Vested Outsourcing and the Best Value PIPS Model

New concepts that will forever change procurement

In recent years, the concepts of Vested Outsourcing (as developed by University of Tennessee researchers led by Kate Vitasek) and the Best Value Performance Information Procurement System (Best Value PIPS, developed by Dean Kashiwagi at the Performance Based Studies Research Group of Arizona State University) have significantly gained in popularity. Leading private sector and public governments are not only beginning to use the methods, but openly endorse them as superior to time honored and tested traditional procurement approaches. Professional associations such as NEVI-Purspective are fully behind both methods, promoting both as ways to help procurement professionals propel the world of procurement to a better place.

In this paper the concepts of Vested Outsourcing (hereafter Vested) and Best Value PIPS (hereafter BV) are compared. Vested and the BV approach share many of the same principles. Both focus on the supplier’s expertise, both think win-win and both consider value above “price”. However, BV and Vested are distinctly different in their focus, application, methodology, and business needs. This article explores the similarities and describes some major differences of these two research-based approaches.

The fundamentals

At the heart of both the Vested model and the BV approach is helping organizations shift away from adversarial win-lose arrangements where one party benefits at the other’s expense. A Vested agreement is focused on creating a relational contract that creates a win-win relationship in which both parties are equally engaged in one another’s success, ergo they are vested in each other’s success. The BV approach also preaches a win-win mindset, but is primarily focused on helping organizations upfront through a competitive bid process that will yield a win-win transaction for both the buyer and supplier.

Both the Vested and the BV methods assume the parties are able to look beyond their own “silo” to create value – versus extract or simply exchange value through a traditional transactional approach. “Silos” are not desired; not between organizations nor within organizations. In this respect, both approaches look beyond the need of “procurement” in the client organization and focus on the needs of the business.

The organization as a whole (or better - the organizations as a whole) are the focus (instead of a certain department).

Both Vested and the BV approach staunchly promote moving beyond price to a philosophy of “best value” that balances other success factors (e.g. quality) into defining success. Both argue focusing on pure price is oftentimes unwise and creates a buyer that is “penny wise and pound foolish.” A key component of this is the emphasis on transparency and the use of metrics.

A final fundamental principle to both Vested and the BV approach is that they both assume the supplier is the expert who is more knowledgeable than the client on the goods or services that are being sourced. This will be elaborated in more detail later.
A deeper dive comparison

This paper explores the similarities and differences of Vested and the BV approach. We have chosen to draw the comparison using the “5 Rules” of the Vested approach to show where and how the models are similar and where they are different.

Vested Rule #1: Focus on outcomes, not transactions

Many conventional sourcing arrangements are built around a transactional model. Most often, this transaction-based model is coupled with a cost-plus or a competitively bid fixed-price-per-transaction pricing model where the supplier is paid for every transaction - whether it is needed or not. Thus, the more inefficient the entire process, the more money the supplier can make. The buying organization gets what it contracted, but perhaps not the best solution.

Vested operates under a desired outcome-based model, with the emphasis on having the supplier align its interests to what the client really wants. Instead of paying a supplier for "transactions" for various service activities, the company and its service provider agree on Desired Outcomes. Desired Outcomes are defined as something the client wants, but does not have; they are typically boundary spanning in nature and require the buyer and supplier to work in a highly collaborative manner. As such, Desired Outcomes are typically transformational in nature and require investment in product and process innovation. Desired Outcomes can take different forms. Some common Desired Outcomes are availability, reliability, cost structure reduction, revenue generation, employee or customer satisfaction, or even asset investment targets. In essence, the Vested model buys Desired Outcomes, not individual transactions. The supplier is paid based on its ability to achieve the (mutually agreed) Desired Outcomes.

The BV approach follows a similar school of thought. Central in the BV approach is the client who sets certain abstract goals, which can be a Desired Outcome, but often are supplier controlled dominant metrics such as output-based Service Level Agreements. Like Vested, the supplier focuses on the output or outcome, not on a certain transaction. In the BV approach, it is the supplier who defines the "level" in the Service Level Agreement. It could be that the client thinks "availability of IT" is important. The suppliers define the availability level they are capable of (e.g. 99.97%). This is inherently different from KPI's set by the client, which act as a minimal standard and which leads to less ways for vendors to differentiate themselves.

In both the Vested and BV methods, the emphasis is on eliminating opportunism. In the BV approach, a supplier is selected who thinks in the interest of the client. Suppliers who merely act in their own interest (as shown by a focus on transactions) will not be contracted. The Vested method takes this one step further, and formally creates a relational contract that embeds a shared vision and formal statement of intent with guiding principles that contractually binds both the buyer and supplier to behave in non-opportunistic manner.

Vested Rule #2: Focus on the WHAT, not the HOW

The Vested Outsourcing: Five Rules that Will Transform Outsourcing book shares the concept of the Outsourcing Paradox. Under the Outsourcing Paradox, a company outsources to a supplier because they are the “expert” and can do a better job – yet then defines the requirements and work scope very strictly. This is not logical: once an organization makes the decision to outsource, it should not make extensive Statement of Works or detailed specifications of how to do the work. The supplier – who is the expert - knows better what to do. It is simply foolish (and paradoxical) that the non-expert client tries to formulate a “perfect” Statement of Work that outlines the “how”.

Focusing on the what and not the how is a fundamental principle of both the Vested and BV approaches – as they both assume the supplier is the expert who is more knowledgeable than the client on the subject that is being sourced (the client does have its own expertise in the things that are not sourced). The assumption of “the supplier as an expert” requires a different kind of behavior from the client. First and foremost, both Vested and the BV methods argue:

- Not to write objectives, requirements, or specifications too tightly or too narrowly
- To allow for and encourage creativity of the suppliers
- To be open to new solutions and new approaches from the supplier
Both Vested and BV explicitly deal with accountabilities on both sides – meaning that each party has responsibilities for success. Sourcing to a supplier does not mean that the client can sit relaxed and wait for the supplier to do its job. In both Vested and BV, the role of the client is acknowledged. In the Vested methodology, the parties create a formal “workload allocation” where both the buyer and supplier are contractually obligated to their responsibilities. This is very different than a conventional statement of work, which traditionally outlines only the supplier’s responsibilities. In Best Value, the clarification phase is used to define workloads for both sides.

The Vested and Best Value approaches differ in their philosophy of how to apply the principle of “what, not the how”. In Vested the client oftentimes is interested in the “solution” (which the supplier proposes). However, in the BV approach, the idea is that a non-expert buyer should not be interested in the proposed solution at all during the selection phase. The BV approach argues the client should only be interested in the extent to which the supplier is able to realize his project goals. In the case of BV, metrics matter more than the technical solution. The only reason why the client wants to see the technical solution is to ask the supplier on the substantiation of this technical solution and possibly to verify it (not to “argue” or “rate” that technical solution). The BV approach works very well when buying value added solutions (e.g. when selecting a Preferred Provider who is expected to drive value added services to meet the client’s need) or when the buyer is wanting to create a Performance-Based / Managed Services agreement where the supplier commits to a key set of dominant output-based metrics to which they have control over the process. In this case, the solution really does not matter to the buyer. Of course, the solution of the supplier has to fit within the constraints as stated by the buyer.

**Vested Rule #3: Agree on clearly defined and measurable outcomes**

The third principle of Vested is to agree on clearly defined and measurable outcomes. BV – like Vested – emphasizes properly designed metrics to measure the success of the business relationship. Both Vested and the BV approach acknowledge that investing time up front (before the execution phase) is critical to ensure that neither the client nor supplier spends time or resources after implementation measuring the wrong things. Both also emphasize selecting a limited number of measures with a rule of thumb that “less is more”. Simply put – just because you can measure something does not mean you should.

The key differences between Vested and the BV approach are in the emphasis on the type of metrics and how they are established. In Vested it starts with the buyer and supplier to mutually develop clearly defined and measurable Desired Outcomes. Desired Outcomes may be controllable by the supplier - but most often they are linked to boundary spanning business outcomes, meaning that both the client and supplier share risk and accountability for achieving success. Once the Desired Outcomes are agreed on and explicitly defined, the supplier can propose a solution, pricing model, and governance structure that are best suited for achieving the mutually defined Desired Outcomes.

In the BV approach the supplier is the one who defines the extent to which it will realize the more abstractly defined project goals of the client. The client is the one who, during the selection phase, picks the supplier that shows the most dominant metrics. During the clarification phase, explicit definitions are established on how success will be measured. In this way, the client also agrees on the defined and measurable way the supplier realizes its project goals. The language of metrics within Best Value minimizes the need of the buyer to think, make decisions or have expectations.

**Vested Rule #4: A pricing-model with incentives that optimize the business**

Both the Vested and BV methods heavily promote looking beyond price. In both Vested and BV, the supplier can optimize their profit and the idea is the more efficient the supplier – the more potential for the supplier; however, no higher profits are guaranteed. Both suggest that a supplier should never take on uncontrollable costs to put itself in a position to potentially not be able to cover actual costs.

In the BV approach, the supplier earns additional profit by implementing their “own” solution or “own” way of working. By not having the client dictate how the supplier should work, the supplier gains autonomy and control over their work.
This very much follows a Performance-Based sourcing business model. In short – if the client is more efficient than the price they have provided, they will win with higher margins and the client wins with a lower price.

In a Vested model, the approach is different. First, Vested uses a pricing model – not a price or pricing. The pricing model is typically structured to cover the base services, flexibility for dealing with out of scope or unknown future services, governance and transformation. The economics are often treated more like a joint venture where the parties are transparently managing both top line and bottom line costs that are under scope of the Vested agreement.

A key technique of the pricing model is margin matching – with the buyer and supplier winning together – and losing together. Much like a joint venture, the supplier will reap the rewards of greater profitability when the parties work collaboratively to achieve the mutually defined Desired Outcomes. Like BV, the Vested method does not guarantee higher profits for supplier, but it does provide them with the authority and autonomy to make strategic investments in their processes and product reliability that can generate a greater return on investment than conventional pricing approaches might yield.

A significant difference between Vested and BV is that Vested shares risk and reward while BV states suppliers should never be made financially liable for client risks (or any uncontrollable risks for the supplier). While both staunchly agree that the supplier should never “write a check” for uncontrollable risk/client risks – the philosophies differ on how the parties treat risk. In Best Value, risk is managed by the supplier using the Weekly Risk Report to make things transparent. The Weekly Risk Report shows where the risks of the client have occurred and how the supplier is going to solve that. An example is when a server (which was supposed to be provided by the client) had not been delivered, a supplier stated that he himself can buy the server. This led to a cost increase (because it was a scope change!) but by acting pro-actively the supplier made sure that (despite the non-performance of the client) there was still an on-time delivery.

In Vested, the supplier often takes investment risk to drive innovation or transformation initiatives on behalf of the client. They are rewarded with a return on investment pending success. This motivates a supplier to invest in and drive innovation for the client. A Vested pricing model also almost always has incentives. While it can use penalties, the creators of the concept do not promote the use of penalties. Results from Best Value projects show that most of the times, it is the client who causes the risk. It would not be fair to penalize suppliers for risk caused by the client.

Lastly, in both cases, the focus is on minimizing the risks of the client. In BV, the risk mitigation process is done by the supplier (as he is the one who is the expert). This will lead to a big pay-off for the client as he contracts with a supplier who thinks in the interest of the client. Risk mitigation is organized by having a supplier work with Weekly Risk Reports. In these reports, the supplier is encouraged to make the non-performance of the client transparent. The supplier is an expert on doing the work under their span of control and has expertise on where similar clients encountered problems. Using the Weekly Risk Report, the supplier can steer the client towards a successful end result by making things transparent. In Vested, risk management and mitigation is typically led by the supplier, but is almost always done in a joint and collaborative manner. The mindset is that risks can also be opportunities and risks are allocated to the party most appropriate to take them. Risk premiums are assigned to the party bearing the risk.

Another difference between Vested and the BV approach is in the way risks and rewards are shared. As discussed earlier, both assume that client risks are not the responsibility of the supplier: client risks are not transferred to the supplier in both concepts. The difference is mainly on the incentive part. In Vested, there is an explicit role for sharing risks and rewards. In Best Value this is not made explicit, although the Best Value approach certainly gives the freedom and creativity for suppliers to come up with a proposal (e.g. in their Value Add plan).

Vested Rule #5: Governance structure should provide insight, not just oversight

In the early days of outsourcing, many companies made the mistake of simply throwing the work ‘over the fence’ to the supplier, with poorly defined requirements and often no performance metrics or service-level agreements. The downside is that many have gone to the other extreme.
Today, many companies often have a small army of program managers who micromanage their outsourced service provider. The same can often be said for some organizations who source for goods and not services, as witnessed by the rapid growth in “SRM” (Supplier Relationship Management) programs that have popped up in the last five years.

Both Vested and BV promote an “insight” versus “oversight” governance. Why? Because the supplier is deemed as the expert. If a company has done a good job picking the right supplier - a trusted expert in its field - why does it need a small army providing general supervision? Procter & Gamble refers to this bad practice as having a “shadow organization” and suggests that governance is a skillset. One of the key skills is to learn how to “let go” and work with the supplier to achieve business objectives versus micromanaging the supplier with a shadow organization – as this is both costly and frustrating to the supplier.

While both Vested and BV have similar philosophies, the application varies. In BV, the supplier comes up with dominant information that satisfies the client. Hence, the insight is done by the supplier. Oftentimes, we see client organizations trying to create this insight. This is seen as a waste, as an expert supplier should have the metrics and should be creating the insight. In Vested, the governance structure is a formal schedule in the contract with a jointly defined structure with mechanisms where the parties work together to achieve the mutually defined Desired Outcomes.

The emphasis of the governance is different as well. In BV, it is governing to the metrics, while in Vested the emphasis is on the need to manage the dynamic needs of the business in a joint manner.

**Major differences**

We have seen that although there are many similarities between the Vested and BV concepts, there are also differences when looking at the Vested Five Rules. In this section we go deeper into some fundamental differences between Vested and the BV approach.

**Origin and Focus**

The first notable difference is the history of where these models come from. In the simplest form, Vested comes from focusing on the relationship while the history of BV is on focusing on the selection of a supplier. Specifically, the Vested approach creates an outcome-based business model where the relationship is the focus. BV creates efficient output-based deals that are focused on driving best value and supplier accountability against dominant metrics (e.g. getting to a good performance-based deal). While Vested can be used to create performance-based deals focused on outputs and BV can be used for outcome-based deals – they typically are not.

Because the relationship is the focus of Vested, cultural fit of “relationship” plays a great role. This is important because Vested deals are primarily longer term in nature and often involve complex and highly interdependent outsourcing deals. The buyer and supplier must work closely together and the people aspect of the relationship is extremely important.

Focusing on the relationship is a fundamental difference between Vested and the BV approach. The importance of “relationships” is considered to be dangerous in the Best Value approach, as this makes the selection process more biased. Instead of relationships or cultural fit, the importance of “metrics” is stressed. In BV the “cooperation” between buyer and supplier means that both will perform the tasks that are assigned to them. This means the importance of cultural fit is diminished: as long as all team members do their assigned job, the end result will be good.

Because the relationship is not the focus on BV, cultural fit between buyer and supplier does not play an explicit role. If there is no cultural fit, but metrics show that the supplier has successfully operated in a similar (culturally unfit) environment, the supplier can still be selected.

**Application**

The second key difference is in the application of the models. The Vested and BV approaches both are used for more complex sourcing initiatives. In the case of Vested, the emphasis is around long term multi-year relationships, typically where the buyer and supplier have a high degree of co-dependency through integration of processes and/or technology. As such, the Vested methodology is primarily used for sourcing complex outsourcing (services) relationships. The Vested methodology can also be used for highly strategic products (McDonald’s with their beef, chicken and baked goods suppliers) where shared risk/reward and unique offerings/solutions are essential. A key point is that each Vested
deal is unique in its own way as the situation at the client is always unique.

The BV approach primarily focuses on complex projects (e.g., construction projects or IT projects; although the Best Value approach is also being used for buying multi-year services). From the eyes of the client, these projects are complex and unique, yet there is always a similarity to a previous project from the supplier’s point of view. Central to the BV approach is to utilize expertise; the supplier should have some prior experience or expertise in a similar kind of project. In this way, BV works best in an environment where there is uniqueness from the point of view of the client, but where the supplier can use his expertise from previous projects. In fact, the supplier is “customizing” his solution for a new client (instead of inventing a totally new solution).

While Vested can also be applied to complex projects (see the Minnesota Department of Transportation and the Department of Energy closure project case studies), and BV can be applied to multi-year relationships (e.g., Food Services at Arizona State University), in practice Vested is more applied in multi-year relationships and Best Value more in complex projects. The higher level of effort in contracting and post-contract management typically steer buying organizations away from Vested unless the project is truly long term in nature.

When
The third key difference is that the BV approach pays more attention and detail to the selection phase while Vested is focused on the contracting and post-contract management of the relationship.

The BV approach is almost used exclusively in competitive bidding situations where the buyer has not yet selected the supplier. The BV method is very detailed on finding and selecting the most suitable supplier (using the Level of Expertise plan, the Risk Assessment plan, the Valued Added plan and interviews). The Vested approach is almost always used in the post-supplier selection contracting phase. In fact, the Vested method is used mostly in “flips” where a buyer and supplier are choosing to restructure an existing relationship/contract to a more strategic relationship with the intent to drive innovation against mutually defined Desired Outcomes.

How
Probably the most notable difference is in the methodology itself. While both offer a structured methodology, the processes are very different. The Vested methodology uses a structured process where a cross-functional “deal architect” team from the buyer and supplier co-create a relational contract following the Vested 5 “rules” and the 10 contractual elements. The University of Tennessee teaches buyers and suppliers how to “architect” complex Vested deals to create a sustainable and value-creating relationship with the purpose to drive innovation and transformation.

Under the Vested methodology, the buyer and supplier team take an online “Creating a Vested Agreement” course, with a step-by-step approach for the parties to create their Vested agreement. Organizations that want action based learning/consulting help work with Vested Center of Excellence such as NEVI-Purspective - which acts as a neutral third party “coach” for the buyer and supplier. The focus is on alignment on interests, and not buying-sell- ing and getting to a deal.

The BV method consists of 3 phases: the selection phase, the clarification phase and the execution phase. The BV method describes in detail the steps of the selection phase. The Contracting Officer from the client side drives the selection process. Suppliers are asked to send in 3 short documents (Level of Expertise plan; Risk Assessment plan and Value Added plan). In this phase the interviews with key personnel take place. The method describes the steps in detail, with the focus on “metrics”.

The clarification phase is an essential part of the BV approach. In this phase the supplier makes his offer more concrete. In this phase the supplier is completely in the lead. He lays out his plan from A to Z (preferably from Z back to A, as an expert starts at the end).
The clarification phase has a number of prescribed activities. Essential of the BV approach is that the client in essence buys the supplier’s plan: the supplier cannot be held accountable for what was not in his plan. In this way, the supplier writes his own contract: the result of the clarification phase is the contract.

In the execution phase the supplier manages his own work, but also manages the client (instead of the other way around). The supplier uses a system of Weekly Risk reports to create transparency. The management style is “management by exception”. Although the focus of the BV approach is the clarification phase, the BV approach is most detailed in the selection phase.

**Business Need**

The fourth key difference involves the business need of the buying organization. As stated with Vested Rule #2 – Focus on the WHAT, not the HOW – clients who use the Vested methodology often are highly interested in the supplier’s “technical solution” (which the supplier proposes or is co-developed with the client). This is because the focus in often on transformation and innovation, and the solution must be something the client can or will be able to live with.

In the BV approach, the idea is that a non-expert buyer should never be interested at all in the proposed solution during the selection phase. The client should only be interested in the extent to which the supplier is able to realize his project goals. There is a clear difference here: in Vested the client is interested in the supplier’s solution, in the BV approach the client is not interested in the solution, but in the metrics of this solution.

In addition, while discussed in Vested Rule #4 - Pricing Model - Vested and BV approach risk differently. The Vested method seeks shared risk/shared reward for the supplier for achieving mutually agreed business outcomes. The BV approach seeks an efficient way to select the most appropriate supplier focusing on dominant supplier controlled (output-based) metrics.

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**Conclusion**

In this paper the concepts of Vested and Best were compared. Vested and the BV approach share many of the same principles. Both focus on the supplier’s expertise, both think win-win and both consider value above “price”. However, BV and Vested are distinctly different in their focus, application, methodology, and business needs. In the table on the next page the similarities and differences are summarized. The most fundamental difference is that Vested focuses on building and establishing trust within the relationship, where BV focuses on metrics. We encourage organizations to try each of these concepts and see what works best for them in each specific buying situation (a fit for purpose).
### Vested Outsourcing and the Best Value PIPS model

<table>
<thead>
<tr>
<th>Vested</th>
<th>Best Value PIPS</th>
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| **Origin** | • University of Tennessee  
• Arizona State University |
| **Focus** | • Win/win deal between client and supplier  
• Focus is the relationship  
• Win/win deal between client and supplier  
• Focus is the supplier’s accountability to metrics |
| **What** | • A mindset, methodology and business model for creating outcome-based business relationships  
• Primarily longer term complex relationships (e.g. outsourced services), with unique conditions at the client side  
• Can also be used for highly strategic, asset specific or unique products or projects |
| **Main Application** | • Focus is the relationship  
• In output-based deals |
| **Method of collaboration** | • Joint plan and joint responsibilities  
• Supplier has its own plan and has its own responsibilities (client also has its own responsibilities) |
| **How** | • Uses a structured methodology where a cross-functional “deal architect” team from the buyer and supplier co-create a relational contract following “5 rules” and 10 contractual elements  
• Uses a structured 3 phase methodology: selection phase, clarification phase, execution phase. Dominant theme in all 3 phases is “metrics” |
| **Basis for contract** | • Mutual trust  
• Contract is written together  
• Metrics  
• Contract is written by the supplier |
| **When** | • Heavy focus on Contract and Post Contract phase  
• Used mostly in “flips” where a buyer and supplier are restructuring an existing relationship/contract to a more strategic relationship  
• Heavy focus on Pre-Contract phase, supplier selection  
• Used mostly in competitive bidding situations where the buyer has not selected the supplier |
| **Business Need** | • Shared risk/shared reward for achieving Business Outcomes  
• Client if often interested in the supplier’s “solution”  
• No shared risk (risk is allocated where it ‘belongs’)  
• Creation of efficient way to select supplier focusing on dominant supplier controlled (output-based) metrics  
• Client is not interested in the supplier’s “solution” |
| **Examples** | • Microsoft (Outsourced Finance Operations)  
• P&G (Outsourced Facilities Management)  
• McDonald’s (supply chain strategic commodities – e.g. beef, chicken, baked goods)  
• U.S. Dept. of Energy (Environmental cleanup/disposition of nuclear facility)  
• Dell (Outsourced Reverse Logistics)  
• Vancouver Coastal Health (Outsourced Environmental Services)  
• Minnesota Department of Transportation (construction)  
• Discovery Health Medical Scheme (outsourced claims and managed care)  
• Ministry of Transport in the Netherlands (road infrastructure)  
• Achmea Healthcare the Netherlands (selecting preferred suppliers for cataract surgery, breast cancer treatment, birth care)  
• State of Hawaii (e.g. roofing projects)  
• University of Alberta (e.g. design and construction of student housing projects)  
• State of Oklahoma (e.g. Commercial Off the Shelf Tax Software (COTS))  
• City of Rochester (building of schools)  
• Arizona State University (e.g. food services, bookstore, Information Technology Networking) |
| **Website** | www.vestedway.com  
www.pbsrg.com |