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Outcomes-based contracts: Will suppliers step out of their comfort zones?

May 2010

A report released by Intellect, the trade association for the UK technology industry, shows that some vendors are beginning to move outside their comfort zone and dip their toes into more outcomes-based agreements. But just how far will suppliers go with this?

One of the first things you learn when advising vendors on their supply contracts is to never commit to achieve the customer's business outcomes. Outputs, functionality and services – that's fine. Business outcomes – never. Only commit to what you can control.

Well, the times they are a-changing. A report released by Intellect, the trade association for the UK technology industry, shows that some vendors are beginning to move outside their comfort zone and dip their toes into more outcomes-based agreements.[1] This trend is set to continue.

What is an outcomes-based agreement?

The report defines an outcomes-based agreement (OBA) as follows:

"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"

The report provides illustrations of what an outcomes-based agreement might look like. For example, in relation to the outsourcing of a website for online ticket sales, the traditional output-based contract would ensure delivery of a website that is operational and fully supported on a 24x7 basis. However, an outcomes-based agreement would measure the number of tickets sold through the website.

[1] *A guide to outcome-based agreements, A better way to do business.* This can be obtained from www.intellectuk.org.

All together now

A key requirement for outcomes-based agreements is close collaboration between the parties. As captured in the definition above, the outcomes are to be achieved "for and with" the customer. The big idea is that there will be a more successful contractual relationship when there is a shared commitment to achieve agreed outcomes.

This is helpfully summarised in the label "Vested Outsourcing", from Kate Vitasek's book of the same name. The label sums up the intent: the customer and the supplier becoming vested in each other's success. It is a move to a more collaborative relationship that fundamentally involves the supplier assuming responsibility for mutually beneficial outcomes, and not just being paid to perform certain activities or tasks.

There's outcomes and then there's outcomes

This doesn't mean you're going to see many (if any) suppliers committing to improve the shareholder value. The report advises suppliers to focus on "intermediate outcomes" such as process performance, unit sales or other key performance indicators. Suppliers are counselled to avoid being too ambitious and to target sensible, tangible and 'aligned to business' objectives. This all makes good sense.

The conditions must be right

To help de-risk outcomes-based agreements, the report suggests 10 pre-conditions that need to be in place for a mutually beneficial agreement. It provides that this highly strategic relationship must have:

- a foundation in shared values;
- a stable and clear baseline against which to measure the intended outcomes;
- openness and transparency, particularly given the inevitable changes in circumstances;
- standardised measurement, including a shared understanding of the performance causalities that underlie the outcomes; and
- clearly stated accountabilities.

To facilitate the right environment the report identifies the following pre-conditions:

- identification and control of external factors, using agreed policies for mitigating and controlling risk;
- full and ongoing due diligence;
- governance, with procedures that are flexible enough to constructively respond to unforeseen developments;
- frequent mutual checkpoints to measure contributions and progress and to act on issues; and
- incentive alignment and balance.

Needless to say, these pre-conditions present a fairly high threshold. Significant effort is required to design a procurement process that ensures that these foundations are properly laid.

Just how far will service providers go with this?

Will suppliers really take responsibility for outcomes that they can't fully control? For many suppliers, outcomes-based agreements will be a bridge-too-far. The risk-reward equation would need to be compelling for the supplier to take a punt, and then only if there's a high degree of certainty around the sort of pre-conditions noted above.

At a practical level, Fujitsu's David Rosewell captures what might emerge as a fairly typical approach to outcomes-based agreements (OBAs):

"The point of OBAs is to tie the two (or more) parties' financial destines 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." (Outcomes-based agreements: From pain to mutual gain)

Rosewell goes on to explain that in practice this would mean that the outcomes based component of the deal may only constitute 5% to 10% of the total (and maybe smaller for larger deals). Perhaps this type of approach will prevail, at least where the supplier lacks full control over the outcomes. It targets the benefits from the outcomes-based deal but recognises that suppliers will be reluctant to put all of their eggs in one outcomes-shaped basket.

We welcome your feedback on this article and any enquiries in relation to its contents. This article is intended to provide a summary of the material covered and does not constitute legal advice. We can provide specialist legal advice on the full range of matters contained in this article.

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