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**Incentive Contracts: The Attributes that Matter Most in Driving
Favorable Outcomes**

by

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Incentive Contracts: The Attributes that Matter Most in Driving Favorable Outcomes

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Abstract

Incentive contracts have been in place for many years. They represent just one of many contractual tools the Department of Defense has at its disposal to drive certain performance behaviors. Lately, the usefulness of incentive contracts has come into question. The dividends have not been readily apparent. This research study set out to determine what generally afforded strong correlations between incentive-type contracts and expected performance outcomes. Twenty-five weapon system acquisition programs offices were interviewed in various stages of their acquisition lifecycles. A standardized questionnaire-survey was used to capture the data. This presentation prepared for the Fourth Annual Acquisition Research Symposium will address the findings and include a few key recommendations intended to better arm the acquisition workforce on the use of incentive contracts.

Discussion

In the past several years, major weapon system development programs have drawn significant attention. The reasons are varied. In some cases, costs have skyrocketed; schedules have experienced significant delays; and performance levels have failed to meet government expectations despite the employment of management tools designed to control costs, preserve schedules and influence performance outcomes. Some of these management tools (including contractual measures, as originally conceived and specified by the *Federal Acquisition Regulations (FARs)*) can give tremendous flexibility to the implementation of government contracts. The use of such contractual measures is one of many handy tools in a program manager's toolkit to help drive performance behavior. However, the GAO recently identified an apparent disconnect between the use of certain measures like incentives and expected outcomes in weapon system acquisitions. In short, it appeared that incentives were not driving performance outcomes as originally envisioned.

So, what about incentives? Are they still a good tool to drive performance behaviors despite the recent criticism and doubt? Have organizations found a way to effectively apply incentives and demonstrate the usefulness of incentives? The answer to all of these questions is, "yes." There is no "one size fits all," but the incentive attributes that seemed to matter the most in influencing performance outcomes for the 25 programs, and generally afforded strong correlations between incentives and desired performance were indicated by the findings.



Conclusion

Strongly Communicated Expectations and Feedback: Frequent and unambiguous communication/feedback made a noticeable difference for incentive contracts. Even though incentive contracts require some additional administrative burden, the outcome justified the increased workload of feedback for most programs under this research review. Continuous and open dialogue at both junior and senior levels led to early discovery and timely reconciliation of many known issues and helped keep a program on track.

Metrics: The selection of key and enduring measures within an evaluation period and of measures that could be connected to subsequent evaluation periods made a noticeable difference for incentive contracts. Key measures can validate whether or not a program achieved certain necessary intermediate milestones along a program's critical glide path. They confirm program momentum. They served as an early warning system—a bell weather—and answer the age old question, “Are we on track”? They also fill a huge role as performance benchmarks. Those interviewed under this research project said when they effectively employed key measures, such tools also helped them navigate their program pathway despite the unavoidable programmatic turbulence. Their measures surfaced either as two types: objective and/or subjective. Without question, selecting the correct type of measures presented the biggest challenge. The ability to hard-wire them to achievable outcomes makes objective measures like Technical Performance Measures (TPMs), Cost Performance Indices (CPIs), Schedule Performance Indices (SPIs), etc., invaluable gauges. They served as tremendous forecasting devices when they were carefully connected to outcomes.

Base Fee: The incorporation of base fee in award-fee contracts made a noticeable difference. Of the 25 organizational interviews, many used some form of base fee on cost-plus-award-fee contracts. Numerous organizations implementing cost-plus-award-fee (CPAF) valued base fees as a leverage tool. Even though the *Federal Acquisition Supplement (DFARS) 216.405-2(c)(iii)* allows up to 3% of the estimated cost of the contract exclusive of fee, a contractor could provide “best efforts” for the award-fee term and still receive no award. As a result, there was some pressure on the government to provide a portion of the award fee for “best efforts.” Further, our research team found that senior defense industry personnel welcomed the use of base fee to better delineate the difference between “best efforts” (e.g., fee) and “excellence” (e.g., award).

Trained and Experienced Personnel: Training and experience made a noticeable difference for incentive contracts. Nothing seems to have a more dramatic impact in DoD like training and experience. Training draws its roots from practical experience. It's systematic. We learn from our successes and failures in the field and make adjustments accordingly in the way we train. The mantra, “we train like we fight and fight like we train” is pervasive within the warfighter arena and, ultimately, leads to advantages on the battlefield. Without question, practical experience helps build better training programs. It can overcome unforeseen shortfalls and the inevitable prevailing uncertainty even within proven systems. It's no different for incentive-type contracts. Organizations that had formalized instruction and/or coached their personnel on the use of incentives indicated such training more favorably influenced outcomes.

The exploitation of an increasingly popular collaborative medium called Communities of Practices (CoPs) on the DAU Acquisition Community Connection offers access to these particular techniques and an even wider array of current experiences and lessons learned regarding incentives ranging from the general to the specific. The DAU has already established a site on the ACC, Award and Incentive Fee Contracts. See



<https://acc.dau.mil/CommunityBrowser.aspx?id=105550>). These and other collaborative training aids are critical because once an incentive strategy is in place, its maximum value truly depends on its ability to implement techniques that drive favorable outcomes. There's no better source of experts who face contract incentive challenges every day than the acquisition workforce who is charged with appropriately implementing the techniques that drive outcomes, appreciably.



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