Evolution of Performance Based Contracting (PBC)

Dr Andrew “Jacko” Jacopino
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Content

• Introduction to Ngamuru Advisory
• What is a Performance Based Contract (PBC)?
• Evolving a PBC – Generation 1, 2 and 3 PBCs
  – Nudging Behaviour
  – Requirements, Rewards and Remedies
• Where next? The Future of PBC
• Summary
Who is Ngamuru Advisory?

• Ngamuru Advisory (pronounced ‘na-muru’) provides strategic advisory and commercial services to Commonwealth and State/Territory Governments and their related agencies.

• We inspire and enable our clients to deliver great projects and initiatives for the good of the nation by providing practical, common-sense and effective advice and assistance.

• We help with:
  – Analysing project delivery options
  – Developing business cases, acquisition strategies or project plans, and commercial arrangements
  – Project management and delivery
  – Undertaking procurements
  – Contract negotiations
  – Contract management including reviewing your procurements
  – Probity advice
  – Performance Based Contracting / Performance Based Logistics.
What is a PBC? (1)

• A Performance Based Contracting (PBC) is:

  “An outcomes-oriented contracting method that ties a range of monetary and non-monetary consequences to the contractor based on their accomplishment of measurable and achievable performance requirements.”

• Five key characteristics of a PBC:
  1. Requirements focused on the contractual outcomes, and not how the work is performed
  2. Set of indicators tied to the outcome
  3. Achievable performance standard for each indicator
  4. Defined process to collect, analyse and report data for the selected indicator
  5. Range of monetary and non-monetary consequences, either rewards or sanctions for the contractor, based on performance
What is a PBC? (2)

Key Performance Indicators (KPIs)

Required Contract Outcomes

Payment Regimes

Relative Weighting of each KPI

Contract Value

Payment

X% Y% Z%

Liquidated Damages

Achieved Performance

Adjusted Performance

At Risk Component

8% payment 100% payment

8% payment 100% payment

8% payment 100% payment

KPI - 1 KPI - 2 KPI - 3

Performance
Intent of a PBC

- There are 3 outcomes of a highly successful PBCs are:
  1. Drive the right behaviours through a focus on:
     - alignment with End User requirements; enterprise performance and mission success and fleet availability
     - collaborative relationship across the enterprise
     - culture of continual improvement
     - management of the product and / or services over a long period
     - transparency and the delivery of shared goal(s)
  2. Provide adequate commercial protections through a commercial construct that incentivises the appropriate balance between:
     - outcome and cost; and
     - risk and reward
  3. Useable framework that:
     - minimises transactions
     - reduces contractual dependencies to a minimum
     - exploits recognised better practice
Generation 1 PBCs

- Australian Department of Defence Aerospace Systems Division (ASD) PBC Handbook
  - Version 1.0 September 2005

- Focused on:
  - Description of the development steps
  - Selection of the performance measures (KPIs and SHIs)
  - Provided series of PBC solutions for support scenarios (e.g. Aero Engine, Through Life Support (TLS), Repairable Item, etc.)
  - Limited bespoke training
  - Limited integration with Australian Standard for Defence Contract (ASDEFCON) Support 2.x template

- Supported by dedicated ASD PBC Cell
Generation 2 PBCs

Generation 1 PBCs
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Generation 2 PBCs
• Defence Materiel Organisation PBC Handbook and Tailoring Guide
• Focused on:
  – Detailed description of the various elements of the Performance Management Framework (PMF)
  – PBC Training as part of ASDEFCON training
  – Significant integration with whole contract (ASDEFCON Support 3.0)
• Supported by Standardisation Office (SO) and ASD PBC Cell
Contract Mgt vs. Enterprise Mgt

Portfolio Management

Capability Manager
Chief of Service Preparedness Directive

Minimum military requirements

Program Management

IPT / SPO
Annual Description of funded and unfunded capability

MSA / SLA

Roll up of Achieved Performance against each level

Project Management

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Enterprise Management

Flowdown of requirements for the delivery of a safe, effective and affordable capability

Contract Management

Contractual description of requirements to be delivered

Sub-contracts

Contractual description of flowdown of performance requirements

Internal performance

Framework of internal management

Additional Contract Organisations

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Generation 3 PBCs

Generation 3 PBCs

- Supported by Defence First Principles Review (FPR)

Generation 3 PBCs focused on:
  - Inclusion of Enterprise Performance and Behaviours in the PMF
  - Dedicated PBC Training
  - Significant integration with whole contract (ASDEFCON Support 3.1)

- Supported by a PBC Centre of Excellence (PBC CoE)
**Generation 1 / 2 PBC Performance Measure Architecture**

Required Contract Outcomes represented by:

- System Health Indicators (SHIs) (non-payment related)
- Key Performance Indicators (KPIs) (payment related)

Outcomes lead to:
- Performance Fee ($)
- Confidence

Non-monetary rewards and remedies (e.g. Award Term / Rolling Wave Determination)
Generation 3 PBCs Performance Measure Architecture

Enterprise Performance
• Focus on capability delivered to the warfighter regardless of scope

Enterprise Behaviours
• Focus on positive, constructive behaviour supporting capability

Strategic Performance Measures (SPMs)

Key Performance Indicators (KPIs)
(payment related)

System Health Indicators (SHIs)
(non-payment related)

Performance Fee ($)

Outcomes

Confidence

Partner

Supplier

Non-monetary rewards and remedies (e.g. Award Term / Rolling Wave Determination)
Focus of Enterprise Behaviours

• Relationship
  – monitor the contractor’s performance in demonstrating positive working relationships with the Commonwealth and other third parties including other contractors

• Best for Project
  – monitor the contractor’s performance in demonstrating ‘Best for Project’ behaviours cognisant of commercial imperatives and acknowledging that successful project delivery requires an integrated ‘one team’ approach

We are starting to use these same behaviours as part of a tender evaluation and source selection
A PBC is fundamentally a behavioural economics situation where we try to:
- “nudge” seller behaviour to deliver the buyer’s outcome by applying range of complementary rewards and remedies.

By using a range of complementary rewards and remedies within a PBC we are creating:
- a “Choice Architecture” that guides and disables seller choice rather than direct legal consequences of a conventional contract such as contractual breach.

Highly successful PBCs should skillfully use a seller’s Choice Architecture to nudge the delivery of the required outcomes.
Nudging Behaviour (2)

• Supporting a PBC is the Performance Management Framework (PMF) which:

“... the ultimate goal of any PMF is to ensure that the delivery of the enterprise outcome by creating a self-regulating agreement which uses a range of incentives to guide and disable choice.”
Requirements, Rewards and Remedies

- Possible rewards and remedies that could be used to influence contractor performance:
  - Award Payments
  - Award Terms
  - Incentive Payments
  - Performance Incentives
  - Performance Payments
  - Pain Share / Gain Share
  - Substituted Performance
  - Withholding Payments
  - Stop Payments
  - Remediation Plans
  - Repatriation of Services
  - Liquidated Damages
  - Warranties
  - Performance Securities
  - Deed of Substitution and Indemnity
  - Termination for Default
Rewards and Remedies – Escalation

Satisfactory

Good KPI Performance through delivery of Contract outcomes resulting in no adjustment to contractor payment

SHI Performance provides confidence in contractor’s ability to deliver Contract outcomes as represented by KPIs

Unsatisfactory

Poor KPI Performance through failure to deliver Contract outcomes resulting in permanent withhold (adjustment) to contractor payment

Continuous Good contractor Performance through continued good KPI, SHI and SPM performance potentially resulting in the award of additional contractor term (Award Term / Rolling Wave)

Continued / Significantly Poor KPI Performance through continued and/or significant failure to deliver Contract outcomes resulting in Stop Payment

If remediated

Continued / Significantly Poor KPI Performance through continued and/or significant failure to deliver Contract outcomes resulting in right of Termination for contractor Default

Following an initial contract term, then assessed and awarded every 1 – 3 years

If remediated
Generation 3 PBCs – Hybrid PBC, Outcomes Based and Relational / Collaborative Contracts
What Next?
Summary

• Successful PBCs have proven to result in better performance to the end user, better value for money to the buyer and a better commercial deal for the seller.

• PBCs have been used since the 1990s and continue to evolve with Generation 3 PBCs using:
  – 3 tiers of performance measures including a focus on Enterprise Performance and Enterprise Behaviours
  – a range of monetary and non-monetary rewards and remedies
  – behavioral economic principles

• Goal for Commercial PBC Practitioners is to design a PBC that:
  – nudges the delivery of the buyer’s outcomes within a Performance Management Framework (PMF) allowing seller freedom to deliver and self-regulate their behaviour by defining the consequences of their actions or omissions.

• While deceptively simple in approach the successful practical application is more complicated.
Dr Andrew "Jacko" Jacopino
Email - ajacopino@ngamuru.com
Web - www.ngamuru.com
LinkedIn – www.linkedin.com/company/ngamuru-advisory/

Additional PBC Information at:
• Blog - www.performancebasedcontracting.com
• Book - Mastering Performance Based Contracts

PBC Training available through IACCM:
• UK Public dates (London)
  • 28 Jan 19 is a 1 day course / 29-31 Jan 19 is 3 day course
• US Public dates (TBA)
  • 25 Feb 19 is a 1 day course / 26-28 Feb 19 is a 3 day course

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