Five Rules That Create Better Contracts
Is There a Better Way?

“The significant problems we face cannot be solved at the same level of thinking we were at when we created them.”

- Albert Einstein
The Contracting Paradox

Original Wright Brother’s Contract (1908)

Contracts and Pricing

Signal Corps, United States Army

These Articles of Agreement

Wm. L. Wright and Orville Wright, to the

United States Army, to furnish and deliver

an airplane of the type and description

hereinafter specified, as specified in the

Schedules hereto attached, as to the

quantity, and as to the price per unit,

and as to the quality, and as to the

specifications and terms of delivery,

and as to the terms of payment,

as set forth in the Schedule attached

hereto, to the United States Army,

at the price of $10,000, payable in

seventy-five dollars, which shall be

paid in the manner and at the time

hereinafter specified,

and as to the delivery of the airplane

and as to the acceptance of the airplane

by the United States Army,

and as to the performance of the

contract,

and as to the execution of the

contract,

and as to the enforcement of the

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and as to the interpretation of the

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Transactional “Buying” Has Inherent Weaknesses

Source: Scott Adams, creator of popular Dilbert cartoon. Please see dilbert.com site for more great Dilbert cartoons.
The Best Had A Different Mindset
What Game Are You Playing?

Jones Lang LaSalle and Procter & Gamble Finalize Real Estate Outsourcing Agreement

CHICAGO and CINCINNATI, June 17 /PRNewswire-FirstCall/ -- Jones Lang LaSalle Incorporated (NYSE: JLL) and The Procter & Gamble Company (NYSE: PG) today finalized a 5-year agreement for one of the most geographically diverse assignments to outsource corporate facilities management and project management services. Already the world’s largest provider of property management services and a leader in business process outsourcing, Jones Lang LaSalle will now manage all P&G-owned and leased corporate real estate -- a total of nearly 13.8 million square feet (1.28 million square meters) of offices and technical facilities located in 60 countries on six continents. Consistent with P&G’s continuing efforts to focus on its core consumer products business, Jones Lang LaSalle will provide a comprehensive range of property management and strategic occupancy planning services as well as Transition nearly 600 employees by January 2004.

The transition process will begin in the United States, where employees and properties located in 20 states and 35 cities will be under management by Jones Lang LaSalle by September 1. The business and employee transition for other countries will occur between November 2003 and January 2004, subject to appropriate government and regulatory approvals. The first transitions to occur in November include properties located in South America, Australia, Canada, Japan, Malaysia, Philippines, Singapore, Thailand and parts of Europe.
Strategic Sourcing in the New Economy

• Based on a decade + of research by the University of Tennessee

• Challenges procurement leaders to include more modern thinking into their procurement practices

• Introduces Sourcing Business Models theory – and provides a step-by-step roadmap for putting the theory into practice

Source: STRATEGIC SOURCING IN THE NEW ECONOMY: HARNESSING THE POTENTIAL OF SOURCING BUSINESS MODELS FOR MODERN PROCUREMENT, Keith, Vitasek Manrodt & Kling, Palgrave 2015
Oliver Williamson: Transaction Cost Economics

The conventional approach sees procurement as make vs. buy decision. If you buy, you use “the market”.

- **Buy**
  - Use “The Market”

- **Make**
  - Create “Corporate Hierarchy”
Oliver Williamson: Transaction Cost Economics

“All complex contract will be incomplete.” Use a “hybrid” approach with “Mutual advantage” to align interests.

There is a whole playground in the middle!

Buy
Use “The Market”

“Hybrid” Approach

Make
Create “Corporate Hierarchy”
Sourcing Business Model Theory

**Source:** STRATEGIC SOURCING IN THE NEW ECONOMY: HARNESsING THE POTENTIAL OF SOURCING BUSINESS MODELS FOR MODERN PROCUREMENT, Keith, Vitasek, Manrodt & Kling, Palgrave 2015

**Sourcing Continuum**

**BUY**
- **“Market”**
  - Basic Provider Model
  - Approved Provider Model

**“Hybrid”**
- Preferred Provider Model
- Performance Based / Managed Services Model
- Vested Business Model
- Shared Services Model
- Equity Partnerships

**MAKE**
- **“Hierarchy”**
  - Approved Provider Model
  - Preferred Provider Model
  - Performance Based / Managed Services Model
  - Vested Business Model
  - Shared Services Model
  - Equity Partnerships

**Transactional**
- Basic Provider Model
- Approved Provider Model

**Relational**
- Preferred Provider Model
- Performance Based / Managed Services Model
- Vested Business Model
- Shared Services Model
- Equity Partnerships

**Investment**
- Basic Provider Model
- Approved Provider Model
- Preferred Provider Model
- Performance Based / Managed Services Model
- Vested Business Model
- Shared Services Model
- Equity Partnerships
The Best Followed Five “Rules”

1. Outcome-based vs. transaction-based business model
2. Focuses on the what, not the how
3. Clearly defined and measurable desired outcomes
4. Pricing model with incentives that optimize the business
5. Insight vs. oversight governance structure

Source: Vested®
Rule 1

Outcome-Based vs. Transaction-Based Business Model
Based on research with…

Source: http://www.youtube.com/watch?v=5-QCigFrsA0
"Rebuild the bridge by December 24th, 2008"

Tim Pawlenty

Former Governor
State of Minnesota
The Desired Outcomes

- **Safety** – safe project area
- **Quality** – reduce future maintenance costs
- **Schedule** – open for use by Dec 24th, 2008
- **Environmental Compliance** – minimal impacts to the environment while using context sensitive solutions
- **Budget** – maximize return on taxpayer investment
- **Aesthetics** – incorporate bridge into surrounding environment

*Source: MnDoT RFP*
Challenging The Process

**DESIGN / BUILD**
(Single Source Responsibility)

MnDOT shifted their approach to a “Design-Build” process that would accelerate the process and enable the contractor to make key design decisions. Saving years over the traditional competitive bid process.

Audio Source: Mn Public Radio Archives “New 35W bridge construction starts before design is finished”
http://archive.mprnews.org/stories/20070824/new-35w-bridge-construction-starts-design-finished
Focus on the
What
Not the
How
Based on research with...

Source: YouTube Ally Bank "Bike" commercial
Based on research with…
A Flexible Foundation Grounded In The Actual Contract

“Seek ways to accelerate cleanup actions and eliminate unnecessary tasks and reviews, by requiring that the Parties work together.”

“Proved the flexibility to modify the work scope and schedules, recognizing that priorities may change due to emerging information on the site conditions, risks and resources.”
DoE Rocky Flats Closure Project
Based on research with...
Clearly Defined and Measurable Desired Outcomes

You got to be very careful if you don't know where you're going, because you might not get there.

Yogi Berra
In their words...

Performance Indicators
   Critical
   Key

Discretionary Metrics
   Relationship Assessment
   Key Projects / Deliverables
   Innovation

Matt McClish
Purchasing Group Manager
Procter and Gamble
Rule 4

Pricing Model With Incentives That Optimize the Business
Based on research with… What Makes It Work!

Source: www.youtube.com/watch?v=VCspMIDPESQ
Using Incentives Is Not New

Wright Brother’s Contract Example (1908)

• Target price: $25,000
• Target speed: 40 MPH
• Incentive:
  • For every MPH over the target, contractor receives an additional $2,500
  • For every MPH under the target, contractor loses $2,500
  • Minimum speed requirement: 36 MPH
• Results
  • Final delivered MPH speed: 42 MPH
  • Incentive actually earned: $5,000
Rule 5

Insight Vs. Oversight Governance Structure

ME  WE

Manage the Business… Not Just the Supplier
In their words...

“None of us is as good as all of us.”

Ray Kroc
Founder
McDonald’s

Source: http://www.biography.com/people/ray-kroc-9369349
CASE STUDY

McDonald’s Supply Chain

Based on research with...

• “McDonald’s... [is] far more rigorous in checking for bacteria and dangerous pathogens. They test the ground beef they buy five to ten times more often than the USDA tests beef made for schools during a typical production day.”

Who ran out of chicken during the Asian Avian Flu crisis?
The Results Are Real...

- P&G (Real Estate/Facilities Management)
- Microsoft (BPO)
- McDonald’s (Supply Chain)
- U.S. Dept. of Energy (Environmental Services)
- State of Minnesota Dept. of Transportation (Construction)
- Integrated Management Services (Staffing)
- Diversey (IT)
- Water for People (non-profit NGO support in developing countries)
*In their words...*

“The benefits of doing Vested are so apparent.

We have not had these kinds of results anywhere else in the world.”

**Todd Shire**  
Logistics Sourcing Strategy Manager  
Intel
Based on research with…

MnDOT I-35 Bridge Rebuild
Based on research with...

- 25% under original budget of $350 Million
- Public savings of $800k a day for early opening

I WIN with lowest possible costs

- Fee was highest among bidders but best value for lowest total costs
- Achieved full fee with maximum incentive pay ($27 million)
- Many awards for excellence and innovation

Completed in eleven months
- Innovations like concrete formula improved future work
- Smart Bridge technology provides vital data winning many awards
- Expedited construction with zero safety accidents
- Redundant Design – if one part fails, the bridge won’t fail

I WIN Bridge Users

Vested Really Does Work!

I WIN Supplier

Many awards for excellence and innovation

Expedited construction with zero safety accidents

Completed in eleven months
- Innovations like concrete formula improved future work
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I-35 Bridge Rebuild
A Real Winner...

- 2009 Grand Prize America’s Transportation Awards
  American Association of State Highway and Transportation Officials
- 2010 Award of Excellence
  Federal Highway Administration
- 2009 Best Overall Award
  Design-Build Institute of America
- 2009 Project of the Year
  American Public Works Ass’n
- 2009 Grand Award
  Associated General Contractors of America/Aon
- 2009 Celebration of Engineering and Technology Innovation Award
  FIATECH
- 2009 Build America Award
  Associated General Contractors of America
- 2010 Bridge Design Award of Excellence
  Portland Cement Ass’n
- And, 8 More National, prestigious Awards!
MEMORANDUM FOR CHIEF ACQUISITION OFFICERS
SENIOR PROCUREMENT EXECUTIVES
CHIEF INFORMATION OFFICERS

FROM: Daniel I. Gordon
Administrator for Federal Procurement Policy

SUBJECT: “Myth-Busting”: Addressing Misconceptions to Improve Communication with Industry during the Acquisition Process

With expenditures of over $500 billion annually on contracts and orders for goods and services, the federal government has an obligation to conduct our procurements in the most effective, responsible, and efficient manner possible. Access to current market information is critical for agency program managers as they define requirements and for contracting officers as they evaluate the industry’s ability to meet those requirements. However, there are often unwarranted assumptions about the information that is available, the costs of collecting that information, and the capabilities to be found in industry. This memorandum is designed to address some of these common misconceptions and to identify how these misconceptions can be overcome to improve communication with industry during the acquisition process.
What Is YOUR Mt. Everest?
Reach Out With Questions!

Kate Vitasek
Faculty, Univ. of Tennessee Graduate & Exec Education

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