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# Trends in Performance-Based Service Acquisition

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14th Annual Acquisition Research Symposium  
Naval Postgraduate School  
April 27th, 2017

# Research Questions

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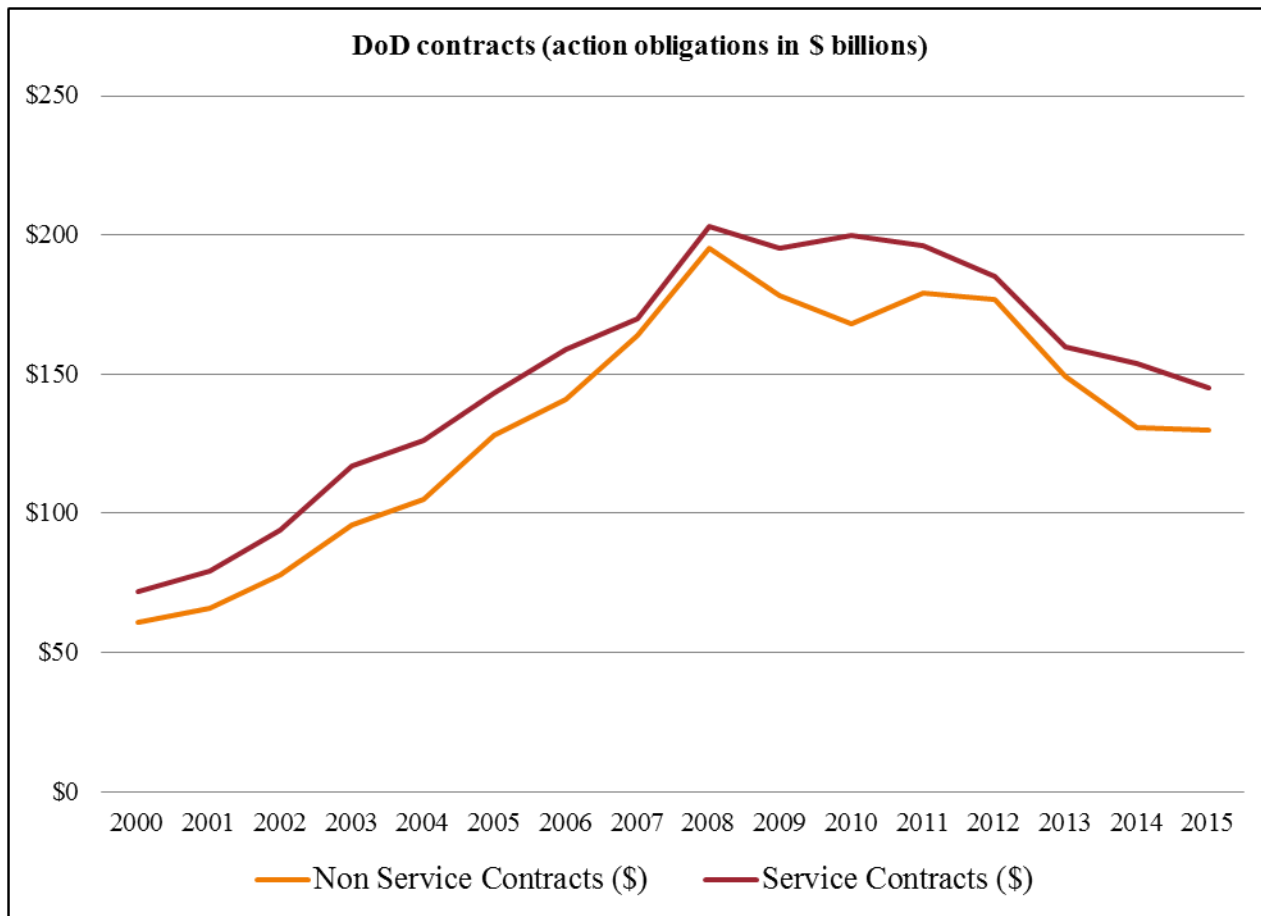
## Primary Question

- ➡ To what extent does the DoD and its constituent organizations rely on performance-based service acquisition (PBSA)?

## Secondary Questions

- ➡ How has PBSA implementation been impacted by directives, definitions, and world events?
- ➡ What is the relationship between PBSA and contract type?
- ➡ Is current use (extent and implementation) of PBSA appropriate?
- ➡ How can use be improved?

# DoD Contracts Spending



**In 2015, services  
accounted for  
53% of all  
contracted dollars**

## DoD contracts spending: supplies vs. services\*

\*Includes contracted R&D

# PBSA Defined

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According to the DoD (2000), a performance-based contract “describes the requirements in terms of measurable outcomes rather than by means of prescriptive methods.”

- ➡ When done correctly, this strategy aligns the objective of the contractor with that of the customer.
- ➡ PBSA is not a contract type
  - Any contract type (e.g. fixed-price, cost-plus, time-and-materials) can be performance-based.
  - Government should use the contract type most likely to motivate contractors to perform at optimal levels.
  - At the same, firm fixed-price is the preferred contract type for PBSA (FAR 37.102).

# Objectives and Benefits

➔ According to the DoD's *Guidebook for Performance-Based Services Acquisition*, PBSA can achieve the following objectives:

- Maximize performance
- Maximize competition and innovation
- Encourage and promotes the use of commercial services
- Shift risk to the private sector
- Achieve savings

➔ When implemented properly, PBSA provides benefits:

- Reduces inspection requirements by government
- Avoids delays in performance
- Avoid claims by contractors
- Increases satisfaction of the buying agency (Bozkurt, 2005)

**With fixed-price contracts, the contractor is incentivized to innovate, finding cost-effective ways to perform under contracts that have fixed funding levels, to increase profit levels. In the long run, this leads to better outcomes at reduced cost.**

# Elements of PBSA

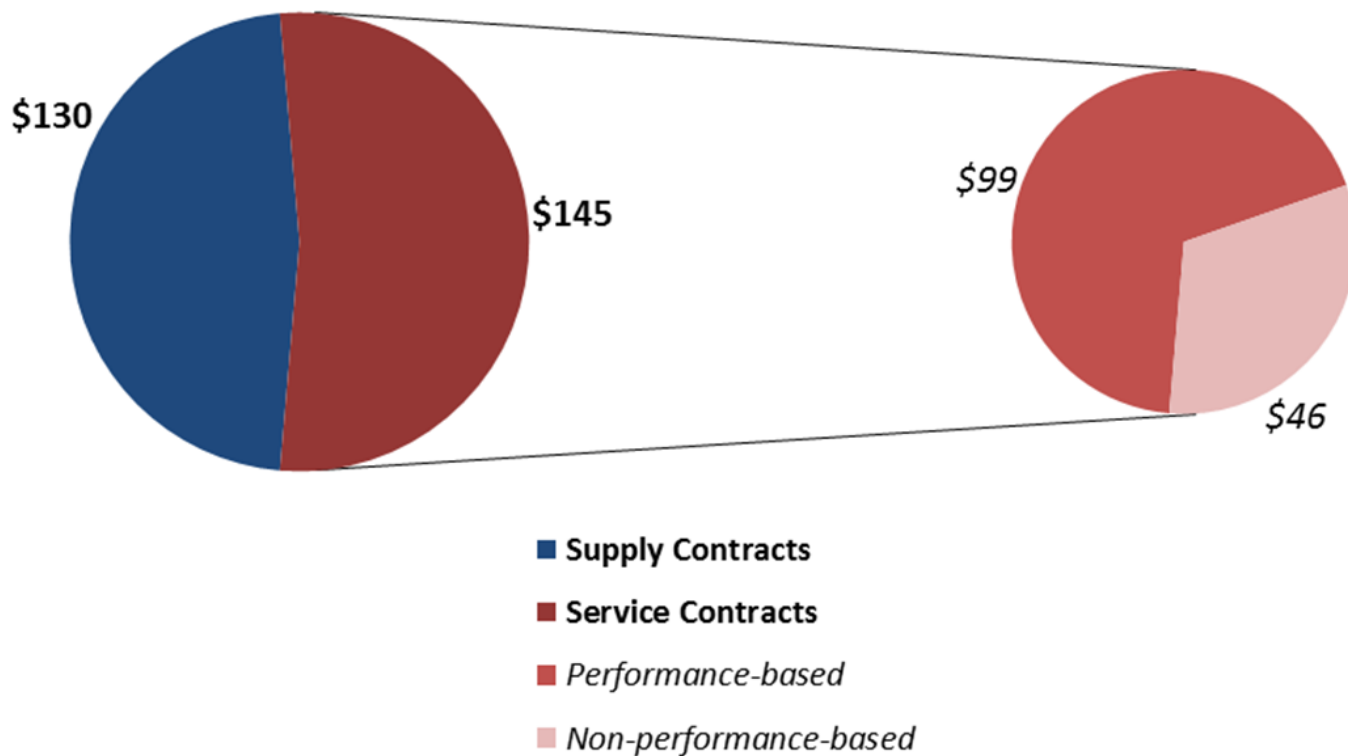
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The *Guidebook for Performance-Based Services Acquisition* identifies four elements that are required, at a minimum, for an acquisition to be performance-based:

1. a **performance work statement**, describing the requirement as a measurable outcome;
2. **measurable performance standards**, used to define acceptable outcomes and determine if performance thresholds have been achieved;
3. **remedies**, the incentives and penalties used to provide incentives for performance; and
4. a performance assessment plan, detailing performance metrics as well as how the contractor will be evaluated.

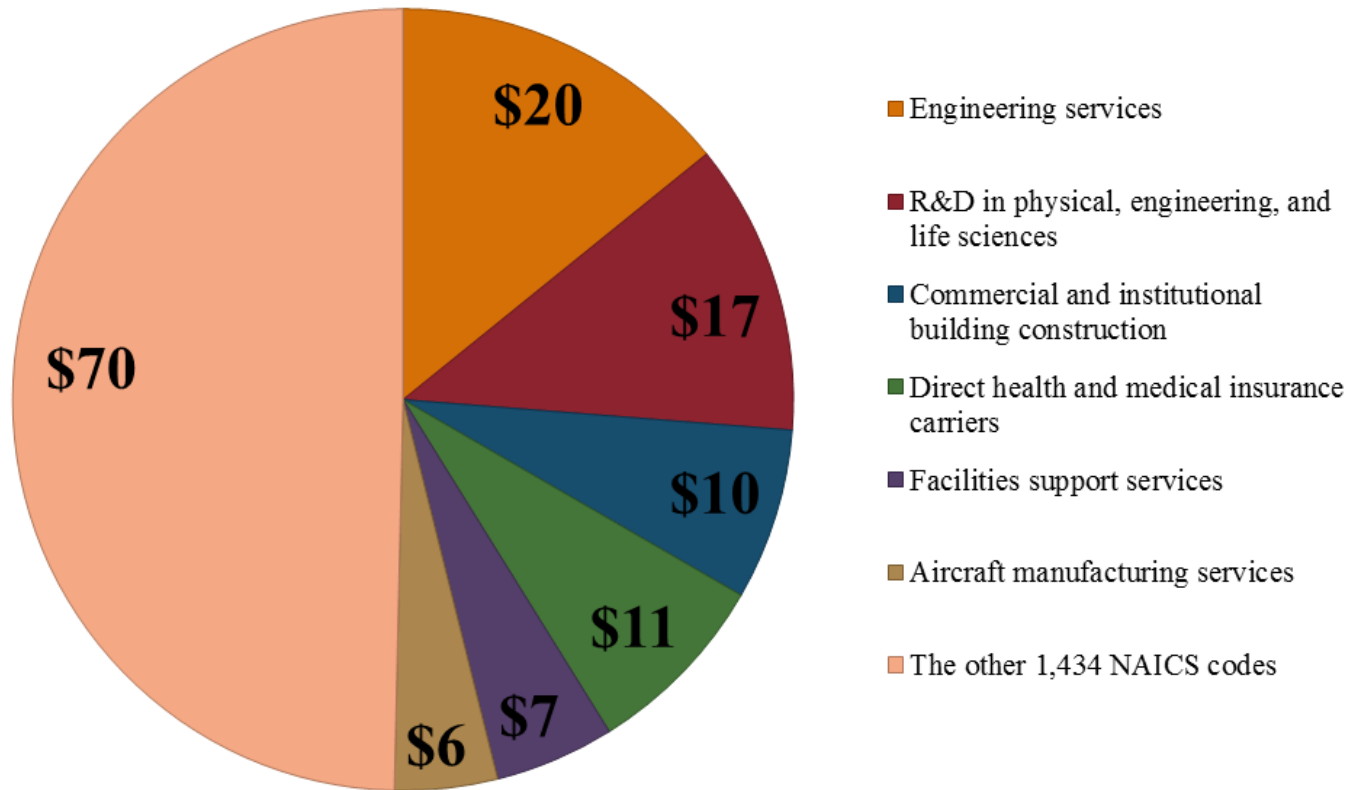
# DoD Contracts Spending

2015 DoD Contracts Spending (action obligations in \$billions)



# Service Contracts Spending by Industry Code

2015 DoD Service Contracts Spending by NAICS code (action obligations in \$billions)



**One quarter of DoD service contract spending occurs in engineering services and R&D.**



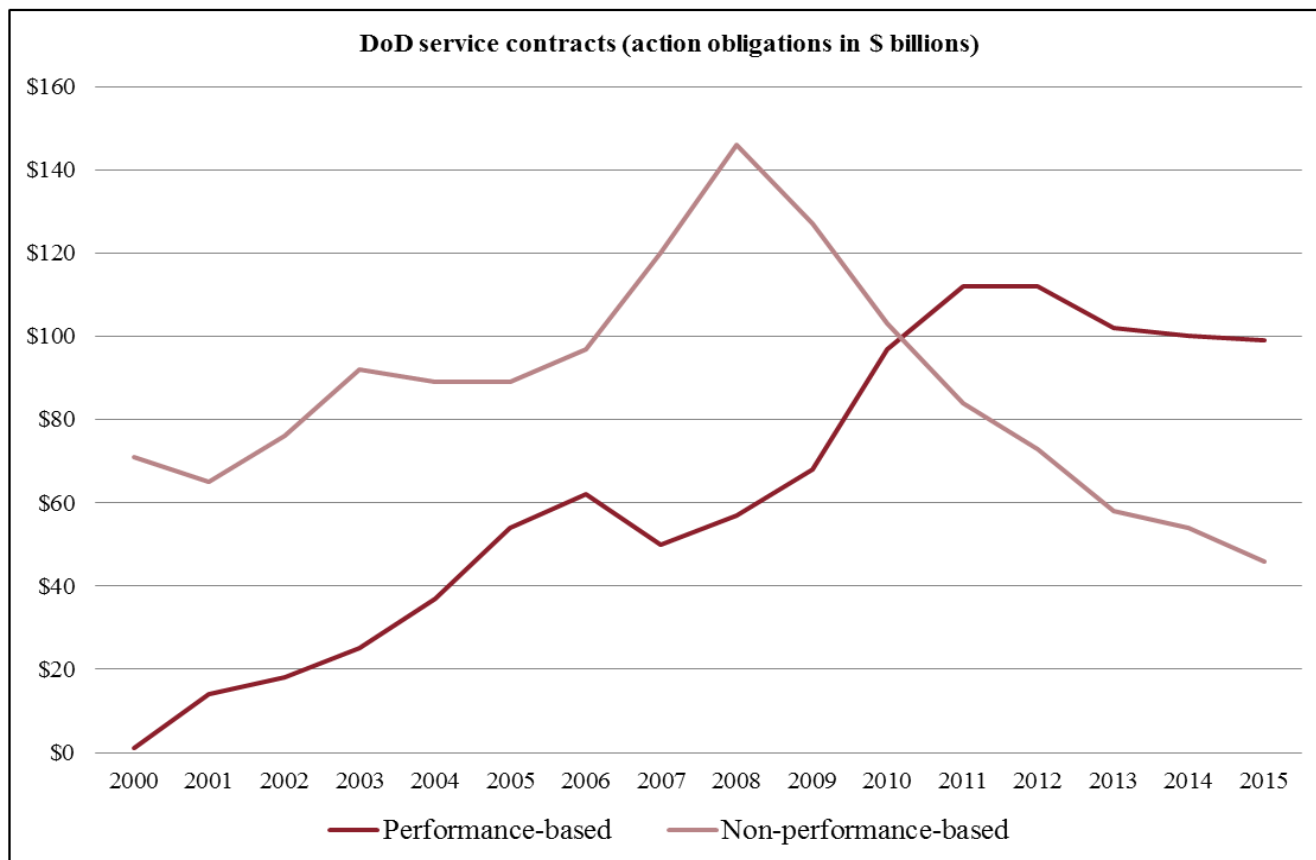


# PBSA Guidance Timeline

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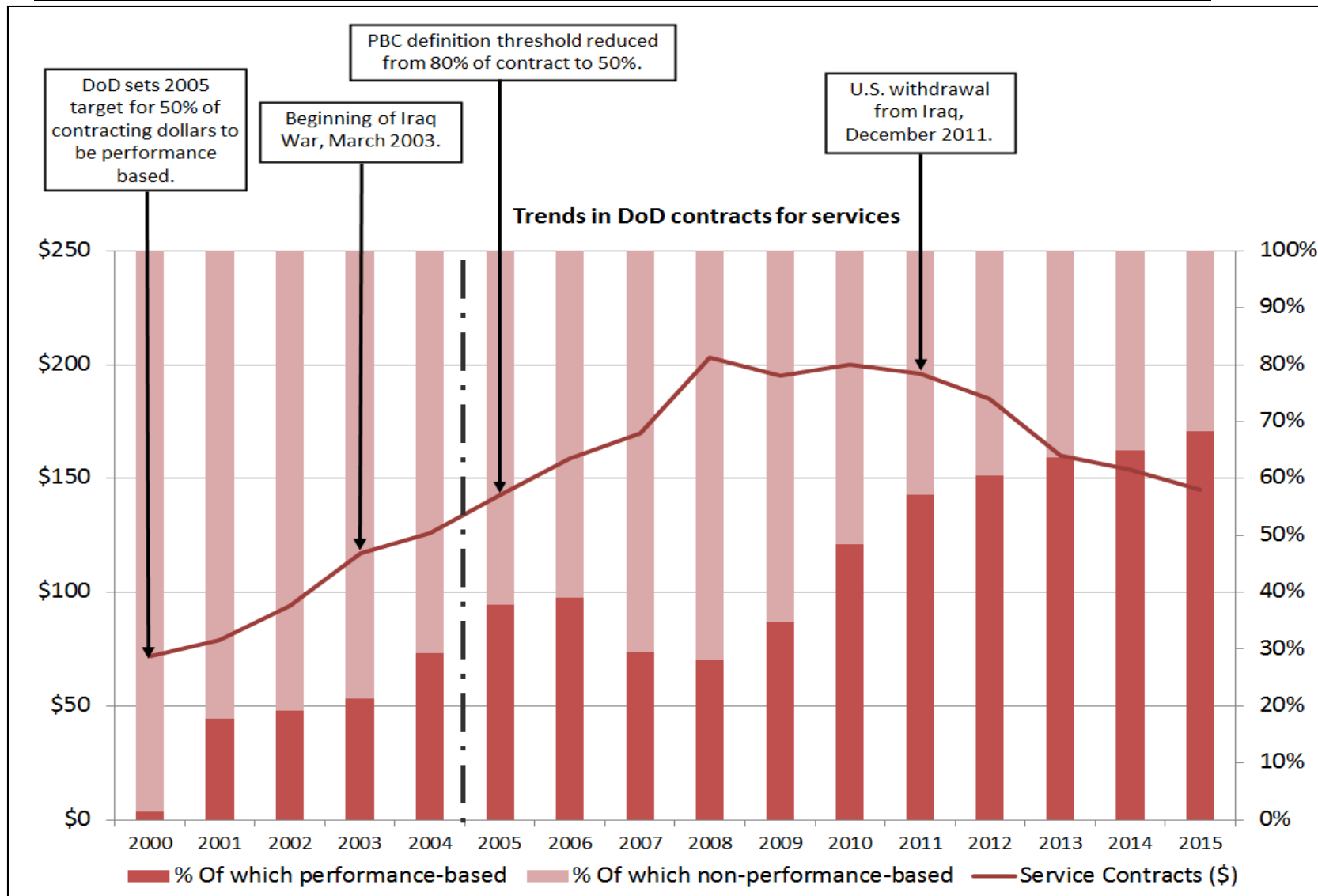
- ➔ **1991:** “It is the policy of the Federal Government that **agencies use performance-based contracting methods to the maximum extent practicable when acquiring services.**” – *OMB*
- ➔ **2000:** “...I establish, at a minimum, that **50% of service acquisitions, measured both in dollars and actions, are to be performance-based by the year 2005.**” - *USD (AT&L) Jacques Gansler*
- ➔ **2004:** “Agencies should apply **PBSA methods on 40% of eligible service actions** over \$25,000, to include contracts, task orders, modifications, and options.” – *OMB*
- ➔ **2005:** Based on recommendation from OMB Interagency Task Force on PBSA (2003), agencies are directed to code contracts and orders as PBSA **if more than 50 percent of the requirement is performance-based**, as opposed to the initial 80 percent requirement. – *OMB*

# Trends in PBSA

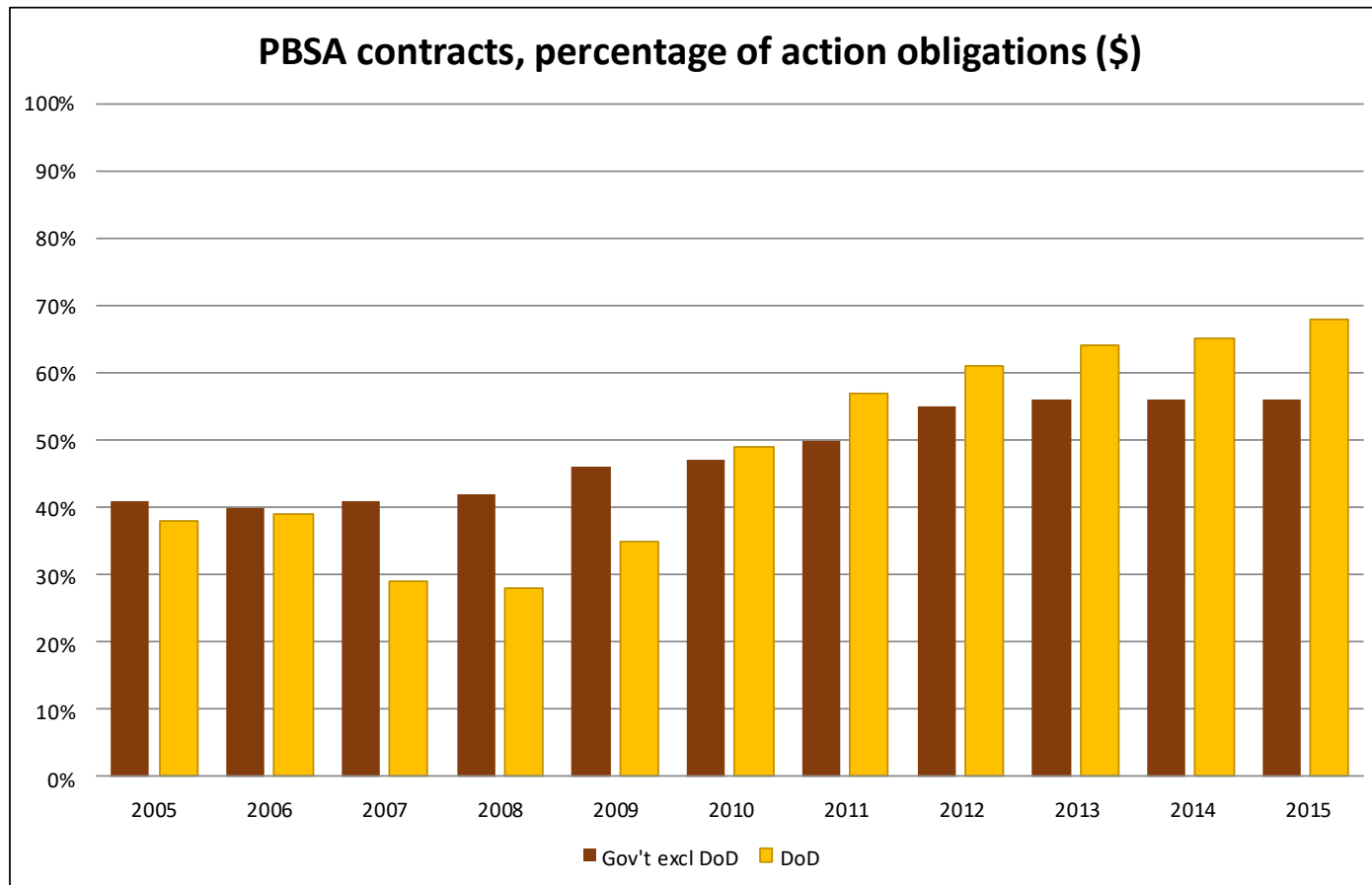


**By 2011 PBSA surpassed Non-PBSA in terms of total DoD contract spending.**

# Trends in PBSA



# PBSA: DoD vs. Civilian



In 2010 the DoD overtook rest of gov't in use of PBSA.

# The Rise of PBSA

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- ➔ PBSA spending has increased dramatically since 2000
- ➔ The military services PBSA rates in FY 2015 are:
  - Air Force - 69%
  - Army - 62%
  - Navy - 58%
- ➔ However, results for one form of PBSA—Performance-Based Logistics—are mixed.
  - Over 200 PBL contracts in 2005; only 87 by 2013.
  - Overall PBL expenditure has increased steadily, likely due to its expansion within successful programs.
  - In other programs, program offices are exerting greater control.
    - For example, the High Mobility Artillery Rocket System transitioned inventory management from the contractor to the government and reverted to cost-reimbursement contracts in in effort to reduce costs.
    - The program is still categorized as “performance-based.”

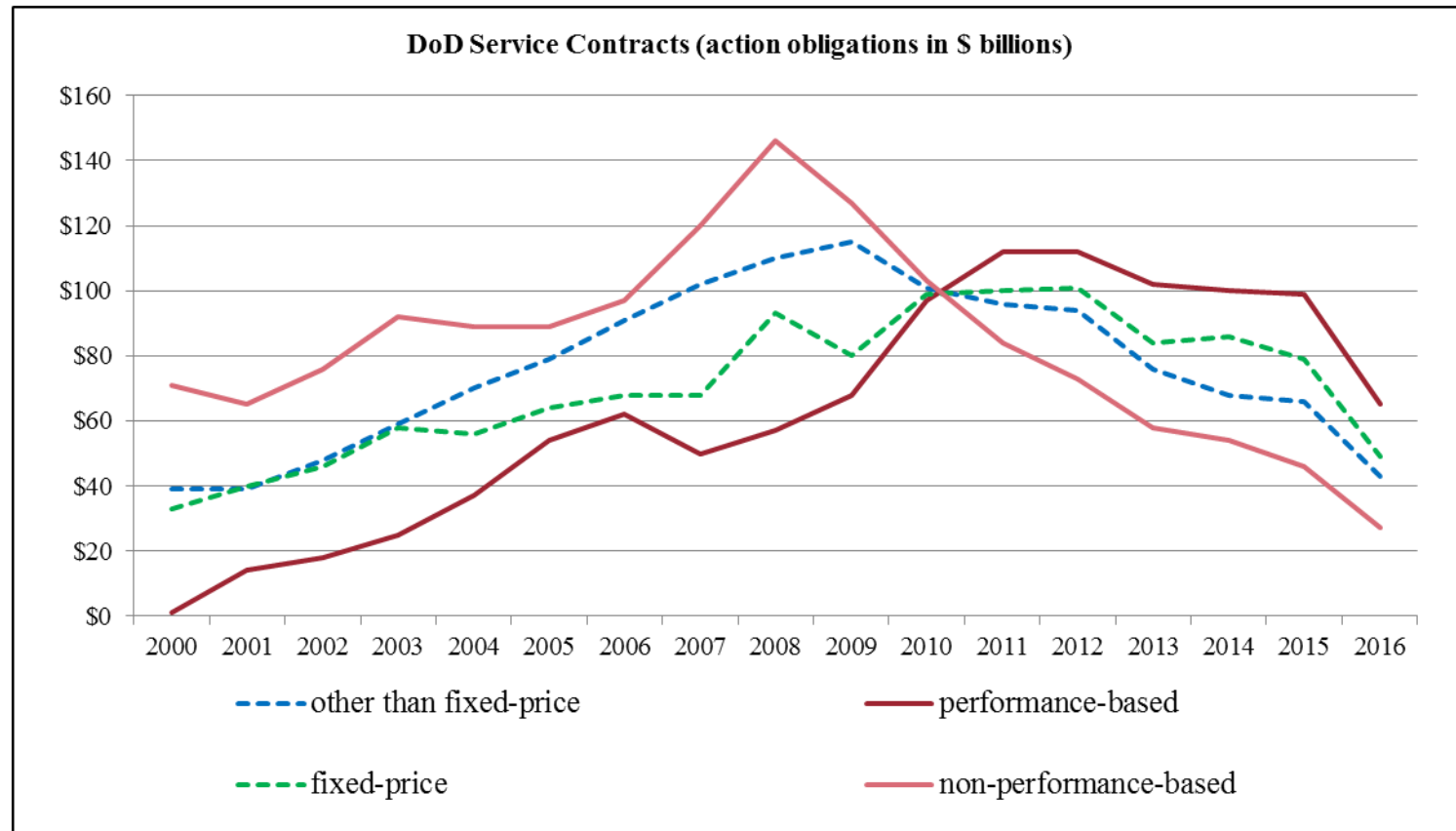
# Data Limitations

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The data may not accurately reflect the extent to which performance-based *strategies* are actually applied.

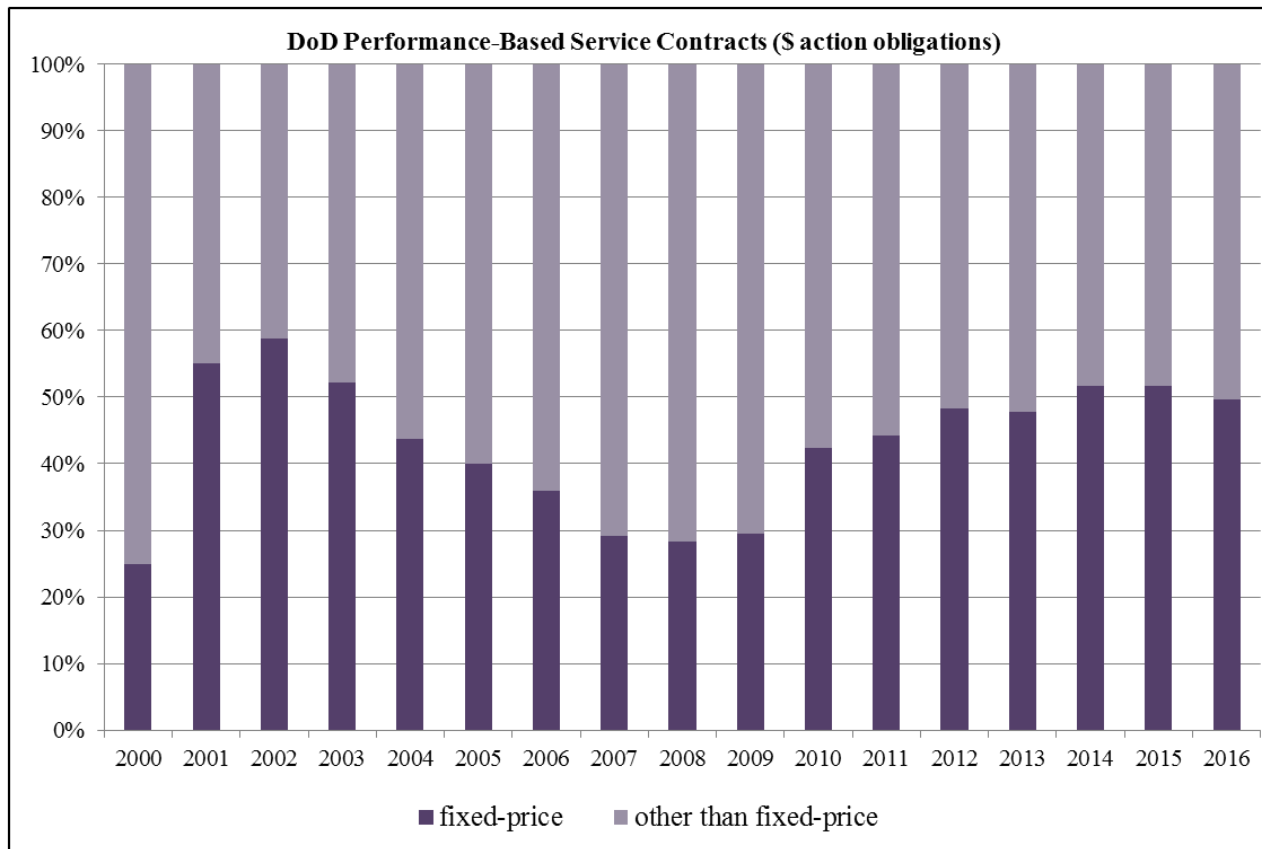
- ➡ 50% threshold makes year over year comparisons imprecise.
- ➡ Some contracts may be performance-based “in name only,” either lacking enforcement mechanisms or disbursing payments even when performance is suboptimal.
  - A 2013 DoD Inspector General audit of 60 programs found that in 33 instances the DoD failed to clearly define criteria for successful completion of various tasks, but disbursed payments to the contractors on a regular basis.
- ➡ However, data on the use of fixed-price contracting (“which best utilizes the basic profit motive of business enterprise” [OMB, 2004]) lends support to the supposition that the DoD is increasing its reliance on performance-based strategies.

# PBSA and Fixed Price Contracts



The trend in fixed-price contracting has risen with the trend in PBSA.

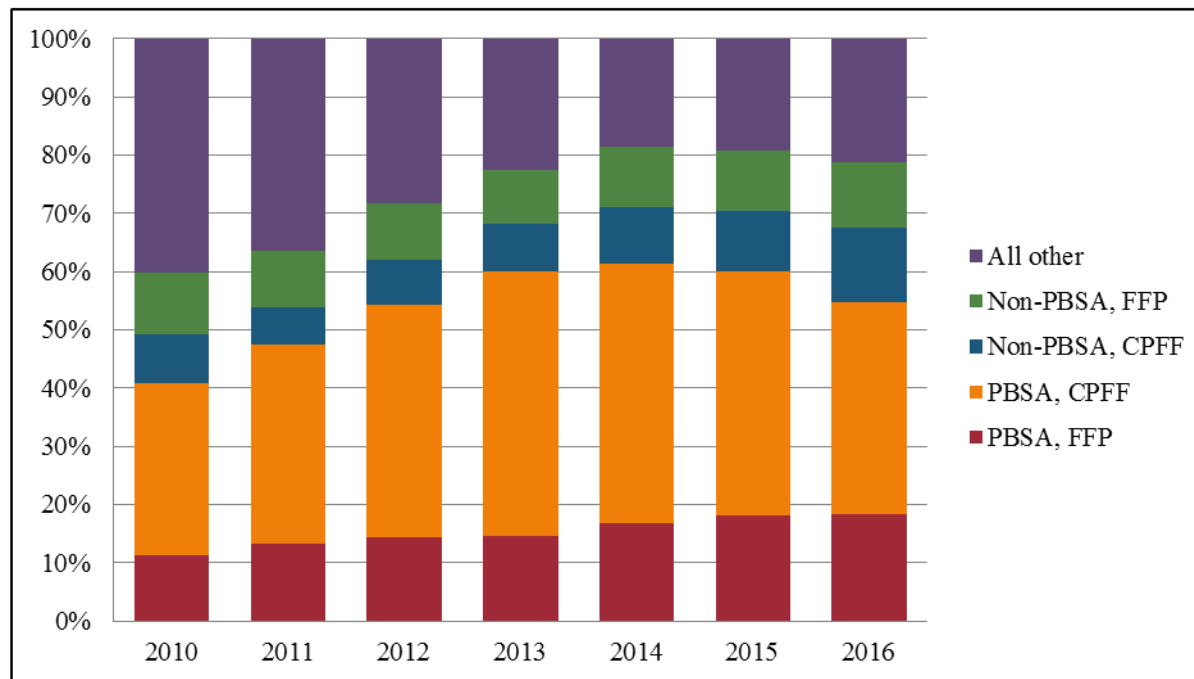
# PBSA and Fixed Price Contracts



**As of FY 2016, roughly half of all DoD PBSA was fixed-price. This finding stands in contrast to the relative composition of civilian services contracts, 38% of which were fixed price as of 2015.**



# PBSA and Engineering Services



DoD engineering services spending by contract type

- ➔ The use of PBSA in engineering services contracting has declined over the last three years, while the proportion of Non-PBSA CPFF spending has increased.
- ➔ Most PBSA engineering services contracts are CPFF, though the proportion of PBSA FFP contracts is increasing.

# Challenges of PBSA

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- ➡ PBSA is rightly described as a “preferred acquisition strategy.”
- ➡ However, the use of PBSA is not appropriate for all acquisitions.
  - There is the potential for PBSA to be viewed as the “default” contracting strategy.
  - However, when an agency cannot describe its requirements and the circumstances and conditions of performance, PBSA is probably not the right strategy.
- ➡ There is not a simple template for the appropriate contract type, metrics, and/or incentives.
- ➡ Inappropriate use or implementation may undermine the effectiveness of the service provided .

# **Navy-Marine Corps Intranet (NMCI)**

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- ➡ Awarded to Electronic Data Systems Corp in 2000, the NMCI contract was performance based, firm-fixed-price, indefinite-delivery/indefinite-quantity vehicle with performance incentives
  - The initial contract required delivery of approximately 415,000 networked computers (“seats”)
- ➡ “It was initially assumed that the number of [outdated legacy] applications was in the thousands. After contract award, the Navy and EDS were shocked to find the number was actually 100,000” (Jordan, 2007).
  - Implementation was slow--by May 2002, only 4,000 seats had been installed
  - In 2003, second quarter losses prompted EDS shareholders to file a class-action lawsuit against the company alleging securities fraud stemming from, primarily due to “problem contracts.”

# NMCI

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- ➡ Firm-fixed-price contracts for high-risk, ambitious programs do not necessarily reduce program costs.
  - The Navy had to award a contract to an additional contractor to help manage IT services.
  - This action solidified the subtle—if unofficial—shift away from the NMCI's initial goal of information superiority (in the form of a battle-ready information system) to simply furnishing the Navy with an operational information network.
- ➡ Metrics included in performance-based contracts may produce unfavorable outcomes.
  - For instance, the metrics involving e-mail transfers and the percent of bandwidth used to provide connection to external networks provided EDS an incentive to severely limit the size of e-mail attachments, frustrating many who were unable to transmit larger files.

# Stryker

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- ➔ Awarded to General Dynamics Land Systems in 2000, the initial PBL for the Stryker vehicle fell under a cost-plus-fixed-fee portion of a larger contract for vehicle manufacture and delivery.
- ➔ The CPFF covered “all fielded vehicles in garrison or deployed” for a five year period.
- ➔ GDLS won two follow-on PBL contracts, in 2007 and 2012, extending sustainment and support for the growing Stryker fleet.
- ➔ Operational readiness rates averaged 96% from October 2003 through September 2005 (GAO, 2006).
  - The Army consistently noted that GDLS was providing impressive levels of support.
- ➔ Contract cost performance is less clear.
  - A 2012 DoD IG report found that the follow-on contract’s continued use of a sole metric (readiness) in combination with a high-ceiling, cost-plus contract unduly incentivized the contractor to accumulate significant excess inventory valued at \$335.9 million (DoD IG, 2012).

# Summary of Findings

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- ➔ DoD has made impressive gains in its implementation of PBSA.
  - Close to 70% of DoD services contracts are now categorized as PBSA.
  - The rate of PBSA within the DoD has increased steadily since 2010, even as overall spending on services has decreased.
- ➔ PBL implementation, however, in terms of the number of programs, has declined.
- ➔ The DoD has outpaced the rest of the government in the implementation of PBSA.
- ➔ The proportion of DoD performance-based contracts that are fixed-price has increased to approximately 50% in 2016, up from a low of 29% in 2007.
- ➔ PBSA may not be the right choice for all acquisitions; when they are used, performance-based contracts are not always structured appropriately.
- ➔ Implementing PBSA is more challenging than traditional contracting, and requires a different skillset.