



# CONTRACTING *in the* NEW ECONOMY

Companies are turning to formal relational contracts to boost collaboration and drive innovation with strategic suppliers.

BY KATE VITASEK AND DAVID FRYDLINGER

The phrase “the new economy” was popularized in a 1983 cover article in *Time*, titled “The New Economy,” which described the transition from heavy industry to a technology-based economy. More than 40 years later, the phrase is still used to describe recent business trends and evolutions affecting how organizations do business. If the global pandemic taught us anything, it is that the phrase “business as usual” has been replaced by “business happens.”

Today’s new economy is characterized by faster, more complex, and intertwined trading partner relationships. The need for flexibility is paramount. But so is the need for innovation and sustainable supply chain solutions. In truth, supplier relationships are crucial to a company’s long-term success. Yet today’s business leaders are facing a dilemma—traditional purchasing approaches and contracts don’t work in complex strategic relationships where the parties are highly dependent on each other, future events can’t be predicted, and flexibility and trust are required. Conventional approaches undermine—rather than promote—the partnership-like relationships needed to cope with uncertainty.

### **The contracting paradox**

Of all the many traps and possible pitfalls in negotiating a complex contract, one of the most insidious is the “contracting paradox.” The contracting paradox is the delusion that we write contracts to make plans, but we cannot actually plan accurately. And, as a nice twist, we trick ourselves into believing we can plan.

Why is the contracting paradox such an easy trap to fall into for contracting, procurement, and outsourcing management experts? As experts, their task is to write forward-looking

contracts that attempt to cover every risk and limit every possible liability. In short, they strive for the complete contract that addresses every “what-if” possibility. But despite their best efforts and contracts, they are not bulletproof—and never will be.

The global pandemic has brought the contracting paradox to the front and center for many supply chain professionals. Simply put, complex contracts are inherently incomplete. It’s not possible to plan for every contract eventuality. Instead, it’s time to embrace a flexible contracting framework designed to keep the parties continually aligned when “business happens.”

We—along with other thought leaders like Nobel Laureate and Harvard University Professor Oliver Hart, and leaders of World Commerce and Contracting—are challenging organizations to rethink their procurement and contracting approaches for their most crucial supplier relationships. But rethink to what?

The book “Contracting in the New Economy” shares dozens of leading research studies that point the way to using a formal relational contract. After nearly two decades of research into relational contracts, the University of Tennessee collaborated with World Commerce and Contracting to put a definition to the concept. It is as follows.

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*A legally enforceable written contract establishing a commercial partnership within a flexible contractual framework based on social norms and jointly defined objectives, prioritizing a relationship with the continuous alignment of interests before commercial transactions.*

The hallmark of a formal relational contract specifies mutual goals and establishes governance structures to keep the parties' expectations and interests aligned over the long term. So, when business happens—there are guiding principles and processes to help the parties work through whatever the new economy can throw at them in a collaborative manner.

### **Five steps to a relational contract**

Researchers at the University of Tennessee developed a simple five-step process for creating formal relational contracts. The five steps are as follows:

*Step 1:* Lay the foundation

*Step 2:* Co-create a shared vision and objectives

*Step 3:* Adopt guiding principles

*Step 4:* Align expectations and interests

*Step 5:* Stay aligned

Combined, the steps shift the focus on negotiating from “this deal” to how the parties can collaborate to create success in the relationship. A linchpin for success? Before you ever start negotiating any aspects of the deal (step 4), slow down and negotiate the foundation of your business relationship.

### **Step 1: Laying the foundation**

This phase focuses on negotiating the foundation of the relationship first and then proceeding to the details. Establishing a partnership mentality is pivotal to sustainable cooperation. When both parties begin the negotiations with the genuine partnership as a formal (written) feature of the contract, it creates room for trust, transparency, and high-level aspirations to flourish—rather than an inherently adversarial mindset. Laying this foundation focuses on outcomes, not transactions, in the earliest phase of the partnership.

### **Step 2: Co-creating a shared vision and objectives**

This starts with identifying specific goals and concerns. Then, these specific desired outcomes are complemented by clearly defined relationship-management processes. Finally, both parties (not just the one with the upper hand) need the space to explain their desired outcomes and goals as well as tactical and measurable objectives. This can be thought of as focusing on the what, not the how. Essentially, in step 1, negotiating parties agree to go on a journey together; in step 2, they draft a roadmap for where they both want to go.

### **Step 3: Adopt guiding principles for the partnership**

Once parties have clearly defined a set of measurable outcomes, adopting guiding principles can help preemptively steer away from potential potholes. These principles are designed to avoid value-eroding friction in the partnership at all costs. No one wants to be treated unfairly—or leave themselves open to exploitation. Likewise, the more unknowns in the picture, the higher the risk. Another phase of the negotiation tries to head off tit-for-tat behavior and preemptively rewards reciprocity.

### **Step 4: Align expectations and interests**

While we can think of the guiding principles as a compass telling us which direction we're going in, aligning expectations and interests demands more instruction. We need more detail than an arrow pointing north, south, east, or west; it's time to hammer out the details. This demands full transparency and applies to all terms and conditions of the relational contract, such as responsibilities, pricing, metrics, etc. It also underlines a problem-solving mentality instead of a negotiation mentality.

### **Step 5: Stay aligned**

Staying aligned requires robust governance mechanisms that hold the contracting parties accountable for living to their intentions. Think of it this way: if the shared vision and objectives are the beacons of the relationship, governance provides the structure and mechanisms for the parties to stop and redirect their efforts when detours occur. This involves both formal and informal governance mechanisms.

From research to results

A growing number of organizations, such as BP, are successfully reimagining their strategic relationships using the University of Tennessee’s formal relational contracting process.

BP has a long history of outsourcing facilities and real estate management services. BP’s total facilities management portfolio includes more than 132 locations in 20 countries—most of which were outsourced to four primary service providers. Like most organizations, BP’s procurement organization used a competitive bid process to test the market to ensure it received the best deal from suppliers. The bid process was named Project Apollo, and a request for solutions (RFS) was issued to seven supplier candidates who could potentially manage over 6.8 million square feet of BP’s corporate real estate.

When Wendy Cuthbert joined BP as global head of workplace solutions in late 2019, Project Apollo was well underway. She thought to herself. “We have some really good suppliers—but we are not challenging ourselves to think outside the box.” Cuthbert came to BP as an outsider. “We were issuing an RFP to the same suppliers using the same approach we had in the past,” she recalls. “So, nothing was really changing besides the fact that we had structured to bid where the smaller parts could potentially be bundled with a global supplier. We hadn’t looked at different sourcing models such as Vested. I tapped into my network, and one of my old commercial managers suggested I contact the University of Tennessee to learn about the Vested methodology for creating a formal relational contract.”

The team got a boost when Bernard Looney took the helm as BP’s CEO in February 2020. Looney’s vision was the most far-reaching transformation in BP’s 112-year history—to transform it from an international oil company to an integrated energy company by shifting BP’s focus

from producing oil and gas resources to one that delivers energy solutions. BP aims to become a net-zero company by 2050 or sooner.

After much soul-searching, BP decided to do something never done before at the company—create a formal relational contract. The first step on the journey would be to pick a partner to help BP reimagine its entire workplace solutions and ultimately help contribute to the zero-emissions goal.

Laying the foundation

Mike Jackson, BP sourcing manager, was the lead procurement person on Project Apollo. He remembers how the nature of discussions with potential suppliers changed as BP moved into the final supplier selection phase of the RFP, where BP would begin to lay the foundation of the partnership.

“One of the things we learned from working with the University of Tennessee is that culture fit was essential when picking a partner. When we issued the final phase of the RFS, we consciously assessed the potential partners using six criteria as part of the Partnership Assessment. In essence, the Partnership Assessment helped us quantifiably score the fit and cultural potential of the partners.” (See Figure 1 for high-level criteria used.)

It would also mean having more transparent discussions. For Jackson, the concept of creating guardrails upfront was strange. “In Vested, we were taught to

FIGURE 1  
BP partnership assessment criteria

PARTNER ASSESSMENT CRITERIA	
CRITERIA	FOCUS
Alignment to BP values	Did the supplier demonstrate an <b>alignment</b> to BP values and culture?
Alignment to vested approach	Did the supplier demonstrate an <b>understanding</b> of vested and approach the session in this manner?
Confidence and trust	How confident are you in the supplier on delivery and do you <b>trust</b> in the supplier's <b>capabilities</b> ?
Adaptability and flexibility	Did the supplier approach the session in an <b>adaptable</b> and <b>flexible</b> style?
Responsiveness	How much did the supplier <b>listen</b> and <b>respond</b> to feedback given from the check-in session? Did they respond appropriately to our written questions?
Innovation	How well did the supplier demonstrate <b>innovative</b> ideas?

Source: Authors



be transparent and put our guardrails on the table to begin with. It felt weird because, for a traditional procurement person, when you say we will share our guardrails, that's a big no-no normally because you are taught to keep our position close to your chest so you can use it for leverage. However, when you think about it, it really pits the buyer against the supplier. So, while setting guardrails upfront felt weird, it worked well and helped us get great results," he said.

Commercial real estate firm JLL was ultimately selected as the partner of choice during the first week of June 2020 with the goal of working with BP to reimagine workplace solutions across the globe. Dominic Soocoormanee, JLL's sales and solutions development director, was excited about where BP was headed. "BP had been on track to buy the same services in exactly the same way using the same type of contractual relationships. BP's reimagined mandate—combined with the UT Vested methodology—created the perfect storm

relational contract. A cross-functional team of BP and JLL worked side-by-side to translate the intent of the relationship into a win-win contract that applied the key constructs of a relational contract.

### Co-creating a shared vision and objectives

Alignment of the relationship kicked into first gear when BP and JLL began to create their shared vision and create desired outcomes for the partnership. Early in the process, BP and JLL began brainstorming names for their partnership. The name that stuck was "wevo," short for workplace evolution. Figure 2 shares the wevo shared vision and six high-level desired outcomes that would become the *raison d'être* for the partnership.

### Adopting guiding principles for the partnership

Besides defining the end-game shared vision and desired outcomes, the partners also adopted guiding principles

FIGURE 2

## Wevo shared vision



Source: Authors

for driving real change in how BP delivered workplace solutions. This was very exciting to JLL," he said.

A key part of that perfect storm was shifting from four primary suppliers with the goal of having one global supplier that would transition in waves. In addition, it would mean BP and JLL would create a joint deal architect team to create BP's first-ever formal

for the wevo partnership, which were formally incorporated into their contract. But the guiding principles were far more than just words in a contract; they were the basis for making fair and balanced decisions for all aspects of the contract and are used post-contract signing to guide the parties' behaviors for working together. Figure 3 shares the wevo guiding principles.

Dave Benbow, JLL global account director, reflects on the power of the guiding principles. “The guiding principles are huge benefits because they are not smoke and mirrors. They are fundamental to how we should work together as a partnership. When we started to look at the partnership through the lens of the guiding principles, it forced us to think and act with the mindset of ‘what can we do together’ and ‘how can we create an environment that is truly a sustainable win-win.’ The guiding principles set the tone for everything we did,” he said.

### Align expectations and interests

Once the parties laid a strong foundation for the partnership, they began developing the commercial aspects of the agreement, agreeing on the partnership’s scope of work and economics.

A big step for the partnership was deciding to leverage the scale and expertise of both organizations to benefit the partnership. This meant rethinking the scope of the partnership—ultimately combining both real estate and facilities management under one umbrella and truly creating a global deal for the first time in BP’s history of outsourcing workplace services. The scope was vast—spanning 47 sites across 18 countries throughout EMEA, America’s, and APAC regions. Facility types ranged from BP’s expansive corporate campuses and

the sprawling Pangborn R&D facilities to strategic data centers. It even included a single one-story childcare facility in Houston.

This step included co-creating a win-win pricing model. Some of the key features of the pricing model are as follows:

FIGURE 3  
Wevo guiding principles

Reciprocity	In respecting one another’s strengths, we will strive to make exchanges that are <b>mutually beneficial to the parties</b> . We will not make any demand upon the other that we ourselves are not willing to return in kind. We recognize that reciprocity lies at the heart of this relationship.
Autonomy	In keeping with the obligation of autonomy, we acknowledge that it is our combined strengths that will lift partnership to a higher level and that <b>neither party will seek to use its power to unfairly influence</b> the other to act against its future interests and those of the partnership. Our goal is to create a respectful win-win culture through freedom, transparency, and trust and we will work as equals in one team delivering workplace solutions to BP.
Honesty	We will strive to have <b>respectful, genuine, and sincere</b> conversations at all levels within the relationship. We encourage authenticity and empower everyone to share their opinion. We will look for the greater good and the value that can come from accepting all points of view.
Loyalty	We will strive to <b>value the other party’s interests</b> to the same extent that we value our own interests. We will seek ways to make the relationship fair and balanced mutually.
Equity	We will strive to <b>reward</b> each party in <b>proportion</b> to the <b>value, risk, or investment</b> made into the relationship and its success. We acknowledge that we will face unpredictable situations. We will work within our governance structure to remedy any identified and agreed inequities.
Integrity	Integrity enables companies to <b>trust in each other’s words and actions</b> . To achieve extraordinary results, our collective words and actions must be aligned with our joint vision and Guiding Principles. We commit to the highest ethical standards and do what is right for the greater good of the relationship.
Celebration	We will <b>celebrate, appreciate, and acknowledge</b> each other and recognize great work/achievements. We will create a space to support and celebrate the Wevo behaviors, achievements as well as individual’s special milestones.

Source: Authors

- Fully transparent “cost-is-the-cost” mantra.** Full transparency enabled the parties to identify the true cost drivers for both organizations and to create a model that incentivizes JLL to drive down cost and reward JLL for achieving non-cost-related desired outcomes such as helping BP achieve its zero-emissions goal.

- **Ensure cost savings are not prioritized over quality and safety.** The pricing model included “unlock” targets based on certain conditions; a safety lock meant that JLL must achieve a certain safety threshold to unlock other incentives.
- **Both monetary and non-monetary incentives.** Contract extensions, recognition/reference cases, and expanded scope as non-monetary incentives are included.

### **Stay aligned**

As mentioned, staying aligned requires creating robust governance that holds the contracting parties accountable for living up to their intentions. Governance mechanisms include:

- a tiered management structure with a formal cadence;
- dedicated key personnel in key leadership roles with a defined process for the continuity of resources;
- peer-to-peer “two in a box” communications with an emphasis on problem-solving at the lowest levels;
- relationship management processes and formal relationship health monitoring processes;
- formal issue resolution management processes;
- formal processes for managing continuous improvement and innovation ideas; and
- formal contractual change management processes.

BP and JLL signed the wevo agreement in November 2021, with the entire process taking five months. The parties then set out to onboard team members with new ways of working.

BP’s Erika Chiuhan and JLL’s Chimene van de Rest found working under the relational contract refreshing. Chiuhan and Chimene assumed a two-in-a-box partnership role for managing continental Europe workplace services. Chiuhan explains what it means to be two-in-a-box partners: “To me, a two-in-a-box partner means there is an equal effort and an equal level of seniority and decision-making on both sides. So you have an informed client and a professional service partner looking at the same outcome.” Chimene agrees: “It’s a partnership, so I feel comfortable moving forward and in how we make decisions as we have the same goal and expectations. And we talk about it a lot, so we know what we can expect from each other.”

The wevo team is now past transition and well into their transformation efforts. To date, wevo team members have partnered to deliver more than 100 projects in the first year. They are also breaking safety records—with the United States achieving zero recordable incidents. At the time of writing this case study, there have been more than 1,000 nominations for both individual and team acknowledgments.

Cuthbert challenges organizations to rethink their traditional approaches to outsourcing: “The traditional way of working with suppliers, I’d like

to think has had its day now, and people will start seeing the real benefits of working alongside business partners in a mutually win-win relationship rather than it being one-sided.”

### **Tips for starting the journey to relational contracting**

Since rolling out the Vested methodology for formal relational contracts in 2010, relational contracting has been gaining traction. While BP and JLL are only in the second year of their relationship, dozens of other organizations have had ongoing success. For example, the University of Tennessee has 20 formal case studies from 36 organizations, with another 32 other organizations being open/public about their success.

As organizations shift to relational contracting, we recommend individuals who play a role in forming or managing business relationships and start writing contracts by reflecting on how relational contracting can improve the results for the organization. Here are four strategies organizations can start implementing in the journey toward relational contracting.

1. *Arm yourself with facts about transactional and relational contracts.* Investigate whether you suffer from problems in your transactional contracts and analyze whether the problems can be understood. Investigate your most successful commercial relationships and analyze whether success may result from using relational contracting elements.

2. *Involve the right stakeholders.* Upper management should become aware of the potential advantages and economic upside associated with relational contracting. Make them your allies and sponsors.

3. *Start with lower-risk contracts and call it a pilot.* That’s a good way to de-risk and build a success story from which you can continue using relational contracting for bigger, more business-critical contracts.

4. *Be patient with naysayers and skeptics.* Relational contracting will probably meet resistance, regardless of the evidence of its advantages in many situations. However, hesitation should not be confused with bad intentions. Instead, try education as the change agent. The good news is that a growing body of research, writing and case law supports relational contracting.

### **The bottom line**

The bottom line? It is your bottom line. Getting contracts right can create millions—if not billions—of dollars of value. But getting them wrong can cost millions of dollars when the parties become misaligned. Therefore, it is time to put past practices, beliefs, policies and contract templates aside and embrace contracting for the future in the new economy. This does not mean abandoning transactional contracts; rather, it means adding relational contracting to your toolkit when best fitting. ☺☺