with enthusiasm: "In moving closer to a Vested arrangement, everyone got on the same page. The methodology itself contributed to our success and enabled us to think about it from an entirely new perspective that is not antagonistic. We now have a very strong foundation and our efforts demonstrated the value of the Vested process to the Buyer community."

"I'm very, very happy with the results," the BS FM Category Manager asserted. "While there were some tough moments and disappointments in the Vested Reset, it is to be expected when you start talking about a lot of money. But being able to use Vested as a framework to keep people engaged on the outcomes that we're trying to achieve and focusing on what we're really trying to deliver was very unifying. And our persistence paid off."

The Supplier Executive Managing Director/Life Sciences believes the entire industry could benefit from the Vested methodology. He adds, "We're encouraging folks to try to see it as groundbreaking. Many think the only way to get a better deal is to use a highly competitive bid process. But through Vested, you are able to change the discussion and find additional value through collaboration versus competition. The Vested process clearly brought additional value to both Buyer and Supplier."

The Supplier VP & Site Lead makes a bold prediction. "I believe we will point to the launch of our Vested journey in a couple of years as a turning point of the relationship that enabled us to accelerate the improvement of the relationship." The Supplier MD adds, "As an overall concept, who wouldn't want to work in a highly collaborative win-win manner? With win-win scenarios – we are taking on more risk, but we are rewarded for it; following Vested's structured methodology enabled us to move from concept to contract and that is very powerful."

The Journey Drives the Change

Many view Vested as “too big” or “too much change.” Vested advocates know the secret sauce for getting to a Vested Agreement isn’t simply the rules themselves, but in having the discipline to align on how you will follow the rules. Many say the secret sauce of Vested lies in the process itself – because the process forces discussion and reflection on how to change the game of outsourcing to a more strategic discussion with the purpose to drive innovation against true Desired Outcomes.

For the Supplier MD and the Supplier executives, this became a key learning. It is common knowledge that Vested was not a new concept to Supplier. They were proud to have been recognized by the University of Tennessee as part of UT’s original research.

The Supplier sales and account executives loved the positive press that came from that book. However, they struggled to go beyond the concept with other clients. While Vested was not a new concept, what was a new concept for Supplier was using the Vested methodology to help transform existing relationships into Vested relationships.

The Supplier MD shares, “Our executives have always been a fan of Vested – having seen first-hand the benefit of the original Vested relationship. However, the Buyer relationship has taught us that the Vested methodology is truly a change driver we can use with clients to help us build trust and establish a true WIIFWe mindset and contract where we win with our clients.”

The Supplier’s Executive Managing Director/Life Sciences attributes the Vested methodology for getting both parties to a Vested Agreement. “The only way to truly get to a Vested Agreement is to follow the rules, and that means following a structured process to help you follow the rules.” The Supplier MD noted: "There's a real value in having a structure to help get people moving in the same direction and working together as a team to meet milestones. As an overall concept, who wouldn't want to work that way? The Vested methodology definitely helps us not only say win-win – but truly create a win-win agreement.”

The Supplier VP & Site Lead adds an interesting spin. “The biggest benefit is that if life is a Venn diagram, it’s getting people to recognize that we have much more in common than not; otherwise, we never would have been in this position in the first place. The Vested methodology helped us work from the center out. The result was an alignment of interests and that is a true win-win for both the Buyer and the Supplier.”

ACKNOWLEDGMENTS

The University of Tennessee and the authors would like to thank the Buyer and the Supplier for sharing their stories, thus making this case study possible.

We would also like to thank and recognize Bonnie Keith and Donna Massari from The Forefront Group – the Vested Center of Excellence and Certified Deal Architect that provided exceptional coaching support to Buyer and Supplier in their quest to create a Vested Agreement.

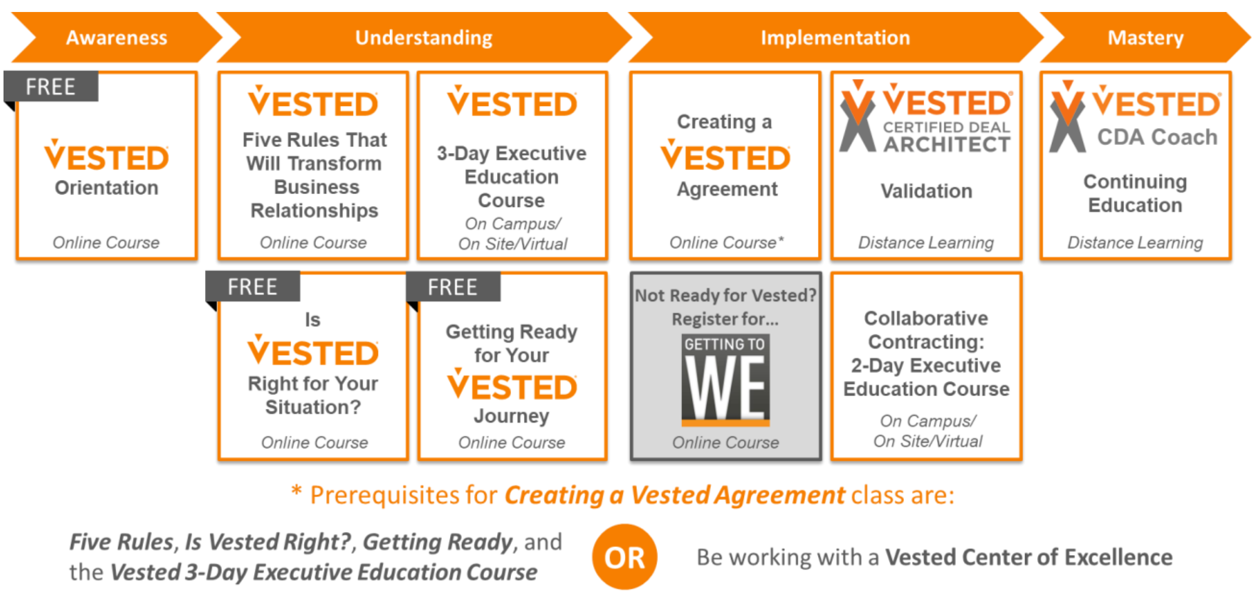
FOR MORE INFORMATION

The University of Tennessee is highly regarded for its Graduate and Executive Education programs. Ranked #1 in the world in supply chain management research, researchers have authored seven books on the Vested business model and its application in strategic sourcing.

WHY   WHAT   HOW   WHEN   NEGOTIATE THE RELATIONSHIP   TELLS THE REAL STORIES

We encourage you to read the books on Vested, which can be found at most online book retailers (e.g., Amazon, Barnes and Noble) or at [www.vestedway.com/books.](http://www.vestedway.com/books)

For those wanting to dig deeper, UT offers a blend of onsite and online courses including a capstone course where individuals get a chance to put the Vested theory into practice. Course content is designed to align to where you are in your journey ranging from Awareness to Mastery. For additional information, visit the University of Tennessee's website dedicated to the Vested business model at http://www.vestedway.com/ where you can learn more about our Executive Education courses in the Certified Deal Architect program. You can also visit our research library and download case studies, white papers and resources. For more information, contact kvitasek@utk.edu.



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Published Fall 2016 by:
University of Tennessee
Haslam College of Business
ISBN: 978-1-959858-18-8

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Facility Management Outsourcing [Case Study]. The University of Tennessee, Haslam College of Business. Fall 2016.

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