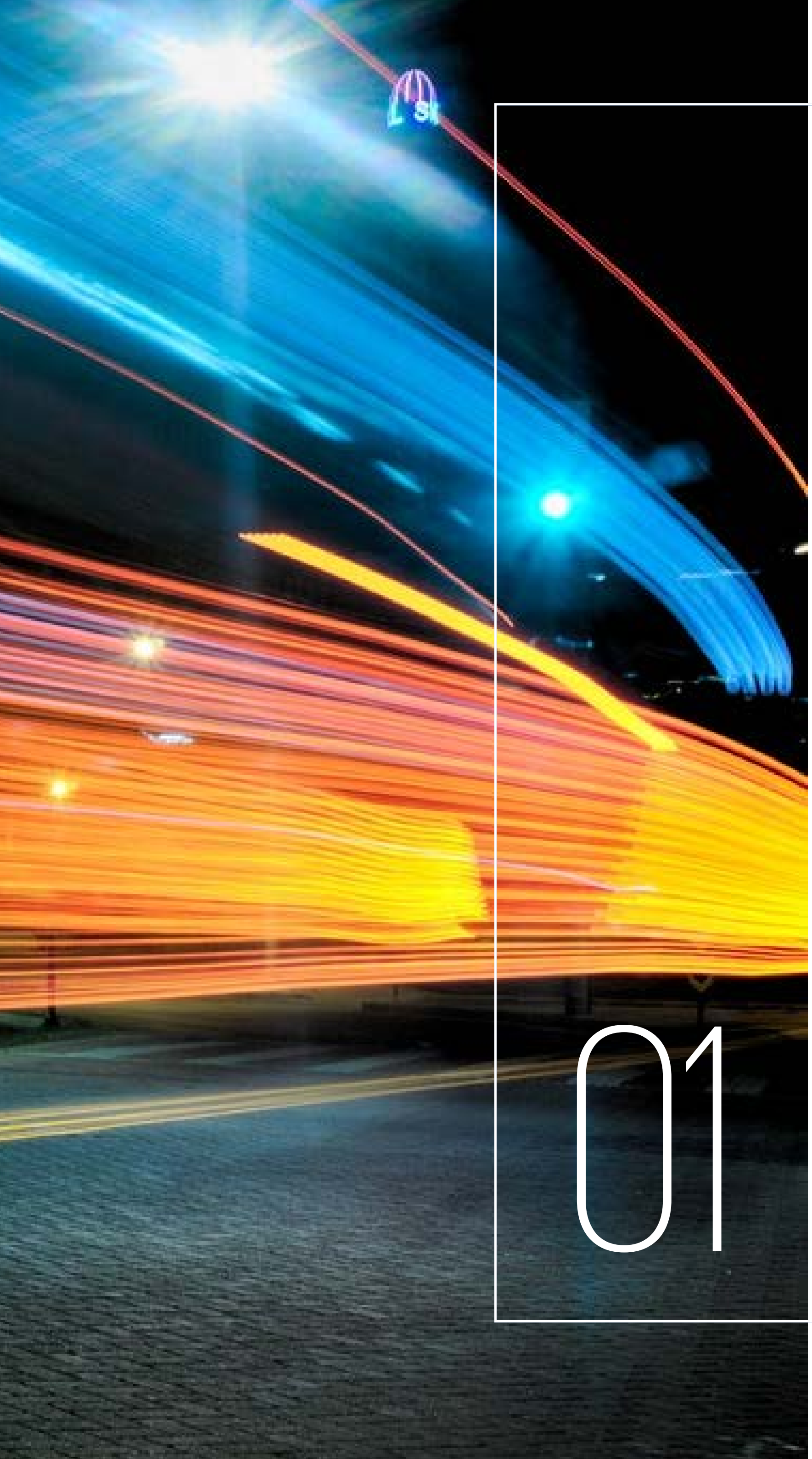
KPMG

Contracting for Agile

Finding a better way

July 2019



Introduction

In today's digital market, agility is the magic ingredient. Businesses know they need to become nimbler and more responsive to market signals, accelerating development and pivoting quickly when required. Nearly eight in ten UK CEOs agree they need to act with agility to survive, and over half are actively seeking to disrupt the sector in which they operate rather than be disrupted.

In order to seize these opportunities, they are turning to Agile. As a way of working, it has flexibility and responsiveness at its core. Through constant iterations and reviews, it increases speed to market and drives up quality.

But one of the major barriers to success is a lack of industry consensus on how to successfully contract for Agile. It represents a fundamentally different way of working from traditional waterfall development. As a result, we argue, it needs a different way of contracting too.

Time and Materials (T&M) seems the most straightforward approach. We estimate that around 70% of Agile projects are contracted for in this way. However, this leaves customers carrying all the risk rather than sharing it with their supplier. The supplier has no compelling incentive to flag quality or productivity issues: they are being paid for their time regardless of the outcome.

> **All too often, the result is that projects disappoint or simply break down. The customer splits from the supplier, having no recourse apart from termination, and has to start again.**

What was supposed to be a case study in Agile can become an exercise in stop-start frustration. However, viable and successful alternative models do exist. We have worked with several large organisations to overcome the contracting challenge.

> **We believe it's essential for the customer and supplier to select a commercial model that both appropriately shares risk and drives the Agile ways of working the organisation is looking to benefit from.**

The key is for the customer's Product Owner, Delivery and Commercial teams to work collaboratively with the supplier to shape the approach.

In the pages that follow, we set out these alternative models. In most cases, we believe that a model that better shares risk between the parties is likely to be a much more satisfactory and productive way of contracting for Agile, benefitting both the customer and the supplier.

We need a new way of contracting for Agile

What are the challenges?

Because Agile is different from traditional waterfall working, the usual ways of contracting can present a number of issues for the customer. Waterfall projects proceed in a 'straight line' with clear sequencing, milestones and pre-defined delivery outcomes. Contracting for them is therefore relatively simple. But Agile works through a continual process of review, in a series of small increments or sprints, and with flexible desired outcomes that may change as the project progresses.

Traditional contracting methods therefore have a number of potential drawbacks for Agile:

01

T&M contracts don't share the risk

T&M is highly flexible but leaves the customer "carrying the can" when a third party delivery partner fails to deliver. Frequently, agreed quality thresholds and standards are not built in. In our view, the inequality of the risk distribution isn't in the spirit of Agile: it's got to be more collaborative and partnership-based.

02

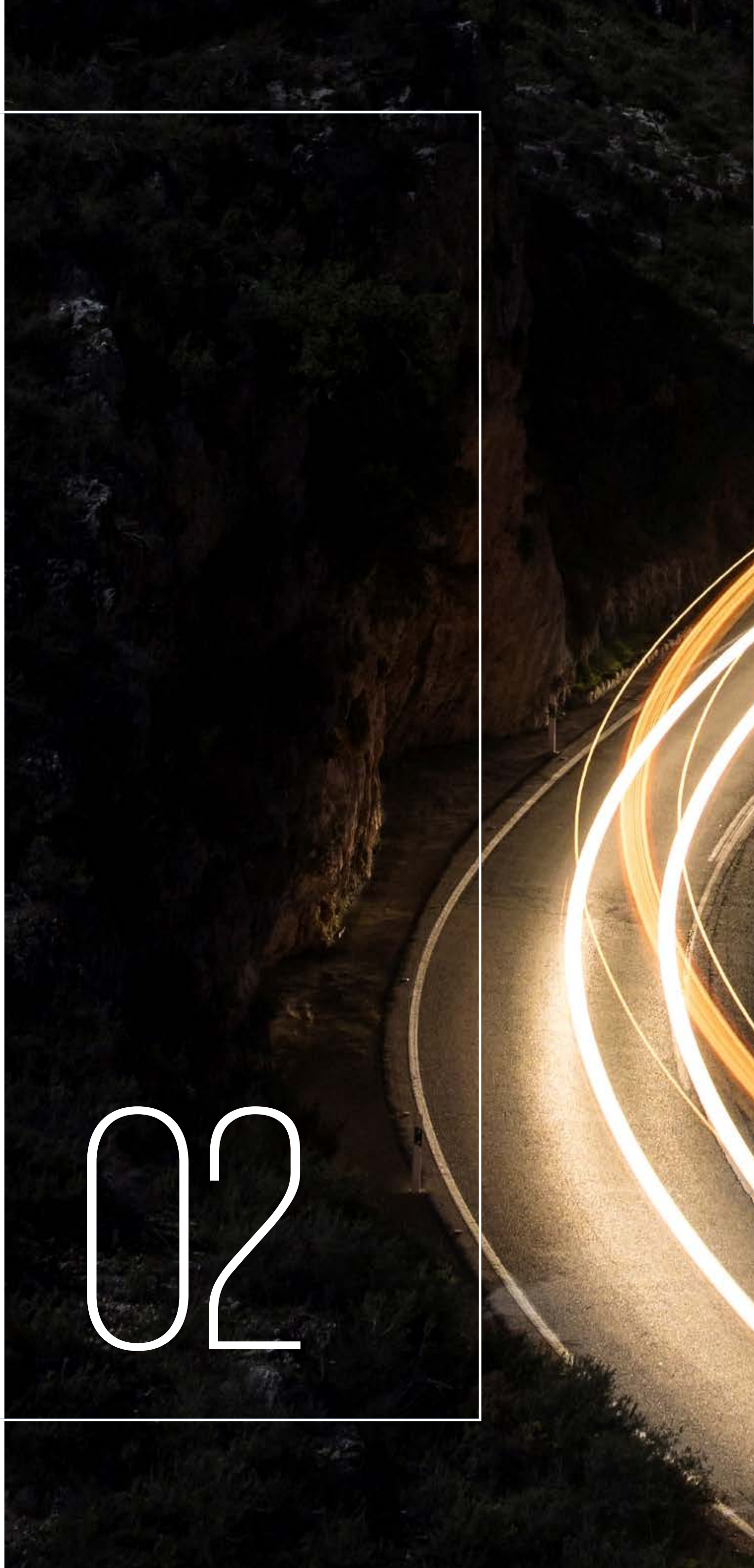
Conventional contracting methods are slow and prioritise negotiation over collaboration

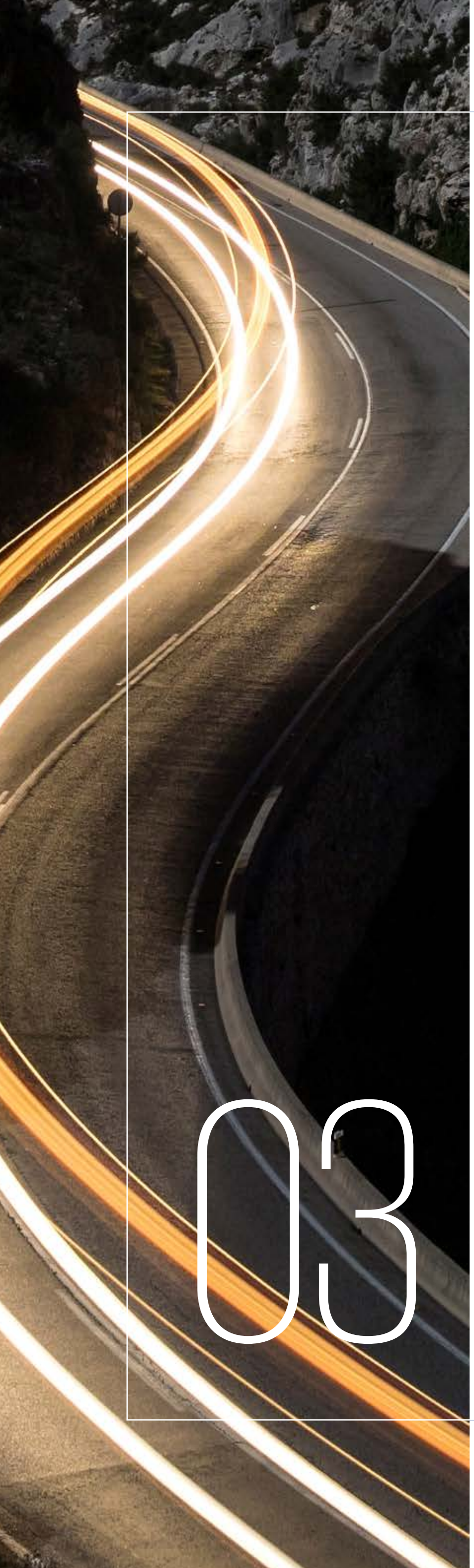
Lengthy fixed scope contracts that describe the requirements and outputs in detail can take months to draft and focus the initial supplier relationship on negotiation rather than collaboration. Again, this is not conducive to the Agile philosophy.

03

Traditional fixed price contracts fail to address frequently changing requirements

Traditional fixed price contracts prioritise the definition of requirements and a plan above collaboration and the ability to quickly respond to change. This overlooks one of the key attributes of Agile – that the project evolves and may shift its focus as it progresses.





What does successful Agile contracting look like?

It's easy to find drawbacks in existing practices, in Agile as in anything. But what does good contracting actually look like, in our view?

A good Agile contract needs to balance the creation of a collaborative culture that allows for continuous delivery of software and embraces change, with the provision of sufficient commercial protection for the customer. It needs to incentivise all parties to work together and take a shared responsibility for success.

In our experience of working with businesses on contracting models, key lessons learnt are:

01

Describe the interactions, not the plan:

Rather than focusing on a pre-defined plan and set of requirements, an Agile contract should describe the overall outcomes and the interactions that will take place between the customer and supplier to achieve the objective (or, EPIC). For example, how long will sprints be? How frequently are they envisaged to take place? Will testing take place within sprints, or outside of them? In this way, development and prioritisation of the requirements will be conducted within a clear framework. Getting clarity on who is doing what and which Agile ceremonies will be followed (important given the proliferation of Agile methods out there) will help avoid confusion down the line.

02

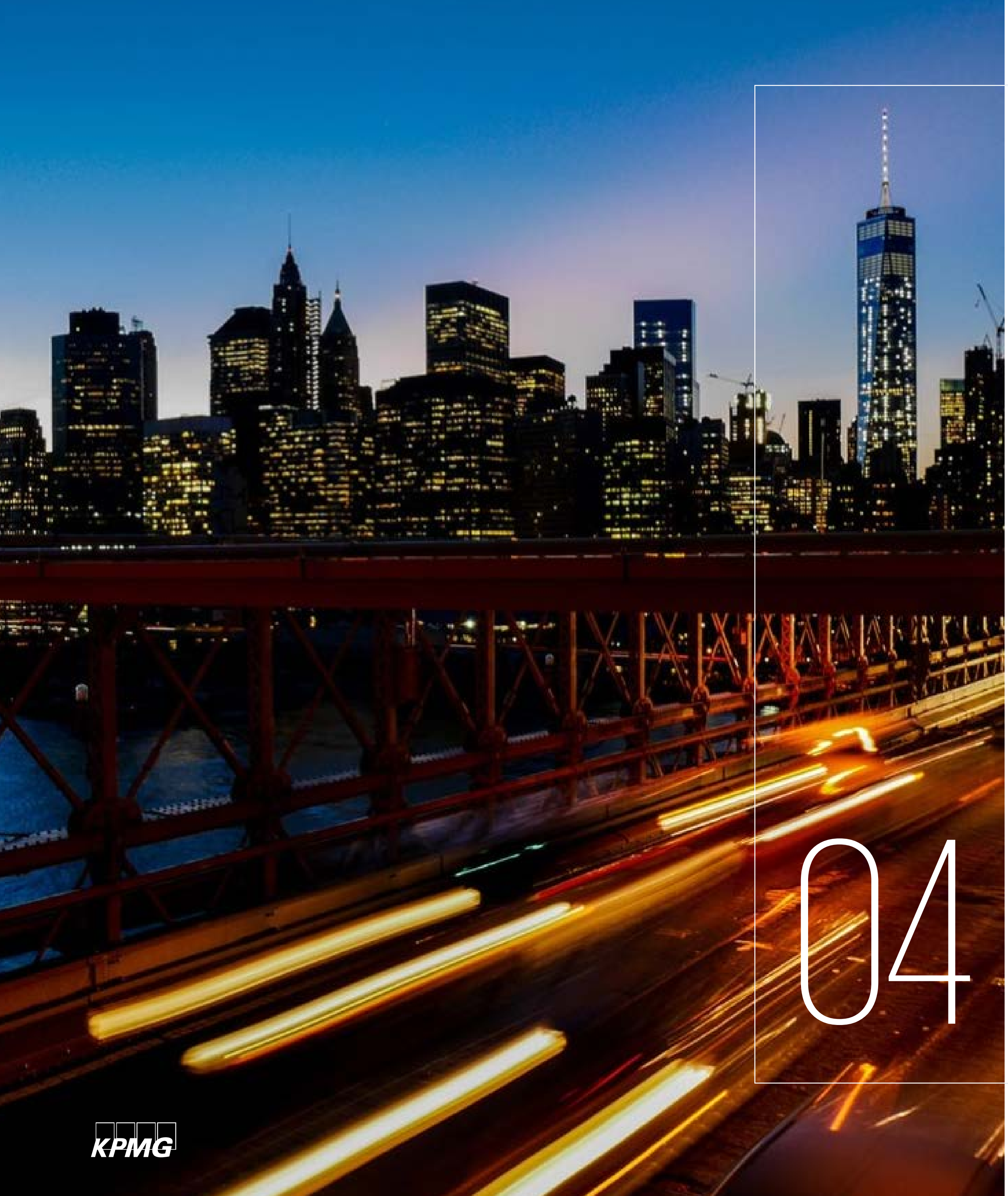
Define clear quality standards:

The contract should be clear on quality standards and thresholds. This means stating when a User Story is ready to enter sprint planning through a "Definition of Ready" that describes the requirements that must be met for this; stating when it is ready to be deployed through a "Definition of Done" that sets out what constitutes the product being production ready; and setting out what level of defects is acceptable post release. The customer needs the ability to hold a supplier to account for quality – but this should be proportionate to the scope of the work, and is also dependent on the customer fulfilling its own obligations such as the quality of design (if the customer is responsible for this).

03

Set out the commercial principles up front and manage through Governance:

Agree principles up front with the supplier that explicitly describe how risk will be shared. Define a governance mechanism that requires the parties to come together if the velocity at which working software is being delivered or the quality of it falls below the agreed threshold. In the event the issue is the fault of the supplier, the customer's commercial recourse needs to be clearly defined - such as an increase in supplier capacity at no cost, a financial credit or a termination right.



Choose the right commercial framework

e.g. T&M, Fixed Price per Sprint, Outcome based:

There are four main ways of contracting for Agile: T&M, Fixed Price per Sprint, Fixed Price per Story Point and Outcome based. Needless to say, the approach selected needs to be appropriate for the project, and this will depend on a number of factors. The approach selected will also drive its own set of behaviours in both customer and supplier.

Time and Materials/ capped T&M

Pros

Highly flexible with supplier working under customer direction.

Relies on trust between customer and delivery partner.

Cons

Customer typically bears the risk of poor quality or under performance.

Supplier may be incentivised to sell time, not to deliver the required outcome.

When does it work?

Useful for requirements development, where the customer is directing supplier resource in the Scrum team, where there are mixed customer / supplier teams or where flexibility is valued above commercial protection.

Fixed Price per Sprint

Pros

Supplier can be held responsible for the quality and volume of what it delivers in each sprint.

Simple commercial mechanism-fixed price for the output of a given size of sprint team. Maintains flexibility as scope is defined in sprint, not up front.

Cons

Penalties for poor quality can encourage supplier to prioritise quality over velocity.

Supplier is only committed to delivery of sprint backlog as prioritised by the Product Owner, not the wider business EPIC.

When does it work?

Useful for projects where Supplier is responsible for the Scrum team, and in which requirements are prioritised on a per sprint basis. Provides commercial protection with consequences if quality and velocity standards are not achieved.

Fixed Price per Story Point

Pros

Similar to Fixed Price per Sprint, but supplier is paid based on the number of Story Points delivered.

Payment is proportional to the complexity of work delivered.

Cons

Requires customer and supplier to have a common understanding of what value a Story Point represents as typically they are relative rather than absolute measures.

When does it work?

Useful where there is a strong common understanding of the value of a Story Point and a desire to pay based on output.

Fixed Price – Outcome based

Pros

Supplier signs up to delivery of the outcome that the customer is seeking to achieve for an agreed price.

Simple commercial mechanism with price tied to an outcome

Cons

Difficult to price accurately without significant up front work to define the scope.

Focus on outcome can reduce the customer's flexibility to change requirements in sprint/programme, and may require the involvement of the Commercial team.

When does it work?

Useful for projects that require the supplier to be aligned with a pre-defined customer vision that is sufficiently well documented. Provides commercial certainty.

Taking a collaborative approach

06

The best Agile contracts are the product of collaboration between the Customer Product Owner, Delivery team, Commercial team-and then the Supplier.

In our experience to make contracting for Agile a success, the customer must bring product owners, delivery leads and commercial teams together. This promotes a collaborative environment from the outset, ensuring that the requirements and associated Statement of Work (SoW) are agreed upon quickly. Key questions for each role include:

Product Owner

What are the EPICs, features and user stories to be delivered? What approach will be taken to the development of the requirements and the design of the software? What role is the supplier expected to play e.g. deliver the end-to-end outcome, support User Story development, or act as the software development engine?

Delivery

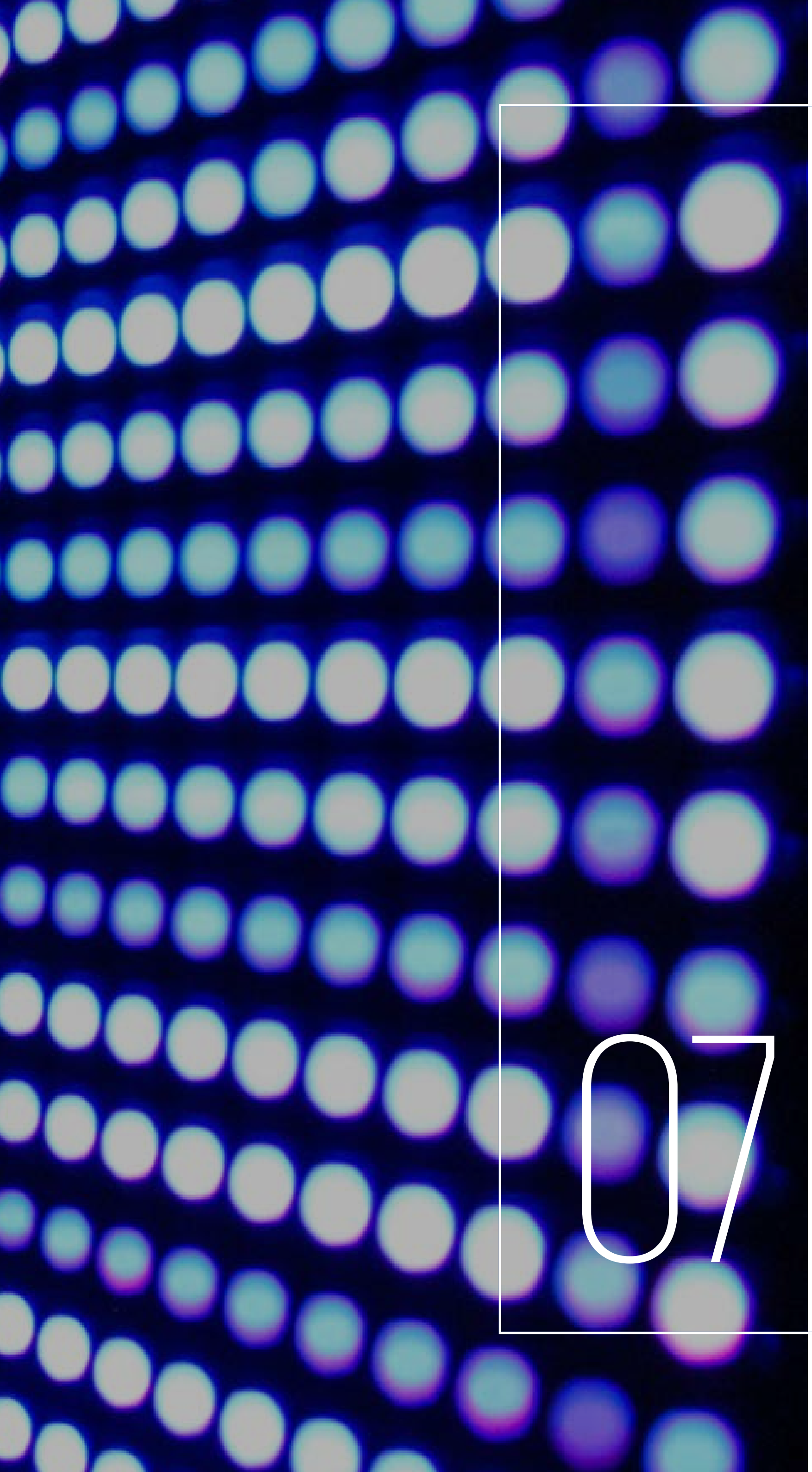
What is the Agile delivery model to be adopted – this could be customer specific, supplier specific or an industry standard like the Scaled Agile Framework? What are the customer and supplier roles and meeting ceremonies? What behaviours need to be incentivised within the SoW?

Commercial

What commercial framework best suits the needs of the product owner and delivery lead? Given the proposed supplier responsibilities what is it possible to stipulate in a contract? What commercial protections are appropriate, and how will they influence the behaviours of the sprint team?

Supplier

What delivery responsibilities and accountabilities will the supplier need in order to accept the desired commercial risk? What dependencies does the supplier have on the customer and are these acceptable? What behaviours will the contract drive, and are these aligned with the business goals?



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Our recommendations

As we have seen, there are a number of key principles that we believe organisations need to embed in their approach to contracting for Agile:

Recognise that Agile contracts need to be constructed in a different way – rather than describing the output in detail, describe the interactions and expected quality standards required

Select a commercial framework that is appropriate to the scale of the project, level of requirements and commercial protections needed

Bring together the product owner, delivery and commercial teams to develop a contract that meets the needs of each party, and that will drive the right behaviours in the project team

Whilst T&M will in many cases remain the most appropriate contracting model, in our view Fixed Price per Sprint provides a valuable alternative - a simple mechanism that holds the supplier responsible for quality, but in which the customer has an appropriate level of shared obligation too. It combines commercial protection with the flexibility needed for the project to develop, allowing the business to prioritise the backlog for each sprint without the need to re-visit the contract.

We believe that it is possible to achieve commercial protection whilst getting the benefits of Agile, and that sharing of risk between customer and supplier will become the become the new industry standard – the default position for the majority of Agile contracts in the future.

Case studies

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Taking an ‘agile’ approach to sourcing at Coca Cola European Partners

“My teams have successfully followed an Agile working approach for some time. We’ve made greater use of Agile delivery across our product portfolio, where it made sense to do so, overcame some steep learning curves, and continuously strived to improve our approach with every sprint. However, the one thing we had yet to figure out was how to get better at sourcing in an ‘agile’ way.

Since Coca Cola European Partners is primarily a soft drinks company and not a software company, we tend to expand our development teams with resources from external partners. Typically, the way to source Agile is through Time and Materials (T&M). However, the problem with T&M is that when something goes wrong, we need to take full responsibility, and there is little incentive for our partners to improve or optimise.

I want our partners to have “skin in the game”, a shared responsibility for a good outcome, but also give them the chance to innovate, so we are all winners. That is why we developed a way with KPMG, to procure Agile development sprints at a fixed cost base.

Consequently, we have greatly improved the achievable and measurable quality of our shippable product, decreased the financial volatility of our Agile projects, and gained greater collaboration with a governance model that has clearer roles and responsibilities. We achieved all this while maintaining the creative freedom that our Agile teams need to thrive.”

Kai Uhlemann
Director, Collaborative Solutions
– Coca-Cola European Partners

Fixed price per Sprint

Coca Cola European Partners (CCEP) wanted to develop a new contracting approach for Agile, which both maintained the benefits and flexibility of Agile, and ensured that its partners were delivering the right quality. This requirement was based on some of CCEP's past experiences with a Time and Materials (T&M) based model, which resulted in a lack of supplier focus on quality and a corresponding impact on velocity, as sprints needed to be refocused on fixing errors rather than implementing new features. KPMG worked collaboratively with CCEP to:

01 Develop a new approach to contracting for Agile, based on a Fixed Price per Sprint model

02 Devise commercial principles and a collaborative way of contracting, which simplified cost management and pushed for shared responsibility for quality with the supplier

03 Agree a pragmatic approach with its suppliers for managing instances where velocity or quality was below the agreed standards

CCEP has successfully adopted the model with multiple suppliers to drive improvements in Sprint velocity and quality, and ensure greater control over costs. This has led to a greatly improved Agile process.

Fixed price – outcome based

A FTSE100 general insurer was determined to transform its brown field insurance and IT platform to enable greater business agility, develop a single view of their customers and reduce the cost to run and change their IT platform. The organisation wanted an Agile delivery method to be adopted, whilst confirming certainty of outcome and cost.

KPMG provided structure and support to help devise a Fixed Price per Outcome approach. We supported the organisation with:

01 Selection of the supplier, from RFI to Down-select

02 Development of the contract, combining Agile ways of working with a fixed price for the final outcome

03 Development of the technical roadmap supported by functional and non-functional requirements development

With our help the customer delivered the selection of an approved System Integrator, an 8-figure investment approval, an Agile-ready business function, and upgraded core trading systems supported by DevOps teams and business automation.

About KPMG

Turning IT sourcing into your competitive advantage

We are experts in digital sourcing, and help organisations successfully derive greater value from the c.$3 trillion they spend on IT services globally each year. We deliver this by applying a tested methodology that supports businesses through the full procurement lifecycle from understanding complex requirements to contract and execution. Aligning our deep understanding of commercial models and robust delivery framework with our customers' core business objectives, we can help them to negotiate strategic vendor relationships and implement the digital solutions that enable them to disrupt their industries.

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