

## Performance Based Logistics

Center for the Management of Science & Technology

University of Alabama in Huntsville

<b>COMPARISON OF SELECTED INCENTIVES</b>	
<b>Award Fee</b>	
The Government determines and measures a contractor's performance within specifically designated performance categories, evaluation criteria, and evaluation periods.	
<b>Targeted Use:</b> Cost Reimbursement and Fixed Price Contracts, <b>Benefits:</b> Plan can be revised when necessary to adapt to program changes. 2. Can be adapted to flow down as individual worker bonuses, making the incentive real and personal. 3. Incentives can be based on simple, reasonable, achievable, and measurable performance. 4. Can construct based on the acquisition. 5. All profit/fee can be based on performance.	
<b>Weaknesses:</b> 1. Requires careful review of the statement of work. 2. Requires administrative time investment. 3. Requires carefully documented record of performance and consistent records. 4. Focus on end item performance. 5. Doesn't link contractor performance evaluation to Government actions. 6. Requires balance between cost, schedule, and task performance so that one area is not emphasized over another.	
<b>Process Elements:</b> 1. Define the evaluation periods and the amount of award fee available for each period. 2. Describe the general procedures to determine the earned award fee for each evaluation period. 3. Define the evaluation criteria. 4. Identify the Fee Determining Official (FDO), the Award Fee Review Board (AFRB) members by position and the Performance Monitors by function with descriptions of their roles in the Award Fee Process.	
<b>Graduated Award Fee</b>	
An approach to award fees that layers incentive elements.	
<b>Targeted Use:</b> Competing areas of focus within a program. Where attention to "macro" or "overriding" elements of performance is required. Where there is a good understanding of the tradeoffs between performance levels. <b>Benefits:</b> Better attention to "macro" or "overriding" performance elements. Improved synthesis of performance elements (inability to maximize one element at the expense of another). Flexibility in establishing the "right" performance hierarchy for a particular requirement.	
<b>Weaknesses:</b> 1. Requires substantial resources to manage. 2. Impact of award fee incentive can be magnified negatively if "wrong" higher-level performance element.	
<b>Process Elements:</b> As an example, the first layer of award fee elements might include strong technical performance in an area, on-time schedule performance as indicated by milestone achievement, and application of a cost tool such as CAIV. The next and "higher" level of award fee might be overall cost control. During award fee review and determinations, the first layer of elements are assessed and assigned "pure" element values. An overall award fee is established based on this first layer. This award fee then is subject to adjustment, up or down, based on evaluation of the higher-level award fee.	
<b>Performance Based Incentives</b>	
Effective performance-based contracts: define work in measurable, mission related terms; contain performance standards; include quality assurance plans for measuring performance; and provide financial incentives and penalties based on performance.	
<b>Targeted Use:</b> Includes quality performance and may be positive, negative, or a combination of both. Should be applied selectively to discourage inefficiency and to motivate contractor efforts that might not otherwise be emphasized. <b>Benefits:</b> 1. Profit is tied to achievement of specific technical performance objectives, delivery schedules, or cost control objectives. 2. Can combine multiple incentive arrangements within a single contract (e.g. use both an incentive fee as well as award fee combined with cost reduction incentives.) 3. Directs contractor management attention to desired performance. 4. Improves communication.	
<b>Weaknesses:</b> 1. Requires real communication between the parties and within the Government organization to ensure that performance objectives, measures, and any other incentives are understood as part of the overall objectives of the program. 2. Structuring all incentives to work together and drive the desired contractor behavior is likely to be complex. 3. Processes and procedures for the application incentives must be documented and understood. 4. Care must be taken to ensure there is a balance in the incentives. 5. Requires constant monitoring and attention. May create complex administrative tasks. Cost tracking at the performance level must ensure baselines are followed.	
<b>Process Elements:</b> Should be challenging, yet reasonably attainable. The goal is to reward contractors for outstanding work but not penalize them for work that is fully satisfactory but less than outstanding. The definition of standard performance, maximize positive and negative performance incentives, and the units of measurement should be established in the solicitation. Care must be taken to ensure that the incentive structure reflects both the value to the Government of the various performance levels and a meaningful incentive to the contractor. The incentive amount should correspond to the difficulty of the task required but should not exceed the value of the benefits the Government receives.	

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<p><b>Targeted Use:</b> Establishment of long-term contractor relationships with proven producer of products or services. Designed to incent the contractor to execute an orderly transition of workload, provide superior support, and control prices. Benefits: 1. Strongly incents contractor performance. 2. Supports long-term sources of quality services and products. 3. Enables supplier to make investments in process improvements that it might not otherwise make when facing short-term or uncertainty in periods of performance. 4. Allows Government to extend performance parameters and accelerating completion. 5. States Government priorities explicitly and gives contractor more autonomy in achieving desired results. 6. Contractor knows the expected outcome up-front and the requirements for success.</p>
<p><b>Weaknesses:</b> 1. Can be a challenge to monitor contractor progress accurately. 2. Reward must be sufficient to drive desired behavior throughout contract performance. 3. Can be a challenge to define the reward scheme precisely so that it drives proper behavior. 4. Care must be taken in assessing pricing for extension periods.</p>
<p><b>Process Elements:</b> 1. Structure similar to award fee but the incentive is periods of performance rather than cash. 2. Effective if performance metrics are objective. 3. Effective when a long-term business relationship is of value to the Government and the contractor. 4. Points are awarded during each year of the contract based on performance in each performance measurement category. 5. Decisions on extending or shortening the award term are made on a year-by-year basis, based on a moving multi-year average of the contractor’s overall point total. 6. Extensions can be set, based upon performance that exceeds requirements rather than just meeting requirements.</p>
<p><b>Share in Savings (SIS) Strategy</b></p>
<p>Encourages contractors to apply ingenuity and innovation to get the work done quickly and efficiently and share in the savings attributed to their planning and execution.</p>
<p><b>Targeted Use:</b> Best used when ROI is big enough to make this a viable business proposition for the contractor. Shifts risk from Government to contractor with commensurate opportunity for contractor reward for successful performance. Requires partnership approach between Government and contractor due to risks involved. Idea is to allow contractor to apply ingenuity and innovation to efficiently deliver the requirement instead of dictating the Government preferred approach. Can be added to FP for critical areas. Can also guarantee no fee, promising payment only when benefits result from the contractor’s efforts.</p> <p><b>Benefits:</b> 1. Requires real communication between the parties and within the Government organization to ensure that performance objectives, measures, and any other incentives are understood as part of the overall objectives of the program. 2. Structuring all incentives to work together and drive the desired contractor behavior is likely to be complex. 3. Processes and procedures for the application incentives must be documented and understood. 4. Care must be taken to ensure there is a balance in the incentives. 5. Requires constant monitoring and attention. May create complex administrative tasks. 6. Cost tracking at the performance level must ensure baselines are followed.</p>
<p><b>Weaknesses:</b> 1. The Government and the contractor must agree if there is a decision to re-invest. 2. The financial mechanics may be difficult to arrange given the issues with comptroller processes and the current appropriation laws. 3. May be difficult for small businesses to participate as primes (this form of contract may often require upfront contractor investments that are paid back only in out years.)</p>
<p><b>Process Elements:</b> 1. Need to be able to establish baseline and methodology for calculating benefit pool. The baseline and methodology do not need to be perfect, as long as there is advance notice of what the baseline or methodology is, contractor buy-in, and consistent application post-award. 2. The Government identifies a monetary benefits pool that successful contract performance will achieve. The benefit pool may be “on-budget” (e.g. reduced O&amp;M spending or reduced spare parts procurement) or “off-budget” (e.g., improved system performance, decreased downtime). 3. The Government then pays the contractor an agreed upon portion of the monetary benefits earned under the contract. In a 100% share-in savings contract, the contractor's entire payment is in the form of a percentage of benefits realized. Alternatively, the contractor may be paid a base fee/profit plus a (smaller) percentage of the benefits. In a reinvestment variation, there can also be an election by the contractor to reinvest all or part of that savings.</p>
<p><b>Early Completion Bonus</b></p>
<p>Incentis early delivery of product or service.</p>
<p><b>Targeted Use:</b> Best used when value of early completion is clear and value can be established for reward. Benefits: Places premium on schedule performance.</p>
<p><b>Weaknesses:</b> 1. Requires balance between other program objectives and schedule to ensure all requirements are met. 2. Requires careful evaluation and substantiation for value of early completion.</p>
<p><b>Process Elements:</b> 1. Offerors bid a target completion date as well as a schedule of rewards or penalties for deviation from the target completion date. 2. Both the target and the reward or penalty structure should be evaluation criteria for source selection of competitive procurement.</p>

**TABLE 3: COMPARISONS OF SELECTED INCENTIVES** <sup>vii</sup>