“Outcome-based agreements: From pain to mutual gain”

In a fast-changing economic climate, organisations need a new style of supplier engagement targeted at successful outcomes and shared benefit

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More than ever, organisations need to squeeze all the value they can from their investments in IT systems and services. And, for CIO’s under pressure to cut costs, it must be tempting to squeeze at least some of those savings from their suppliers. The typically adversarial nature of such contract negotiations is somewhat Gladiatorial. However, while such battles may be appropriate for some commodity-level contracts, a combative approach can be damaging when it comes to the kind of projects you hope will deliver business goals in a revived financial environment. I’ve been convinced for several years that the key to the success of such strategic contracts is a new kind of engagement – outcome-based agreements (OBAs). Basing a proportion of what customers pay suppliers on agreed, measurable business outcomes can focus both parties on doing all they can to ensure any deal delivers ongoing business improvements and customer satisfaction.

Skin in the game
So why hasn’t the OBA model been universally adopted to date? One of the main reasons is such agreements are very hard to get right. They require firm but flexible governance and strong relationships based on mutual trust, openness and understanding. In the urgency to control costs, we perhaps find it easier to revert to the familiar adversarial style of contracting. This is especially ironic since now is the very time businesses need to do all they can to ensure agreements deliver the outcomes they want.

We’re not saying every part of every agreement should be outcome-based, That’s clearly not realistic. From the customer’s point of view, it certainly makes sense to base many deals primarily around cost – particularly when procuring commodity IT. And from a supplier’s perspective, it would be far too risky to agree that all our revenue will be calculated based on a customer’s business outcomes, since many of those outcomes depend on factors beyond our control. The point of OBAs is to tie the two (or more) parties’ financial destinies together just enough to ensure ongoing and real commitment, but not so much that your mutual fates can be sealed by the vagaries of the market. In practice that means the outcome-based element of the deal should generally constitute no more than 5% to 10% of the total – and maybe a smaller percentage on very large contracts.

However, I am convinced that OBAs are the way forward if we want to ensure our organisations are prepared to hit the ground running as the economy turns round. They reflect the kind of collaborative, mutually supportive business partnerships that will become increasingly key to success in the future, as a growing number of industry experts agree. For example, Fujitsu recently worked with IT industry analyst Intellect to create a guide to outcome-based agreements (see sidebar on next page). This research found there was a clear commitment on the part of the supplier community to move towards a model of engagement based on “business relationships with foundations strong enough to respond flexibly, creatively and positively to the inevitability of changing business and technology circumstances”.

In line with that, customers increasingly ask us for help to realise the benefits of their IT
“Suppliers and customers need to be prepared to go beyond platitudes and work together to build the genuine mutual trust and understanding necessary for success”

Outcome-based agreements defined

“An agreement between a customer and supplier in which the supplier is contracted to directly achieve business outcomes for and with the customer – rather than being contracted in terms of delivery of the supplier’s inputs, outputs or deliverables.”

(Intellect)

How do OBAs work in practice?

In the case of an outsourced ticket-sales website, for example, a traditional supplier contract would be measured by its success in delivering the site as specified; in an outcome-based agreement, it might be measured according to the number of tickets sold through the site per month. The outcomes defined should be intermediate, measurable ones like process performance or unit sales, not high-level business goals like ‘improving shareholder value’.

An outcome-based mindset

Parties thinking of striking an OBA need to ensure they enter the agreement with shared values, a stable and clear baseline against which the outcomes can be measured, a willingness to operate with openness and transparency, a standardised means of measurement and a clear set of accountabilities. OBAs will only ever be successful if both parties work to mitigate external risks, conduct full and ongoing due diligence, ensure effective governance, conduct regular mutual checkpoints and maintain aligned incentives.

What next?

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Download Intellect’s ‘Guide to outcome-based agreements’ at www.intellectuk.org/content/view/5109
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