



An Outcome-Based Business Model

By Robert Gelinus

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Outcome-Based Business Models synchronize vendor and client goals, eliminate adversarial dynamics, and create the best opportunity for a true “win/win.”

Allies Not Adversaries

When Ross Perot left EDS/GM and founded Perot Systems, one of the first market segments his new company sought to serve with IT Outsourcing services was the data center operations of State Governments. What was unique about his approach was that his pricing model wasn't based upon traditional man-hour rates, headcount, flat project fees, etc. Instead, he simply asked to be paid as a percentage of the current operational cost savings he created with his services.



In effect, if Perot could reduce an organization's existing IT operating costs by, say 30%, and he took a percentage of that, then the net savings was still a good deal for the client—with no “breakeven point” that had to be achieved at some theoretical point in the distant future before appreciating the savings, plus the cost of the operation was coming from existing budgets, and therefore already funded. Plus, the more Perot was able to save them, the more he made.

A scenario like this puts both the vendor and the client into a business model of mutually compatible and synergistic goals. The client values the tangible and desirable goal of lowering their costs/expenses, whereas the vendor believes their value proposition could genuinely result in major new operational efficiencies. But rather than the vendor telling the client that they have to pay X in order to receive benefit Y, i.e. direct cause and effect, in Perot's case, instead they made X a factor of Y. If Y (benefit produced), then X (payment).

This logic effectively takes off the table the notion that the client could potentially end up paying X cost but maybe not receiving Y benefit as promised, essentially having to bear all the risk of the relationship and financial investment alone. But the synergy of this approach goes further, creating the opportunity that the vendor might even deliver results superior to Y, and thereby increase their own ROI (2X?), by virtue of the business model structured to be in the vendor's best interests to do so. More value delivered to the client means the greater the vendor's reward.

Fees for service as a percentage of savings isn't the only example of this principle. In some instances, direct costs savings might not be a practical objective – e.g. where an incremental investment is what is required to achieve a greater business goal. That doesn't mean that an Outcome Based Business Model is precluded.

For example, what if the goal for the client is to generate a specific revenue goal; or to achieve a certain degree of Gross Margin, Net Operating Income (NOI), Profitability, or Earnings Per Share (EPS); or perhaps to bring a deliverable product or service to market by a specific target deadline that gives the client a competitive advantage in their own market. What about an Annual Growth Rate (AGR) target? All of these goals can have a compensation component for the vendor who is able to make them happen.



Shared Risk

The obvious downside to the above thinking is that there exists the potential to shift virtually all of the risk of success over to the vendor, away from the client. If the proposition is purely – “We’ll guarantee your success, Mr. Client, and after we do, then you can pay us” – who wouldn’t want that deal?

Sure, there’s always the inherent risk of operational disruption arising from any significant change to an environment or process, but one would think that after some proper due diligence, if you are talking about a credible vendor relationship that you would consider using anyway, if all other considerations are equal, and the only difference is a pricing structure that puts all the performance obligations on the vendor with no advance financial risk to the client until the success has been achieved – that’s a very compelling business proposition.

To be clear: the extreme interpretation of this idea here is analogous to the home contractor who tells you that their labor and materials are free until the job is done, when you’re 100% happy, and *then* you pay. Unfortunately, the only vendors/contractors who offer such “deals” are those who are supremely confident in what their work will produce, the carrying cost of the job is not cost-prohibitive, and the risk of the client not being happy when done is highly unlikely.

This approach may be reasonable for small-scale endeavors. But what about large, enterprise-class undertakings that might be months or even years in scope, involving many fulltime personnel and resources, where the ability to defer vendor compensation to the very end isn’t a financially viable strategy? Is an Outcome-Based Business Model still an option?

Yes.

When You’re Lost, Buy a Map

Embarking on a year-long or more, six- or seven-figure project, or multiple overlapping projects long-term, and doing so starting from scratch with a brand new third-party vendor, can appear to be a very risky proposition in terms of having any reasonable assurance of long-term success—regardless of how well-reputed or experienced a vendor is that you may be considering using. The vendor may do everything right themselves, but a client’s own organization may have idiosyncrasies and nuances that just don’t integrate well with outside parties that create stumbling blocks and potential risks.

Plus, as noted above, it might be completely unreasonable/unviable for any outside vendor to be willing to take on most or all of the financial risk of a major, long-term endeavor prior to the execution and production of all deliverables and results.

In all likelihood, the client has some idea of what they wish to achieve, even if the roadmap to achieving it working in concert with an outside party isn’t fully understood. The client may, indeed, have some idea of what it would take if they did it all themselves, hired and deployed all of their own resources, obtained all the requisite tools and implemented all the necessary best-practice processes, etc. But knowing those facts is what likely prompted the client to seek out third-party help in the first place – i.e. in an effort to reduce costs, accelerate time frames, and produce a stronger result. But the exact parameters of what it would take for a third party to achieve the client’s goals in terms of time and money and operational process are completely unknown. And even if these variables were fully known, i.e. coming in the form of a traditional bid, a budgetary figure and target deadline does nothing to mitigate any of those risks and concerns associated with assuring long-term success.

So how can this dilemma be resolved? Enter the expert Business Analyst.



All the pertinent variables in the “master equation” in terms of what needs to be accomplished and what it will take to do it successfully can be quantified. Moreover, the business drivers that served as the catalyst for initiating and approving the project(s) themselves can be identified and quantified – i.e. in terms of the goal of increasing revenues and/or productivity, producing better margins, lowering operating costs, generating higher EPS, etc. All of that data can then be synthesized into a Total Cost of Ownership (TCO) / Return on Investment (ROI) model.

That TCO/ROI Model can then serve as the foundation for an incremental Project Plan, broken down into phases/milestones, whereby “Success” can then be defined and quantified, not in terms of a single end result, but in terms of sequential achievements that a vendor can then potentially viably shoulder, taking on a measure of that risk and/or make an investment with sufficient confidence that their own operating costs are neither cost prohibitive nor is the outcome of the incremental deliverable uncertain.

For the client’s benefit, the production of this Gap Analysis, TCO/ROI Model, and Project(s) Development Roadmap is a relatively small investment in terms of both time and money – ***which is an investment that needs to be undertaken regardless of who ends up doing some or all of the work.*** That’s Key to understand.

Thus, the risk mitigation strategy becomes simple and clear:

- 1) A client should first invest in a Development Roadmap, predicated upon objective and highly quantitative Business Analysis within the context of Client Defined Business Objectives
- 2) The Roadmap then provides the Basis/Foundation for Incremental Win/Win Outcome-Based Business Model Transactions, with Shared Risk and Investment
- 3) Vendor Integration and Partnering can then be evaluated moving forward based upon Pilot/Test projects to establish effective communication and collaboration processes, and the trust and confidence necessary to proceed with the execution of the full Development Plan

The Best of All Worlds

Outcome-Based Business Models, with shared risk and investment, is the most financially advantageous and lowest risk scenario for a Client-Vendor relationship – for both parties. It is possible to enjoy such a business model, even in the context of large-scale business objectives if approached with the proper strategy and an incremental and evolutionary development process.

About the Author

Robert Gelinas is the President and CEO of JPE Inc. Consulting (www.jpeincconsulting.com). He has spent over 20 years in the IT industry as a senior executive and sales and marketing leader, having built many national and international Enterprise IT sales and marketing organizations. He has both an extensive Fortune 500 background as well as a wealth of successful Start-Up experience. He is also a published novelist, writer, publisher (www.archebooks.com) and frequent public speaker on both IT marketing and the writing and publishing industry.