# VESTED® For Success Case Study

## How *Dell* and *FedEx Supply Chain* Reinvented Their Relationship to Achieve Record-Setting Results

A Report Authored By:

Kate Vitasek, Karl Manrodt, Jeanne Kling and Bill DiBenedetto

HASLAM COLLEGE OF BUSINESS
THE UNIVERSITY OF TENNESSEE, KNOXVILLE

# TABLE OF CONTENTS

# EXECUTIVE SUMMARY

For over 28 years, Dell has empowered countries, communities, companies and people everywhere to realize their dreams through the use of information technology. Success also brings great challenges—especially in areas of non-core competencies such as reverse logistics.

Dell had worked with GENCO since 2005 (GENCO was acquired by FedEx in 2015 and rebranded as FedEx Supply Chain® in 2017). As customary in the fast-paced high-tech industry, Dell operated under a procurement strategy of "every dollar, every year," meaning it used frequent competitive bidding processes to drive down prices. By 2011, the honeymoon was over in the relationship.

Dell was driving for the lowest cost, but FedEx Supply Chain believed Dell's short-term thinking was putting capabilities at risk. A major tension point was that Dell wanted FedEx Supply Chain to drive proactive innovations and assume the cost of investments. FedEx Supply Chain resisted because it had no guarantee of return on investment within the existing contract structure and constantly faced hard-driving cost reductions.

One thing was abundantly clear: Neither party was content with the current contract. The existing contract structure and relationship dynamics placed a wedge in the trust level between the two companies. A better way was needed.

Dell—regarded as a progressive leader in supply chain operations—has consistently ranked on Gartner's Top 10 list of companies that excel at supply chain management. To stay on top, Dell leaders constantly seek pioneering solutions to manage its operations. Bill Hutchinson, a Dell executive and University of Tennessee (UT) MBA graduate, was familiar with UT's work in Vested outsourcing. Hutchinson was intrigued by the win-win concepts promoted under the Vested model and decided to send two Dell team members to UT's inaugural Vested Outsourcing 3-day Executive Education class in Knoxville to learn more.

After many internal discussions, and later discussions with FedEx Supply Chain, the parties decided the relationship was the perfect testing ground to try the Vested methodology. The rest, as they say, is history. Dell and FedEx Supply Chain have been successfully operating under a Vested model since 2012 when their new Vested agreement took effect. Six years later, the parties went through a "refresh" to update their agreement to address "lessons learned" and the changing business environment.

Of course, many thought Vested would be a fad. Or that the results would not be sustainable. But because the Vested model is anchored in a flexible contracting framework, it allows the parties to continually align their interests. The relationship has successfully navigated both Dell and FedEx Supply Chain through not only transforming how they work, but navigating the changes needed to drive transformation in their reverse logistics operations.

This case study profiles the Dell-FedEx Supply Chain Vested journey from 2011 to 2017.

## BACKGROUND

In 2005, Dell selected GENCO (now part of FedEx and operating as FedEx Supply Chain)[1] to help expedite Dell's return and repair process. FedEx Supply Chain performed well and earned Dell's respect. While service levels were high, Dell could not escape highly competitive cost pressures and decided to take a more strategic approach to outsourcing. Dell wanted to consolidate existing sites and create a single refurbishment center, including testing, remanufacture, repair and refurbishment of desktop, notebook, server and storage systems in its Lebanon, Tennessee, facility. Ultimately, Dell decided to sell its 298,000-square-foot Lebanon facility—along with the transfer of Dell employees—to a service provider who would run the facility under a strategic outsourcing agreement. FedEx Supply Chain was on the shortlist of potential bidders.

In July of 2009, FedEx Supply Chain again prevailed as Dell's supplier of choice. Under the agreement, FedEx Supply Chain agreed to acquire Dell's buildings, assets and people under a three-year outsourcing contract. At the time, Dell considered a three-year contract a long-term deal.

In the high-tech industry, change is rapid, and Dell operated under a procurement strategy of "every dollar, every year," meaning it used frequent competitive bidding processes to drive down prices. Darrin Browder, at that time Dell's Strategist and Supplier Relationship Manager for the FedEx Supply Chain relationship, explained: "This had worked well for us over the years and consistently helped keep our prices in check. But with the sale of the building and transfer of the people, we knew we needed a longer-term contract in order for FedEx Supply Chain to amortize the high upfront costs."[2]

The Dell-FedEx Supply Chain contract—known as Nighthawk—was a typical transaction-based outsourcing agreement that challenged FedEx Supply Chain to assume the risk of meeting the price per activity while maintaining service levels. The contract had nineteen different billable line items and more than one hundred service-level agreements (SLAs).

The arrangement worked reasonably well for a time, but it eventually developed significant problems. What was a good "deal" in 2009 when the parties signed the contract was no longer sustainable. The explanation was complicated. It stemmed from structural challenges in the nature of the deal itself. Dell had sold its operations to FedEx Supply Chain with stipulations regarding transferred employee wages and retention. FedEx Supply Chain assumed efficiency risks and committed to reducing costs, on which it was delivering.

From Dell's perspective, FedEx Supply Chain's cost reduction commitments—while on target to their commitments—were no longer good enough to provide Dell a competitive advantage in the marketplace. Raj Subramonian, who was then Dell's General Manager of Global Dell Outlet, was under persistent pressure to reduce costs. "When I look back, I have no memory of fondness. It was glaringly obvious in the first quarter of my job: We were hardly close to industry standard for the cost side of things. The key metric was cost per box (CPB), and we missed it every quarter. For eighteen months in a row, I had to stand in front of executive meetings to explain why our costs were so high."[3]

Dell's procurement team continued to press FedEx Supply Chain on cost reductions under an "every dollar, every year" mantra, even though Dell and FedEx Supply Chain had established a contract in which FedEx Supply Chain took much of the risk at a set price. FedEx Supply Chain grew frustrated as Dell sought to renegotiate the three-year agreement every six months. A major tension point was that Dell wanted FedEx Supply Chain to proactively invest in innovations to keep up with the fast-paced, high-tech market. FedEx Supply Chain resisted because it had no guarantee of return on investment within the three-year contract term and constantly faced hard-driving cost reductions.

FedEx Supply Chain reached a point where it did not believe more savings "could be squeezed out of the lemon," and it was unwilling to make investments without some added compensation that allowed a fair return on investments. To make matters worse, water-cooler talk suggested the issues were FedEx Supply Chain's fault and Dell needed to change its service provider.

One thing was abundantly clear: Neither party was happy. The existing contract structure and relationship dynamics during the 2011 time period put a wedge in the trust level between the two companies. By the end of the second year, the parties knew there was a definitive need to renegotiate terms. A better way was needed.

Dell leaders tossed around ideas for change. Maybe they could near-shore the operation to Mexico where labor was cheaper or, perhaps, even offshore to Asia. Could they explore a combination of performing light-touch processes in the United States and more complex fixes elsewhere?

A small group within Dell did not agree that switching the service provider or offshoring to a low-cost country would be a panacea. Subramonian explained, "The Dell-FedEx Supply Chain relationship had legacy issues, with issues on both sides. FedEx Supply Chain was rewarded for enhancing its profitability through its services. Dell was rewarded for getting the lowest costs. Dell and [FedEx Supply Chain's] interest needed to be aligned: If we created the same contract structure with a new supplier, we would have the same issues. I felt strongly we had to consciously challenge years of historical precedent and make changes in contract penalties, and incentives."

Robert McIntosh, now Dell's Senior Vice President, Dell Global Fulfillment, Logistics and Trade, agreed: "We knew FedEx Supply Chain was a best-of-breed supplier. When we performed the previous competitive bid situations, FedEx Supply Chain always came out on top. If we moved to another supplier, we would have exorbitant transaction costs and added risks of a supplier who might not perform as well as FedEx Supply Chain."

Hutchinson was familiar with UT's work in Vested Outsourcing and suggested Dell send two team members to UT's inaugural Vested Outsourcing 3-Day Executive Education class in Knoxville to learn more. The reports were positive. Vested was an innovative approach for creating win-win outsourcing agreements.

Hutchinson was intrigued and decided to host UT faculty for a one-day executive education session at Dell's corporate headquarters. The event exposed 30 cross-functional Dell leaders to Vested concepts. "The session was evocative," Hutchinson says. "Some walked away thinking Vested would be a game-changer for Dell. But many were reluctant to embrace a concept that seemed to be ‘too soft and fuzzy’ to be effective in the real world of the dog-eat-dog high-tech industry.”

Stephen McPherson, Global Operations Reverse Supply Chain Senior Manager at Dell, added that Vested “seemed to be too idealistic, too unrealistic. I don’t want to label myself as a pessimist. But, being more of a realist from operations, I thought it all sounded too good to be true.”[4] He was not alone. The Dell engineering team was especially skeptical.

While Dell faced its dilemma and the contract’s pending expiration, a few team members who worked directly with FedEx Supply Chain felt a Vested approach might be the radical solution needed. Darrin Browder, now Director of Operations, Transportation and Logistics, Americas, at Dell, was one of those people. “I was immediately attracted to the logic behind the Vested approach. I had worked on the operations side of the business and knew firsthand the conflicting goals between operations and procurement.” Browder could easily have identified the inherent misalignment in Dell and its supplier’s goals. He believed adopting a Vested approach could revitalize the Dell-FedEx Supply Chain relationship and bring transformative results. After several thought-provoking discussions, Browder convinced McIntosh a Vested approach would provide a strategic alliance focused on adding value, not simply managing transactions.

McIntosh wanted to make sure the organization had enough buy-in to make it work. He organized a book club to encourage his team to learn more about the Vested approach. Over a period of three months, people were assigned as chapter champions to read and digest the first edition of *Vested Outsourcing: Five Rules That Will Transform Outsourcing*. Discussions revealed the Nighthawk contract was guilty of all 10 of the “Outsourcing Ailments.”

The book club meetings were important, McIntosh said, because “they really helped us realize that we needed to try a different approach and that the Vested approach provided a solid option. Dell’s innovative culture allowed us to challenge the status quo, and the internal team ultimately came to the conclusion that it made sense to approach FedEx Supply Chain with the thought of converting our contract to a Vested agreement.”

The rest of this case study tells the story of how Dell and FedEx Supply Chain implemented the Vested business model in 2012, and ultimately refreshed and renewed their original agreement five years later in 2017.

## LAYING THE FOUNDATION

Dell appointed Matt Snyder, who was at the time the company's Director, Global Reverse Supply Chain, to lead the initiative. Snyder began discussions with FedEx Supply Chain to explore whether Vested would be a good fit to help the parties get out of their rut. Snyder began by asking FedEx Supply Chain's management team to read an article on Vested Outsourcing. Like Dell, several were intrigued.

Just as Dell did initially, some FedEx Supply Chain leaders felt the Vested idea might be too good to be true. Their relationship history suggested Dell held tight to its "big stick." Dell contracts were one-sided: FedEx Supply Chain assumed the risk and received little reward. FedEx Supply Chain questioned whether Dell could get to a true win-win contract espoused under the Vested methodology. FedEx Supply Chain knew all too well that Dell would share the risk, but would Dell follow through with shared reward? Could they walk to the talk of Vested's "What's in it for We" mindset?

The companies met at a neutral offsite location in June 2011 in Fort Worth, Texas, to have candid discussions about each party's commitment to convert its contract to a Vested approach.

It sounds simple, but the ensuing conversations were challenging. The historical lack of trust between FedEx Supply Chain and Dell were apparent. Both parties understood a Vested agreement could not succeed without trust and transparency, but old habits die hard. Tom Perry, former Vice President & Chief Technology Officer at FedEx Supply Chain, reflects on the meeting: "There was absence of trust. Not because people were bad, but simply because the conventional approach did not foster trust. The Nighthawk contract was a win-lose proposition. If one of us won, the other automatically lost. And quite honestly—we were both losing,"[5]

The meetings were so tense at times that Dell and FedEx Supply Chain attendees went to separate rooms to cool off and think through their desired paths. Perry recalled, "There was a moment of truth in that June meeting. I did not want to proceed because I didn't have enough trust to move forward." But during those times of separation, his peers at FedEx Supply Chain convinced Perry to stay the course. Perry is glad he did: "I had an epiphany. If you can't get past the absence of trust, you can't ever make it work. I can't say enough about how that's changed everything."

Dell and FedEx Supply Chain agreed to move forward with a goal to create a new Vested agreement with a commitment to include a new attitude and approach toward risk and reward sharing.

Dell and FedEx Supply Chain appointed a small "Core Team" that would ultimately transform the relationship and transition from a transaction-based contract to a win-win Vested business model. The team included leaders who were passionate about the need to think differently about the relationship. Snyder from Dell was named the project manager and was joined by Browder (procurement), Kevin Meyers (operations), and Nimesh Porbandarwell (who was then at the Global Dell Outlet business unit). On the FedEx Supply Chain side, former executives in engineering and reverse logistics led the transformation effort—joined by John Coleman, then and current General

Manager overseeing one of the Dell operations. Coleman was responsible for the day-to-day operations of the Dell business for FedEx Supply Chain, and his buy-in and support were essential. He and his team ultimately needed to make big changes operationally under the transformational nature of the new Vested agreement.

**Figure 1**

| Part 1: Laying the Foundation | |
|---|---|
| Introduction | How To Use This Course & Toolkit |
| Module 1 | Getting Ready |
| Module 2 | Contracting By The Rules |
| Part 2: Contracting by the Elements | |
| Module 3 | Business Model |
| Module 4 | Shared Vision & Intent |
| Module 5 | Statement Of Objectives |
| Module 6 | Performance Metrics |
| Module 7 | Performance Management |
| Module 8 | Pricing Model - Part 1 |
| Module 9 | Pricing Model - Part 2 |
| Module 10 | Pricing Model - Part 3 |
| Module 11 | Pricing Model - Part 4 |
| Module 12 | Pricing Model - Part 5 |
| Module 13 | Relationship Management |
| Module 14 | Transformation Management |
| Module 15 | Exit Plan /Special Concerns |
| Part 3: Staying Vested | |
| Module 16 | Finalizing Your Agreement |
| Module 17 | Transitioning To Your New Agreement |

The joint Dell and FedEx Supply Chain Core Team turned to the University of Tennessee's Vested online course, "Creating a Vested Agreement," to help them restructure their outsourcing relationship and contract to follow the Vested Five Rules. The course consisted of 17 online training modules (Figure 1) and is designed for a buyer and supplier team to "learn and do" using the University's *RealPlay*® format. Team members first complete an online training module (learn), and then come together to "do," where they co-create deliverables that ultimately become key elements of the parties' contract. For example, they created a shared vision, and they mutually defined Desired Outcomes, including key metrics, a pricing model with incentives, and a governance structure—all essential to a successful outsourcing agreement.

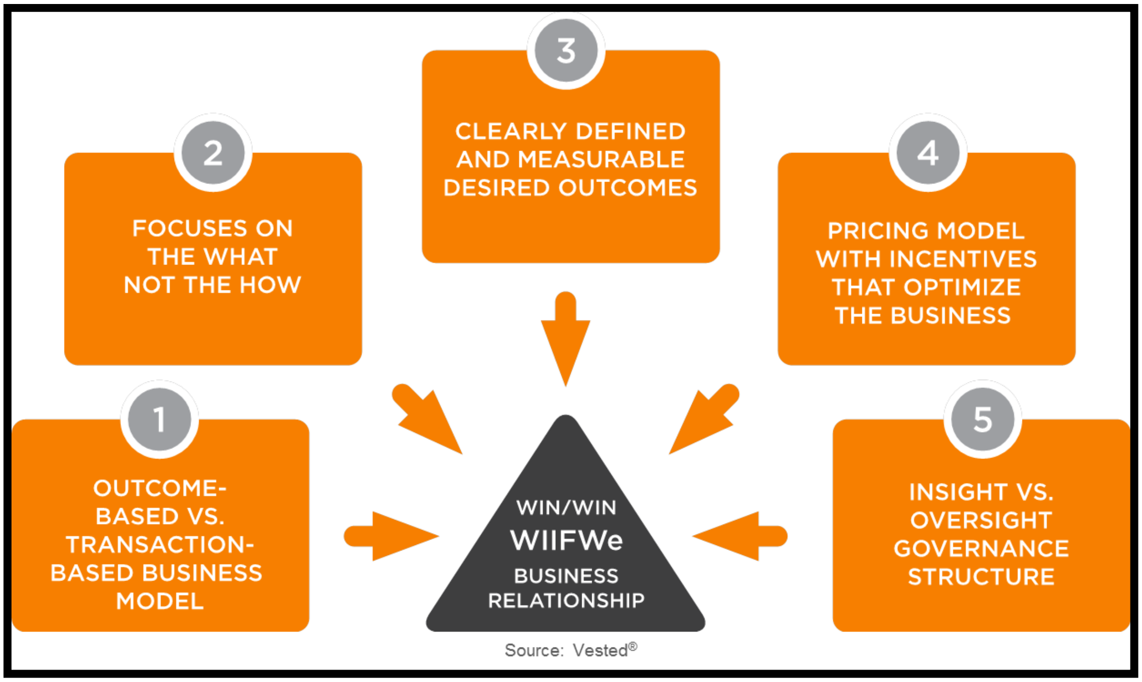
Dell and FedEx Supply Chain ultimately decided to bring in Steven Symmes, a Vested Certified Deal Architect, to help them restructure their agreement. Symmes' role was that of a neutral third-party facilitator to help the companies understand the business and transition the existing relationship to a Vested agreement.

Browder appreciated the transformative structure of using the step-by-step Vested approach. "We worked through the online course at a rate of one module per week. Symmes reviewed each of the completed 'homework' elements with the team, helping us make adjustments where needed. Completing the homework elements gave the team the building blocks for our contract and governance structure."

## FOLLOWING THE VESTED FIVE RULES

The Vested methodology—when followed—creates a relational contract with outcome-based economics. The contract is a flexible framework that allows for the dynamic nature of business. As such, the parties document "rules" they will follow as they seek to achieve mutually defined Desired Outcomes (Figure 2).

**Figure 2**




The following profiles how Dell and FedEx Supply Chain followed the Five Rules.

### RULE 1: FOCUS ON OUTCOMES, NOT TRANSACTIONS

Dell and FedEx Supply Chain kicked off their Vested journey with a Partnership Summit in August 2011 in Round Rock, Texas. A key objective? Tackle Vested Rule #1: Focus on Outcomes, not Transactions. The existing transactional approach lay at the heart of the problem. A former FedEx Supply Chain team member observed, "Getting paid for every activity shouldn't be the focus. What does the business really want to achieve? Dell wanted transformation in its supply chain, but the Nighthawk contract bought activities—not creativity, not innovation. We both knew we needed to shift the focus to value."

Symmes agreed: "Dell fell into the typical trap of focusing on transactions and transaction costs. It was all about reducing the "cost per box," that is, keeping the FedEx Supply Chain cost of processing and refurbishing each returned item as low as possible."[6] The group eventually broadened its viewpoint to one of total cost, considering the total cost of a return or the "loss per box," which shifted the focus to profitability and margin.

"Once we got to thinking clearly about how we minimize Dell's margin loss from a return, everything else fell into place," Coleman explained. "It was easy to think about a common shared vision we could both rally around." The parties ultimately agreed on the following formal shared vision:

> *"To maximize recovery and reduce margin loss on Dell returned products globally through secondary market leadership, supply chain intelligence, and operational excellence."*

With a shared vision in hand, Dell and FedEx Supply Chain went to their individual drawing boards to come up with goals—or, in Vested terminology, "the Ponies." Ponies are those initial ideas that would kick-start an entrepreneurial and Vested spirit. In Vested terminology, a Pony is defined as the difference between the existing solution and results and the desired future results. The parties collaborated, asking the important questions, such as: How much money can we save by working together? How can the two companies become more efficient?

Other issues and questions emerged: Maybe FedEx Supply Chain could help discover failure rates better? Maybe three hours of phone support is unnecessary to avoid the "cost per box" penalties? Maybe a technician can fix the box in the field and reduce the amount of returned product? Perhaps at a higher level, more informative metrics can be defined to continuously improve the process? These were just some of the ideas on the table.

In all, Dell and FedEx Supply Chain identified 55 Ponies. The Ponies were broad-reaching, running the gamut from business expansion and marketing opportunities to sustainability and creating white space (capacity). The team ultimately agreed they would work on 15 of the highest potential Ponies with the best potential return on investment.

McIntosh—a long-time Dell veteran—understood the importance of the Ponies in developing a formal business case that would pass the test of Dell's senior management. The team needed hard numbers to get formal approval if they were going to share the rewards with FedEx Supply Chain. Nimesh Porbandarwell, Lead Strategist for Global Dell Outlet and an Excel spreadsheet whiz, was recruited to create a business case that reflected the costs and savings generated from the ideas that were being tossed around. Porbandarwell responded, "I wanted to show the impact on profitability if we focused on margin rather than cost savings alone. At Dell, we were always focused on costs, but this view was myopic. In reality, Dell could benefit even more if we focused on our overall margin from our repair and refurbishment business." Porbandarwell's business case revealed the strategic initiatives that were collaboratively identified could easily bring Dell millions of dollars in benefits.

It was now time to align interests in a formal Vested agreement, laying out the mechanisms the parties would use to unlock the value of the Ponies through the Vested Five Rules. This would include co-creating a pricing model with incentives that would allow FedEx Supply Chain to share in the value that would be created.

## 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. If Dell wanted to unlock the potential of Ponies, they would need to learn how to “let go” and allow FedEx Supply Chain to proactively change the existing “how” practices that were generating the current results. Simply put, not following Rule 2 would leave Dell in the Outsourcing Paradox they were in—outsourcing to an expert and then telling them how to do the work.

Coleman, one of FedEx Supply Chain’s general managers for the Dell business, noted that the biggest challenge came in the day-to-day actions of how Dell lives Vested Rule No. 2: Focus on the What, Not the How. “During the Nighthawk contract, Dell kept its finger on everything,” he explained. “We used to think Dell team members were watchdogs.”

“Vested Rule 2 gave us the freedom to get creative,” Coleman said. The new Vested agreement accomplished this by shifting the approach from dictating a detailed statement of work to holding FedEx Supply Chain accountable for a broad work scope to achieve the mutually defined Desired Outcomes. FedEx Supply Chain executives now felt confident in making investments in Dell.

One thing that virtually all of the Dell team members agreed upon is that relinquishing control by any business, or person for that matter, is difficult. Dell’s McPherson, who works with the FedEx Supply Chain team in Nashville, said, “Dell leaders had to learn how to trust FedEx Supply Chain to figure out the how-to’s of Desired Outcomes. We had to constantly watch ourselves to make sure we were not micromanaging. But it has been fun to see the transformation. Once we began to be more transparent and looked to FedEx Supply Chain for solutions—rather than telling them what do to—the culture really changed.” McPherson recalled the culture changed “virtually overnight,” adding, “Now we are more proactive and innovative.”

Perry also noted Dell’s progress in embracing Rule No. 2. “Those exact words [Focus on the What, Not the How] were adopted in our meetings. Dell people [would] stop mid-sentence to correct themselves. ‘No, I’m telling you the How: We want to focus on the What.’ It is fun to see the FedEx Supply Chain people light up and say, ‘You’re right.’ And it is our job to hold Dell accountable by reminding them when people slip into old behaviors.”

Commenting on the power of Rule No. 2, Coleman asserted, “It’s like we broke open a new innovation piñata. FedEx Supply Chain employees now know that we will share in the reward for good ideas. Now, every quarter we make new priorities that align with our defined mutual outcomes.”

## RULE 3: CLEARLY DEFINED AND MEASURABLE OUTCOMES

As the saying goes, "You get what you measure." Vested Rule 3—Clearly Defined and Measurable Desired Outcomes—was essential to ensure that the team carefully selected metrics that would align with the mutually defined Desired Outcomes. If the team did not challenge the existing metrics, they would clearly get the same results they were getting under the Nighthawk contract.

Symmes coached the parties through the process of preparing a Requirements Roadmap©—a critical deliverable in the Vested methodology—that would link Dell and FedEx Supply Chain's Shared Vision and Desired Outcomes to metrics and incentives. A properly prepared Requirements Roadmap is an easy-to-use tool that summarizes the essence of the deal structure.

The Nighthawk contract had over 100 service-level agreements (SLAs). As part of the process, the team drastically reduced the number of metrics to less than 20 key performance indicators. And most importantly—all of the metrics were aligned to one of six mutually defined Desired Outcomes. Ultimately, the team aligned all 20 metrics to the following six Desired Outcomes:

- Build and operate an industry-leading supply chain
- Design and operate world-class remanufacturing processes
- Reduce Dell customer returns rates
- Develop and execute a sourcing solution for refurbished products
- Design and build a web portal to maximize recovery amounts
- Expand and implement industry-leading supply chain solutions outside of the United States

Browder was chartered to turn the Vested deliverables into a formal outcome-based contract. Browder reflects on the power of the Requirements Roadmap tool. "Using the Requirements Roadmap was great," he said. "After we completed that tool, I used it more than anything else when writing the contract. It was the most helpful tool of all of the Vested tools. I can't tell you how many times I referred to it when we were writing the contract, because it really is the heart of the contract."

## RULE 4: PRICING MODEL WITH INCENTIVES

In conventional outsourcing, companies purchase services for a transactional fee (cost per shipment, pallet storage, etc.). In Vested, buyers and service providers develop a pricing model with incentives that reward the supplier when mutually defined Desired Outcomes are achieved. In short, the supplier is Vested in the buyer's success—and vice versa. Creating a pricing model with incentives would prove to be Dell and FedEx Supply Chain's toughest challenge.

"The pricing model became the place where win-win would move from theory to economics," explained Browder. "After all, pricing is where the rubber meets the road." The parties agreed to several guiding principles on how they would structure the pricing model:

- They would shift away from a price per activity to a pricing model that tracked the overall profitability of the business based on the mutually defined Desired Outcomes to reduce loss per box and measure the overall profitability of Dell and FedEx Supply Chain.

- The team felt it was unfair for FedEx Supply Chain to assume risk on the Dell business when certain components—such as volume and mix—were not under its control. For this reason, the base book of work was reconfigured to provide FedEx Supply Chain with a below-industry-normal base margin: FedEx Supply Chain would not lose money on base work, but would not make much either. One consideration was, "Who is in control of any given activity?" FedEx Supply Chain controlled events within its facility. However, certain aspects, such as the number of units returned, were clearly not in FedEx Supply Chain's control. Porbandarwell carefully devised pricing protocols that neither rewarded nor penalized either partner for anything outside its control.
- FedEx Supply Chain would earn higher-than-industry margins for achieving the mutually defined Desired Outcomes. The better FedEx Supply Chain did at achieving the Desired Outcomes, the more they would share in the financial benefits.
- The parties agreed to a shared value ratio that gave FedEx Supply Chain a higher share of the benefits earlier, but decreased the share over time. This plan enabled FedEx Supply Chain to recoup investments more quickly, yet allowed Dell to earn a bigger share of the benefits after FedEx Supply Chain recouped its initial return on investment.

The companies also agreed to create a dynamic baseline that readjusts over time: The rationale was that both parties needed to seek innovations to continue to drive benefits—not just continue to reap rewards in the years after the initial investments and innovations brought value. Porbandarwell was challenged to craft a pricing model that literally tracked the entire business and projected the profitability for the parties. In essence, the pricing model was a "joint P&L," where each month the business parameters were entered (volumes, mix) and then results calculated, including the fees and incentives that FedEx Supply Chain would earn.

McIntosh said a key lesson is budgeting and planning for dollars at the Total Cost level to support the program. "We had never done anything like this in the history of Dell. You could say, well, gainsharing is nice, but Vested goes further than gainsharing. Vested allowed us to go down that path where we are expecting year-over-year rate reductions—but the key difference is that now we think about total cost of ownership and not just about the price per box. It really is a more holistic and productive way to think about the economics of outsourcing."

The team gives tremendous credit to Porbandarwell for his financial savvy at coming up with a pricing model that turned Vested theory into reality. While Porbandarwell led the actual creation of the pricing model, FedEx Supply Chain could test and challenge the model to ensure the model was achieving the agreed-upon objectives. After significant testing, the parties were confident that the pricing model was based on fairness and win-win economics.

## RULE 5: INSIGHT VERSUS OVERSIGHT GOVERNANCE

McPherson clearly remembers the old governance structures: "The Nighthawk contract was difficult to manage. On both sides, there were hidden agendas. And paranoia. Information was closely held. Besides that, the contract term required recurring RFQs. Why should FedEx Supply Chain invest in innovations and infrastructure if some other company is going to get the contract? There was no assurance of a return on investment."

Coleman agreed: "The ad hoc governance was not efficient—or effective."

As part of the Vested methodology, the Core Team set up a Vested governance structure that would ultimately help the parties navigate their relationship well past the contract signature. From executive levels to frontline working levels, folks are aligned. The responsibility of managers for specific areas is clearly outlined to keep the companies' program and account managers informed. Direct and continuous communication improves information flow and empowers service provider teams.

Weekly, monthly and quarterly meetings are scheduled at the beginning of each quarter according to identified priorities. Quarterly meetings provide Dell and FedEx Supply Chain executive leadership with status reports, and an opportunity to plan for the future. Key leaders from the companies share the responsibility for planning and facilitating the meetings.

"In the old days, collaboration wasn't the focus," Coleman says. "Now, we review progress and get down to the business of thinking about the future. Where are the emerging opportunities? How can FedEx Supply Chain bring real value to Dell's bottom line?"

## VESTED FOR SUCCESS: THE RESULTS ARE REAL

For folks like McPherson who were somewhat uncertain about Vested initially, the results speak for themselves. “The results have been beyond my wildest dreams,” he says. “It has simply been amazing to see how we could literally turn around the culture and see such drastic results in such a short timeframe.” Even the early “believers” like Browder have been pleasantly surprised. “I knew that a Vested approach would work—but we have been far more successful than anyone imagined.”

So, what exactly does a Vested win-win look like? Browder said he was really pleased when, during the first official Vested Quarterly Business Review, he presented FedEx Supply Chain and the Global Dell Outlet Business Unit with checks in excess of $1 million that were the direct benefits from the new Vested relationship. One million dollars may not seem like a lot, but for FedEx Supply Chain, the difference is substantial because the quarterly incentive check goes straight to the bottom line. Coleman said, “Before we were fighting tooth and nail and not even seeing industry averages for margins on the Dell account.” Under the Vested agreement, FedEx Supply Chain *tripled* its margins over industry averages.

The parties have been operating under a Vested agreement since 2012, and quickly began to realize success against their Desired Outcomes. In fact, all but one of the initial six Desired Outcomes panned out in 2011. While the parties have not publicly released the official amount of incentives paid out to FedEx Supply Chain under the Vested agreement for helping to achieve the Desired Outcomes, both parties readily admit that Vested works. Some of the results include:

- Reducing Dell’s cost structure by a total of about 44 percent in the first three years
- Achieved record high levels for Quality targets DPPM (Defective Parts per Million), Missing Wrong and Damaged (MWD), and Repeat Returns since time of shipment over the previous 90 days (RR90)
- Achieved the Parts Dollars targets, enabling Dell to carry record low dollars in repair parts

But winning is not one-sided in a Vested agreement. FedEx Supply Chain also came out winners. A key part of the contract was the incentive for driving transformation results. Recall that in the first quarter FedEx Supply Chain received a $1 million bonus check as their share resulting from the successful implementation of Ponies that drove down Dell’s Total Cost. In addition, FedEx Supply Chain received automatic contract extensions.

### WHERE DO THE RESULTS COME FROM?

Skeptics often find the results from a Vested agreement hard to believe. Some even pass off the results as “low-hanging fruit” or accuse the supplier of “sandbagging.” But ask anyone involved in the Dell-FedEx Supply Chain Vested relationship and they will tell you the results come from the win-win nature of transformational efforts. In a properly structured Vested agreement, the supplier is rewarded for investing in innovation and process improvements, because they will get a return on their investment if the transformation initiatives help the parties achieve their Desired Outcomes. Remember the Ponies? In short, there is a payoff for winning Ponies.

Coleman—an advocate of Vested from the beginning—stressed that one key to success is that the Vested agreement channeled the parties to look at the bigger picture and align interests: “We used to think the only option was a continual reduction of cost per box. With Vested we have a framework that says when we make money or save money, we do it together. At FedEx Supply Chain, we’re all in, and that means all of the employees are in—every hour, every day—at driving value that drops to both Dell and FedEx Supply Chain.”

So where exactly did the results come from? Simply put, from the value created from the transformation initiatives—or “Ponies”.

Perhaps one of the most impressive transformation initiatives revolved around reducing scrap materials. The parties were able to tackle this Desired Outcome much quicker than anyone thought. In the first 18 months after making the shift to Vested, the companies realized a whopping 67 percent decrease in product headed for scrap disposition.

Before Vested, the Nighthawk contract paid FedEx Supply Chain a set fee for simply discarding the returned product. The Vested agreement provided incentives for waste reduction. As a former FedEx Supply Chain executive explained, “The golden metric is loss per box. A lot of initiatives we do (i.e. scrap) directly feed that objective. Why throw away a laptop if we can salvage 35 percent of the cost? Yes, it adds a step in the process and costs to FedEx Supply Chain—but now it is worth the effort because when we save Dell money and use fewer parts, we also win. Before we were in a win-lose situation. Having a win-win solution is a game-changer in driving sound business decisions.”

Coleman offered an example of how quickly a Vested approach changed the culture within FedEx Supply Chain. “Before the Vested agreement, Dell sold all returned products on a retail basis. If the product didn’t meet retail standards, it was scrapped. For years, I had asked Dell to come up with a system to use wholesale as an additional option. It was a good idea, but Dell could not generate internal interest in investing in a project. FedEx Supply Chain had no reason to make investments besides just contributing the idea. Under the Vested agreement, I jumped on the idea, and we created a project called Company 37.” As part of Company 37, FedEx Supply Chain created a wholesale alternative for refurbished merchandise. Dell gave FedEx Supply Chain the green light and FedEx Supply Chain made the investments to take the concept from idea to reality. Coleman added, “In the thirteenth week, we sold our first pallet. Company 37 was a success in the very first quarter: It was a turning point for me and a clear win—right off the bat.”

Another transformation initiative was known as Sell as New (SAN). Under SAN, FedEx Supply Chain identifies Dell products in which the e-seal has never been broken, credits the customer, repackages, and returns them to Dell’s new sales channel. The benefit of SAN for Dell is obvious. As Coleman explains, “This allows Dell to achieve 100% recovery.”

FedEx Supply Chain also invested in a proprietary Test/Burn solution. “We added new tests for technology upgrades—touch screen testing, more rigid testing on high-end graphic cards, testing for onboard speakers,” added Coleman. “This improved quality and allows Dell to maintain premier pricing for best-in-market quality products.”

## THE INTANGIBLE BENEFITS OF VESTED

Results are nice. And incentives for results are even better if you are a supplier. But for the people involved in the relationship, the definition of a win-win goes well beyond the economics. Perry explained that one of the best things that happened was the cultural change. “The atmosphere inside the room is 180 degrees different from the past. There is a recognition for the importance of relationships, and, most importantly, trust.” Describing a meeting he added, “We held a three-day session down in Austin. It was geared more toward insight rather than governance—to discern the things that are the next frontier for us. Things like IT, international expansion, and the web platform. If you came into the workshop sessions and didn’t know the participants, you wouldn’t know who was on which payroll.”

## SIX YEARS LATER: LESSONS LEARNED LEAD TO A REFRESH

No matter who you ask, all will agree that success does not come without hard work and the courage and persistence to try something different. For Dell and FedEx Supply Chain, the difference was moving from "saying" strategic ally to truly becoming strategic allies. And this was backed by a contract that shared risk and reward for the relationship.

Of course, there were many lessons learned along the way. Lessons not just from the early days, but equally important lessons on how to sustain a Vested agreement, especially because people come and go and the nature of each business may change over time.

The parties ultimately decided to take the lessons learned and "refresh" their Vested agreement to not only update it to reflect the nature of the changing business environment, but to also rethink areas they felt could be improved due to lessons learned. Three key focus areas emerged:

- A streamlined set of Desired Outcomes
- A refreshed and more flexible pricing model
- Better attention to governance, including the onboarding and meeting process, and buy-in from new top-level executives

Each is discussed in more detail.

### REFRESHING THE DESIRED OUTCOMES

One thing Dell and FedEx Supply Chain wanted to do as part of the refresh was to update the Desired Outcomes. On the positive side—the parties had achieved five of the six Desired Outcomes they set out to accomplish in 2011. But by 2017, the business environment had changed dramatically.

McPherson reflected on the refresh of the Desired Outcomes. "We just released the whole contract to see where the whole agreement was and to see what we could do better." Those involved in the refresh "threw out" things—such as the focus on scrap systems—that were not necessarily applicable anymore. McPherson added, "While scrap reduction was a key Desired Outcome of the original agreement—we had clearly met those goals and in 2017 it was no longer a focus area. Rather than focusing on the cost of scrap systems, we felt it was now more important to focus on velocity and rewarding FedEx Supply Chain for moving product into finished goods. You know there are several things that affect processing speed and, subsequently, how often the sales team has fresh product available for potential customers."

The parties ultimately settled on three Desired Outcomes that would set the direction for the future of the Dell-FedEx Supply Chain relationship. The new Desired Outcomes are:

- Make every customer experience excellent by identifying and eliminating quality issues. This includes maintaining applicable Dell environmental and data security requirements, and reducing waste in the remanufacturing process.

- Optimize inventory levels while maximizing the net recovery of consumer returns.
- Enable solutions to increase the Global Dell Outlet's revenue and margin.

Jeff Spodnik, an industrial engineer at FedEx Supply Chain, notes the revised Desired Outcomes "are much simpler and cleaner." One of the key Desired Outcomes is to optimize inventory levels while maximizing the net recovery of consumer returns. The logic behind this was to incentivize FedEx Supply Chain for how efficiently they manage the end-to-end reverse logistics process and return products to Dell's stores as available for resale. This focus on velocity allows Dell to maximize their recovery of the original cost of the computer during the resale process.

Finally, the parties created an incentive tied to throughput cycle time that rewarded the agreement based on higher velocities of moving product to the sales team. This single, simplified metric was identified by Dell as a key contributor in determining their recovery cost on refurbished technology that was being replaced at an increasingly faster pace.

## REFRESHING THE PRICING MODEL

A second focus area was to refresh the pricing model. It was apparent many of the assumptions used to build the original pricing structure had changed drastically since its inception in 2011. For example, computers and peripherals had become smaller and more complex in 2017 with the advent of the tablet and all-in-one as alternatives to the laptop and desktop. As such, the original pricing model had nearly become obsolete. The introduction of web cameras, touchscreens, and high-definition audio and video also created more complex testing requirements with quality standards higher than their counterparts of the past.

Both parties agreed a refresh of the pricing model was essential to keep with the spirit of Vested being a flexible contract framework to reflect the dynamic nature of the technology industry.

Spodnik was chartered to focus on the pricing aspects of the refresh. "The old pricing model worked well when Dell's business was less complex. But as Dell's business changed, the old pricing model was unable to adapt to the rapidly changing technology sector. There were also some real difficulties in managing the original pricing model. The original model was simple in concept, but the actual mechanics of the pricing model were quite complicated. While Porbandarwell had built a brilliant model that had worked fabulously during the early years of the relationship, it was simply too complicated to sustain—especially after Porbandarwell rolled off the governance team. One of my key roles as part of the refresh was to help create a pricing model that would not only adapt with changing business needs and drive the right behaviors, but also would be simpler to manage."

A key change to create more flexibility was that the generic "PC" or "Personal Computer" segment was divided into desktop, notebook, tablet and all-in-one categories. In addition, important cost and pricing distinctions were made between systems that needed major repairs as compared to ones that were "like new" and might only require new packaging to be resold.

A key principle in developing the new pricing model was to maintain the win-win spirit of the relationship. Spodnik says: “The new pricing model has 54 different options that are directly related to how much investment is required to prepare products for resale, disassemble for parts, or process in bulk for alternative sales channels. While the new model sounds more complicated, it is actually easier to update and maintain and, more importantly, better reflects the dynamic nature of the technology industry.”

## REFRESHING GOVERNANCE

The original design of the Vested agreement had a key goal for the parties to create highly collaborative relationship management and transformation management mechanisms that would enable the parties to break down silos—both internally and across the companies. McPherson asserts, “The Vested process did more than just align Dell and FedEx Supply Chain—it really helped align Dell. Our governance structure created mechanisms where we would come together and make decisions that supported the Desired Outcomes. It worked really, really well and enabled us to break down a lot of Dell internal silos in our quest to drive innovation in reverse logistics with FedEx Supply Chain. In fact, breaking down the silos and getting other parts of Dell talking together was one of the best things that came out of the Vested governance structure.”

McPherson admits that the early success was likely also a curse. “While Dell senior leadership was diligent about maintaining governance in the beginning, they ‘fell off the wagon’ over time because things were going so well.” He adds, “It was simply too easy to stop coming to governance meetings because people had more pressing issues that needed their focus. The result was the folks in the trenches were left to keep things going. The Vested “What’s in it for We?” mindset could have easily fallen off the track as John and I were really kind of just left in a state of limbo to self-manage.”

McIntosh observed how easy it was to lose focus. “Everything was going really well under the Vested agreement, and it was easy to take our eye off the ball. But this is a good lesson learned. Just because your car's running right doesn't mean it doesn't need maintenance. We began to realize the need to do the refresh—otherwise, we may start to treat the FedEx Supply Chain relationship the same as every other relationship, and the magic would disappear as we grew more and more misaligned over time.”

To make matters worse, as time went by both FedEx Supply Chain and Dell changed key resources that supported the Vested agreement. McPherson comments, “It seemed like every time we turned around, people familiar with the why and how of our Vested relationship began to leave or change roles. As new people came on, we forgot to go back and educate them on what Vested meant and why we had made the shift to Vested. This was especially true for anyone in the more senior governance roles.”

Mark Penniman was one of these “newbies” on the team. Penniman made the shift from being a Dell employee to being the Vice President of Operations for the Technology Solutions business unit at FedEx Supply Chain. While not entirely an “outsider” to the companies, he was new to the Dell-FedEx Supply Chain Vested relationship. “At first I was skeptical of the Vested model. Dell has had a reputation for being tough on its suppliers. But I would say that after three and a half years, I have seen the reality of Vested in action. It has provided benefits for both Dell and FedEx Supply Chain, and I have been encouraged by the Vested relationship since first learning about it."

Coleman agrees the parties did not do as good a job at onboarding folks like Penniman as they should have. "With Vested, it's a little bit more of a recipe of getting people acclimated and ramped up on the concept and how it works. We were good at this in the trenches, but we really missed onboarding at the more senior levels. By 2017, we found ourselves operating our Vested agreement in a vacuum where several of the senior leaders liked the results we had achieved—but truly did not understand why we did things in a different 'Vested' way."

## REFLECTING ON THE VESTED JOURNEY

Coleman shared a perspective that many at Dell and FedEx Supply Chain share when it comes to Vested: “Vested has taught us that in order for both sides to survive we have to be really honest with each other. I still remember the old days when we used to be in meetings and kind of dance around. We’d talk about what's going well and what is not going well. But now, we at FedEx Supply Chain truly have a vested interest in the success of Dell—and vice versa. We are comfortable telling Dell that for us to survive, we need Dell to get better at X or Y, or share specific information with us. And then they, in turn, say ‘thanks FedEx Supply Chain. If we want to survive, we need you to get better at doing A, B and C.’ And then we roll up our sleeves and get to work—together.”

Both companies admit that one of the biggest lessons learned is that they waited way too long to do a refresh. McPherson comments, “It took a long time because the unfortunate thing was, we had so many changes with new people, new roles. We would get out of the gate on the refresh and then have to restart. This really highlighted the weaknesses of our governance structure, because if we had been living into the governance we had designed, the refresh would have been a natural part of our governance cadence.”

While it took a while to make the refresh happen, Spodnik credits the refresh with making a much-needed focus to help the parties take their relationship to an even better place. “The refresh has really made some major strides, and it's definitely an improvement over the original agreement.”

Coleman is glad the parties stayed the course to complete the refresh to keep the Vested agreement up to date with the realities of the Dell-FedEx Supply Chain business environment. “It’s important to realize that business is dynamic, and that the relationship between a buyer and supplier needs to dynamically change with the nature of the business. The original Vested agreement gave us that flexibility, but with the fall off of governance we were slowly letting misalignment in. The refresh helped us get back into alignment by reevaluating how playing by Rules was different in 2017 than it was in 2011. The Rules are still just as valid as they have ever been, but the refresh allowed us to see that we needed to revise how we manifested the Rules to keep aligned and keep enabling us to have a win-win relationship.”

Coleman continues, “I think the cool thing is we continue to mature every year. In the original Vested agreement, it was about Dell and FedEx Supply Chain coming together as Vested partners. We were learning to truly collaborate, and the results have been spectacular. But now we're blurring in those lines even more. We are truly fighting on the same team. For example, I got invited to come down and be part of Dell's annual sales strategy meeting. That would have never happened before our Vested journey”[7]

## CONCLUSION AND NEXT STEPS

It was during the dog days of a hot August summer in Round Rock, Texas, that Dell and FedEx Supply Chain stopped thinking about “What’s in it for Me (WIIFMe)” and embraced Vested’s “What’s in it for We (WIIFWe)” mindset. The companies laid the foundation by challenging the status quo of their transaction-based business model. They took the time to understand the business, create mutually defined Desired Outcomes, and identify the Ponies. Next, they aligned interest with a sound pricing model that best allocated risk and rewards, ensuring that FedEx Supply Chain got its fair share when it drove innovation and made smart investments that generated a positive return on investment. From there, it was easy to establish the contract both parties knew would drive the right behaviors. And finally, they walked the Vested talk—actually living the agreement by applying sound governance mechanisms.

The change to Vested has morphed the two companies into a hyper-productive alliance. “We started out on opposite sides of the table in June—challenging each other and ultimately committing that a Vested approach made sense,” a former FedEx Supply Chain executive said. “Once we decided to move forward, we restructured the agreement in about four months and, by the end of the first quarterly business review under our Vested relationship, we had achieved impressive results.”

But what is equally impressive is that the parties have been able to sustain the positive momentum of their relationship after six years. “Our numbers speak for themselves,” McPherson says. “We're simply awesome. Period. And that's what we do, we continue to succeed. Vested has given us much needed alignment and win-win economics to drive true transformation initiatives.”

And a key part keeping the magic of their relationship alive is in recognizing Vested is not a “once and done” contracting process, but rather a methodology to seek continual alignment. Coleman explains, “The refresh process was a necessary exercise: It allowed us to revisit our desired outcomes. But more importantly, it allowed us to reflect on areas where we had grown apart and helped us rework key governance mechanisms, such as onboarding, executive churning and buy-in.”

McIntosh—who has been part of the Vested journey since its inception—reflects on the relationship after six years: “In 2012, we set out to rethink how we worked with FedEx Supply Chain to focus on total cost of ownership and drive innovation. Vested proved to be a sustainable model for both Dell and FedEx Supply Chain. Doing the refresh enabled us to keep the win-win nature of our relationship sustainable over time. And our lessons learned around governance will help us keep our eye on the ball to continue to bring innovative ideas to the forefront.”

Penniman adds, “The relationship is stronger than ever. Going through the Vested refresh process has enabled us to continue to seek alignment and develop mutually defined Desired Outcomes that will continue to be mutually beneficial to both Dell and FedEx Supply Chain.”

## ACKNOWLEDGMENTS

The University of Tennessee and the authors want to thank Dell and FedEx Supply Chain for their invaluable contributions to this case study.

We would like to give special thanks to John Coleman, Stephen McPherson, Jeff Spodnik, Brad Tarr, Rob McIntosh and Mark Penniman for their support and active participation in developing this case study.


## ABOUT THE AUTHORS

***Kate Vitasek*** is one of the world's authorities on highly collaborative win-win relationships for her award-winning research and Vested® business model. Author of seven books and a Graduate and Executive Education faculty member at the University of Tennessee Haslam College of Business, she has been lauded by World Trade Magazine as one of the "Fabulous 50+1" most influential people affecting global commerce. Vitasek is a contributor for Forbes magazine and has been featured on CNN International, Bloomberg, NPR and Fox Business News. You can reach her at kvitasek@utk.edu

**Karl Manrodt** is a Professor of Logistics at Georgia College & State University. The author of three books and over 50 scholarly articles, his publications have appeared in such journals as the Supply Chain Management Review, Transportation Journal, the International Journal of Physical Distribution and Materials Management, Interfaces, and the Journal of Business Logistics. Dr. Manrodt was recognized as a "2004 Rainmaker" by DC Velocity Magazine and in 2005 was awarded the Eugene Bishop Award for Sustained Academic Excellence by the College of Business at Georgia Southern University. He served on the Board of Directors for the Council of Supply Chain Management Professionals. You can reach him at karl.manrodt@gcsu.edu

**Jeanne Kling** is a Research Associate for the University of Tennessee, specializing in the Vested Business Sourcing Model, and is a graduate of the University of Tennessee's Certified Deal Architect Program. She has co-authored multiple case studies, white papers, and two books, including *Vested: How P&G, McDonald's and Microsoft are Redefining Winning in Business Relationships.*

**Bill DiBenedetto** is a Research Associate for the University of Tennessee. He is a freelance writer, ghostwriter and editor for a variety of online and print publications and companies. He lives in Seattle, Washington.

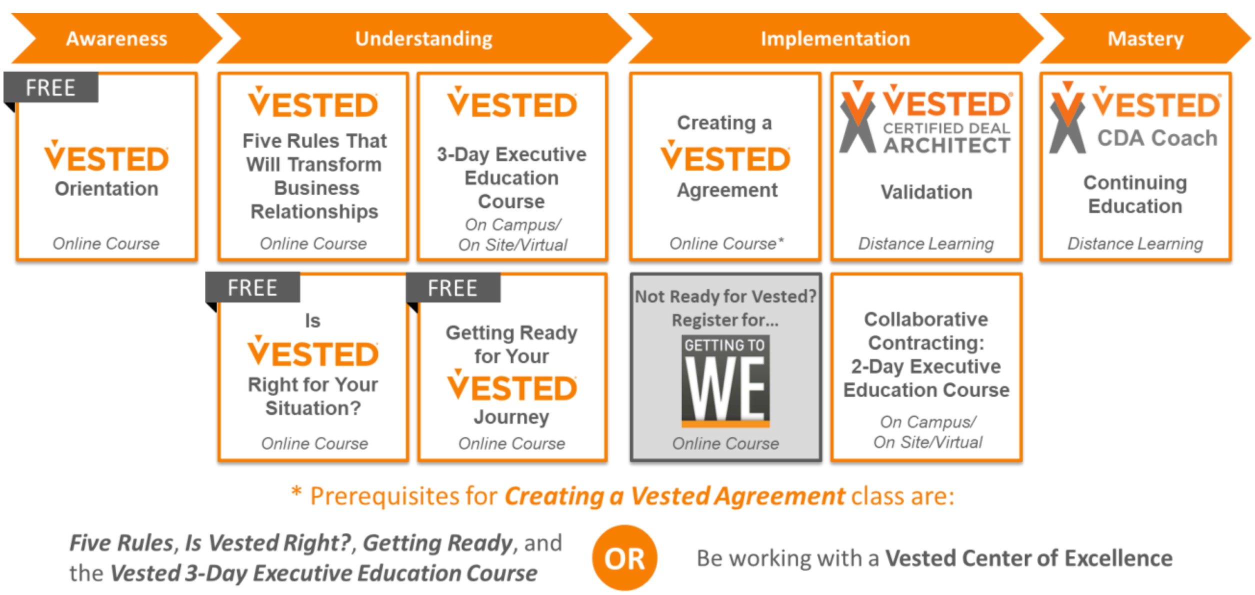
## FOR MORE INFORMATION

***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 in 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/](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](mailto:kvitasek@utk.edu).



## ENDNOTES

[1] "GENCO Is Being Rebranded to FedEx Supply Chain," January 11, 2017, FedEx Supply Chain. Available at https://supplychain.fedex.com/resources/genco-rebranded-fedex-supply-chain/

[2] August 14, 2012 interview with Darrin Browder by Kate Vitasek and Jeanne Kling. Browder is now Director Operations Americas Transportation and Logistics | ISM-Austin

[3] Interview with Raj Subramonian by Kate Vitasek, Alex Miller and Jeanne Kling, July 27, 2012. He is now Senior Vice President & General Manager of DJO Global.

[4] Interview with Jeanne Kling, Alex Miller, and Kate Vitasek on July 19, 2012.

[5] Interview with Tom Perry by Karl Manrodt and Jeanne Kling, August 8, 2012

[6] Interview with Steve Symmes, Jeanne Kling, and Alex Miller; June 11, 2012

[7] All of the quotes in this section are based on interviews conducted by Kate Vitasek and William DiBenedetto in July, August and September 2017.