

# Incentive Strategies for Defense Acquisitions



ACQUISITION,  
TECHNOLOGY AND  
LOGISTICS

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MEMORANDUM FOR SERVICE ACQUISITION EXECUTIVES  
DIRECTORS, DEFENSE AGENCIES  
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Incentive Strategies for Defense Acquisitions

Incentives exist in every business arrangement. The effective application of incentives is key to building successful business arrangements that jointly maximize value for all parties. It is essential that the Department adopt incentive strategies to successfully attract, motivate, and reward traditional and nontraditional contractors, thus ensuring successful performance. Incentive strategies must also maximize the use of commercial practices to enhance our ability to attract nontraditional contractors.

Incentives can be monetary or non-monetary, and should be positive but balanced, when necessary, with remedies for missing specific program targets or objectives. They can be based on price, cost, schedule, and/or performance. Regardless of the final composition and structure of the incentive(s), the goal is to encourage and motivate optimal performance.

Historically, choice of contract type has been the primary strategy for structuring contractual incentives. With the exception of competitive firm fixed price awards, procurement incentives have predominately been based on projected or actual costs. This practice, while effective where costs cannot be precisely estimated, does not always ensure that contractors maximize efficiencies regarding underutilized or inefficient operations, practices, and facilities. Such incentives can have the opposite effect of rewarding industry for the retention of inefficient practices or underutilized capability. When cost-based incentives are used, care should be taken to ensure that these unintended consequences do not occur.

Alternatively, non-cost-based incentive strategies more closely approximate commercial agreements and are based on clearly defined performance objectives or product functionality rather than detailed requirements. Such agreements reflect joint goals of efficiency and effectiveness, reflect acceptable risks for all parties, and establish performance metrics. Program teams should structure incentive strategies to attract nontraditional defense entities, as well as to reward successful performance of traditional defense firms. Thorough market research should be conducted to develop a better understanding of the business strategy from both the government's and the contractor's viewpoints, leading to behavior that jointly achieves the mutual goals of all parties (e.g., best value acquisitions and targeting high performance based on best business practices).

The attached guidance amplifies existing policy regarding use of incentives in defense acquisitions. In addition, to assist the acquisition workforce, an *Incentive Guidebook* is being developed based on work conducted by the Army and the Massachusetts Institute of Technology.

Attachment:  
As Stated



J.S. Gansler

**Editor's Note:** This information is in the public domain. To download the attachment to Gansler's memorandum, go to the Defense Acquisition Reform Web site at [www.acq.osd.mil/ar/whatsnew.htm](http://www.acq.osd.mil/ar/whatsnew.htm).

