CHAPTER 3

RULE #1: FOCUS ON OUTCOMES, NOT TRANSACTIONS

Adam Smith, an eccentric Scottish academician at Glasgow University, observed human propensity for self-interest and formulated the law of supply and demand in 1776 with the publication of *An Enquiry into the Nature and Causes of the Wealth of Nations*. His theory said that society benefits as a whole from a multiplicity of trading transactions because humans seek what is best for them, resulting in fairness and honesty among equals. As demand for repeat transactions emerged, trading preferences evolved and modern transaction-based business models were born. These transaction-based business models have been the cornerstone of conventional business relationships ever since.

Transaction-based thinking is widely adopted in today’s outsourcing business practices. Conventional outsourcing agreements typically focus on negotiating agreements at a detailed per-transaction level, by paying either for a business task (cost per pick, cost per minute of call) or on a per-headcount basis. Unfortunately, many business professionals wrongly assume that a transaction-based business model is the most cost-efficient model. *For simple transactions with abundant supply and low complexity, a transaction-based business model is likely*
the most efficient model. But real weakness in transaction-based approaches emerges when any level of added complexity, variability, and mutual dependency is part of the transaction. A transactional approach cannot produce perfect market-based price equilibrium in variable or multidimensional business agreements.

To make matters worse, procurement philosophies introduced in the 1980s, such as the Kraljic model, encouraged businesses to selfishly use buying power to condition the supply chain and force a change in the demand curve to lower dependency on service providers. The ultimate objective of the buying approach is to trigger lower-cost entrants into the market and force reductions in price and, by default, validate the make/buy decision. The more companies applied dominant win-lose behaviors, the more service providers hunkered down to protect their margins. These heavy-handed transaction-based approaches lead to perverse incentives and missed opportunities to innovate that were outlined in Vested Outsourcing.²

A heavy-handed transaction-based approach can be lucrative in the short term if the buyer gets away with it; however, it is completely inefficient over the long term, especially where a service provider will need to make investments in business infrastructure that require trust and cooperation to deliver results. For this reason, organizations have been exploring other types of sourcing business models that challenge the Kraljic model.

This chapter has two purposes. First, it ensures that you fully understand what an outcome-based business model is so you can determine if it is right for your organization. As you work through this chapter, be prepared to document your business model to ensure that all parties fully understand its nature and agree that Vested Outsourcing is the right choice for your business. Second, this chapter helps you take the first step in crafting your agreement by providing direction to help you create a Shared Vision statement and the associated Statement of Intent.