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HOW TO MAKE INCENTIVE AND AWARD FEES WORK

Alan S. Gilbreth and Sylvester Hubbard

Incentive and award fees are not driving performance outcomes as originally envisioned. In 2005, the Government Accountability Office (GAO) identified an apparent disconnect between the use of certain measures like incentive and award fees and expected outcomes in major acquisitions (GAO, 2005). In response to the GAO report, the authors conducted a research effort to better understand where incentive and award fees had favorable impact on performance outcomes and why. This article summarizes the findings of the research, highlights several organizations that clearly used techniques that drove favorable outcomes, and provides recommendations and take-aways that will promote effective and efficient incentive and award fee programs.

Recently, major acquisition activities have received significant attention due to failure to achieve desired outcomes, such as meeting cost and schedule goals and delivering desired capabilities. The GAO has looked closely at the effectiveness of incentives in DoD contracts. They selected a sample of 93 contracts from a study population of 597 DoD incentive and award fee contracts that were active between fiscal years 1999 and 2003. Fifty-two contracts (56 percent of the sample) were award fee, 27 contracts (29 percent of the sample) were incentive fee, and 14 (15 percent of the sample) included both incentive and award fee provisions. The GAO published their report in December 2005 (GAO-06-66) and asserted that "DoD has paid billions in incentive and award fees without favorably influencing performance outcomes" (GAO, 2005).

In response to the GAO report, then Under Secretary of Defense for Acquisition, Technology and Logistics Ken Krieg directed the Defense Acquisition University (DAU) to conduct a research effort to better understand where incentive and award fees had a favorable impact on performance outcomes and what made these programs effective. The goal of the research was not to validate or reclama the GAO study. Instead, the research effort was to investigate where the acquisition community implemented award and incentive fee practices that had a favorable impact on performance outcomes and could be adopted as best practices throughout the acquisition community. The authors collaborated with faculty members from other DAU regions on this research (Tremaine, 2007) and specifically conducted surveys of program offices located at Tank-Automotive and Armaments Command Life Cycle Management Command (TACOM LCMC) in Warren, MI; Air Mobility Command (AMC) at Scott Air Force Base (AFB), IL; and Aeronautical Systems Center (ASC) at Wright-Patterson AFB, OH. The program offices interviewed (Table 1) were recommended by their major commands as having an effective and efficient award or incentive fee program.

TABLE 1. PROGRAM OFFICES INTERVIEWED

ORGANIZATION	PROGRAM OFFICE
TACOM Life Cycle Management Command (LCMC)	Army Future Combat Systems (FCS)
TACOM LCMC	Army Total Integrated Engine Revitalization (TIGER)
TACOM LCMC	Army Biological Detection System
Aeronautical Systems Center (ASC)	B-2 Aircraft-Radar Modernization Program-Frequency Change
ASC	C-17 Aircraft-Sustainment
ASC	F-15 Aircraft-Suite 6 Software Upgrade for A, D, & E Models
ASC	F-16 Aircraft-Operational Flight Program Development
ASC	Global Hawk-Unmanned Aerial Vehicle
Air Mobility Command (AMC)	Global Transportation Network (GTN)
AMC	Air Mobility Command Contractor Tactical Terminal Operations

The research team conducted each survey interview with the program or project manager and contracting officer for the particular program or project. Even though the team did not meet individually with the industry representatives, contractor perspectives were considered an important element of this research.

During midsummer 2006, DAU hosted an Industry Day at Fort Belvoir, VA. Eighteen senior-level industry representatives from throughout the United States came to Fort Belvoir and spoke candidly about their experience with incentive contracts. Table 2 represents a summary of their consensus views.

This article highlights the award and incentive fee findings that resulted in favorable outcomes and examines the innovative use of award and incentive fee, as demonstrated in several acquisition programs.

TABLE 2. SUMMARY OF CONSENSUS VIEWS

1.	Government construction of the award fee plan (including metrics, incentives, etc.) may not link with the offeror's proposed solution or motivations
2.	Industry welcomes the use of base fee to better delineate the difference between "best efforts" (e.g. base fee) and "excellence" (e.g. award fee)
3.	In some cases, the government does not follow its own policies on award fee
4.	On occasion, award fee evaluation criteria are poorly explained or justified and communication of award fee goals and criteria are not clearly explained
5.	It is difficult to establish the relationship between awards for month-to-month activities to the goals of a multiple-year program. The linkage is not always apparent
6.	Administration of award fee criteria can change in post award and create problems during contract execution
7.	Government personnel are not always adequately trained in managing award fee contracts
8.	Post-award administration of award fee contracts is time and resource intensive
9.	Desired outcomes are not always driven by the award fee because of insufficient funds available and subjectivity of the final evaluation
10.	There are sometimes inconsistencies in the timing of the award fee in line with the evaluation criteria
11.	Government and contractors sometimes have different perceptions of the purpose of award fees
12.	In some cases, there is government failure to understand the economics of defense contracting and its impact on government contractors
13.	From time to time, there is inappropriate use of award fee contracts
14.	Requirements are sometimes too subjective and do not measure outcomes that are sought by DoD

FINDINGS

The eight findings presented here are the result of survey data from several program offices and other support material, which allowed the authors to draw conclusions that the information and techniques would help acquisition organizations drive favorable outcomes in their incentive programs. The intention is to have acquisition organizations review all of the findings in a holistic manner to truly drive favorable outcomes.

REGULATORY GUIDANCE RELATING TO INCENTIVE CONTRACTING IS SUFFICIENT

Program managers and contracting officers interviewed supported the view that the Federal Acquisition Regulation (FAR) and the Defense Federal Acquisition Regulation Supplement (DFARS) were clear and complete. The problem is that in many cases, these regulations are not followed when a specific situation occurs that requires a decision regarding incentive contracting. For example, cost-plus-award-fee (CPAF) contracts certainly have their place in an acquisition professional's tool kit, but FAR 16.405-2(b) states that a "cost-plus-award-fee contract is suitable for use when the work to be performed is such that it is neither feasible nor effective to devise predetermined objective incentive targets applicable to cost, technical performance, or schedule" (FAR, April 2008). It also goes on to further define more specific considerations for application. The logic behind the FAR verbiage is that the first choice to be considered is not award fee, but incentive fee using predetermined objective incentive targets applicable to cost, technical performance, or schedule. Given this logic, one could reasonably conclude that the DoD would use more incentives with predetermined objectives rather than award fee in their contracts.

Fundamental to making a good business decision on which incentive tool will yield the desired behavior is a thorough knowledge of program risk and contract types, and particularly how contract type impacts risk.

The same logic from the paragraph above applies to fixed-price incentive contracts versus fixed-price contracts with award fee. FAR 16.404(a) states, "award-fee provisions may be used in fixed-price contracts when the government wishes to motivate a contractor and other incentives cannot be used because contractor performance cannot be measured objectively" (FAR, April 2008). Again, given this logic, DoD would use more incentive contracts with predetermined objectives rather than fixed price contracts with award fees.

Fundamental to making a good business decision on which incentive tool will yield the desired behavior is a thorough knowledge of program risk and contract types, and particularly how contract type impacts risk. Part 16 of the FAR has an excellent treatment of contract types. The use of appropriate contract types and associated incentives represents a foundational communication and risk tool for the acquisition professional.

This first finding might lead one to conclude that if award fee requires additional administrative effort, people, and cost, and should only be used when the work to be performed is such that it is neither feasible nor effective to devise objective incentive targets, then why use award fee at all? The answer is there are times when only a subjective incentive will achieve the desired goal or outcome. Subjective measures may be appropriate to drive critical processes, management responsiveness, and other unquantifiable behaviors. In those situations, award fee may be used as long as the expected benefits are sufficient to warrant the additional administrative effort and cost. Due to the complexity and difficulties associated with award fee contracts, most of the findings in the remainder of the article will focus on award fee.

CONSISTENT INCENTIVE PHILOSOPHY

Every government buying activity should have a clearly defined incentive philosophy and broadly communicate that philosophy to its personnel and potential sources. Remember, however, that consistency and flexibility are not mutually exclusive. A consistent incentive policy can and should provide flexibility to arrive at an appropriate incentive strategy that suits the circumstances of each contract action. This may cause one to use multiple incentive types, as is occurring in many successful incentive programs.

Use the contract and incentive plan to communicate the philosophy and overall mission objectives to the contractor. The result will be consistent communication between the buying activity and the contractor community.

MULTIPLE INCENTIVE-TYPE CONTRACTS—BUILD TO NEED

According to the majority of organizations interviewed, the combination of objective and subjective measures indicated the strongest correlation to expected outcomes. The subjective measures were only used when objective measures alone would not achieve the desired outcome to the same level.

BASE FEE—AN INTEGRAL PART OF COST-PLUS-AWARD-FEE CONTRACTS

The research team found that organizations that were successfully implementing CPAF understood the purpose and value of using a base fee as a leverage tool for the proper use of the award fee portion of CPAF. The DFARS 216.405-2(c) (iii) currently states, “the base fee shall not exceed 3 percent of the estimated cost of the contract exclusive of fee” (DFARS, July 2006).

Using a base fee allows the government to reward the contractor’s “best efforts” without compromising the intent of the award fee portion. In a scenario where the contract calls for no base fee, contractors could provide their best efforts for the award fee period and receive no fee if they did not achieve "excellent" performance. Best efforts refers to the contractor's responsibility to meet the contract requirements under the terms of the contract. When no base fee is provided in the contract, it puts pressure on the government to provide some portion of the award fee for best efforts. This opens the door to more administratively burdensome measures like the 2003 rule in DFARS 216.405-2(b)(3) that permits provisional award fee payments. Properly using base fee could alleviate the need for provisional award fee payments. When a portion of the award fee is paid for best efforts, it opens the government to criticism by oversight agencies for providing award fee for less-than-excellent performance.

When no base fee is provided in the contract, it puts pressure on the government to provide some portion of the award fee for best efforts.

If a base fee is in the CPAF contract, the contractor will receive some amount above costs for best efforts. For example, the F-15 Systems Program Office (SPO) communicated with the contractor that they were only going to pay award fee for excellence, and in their deliberations the contractor asked for a 3 percent base fee. The F-15 SPO agreed with the contractor, the logic being that it would provide the SPO the leverage they needed to only pay the award fee portion for excellent performance. To further explain the leverage aspect of the base fee in a CPAF contract, the base fee should be paid regardless of performance on the contract as long as the contract is not terminated. On government cost reimbursement-type contracts, the actual payment of a base fee typically accompanies a contractor's regular invoice for reimbursement of costs.

Other programs that have used CPAF successfully appear to be recognizing the value of using a base fee. To distinguish excellent performance from best efforts, the Global Hawk SPO revised their contract to include a 3 percent base fee.

The defense contractors interviewed at Fort Belvoir agreed in principle that in CPAF contracts, some amount of base fee for their best efforts would more clearly delineate the difference between payment for best efforts and payment for excellent performance (award fee), thereby reducing the criticism concerning the use of award fee contracts.

EVALUATION PERIODS—LINKAGE IS KEY

One common data point for determining evaluation periods is linkage to significant events. Using events or outcomes to determine award fee periods instead of time ensures that the award fee period will be appropriate to the events or outcomes. When award fee is based on time, there is an assumption of what events or outcomes will occur in that time period; and that assumption also drives the amount of award fee for the period. In complex contracts, schedules often slip, so if the award fee period is based on time, and a significant event or outcome slips to another award fee period, the government could have an inappropriate amount of award fee available for the wrong reasons, thus not achieving the objectives of the award fee plan.

Examples of evaluation periods linked to significant events are: (a) The F-15 program tied the award fee periods to program milestones so the award fee periods varied from 6 to 9 months depending on when the milestones were reached; (b) Global Hawk added alignment with the contractor's fiscal year; and (c) Both the Army's Future Combat Systems and Total Integrated Engine Revitalization Program used cost-plus-fixed-fee (CPFF) contracts with incentive events.

The events were tied to contract outcomes and varied with each period. These examples clearly indicate that when possible, evaluation periods should be linked to events or outcomes rather than time.

FEEDBACK—SHOULD BE FREQUENT AND UNAMBIGUOUS

Feedback in incentive contracting is important, particularly in contracts with an award fee element because they require so much administration. The administrative burden can seem to be bureaucratic and excessive. However, the research results showed that monthly feedback within the joint government and contractor team was more effective than quarterly or biannual feedback. Continuous and open dialogue at both junior and senior levels led to early discovery and timely reconciliation of many known issues and helped keep the program on track. Many program offices emphasized that they were very open with the contractor; therefore, the contractor was never surprised. Additionally, some programs instituted certain techniques like "emphasis letters" during the award fee periods to stress the importance of certain outcomes or events. One particular program office employed what they called a "barometer report" during interim reviews to ensure that information from monitors was readily available to manage at critical junctures.

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Several program offices found it necessary to establish a glossary, particularly for terms related to critical outcomes or events in incentives. The glossary was used as a tool to improve communication during the evaluation briefings. Glossaries were also beneficial when team member changes occurred. A good example for the use of glossaries occurred in the B-2 SPO on the Radar Modernization Program–Frequency Change contract. The program was in the systems development and demonstration

(SDD) phase, and there was a requirement in the contract that the radar make first flight to demonstrate success. The government understood first flight to mean aboard an aircraft and demonstrating functionality. The contractor understood a successful first flight to be only aboard an aircraft. They never intended the radar to demonstrate functionality on first flight. Contracts that include incentives must be unambiguous, and glossaries are a good tool to prevent misunderstandings.

CONDUCT TRAINING AND USE EXPERIENCED PERSONNEL

Nothing seems to have a more dramatic impact in DoD than training and experience. One learns from successes and failures in the field, and then makes adjustments. Incentive-type contracts are no different. Many of the program offices responding to the survey incorporated the practical incentive/award fee experience of personnel already embedded in their organizations. Other program offices formalized instructions while continuing to coach personnel on the use of incentives. Several program offices suggested that the most effective training is just-in-time training with the entire incentive team attending. They emphasized that the entire team includes the monitors, program managers, procuring contracting officers, board members, fee determining official, and the administrative contracting officer, if applicable. Some program offices suggested that performance monitors observe how other program offices conduct assessments to help them appreciate the depth of evaluations. The interview surveys clearly lead to the conclusion that each program office must develop its own unique, just-in-time incentive training based on the incentives in the acquisition and the experience of the acquisition team. Depending on the experience of the team, it may be necessary to obtain assistance from other program offices or training organizations such as the DAU. Training as a team is essential to success.

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ROLLOVER—ANOTHER INCENTIVE TOOL

Unearned award or incentive-based fees may be carried forward for possible award in subsequent evaluation periods; however, this process should be the exception and not the rule. The vast majority of the program offices surveyed expressed caution and noted that they either used rollover judiciously or not at all. Rollover has certain disadvantages regardless of how or when it is used: it devalues previous periods and it allows contractors to lower performance in some periods without consequences (Garrett & Gilbreth, 1992).

In certain limited situations, rollover may be appropriate where circumstances beyond the control of the contractor prevent excellence in performance or where the government wishes to motivate excellent performance in subsequent award fee periods. An example of the latter could be maximizing the incentive for the contractor by allowing rollover on pre-flight testing when the successful launch of a satellite is the government's ultimate goal.

REALISTIC INCENTIVE STRATEGIES—PATHWAY TO SUCCESS

As described in the findings, the research team visited many acquisition organizations that used specific techniques to drive favorable outcomes. This section highlights several acquisition organizations that are using incentive strategies tailored to relate very well to their desired contractual outcomes. This research demonstrated that one size or type of incentive strategy does not fit all situations or outcomes. While the research team could have used examples from many other acquisition organizations, the variety and types of incentives and outcomes were key in these selections.

AIR MOBILITY COMMAND (AMC) CONTRACTED COMMERCIAL GATEWAY SERVICES AT BALTIMORE–WASHINGTON INTERNATIONAL AIRPORT

The contract is a fixed-price-award-fee (FPAF) services contract for passenger handling at $1 million per year for 5 years. At first glance, many acquisition professionals would say they do not like award fee on fixed-price contracts, but AMC thought otherwise. According to the contracting officer:

> We use an award fee for the Commercial Gateway at Baltimore because this contract provides a very customer-focused service. The contract spells out the requirements needed; however, there is much more the contractor can provide to ease the stress of our travelers. We all recognize good customer service when we see it, but it is difficult to put in writing. As various situations arise, it is very beneficial to have a contractor who recognizes ways they can assist and has the initiative and authority to step up and do so.[1]

The goal of the program office in using award fee was to motivate the contractor to provide the military with the best commercial air service possible. The award fee earned by the contractor is determined at the completion of two award fee periods per year, but performance monitors submit their evaluation reports to the Functional Director (FD) every month. Reports fully document the contractor's performance during the period. An overall rating of excellent, very good, good, satisfactory, or unsatisfactory is assessed on each completed report to the FD. In addition to the reports, performance monitors collect all observations (e.g., customer complaints/surveys, etc.) and submit them to the FD every month. All reports/performance indicators are consolidated by the FD into a performance report and submitted to the contracting officer with a recommended rating. These reports are then forwarded to the contractor within 20 days after the close of each month. In making its recommendation, the Award Fee Review Board considers both the FD's report as well as the contractor's presentation.

The contractor was evaluated on four categories: customer service, passenger service, baggage service, and management. The categories were weighted evenly because the contractor needed to perform equally well in all categories. The award fee plan provided for no earned award fee for unsatisfactory performance. Additionally, the plan provided no award fee for satisfactory performance (meeting the terms and conditions of the contract). The rationale is that the profit inherent in the fixed-priced contract rewards the contractor for satisfactory performance.

This fixed-price award fee contract has been very successful and achieved favorable outcomes.

Both the program manager and contracting officer stated that the award fee was very effective at motivating the contractor, and this was validated by customer surveys. They also felt that objective criteria would not achieve the level of favorable outcomes that they have achieved with award fee. This fixed-price award fee contract has been very successful and achieved favorable outcomes. Customer surveys support that conclusion.

TACOM LIFE CYCLE MANAGEMENT COMMAND, FUTURE COMBAT SYSTEMS (FCS)

The FCS is the Army's new generation of manned and unmanned ground vehicles, air vehicles, and munitions, each of which taps into a secure network of superior combat information. These weapons systems are designed to be a fraction of the weight of current weapons, but are just as lethal and survivable.

The SDD contract is an innovative CPFF contract with incentive. The current fee arrangement includes a 7.5 percent fixed fee and a 7.5 percent incentive fee component. The incentive fee clause in the contract states:

> The key objectives of the SDD program are to prove out technologies and systems integration and to move the program forward into readiness for initial production, at an affordable cost and on schedule. The purpose of the incentive fee is to encourage and motivate the contractor to place the program in an appropriate risk position. To this end the government desires to incentivize the contractor for successfully meeting these objectives within certain performance, cost, and schedule constraints.[2]

The cost constraints are comprised of Life Cycle Cost Containment (LCCC) and Average Unit Procurement Cost (AUPC). The incentive fee is focused on the performance of selected program events. The SDD contract includes nine incentive events with four or five sub-criteria defined for each event. The events and sub-events associated with performance elements are defined in the Integrated Master Plan (IMP); the events and sub-events pertaining to the schedule elements are based on the Program Event/Milestone thresholds in the Acquisition Program Baseline (APB) or on the Integrated Master Schedule. The assessment and the percentage allocation of the available incentive fee are determined by mutual agreement of the government and contractor, and are incorporated into the contract clause at least one incentive event prior to the event under consideration. This continuous dialogue allows the government and contractor to reassess the criteria and determine if the weightings still have merit as written or should be altered, and if additional criteria should be added. In those cases where no incentive fee allocation is set for a specific event, a default allocation is applicable.

The incentive categories selected for the FCS SDD contract were designed to insure that the program office could afford to produce the items developed in SDD. The CPFF with Incentive strategy is very effective in motivating the contractor: the contractor is meeting cost and schedule objectives; technical performance is successfully proceeding as the first prototype nears delivery; and the Army is pleased with the contractor's performance.

TACOM LIFE CYCLE MANAGEMENT COMMAND, TOTAL INTEGRATED ENGINE REVITALIZATION (TIGER) PROGRAM

The TIGER program is an Army initiative to revitalize the Automotive Gas Turbine (AGT) 1500 engine fleet that supports the Abrams Tank and derivative vehicles—the M1A1 tank, M1A2 tank, System Enhancement Package (SEP) tank, and the Heavy Assault Bridge (HAB). The TIGER program will increase the reliability of the AGT 1500 engine by improving the overhaul processes to a near new engine standard, including durability-based design improvements, and will provide the support to Anniston Army Depot (ANAD) for the overhaul of approximately 1,060 AGT 1500 engines per year.

The contractor's performance is measured by four metrics: Engine Availability, Durability, Cost, and Small Business Participation.

The contract is fixed-price with an incentive fee consisting of a Program Year Transition (PYT) and PY 1 through PY 3 determinations. A unique aspect of the contract is that the incentive metrics are objective as one would expect, but also included therein are attributes similar to award fee such as having a review board and fee determining official. The board meets annually to evaluate and validate the contractor's performance. The contractor's performance is measured by four metrics: Engine Availability, Durability, Cost, and Small Business Participation. In each program year, the amount of the fee pool and the weights assigned to the four incentive metrics are determined based on the events of the particular program year. These metrics are considered to be of key importance in achieving the overall performance goal, which is to improve the mean time between depot return (MTBDR) from the current 700 hours to 1,400 hours at a reasonable cost by the end of PY 3.

In each program year, the contractor will be challenged to exceed the government threshold. If contractor performance is considered satisfactory, the contractor will not receive any incentive fee. In other words, incentive fee is only paid for exceeding the threshold/satisfactory performance level.

Using a fixed-price contract with incentives that also allows rollover...may be necessary to achieve success.

This incentive approach is tied directly to the metrics creating a strong link to favorable outcomes. Additionally, incentive funds not earned for a period may remain in the incentive fee pool as rollover. The program office is judiciously using the rollover incentive funds and realizes that the contractor still has to earn all incentive fee payouts.

As can be seen, this incentive strategy is a highly leveraged construct that requires the achievement of many goals designed to enable the contractor to reach the overall performance goal of 1,400 hours MTBDR within specific cost objectives. Using a fixed- price contract with incentives that also allows rollover is certainly a challenging strategy for the contractor to meet, but it may be necessary to achieve success. Whether the contractor will meet cost, schedule, and performance incentive parameters is too early to tell, but the Army's communicative and innovative approach makes success much more likely.

AERONAUTICAL SYSTEMS CENTER (ASC), F-15 AIRCRAFT SUITE 6 SOFTWARE UPGRADE FOR A-E MODELS

The F-15 Aero Systems Group uses a unique CPAF contract to perform this effort. While a typical CPAF contract uses only subjective criteria, the F-15 Aero Systems Group used both objective and subjective criteria as they deemed appropriate. They used government-contractor integrated process team (IPT) sessions to establish the criteria used in the award fee periods, which has been very successful. Each award fee period is tied to key deliverables and has preplanned adjustments. In the first award fee period, cost and schedule were weighted more heavily than the other criteria. Cost and schedule were each weighted at 30 percent, and program management and subcontract management were each weighted at 20 percent. The subjective evaluation criteria are program management and subcontract management. The program office created a strong link to favorable outcomes and reduced program risk by developing the award fee objectives and linking the award fee periods to key deliverables.

It is interesting to note that the contractor initially preferred an award fee with only subjective criteria, and expressed concern at the use of objective criteria. However, when the program office structured a base fee of 3 percent, the contractor accepted the government's plan. This demonstrates how the base fee can be leveraged, thereby requiring excellent performance to receive the "award portion" of award fee.

Each of the four example programs cited here was quite different, but they used specific incentive strategies that related very well to their desired contractual outcomes.

This CPAF contract is still in the early stages of performance; however, the use of the IPT in developing the award fee objectives, linking the award fee periods to key deliverables, and leveraging the base fee by only awarding the award portion of award fee for excellent performance, should provide a solid foundation for successful contract performance.

Each of the four example programs cited here was quite different, but they used specific incentive strategies that related very well to their desired contractual outcomes.

RECOMMENDATIONS AND TAKE-AWAYS

INCENTIVE PHILOSOPHY

Every government buying activity/command should have a clearly defined incentive philosophy that is consistent with the FAR, DFARS, and Service/Agency policy. This incentive philosophy should be clearly communicated to all personnel and potential contractor sources.

TRAINING

The amount of training depends on the team's experience. Experienced teams may only need refresher type training (e.g., Phase 3 below). Inexperienced teams should consider a three-phased approach to training. The first phase is a comprehensive core block of instruction on incentive contracting for Defense Acquisition Workforce Improvement Act (DAWIA) Level II business and technical personnel. This provides a basic body of business and acquisition knowledge for the individual acquisition members. The second phase is just-in-time training using a continuous learning module on incentives. The third phase is lessons learned on a community of practice (COP) or by classroom teaching from within or by an institution such as the DAU. Once the required amount of training is determined, the authors recommend that the entire acquisition team should participate in Phase 3 together. This develops teamwork in the learning process, which benefits the acquisition team.

FEEDBACK

Cost-plus-award-fee and other incentive-type contracts provide contractors with numerous avenues to communicate openly with the government during contract performance. Moreover, incentive contracts provide the government with greater input or leverage to motivate contractors to achieve exceptional performance. More specifically, the authors recommend that program offices document in their contracting file the use of any subjective incentives, rollover features, incentive ratings, creative approaches to incentivizing, and any exceptions to policy. Documentation or approvals required to take a certain specialized acquisition approach should never discourage one from being innovative, if the business acumen supports such an approach. The authors also recommend that program offices create a glossary of terms, particularly terms related to critical outcomes or events. This will prevent misunderstanding between the program office and the contractor in the evaluation of incentives, and also prove helpful for personnel who are new to the program office and its associated terminology.

AWARD FEE

When an acquisition tool comes under scrutiny, the tendency is to avoid it. This has occurred with award fee contracts. Invariably, in certain circumstances only a subjective incentive will achieve the desired goal or outcome. However, award fee should be used only when performance cannot be determined objectively. The contract file should clearly communicate the rationale and decision to use award fee. This may result in a multiple incentive-type contract containing both incentive and award fee clauses. This is consistent with new guidance provided by memorandum from the Office of the Under Secretary of Defense for Acquisition, Technology and Logistics (OUSD[AT&L] Memorandum, April 2007). The following recommendations relate primarily to award fee:

Base Fee. Use base fee in CPAF contracts. It provides the necessary leverage for the proper use of the award portion of CPAF. The DFARS (216.405-2(c) (iii)) currently has a limit of 3 percent on base fee. Consider requesting a deviation to the DFARS to increase the base fee percentage and make better use of base fee as a leverage tool.

Evaluation Periods. Set the award fee periods based on events or outcomes rather than based on time. This will ensure that the award fee will be appropriate for the work accomplished within the period.

Relate Fees to Outcomes. The percentage of the fee pool for the award portion of the award fee should be commensurate with the importance of the outcomes for that award fee period.

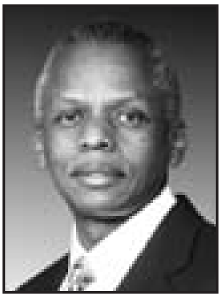
Rollover. Rollover should seldom be used, but in certain limited situations the advantages to the government of using rollover outweigh the disadvantages. Weigh this decision carefully and always document the rationale.

CONCLUSIONS

When it comes to incentives, evaluate all options. As shown in the four examples in this article, one size does not fit all situations. In the early stages of acquisition planning, seek help from experienced acquisition professionals in the organization or from the DAU faculty who have experience in the use of incentive contracting and developing incentive strategies. These experienced professionals can also be very helpful by conducting real-time training and providing facilitation for the acquisition team. Use Defense Contract Management Agency (DCMA) support through the FAR delegation process; DCMA can serve as a valuable asset for evaluating contractor performance. Seek cost estimating and pricing support. In the acquisition planning phase, build the team and gather market research information. This will enable an accurate determination of risk necessary for determining contract type and will help in the structuring of logical and effective incentives tailored to the program. Developing effective and efficient award and incentive fee programs is truly a team effort.

Mr. Alan S. Gilbreth is a professor of contracting at the DAU Midwest Region. Prior to joining the DAU faculty, he served over 24 years in the U.S. Army. His Army career included duty as a warranted contracting officer and assignments in numerous management positions. He is currently the regional representative for the Advanced Business Solutions for Mission Support (CON 353) course and holds an MS in Business from Eastern Washington University.

(E-mail address: alan.gilbreth@dau.mil)



Mr. Sylvester Hubbard is a professor of Program Management at the DAU Midwest Region. Prior to joining the DAU faculty, he served over 25 years as an officer in the U.S. Air Force. His Air Force career included numerous acquisition assignments. He is currently the department chair for Program Management teaching the Program Management Office Course (PMT 352) and holds an MS in Procurement from Webster University.

(E-mail address: Sylvester.hubbard@dau.mil)

AUTHOR **BIOGRAPHY**

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ENDNOTES

1. Commercial Gateway Baltimore contracting officer's E-mail response, January 11, 2007, to research team interview/follow-up question.

2. Incentive Fee Clause excerpted from U.S. Army TACOM Life Cycle Management Command Contract W56HZV-05-C-0724, System Development and Demonstration issued in 2005.