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Best Practices for Outcome-Based Pricing:

How New Partner Model Can Deliver Wins to MSOs

WHITE PAPER

Best Practices for Outcome-Based Pricing: *How New Partner Model Can Deliver Wins to MSOs*

MSOs face increasing pressure to improve quality and efficiencies, reduce costs and enhance customer experience, are relying more and more on specialized partners for critical post-sale supply chain services.

Managing this growing network of partners can be daunting, to say the least. One of the biggest challenges is ensuring the goals your partners are pursuing are aligned with your strategic direction. Doing so requires partners to be accountable for driving targeted business outcomes.

So how can you accomplish this? The most effective way is by using pricing models that incentivize partners to perform. However, the traditional models most companies use are designed for budget control, not accountability. That's why many businesses are exploring outcome-based pricing, where partners share your risk and rewards.

Outcome-based models are incredibly appealing to key business stakeholders. They can also be challenging to implement since they're a new concept for many organizations, and figuring out how to balance budget requirements with pay-for-performance pricing is complex. The good news is that, by following best practices around planning, measurement, structure and collaboration, you can get on the right path to success.

Pricing Models At-a-Glance

To appreciate the benefits outcome-based models can deliver, it helps to compare them to traditional resource-based and transactional pricing.

Resource

These models are structured as per minute, hour, week or month for each resource. They work well for outsourcing specific functions and securing a pool of experienced people to complete work. You manage them by tracking productivity of resources to ensure you're only paying for actual utilization. The downside is that forecasts generally need to be locked in 60-90 days before work is performed, so heavy administration is required to track forecasting, triggers for adding or reducing staff, training and overtime rates. In addition, performance measures focus on productivity, and any conversations you have with partners about how to improve business outcomes often circle back to a resource discussion.

Transactional

Transactional pricing models have embedded productivity control, as you scale volume and pay partners only for work performed. Partners generally assume responsibility for flexing resources when volumes fluctuate. To help ensure staffing levels are maintained, transactional models include tiered pricing and minimums. This type of model is less burdensome for you, since partners take on more of the administrative work. You're also more likely to have business-level discussions, including driving to outcomes such as improving revenue and reducing cost.

Outcome

Innovative outcome-based, pay-for-performance pricing models are more sophisticated. They tie payment of services to a positive business result. They also require a much heavier commitment on your part, as well as your partners', and a clear understanding of process, performance and costs.

Outcome-based models operate on two levels:

- Pay-for-successful transaction model: By paying the partner per successful installation, service order or returned asset, for example, you pave the way to broader business objectives. For instance, increases in improved asset recovery drive reductions in capital spend. This model incents partners to push for more successful outcomes so they can achieve their own financial goals, and helps ensure a baseline of performance.
- Pure outcome model: You share success once broader business objectives are achieved, such as when your company reduces annual capital spending for new equipment by 20 percent. Payments to partners may be structured as monthly milestone payments and scaled on percent attainment.

RESOURCE-BASED

Pay for resource applied to a service

- Structured per minute/hr./wk./month
- Based on headcount and utilization
- Required forecasting in advance
- Multiple rate tiers for training, production, and overtime
- Highly administrative
- Less focus on business outcomes

TRANSACTIONAL

Pay for transactions worked

- Only pay for transactions processed
- Tiered pricing and minimums
- Built in productivity
- Partners flex to address volume fluctuations
- More focus on business outcomes

OUTCOME-BASED

Pay for business outcomes

- Payment is based on successful transactions (e.g. installations, resolutions, equipment returns)
- Service provider shares in ownership and incentive to improve results
- Shared success when broader goals are achieved

Best Practices for Outcome-Based Pricing

The following best practices can help you build a successful outcome-based model that balances achieving business objectives with adhering to budget parameters, and functions as a collaboration between your organization, the procurement team and your partners.

Internal Alignment

Due to the complexity of setting up and managing outcome-based pricing models, all key stakeholders must be aligned. Business owners and procurement teams, in particular, must be in sync. The relationship between savings and improvement and payouts to vendors does not always have a clear connection for procurement partners who are tasked with getting the best price and value from partners.

Planning and Communication

Early, candid communications between you and your partners about business goals and metrics are critical for pay-for-performance models. Do your partners understand your business objectives? Are the goals achievable? When they're agreed upon by all parties, you're much more likely to succeed.

It's important that goals are not ambiguous. The more specific they are, for instance, tied to defined segments, business units, geographies and/or time frames, the more likely they are to be met. For example, a goal might be reducing cost-to-serve for new broadband customers in the Pacific Northwest region by 10% in Q4 2017.

Baselines and Measurements

The old adage 'you can only improve what you can measure' is certainly true for pay-for-performance models. One of the most important steps in introducing an outcome-based model is clear measurement of baseline and ongoing performance. You need 100% transparency in order to alleviate ambiguity and concerns about loss of control and profitability, both for you and your partners.

This new model, where pricing is driven by collaborative, cross-functional process management, requires business to change how and what they have been measuring. Instead of managing process vertically to SLAs, you manage process horizontally to business outcomes. The gold standard is to measure casual-effect, applying randomized control trials. This helps build buy-in and trust. Keep in mind that a change of results over time is rarely causal-effect, and may reduce levels of trust in the results.

Questions to address include:

- What is the current baseline for performance?
- What are specific goals for improvement?
- How can each partner contribute to business objectives?
- Are you ready to take your partners' suggestions for improvements?
- Is data available to measure performance fairly and accurately?
- Who will provide reporting and at what frequency?
- How will exceptions or conflicts be addressed?

Structuring a Plan

Each element of an outcome-based pricing model should be structured with success in mind. While scaling payments based on levels of performance can be a great way to incentivize partners, models that are extreme can backfire.

If the risk/reward model cuts too deep when partners don't achieve goals, they'll be hamstrung and unable to make investments to improve results. Likewise, if a reward or bonus model is too rich, it can be a budgeting nightmare that results in a quick RFP back into a traditional cost-based model. Scaling payouts should be done in the spirit of risk/reward driving the best results.

Anticipating the Unexpected

Plan for events outside your and your partners' control, that could impact performance or accurate measurements. Everything from IT initiatives like new ERP, CRM or billing systems, to new management, warehouses, channel and partners in the eco-system, to budget freezes, are normal events that have a temporary impact on performance. For this reason, it is critical to structure outcome-based models with contingencies. Have an agreed-upon, neutral fallback position for payment that allows work to continue uninterrupted and partners to get paid while impacts are assessed and plans are made to get back on track.

Committing to a Partnership

With multiple competing priorities, it can be easy to let partners who are achieving a minimal level of performance 'coast' from month to month. But that doesn't serve your purpose.

Outcome-based pricing is not a set-and-forget model. It's extremely interactive and requires commitment by you and your partners to continually work together toward a common goal. It requires thinking differently about how you measure success, and working with your partners to institute those new measures throughout your service supply chain.

Think about outcome-based pricing as a partnering model that drives business value versus a pricing model that stands alone. If performance is not where it needs to be, it often takes a partnering approach to get things back where they need to be. For companies that are resource constrained and don't have the time or inclination to work with partners on improvements, traditional pricing models may be a better choice.

Walk Before You Run

Many companies aren't set up for pure outcome-based models. If that's the case for your business, a graduated, walk-before-run approach may be the best way to go. For instance, you could begin partner engagements with a traditional pricing model for a six-month-or-so period, and then add or replace part or all of that with outcome-based pricing. During the initial period, your vendor could use data analytics to identify current KPIs so they can later make recommendations for process improvements over the vetted baseline, as well as identify if the currently measured KPIs are actually the right KPIs to measure.

To learn more about how to plan and implement successful outcome-based partnerships, contact OnProcess at **508-623-0810** or visit **www.onprocess.com**.

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