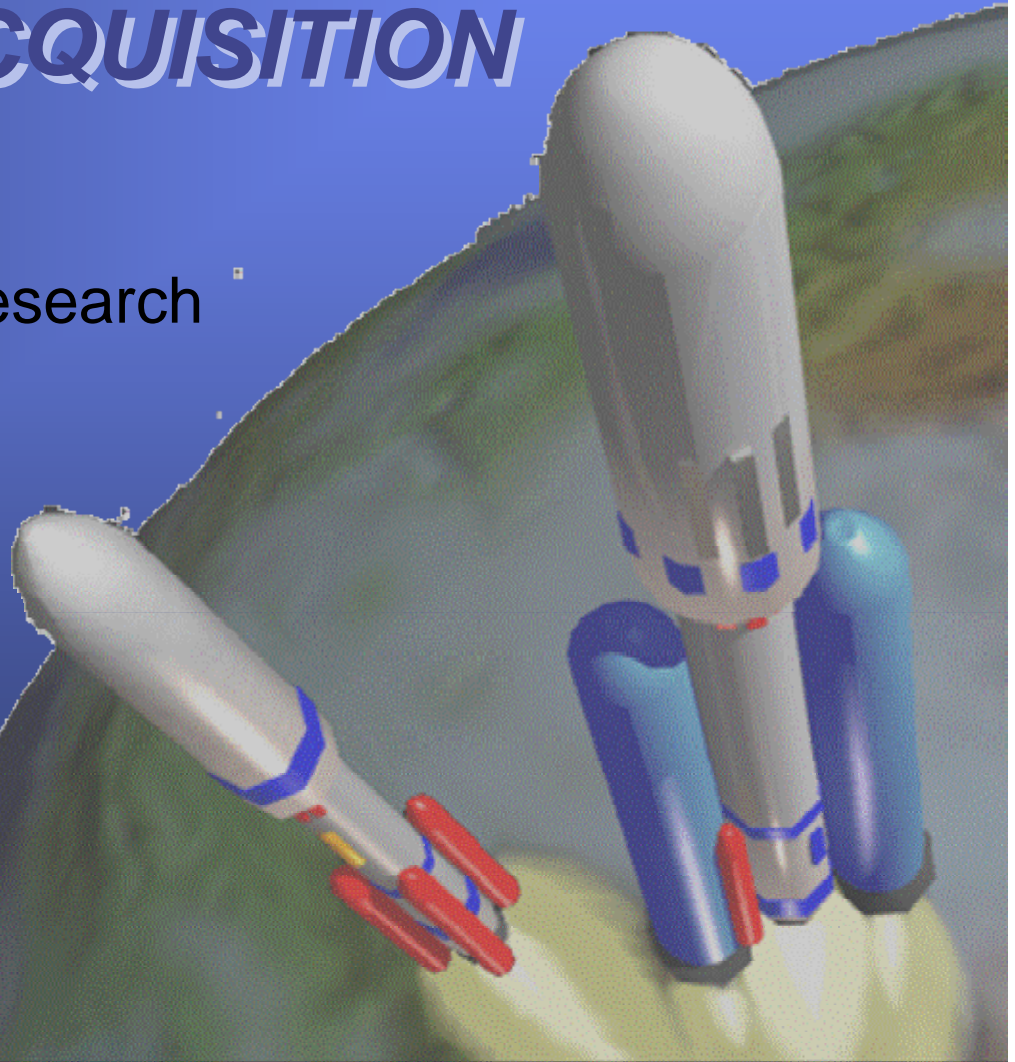




INCENTIVE ARRANGEMENTS FOR SPACE ACQUISITION

NPS Annual Acquisition Research
Symposium

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OUTLINE

- ▶ **Historical Use of Incentives at SMC**
- ▶ **Incentive Reform**
- ▶ **Current Initiatives**
- ▶ **Way Ahead**





WHAT ARE INCENTIVES?

▶ **GAO defines Incentive Contracts as:**

- **“A contract used to motivate a contractor to provide supplies or services at lower costs and in certain instances, with improved delivery or technical performance, by relating the amount of fee to contractor performance”***

- ▶ **Incentives, for the purpose of this briefing, may be defined as the approach by which the customer motivates performance by the use of positive and negative provisions to a Kt for a product or service**

* *GAO Report 06-66, DOD's use of Monetary Incentives*





DO INCENTIVES WORK?

- ▶ **Fundamental Question – Still Being Debated**
- ▶ **GAO Suggests that there is no evidence that Incentives alter behavior**
- ▶ **Most Contractors want to do good work – Do Incentives help set priorities?**
- ▶ **Incentives are Situational**
 - **Motivational prioritization is critical**
- ▶ **All Contractors Consider Fee when evaluating Business Opportunities, some cases fee not primary concern**
 - **If not Fee, then what?**



DO INCENTIVES WORK?

- ▶ **How Can the Government Make Performance a Condition of Receiving Fee? Should It?**
- ▶ **How about payback – a good idea?**
- ▶ **For Service Effort, What Incentive Arrangements Motivate Performance?**
 - **PBSOW's tied to fee?**
 - **Where and How Much?**
- ▶ **Especially in today's harsh economic times – future Business is High on contractor's list of importance**



HISTORICAL USE OF INCENTIVES AT SMC?

- ▶ **1970's - 80's Incentives included CPIF R&D contracts, orbital incentives, cost incentives, warrantees, EPA's DTUPC, VECP**
 - **Adversarial relationship with Industry**
- ▶ **80's - 90's Druyun Era rise of the use of Award Fee, Fixed-Price development contracts, (rise and fall)**
- ▶ **90's - 00's Era of Acquisition Reform – TSPR, commerciality, Lightning Bolts, Insight, IPT's**
 - **Non-adversary relationship (teammates)**
- ▶ **'05 - present – Back to Basics, verify performance, CPIF and AF, Block Development, Shared responsibilities, Incentives tied to acquisition outcomes**
- ▶ **Future – More oversight, harsher consequences for “failure,” Warning of becoming “too close”**



INCENTIVE REFORM

- ▶ **GAO Report, Defense Acquisitions, Dec 2005**
 - Recommended reform of current incentive practices
 - Recommended fee tied to acquisition outcomes
- ▶ **USD (AT&L) and SAF Policy Letters, Mar-Apr 2006**
 - Linked fees to performance outcomes
 - Rollover to be used only on an exception basis
- ▶ **SMC/CC Letter dated 15 Aug 2006**
 - Implemented GAO recommendations, and USD(AT&L) and SAF policies
- ▶ **DPAP Policy dated 24 Apr 2007**
- ▶ **SAF/AQ Policy 15 Jun 2007**
- ▶ **SMC/CC Policy dated Dec 2008**
- ▶ **New Report commissioned by Congress in 2008**
to Review impact of DoD policy changes
- ▶ **Visit from GAO – preliminary indications are that they believe that SMC is on board with new policy**





INCENTIVE REFORM

▶ SMC/CC 2006 Incentive Policy Letter:

- Highly encouraged use of CPIF contracts, with potential award fee**
- Mandated that performance, schedule, and cost incentives & their order of importance to the program to be discussed in acquisition strategy plans**
- Encouraged Award Fee plans to link fees to mission success, achievements, deliverables, and objective results**
- Chartered SMC/PK to develop an SMC Incentive Guide to provide guidance in implementing SMC/CC policy**



INCENTIVE REFORM

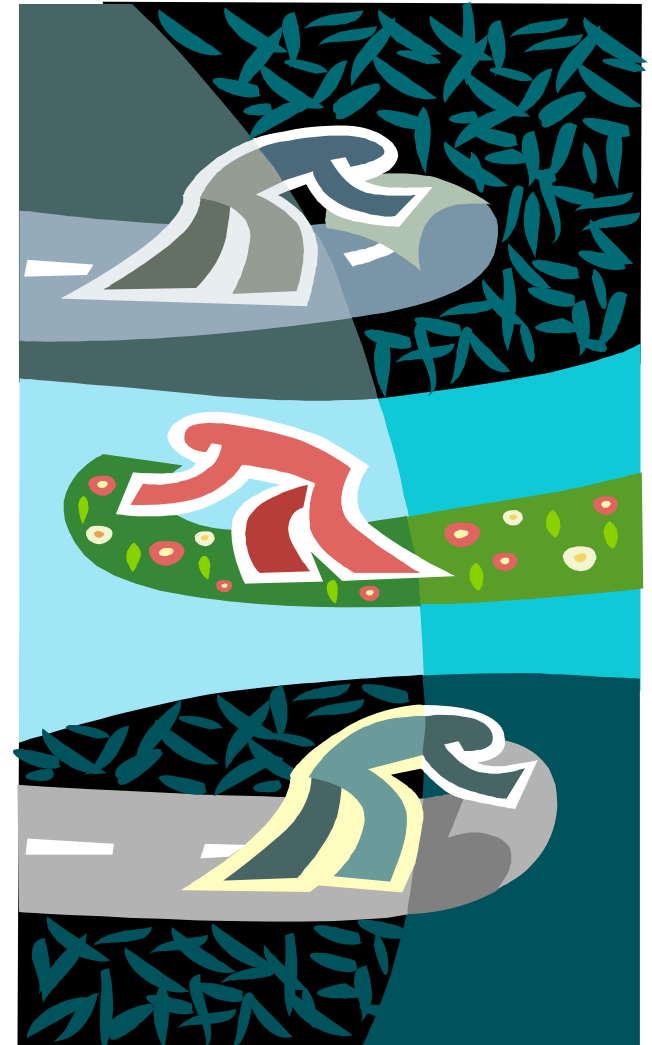
▶ SMC/CC 2006 Incentive Policy Letter (cont.):

- Encouraged consideration of full range of incentive Kt types & features**
- Emphasized use of hybrids that address cost, schedule & performance**
- Discouraged overly complex incentive arrangements**
- Encouraged collaboration with industry**
- Noted that CPAF contracts, with subjective award fee criteria no longer were the preferred incentive approach**



WAY AHEAD? - GET “BACK TO BASICS”

- ▶ **Emphasize deliberate risk apportionment**
- ▶ **Utilize four-staged acquisition approach**
- ▶ **Develop rhythm of research, design, build**
- ▶ **Improve collaboration on requirements**
- ▶ **Cost at and fund to 80% confidence**
- ▶ **Emphasize Systems Engineering and Integration**





CURRENT INITIATIVES

- ▶ **Cost incentives relate profit or fee directly to results achieved by Ktr**
- ▶ **Are normally based on a share formula**
 - (i.e., fixed-price incentive (FPI) or cost plus incentive fee (CPIF) contracts) or the payment of a fee from an award fee pool
- ▶ **To be effective they must be:**
 - Quantitative
 - Clearly related to the desired outcome
 - Achievable
- ▶ **Must offer rewards commensurate with risks the contractor assumes**
- ▶ **Cost to the Government must not be overemphasized or underemphasized relative to other program objectives**



CURRENT INITIATIVES

- ▶ **Cash flow is important to contractors in any incentive plan –**

- ▶ **Some arrangements that aid cash flow are:**
 - **Provisional payments for award fee**

 - **Award fee with a base fee**

 - **Performance-based payments for FFP contracts**
 - ▶ **Allow Ktrs to get paid upon completion of specific events**





CURRENT INITIATIVES



▶ Performance Incentives

- **Are designed to relate profit to the contractor's achieved results**
- **Based on specified targets: Quantifiable/Achievable/Easily Administered**
- **Should be used when they will induce better quality performance**
- **May be positive, negative, or a combination of both**
- **Performance-based SOW's are mandatory for Service Contracts**



CURRENT INITIATIVES

▶ Performance Incentives

- **Should be applied selectively to motivate efforts that may not otherwise be emphasized & to discourage inefficiency**
- **Incentives should apply to the most important aspects of the work, rather than to each individual task**
- **Limit number of incentives, otherwise**
 - ▶ **Dilutes the monetary importance of each requirement**
 - ▶ **Creates an administrative burden for the government focus on core, critical outcome-based expectations**





CURRENT INITIATIVES

- ▶ **Schedule Incentives focus on getting a contractor to meet or exceed **minimum** delivery requirements**
 - They can be defined in terms of:
 - ▶ Early delivery
 - ▶ Attaining or exceeding milestones
 - ▶ On-time criticality
 - ▶ Meeting rapid-response or urgent requirements
- ▶ **Reward to the contractor for accepting schedule risks must be consistent with the level of risk it assumes**





CURRENT INITIATIVES

▶ Award-Term Contracts

- Award-term contracts reward exceptional contractor performance by extending

the period of the contract for a prescribed period of time

- Must comply with the *Competition in Contracting Act (CICA)*



- ▶ To comply with *CICA*, ensure the maximum potential term and price/cost for that effort

was part of the competition or the J& A Documentation



QUESTION

Is competition always a positive incentive?





INCENTIVES TODAY

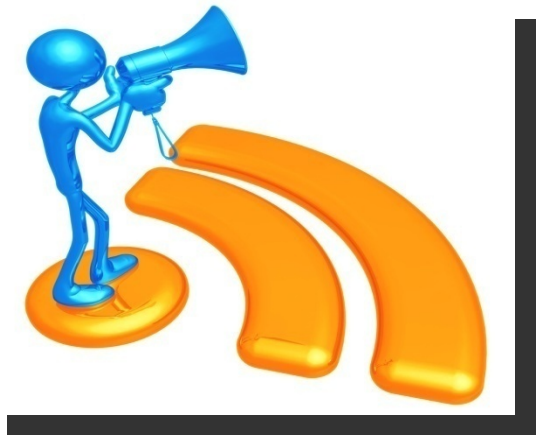
- ▶ **Senior DoD Leadership is averse to award and fixed fee contract types**
 - Proper justification will ensure use of these types can be approved

- ▶ **New SMC contracts/restructures are using more objective incentives**
 - GPS III, NPOESS, WGS, SBIRS

- ▶ **Payback provisions have become popular**
 - Pro's vs. Con's

- ▶ **Senior leadership is encouraging “inclusive” approach to incentives**
 - Multiple incentives

 - DCMA participation recommended





INDUSTRY FEEDBACK

- ▶ **Wants base fee and provisional payments of award and incentive fees**
- ▶ **Disagrees with no fee for mission failure (high risk business)**
 - **Competing for capital with other business sectors**
 - **Wants proportionate fee for partial successes**
- ▶ **Rollover seen as effective tool**
- ▶ **Takes exception to withholding of cost**
- ▶ **Wants higher award fee pool in light of objective criteria**
- ▶ **Wants negative incentives offset with positive or higher pools**





SUMMARY

- ▶ Incentives should be designed so that the contractor earns the negotiated profit/fee if it meets the contract requirements
 - Exceeding the minimum contract requirements should result in more profit/fee
 - Not meeting Kt requirements should result in less than the negotiated profit/fee
- ▶ Incentives in the pre-delivery phase should motivate the contractor to achieve performance requirements, schedule, and cost in that order
- ▶ In post-delivery phase, remedies should be sought for missing Kt targets
 - Positive incentives should be provided for exceeding contract targets
- ▶ An incentive plan should be created that explains:
 - The nexus between the cost, schedule, and performance incentives, and
 - The allocation of the negotiated fee/profit to each area



SUMMARY

- ▶ **Correlate incentives to desired program results**
- ▶ **Use single or, when appropriate, multiple incentives**
- ▶ **Make incentives challenging, but achievable**
- ▶ **Recognize contractor motivations as well as Government needs**
- ▶ **Establish milestones associated with subcontract performance if critical**
- ▶ **Ensure to not overburden the Government and Ktr with administration**
- ▶ **Consult with legal on funding of incentives – must be enforceable**
- ▶ **Remember the stage of the acquisition when establishing incentives**





The Way Ahead

- ▶ **WHERE ARE WE HEADED?**
 - **More Oversight – DCAA, GAO, IG, Auditors**
 - **FIXED-PRICE CONTRACTS**
 - ▶ **Development & Production**
 - **Harsher Penalties for Failure (Schedule & Cost)**
 - **Less Team Orientation – Possibly More Adversarial**
 - ▶ **DCAA paradigm**
 - ▶ **IPT Pricing (Alpha contracting, Shoulder-to-shoulder)**
 - **More Competition**
 - **More Help from our friends in Congress**
 - ▶ **Regulatory and Statutory**
 - **Back to the 80's?**



QUESTIONS?

