

PERFORMANCE-BASED CONTRACTING APPROACHES

NOTE TO DoD BPA USER: This Attachment C has been developed to provide guidance, education and a starting point for programs that wish to engage a systems integrator using a performance based service contract. The approaches and any terms that may be contained herein are a baseline from which your program may negotiate and develop performance based payment structures after negotiation with the BPA holder.

C.1 Overview

The essence of partnership is shared risk and joint commitment to success. A partner's ability to truly commit to a successful program is, in part, a function of its financial resources and soundness, as well as its confidence in delivering a timely and appropriate solution.

C.2 Performance-Based Service Contracting Approach

C.2.1 Performance-Based Fixed Price = Shared Risk

IBM is able to demonstrate its commitment to successful ERP implementations under this BPA by having performance-based pricing in every implementation. The approaches outlined herein describe a framework that can be applied to any ERP project. On each individual project, IBM will work with the Government to understand its specific objectives and establish performance-based pricing that tie incentives and disincentives to key factors that support those objectives.

This performance-based framework results in a strong incentive for IBM to meet performance/schedule requirements and demonstrates a commitment to delivering successful programs. Other type of pricing arrangements can be negotiated in task orders under this BPA.

The basic pricing/payment structure outlined in the Price Schedules ties IBM payment to successful performance. Payment is made upon completion of agreed upon deliverables so that the risk is shared by IBM.

C.2.2 Incentives and Disincentives

Percentages for incentives and disincentives on ERP projects under the BPA are as follows:

- Incentives: Up to 10% of the FFP
- Disincentives: Up to 15% of the FFP

At the task order level, factors must be established to measure for incentives/disincentives based upon the Government's stated objectives. Further, based upon the Government's input, a relative weight must be assigned to each factor. Examples of factors that IBM could include in the performance-based pricing model:

- Meeting Schedule
- Utilization of Small Businesses
- Customer Satisfaction
- Continuity of Personnel
- Other – factor(s) that the Government deems important to a successful implementation

C.2.3 Performance Based Example

Based upon how IBM scores against the factors listed in C.1.2, it would receive an incentive or incur a disincentive (or neither). An example of how this would work is as follows:

Fixed Price for ERP Implementation: \$5,000,000

Incentive Pool (10%): \$500,000

Disincentive Amount (15%): \$750,000

When tied to the performance factors, the Incentives and Disincentives would have the following impact on the contract value:

- **Meeting Schedule** – If IBM beats the overall schedule by 30 days or more it will receive the Incentive. If IBM fails to meet all material schedule milestones it will incur the Disincentive and the FFP is reduced by the disincentive amount. If IBM meets all material schedule milestones there is no Incentive/Disincentive, resulting in a price of \$5,000,000.
 - Weight: 30% (Incentive - \$150,000; Disincentive – \$225,000)
- **Utilization of Small Businesses** – If IBM allocates more than 25% of the contract revenue to Small Businesses over the duration of the project it will receive the Incentive. If IBM allocates less than 20% of the contract revenue to Small Businesses it will incur the Disincentive and the FFP is reduced by the disincentive amount. If IBM allocates between 20-25% of the contract revenue to Small Businesses there is no Incentive/Disincentive, resulting in a price of \$5,000,000.
 - Weight: 20% (Incentive - \$100,000; Disincentive – \$150,000)
- **Customer Satisfaction** – IBM and the Government will jointly establish a customer satisfaction survey with ratings and scoring thresholds. If IBM receives a rating above the agreed upon thresholds it will receive the Incentive. If IBM receives a rating below the thresholds it will incur the Disincentive and the FFP is reduced by the disincentive amount. If IBM receives an average rating there is no Incentive/Disincentive, resulting in a price of \$5,000,000.
 - Weight: 25% (Incentive - \$125,000; Disincentive – \$187,500)
- **Continuity of Personnel** – If no Key Personnel leave during the course of IBM performing the project, IBM will receive the Incentive. (Not applicable if the Key Personnel employees leave the company or become unable to work). If more than X number (or X percentage) of Key Personnel leave the project before completion IBM will incur the Disincentive and the FFP is reduced by the disincentive amount. If less than X number (or X percentage) of Key Personnel leave the project before completion there is no Incentive/Disincentive, resulting in a price of \$5,000,000.
 - Weight: 25% (Incentive - \$125,000; Disincentive – \$187,500)

This represents an example of how performance-based pricing could be established for the Implementation of an ERP under the BPA. In an actual ERP implementation, the performance-based structure would likely be significantly more complex in terms of variables and performance levels. For example, the Incentives/Disincentives would not have to be “all or nothing”. There could be one incentive for beating the schedule by 10 days, another amount for beating it by 20 days, and so on. Another example is that the Incentive/Disincentive in a category may not be tied to a single occurrence. There could be periodic customer satisfaction surveys and a requirement of meeting thresholds for a series of periods before receiving the incentive. IBM will work with the customer on a

project-by-project basis to establish the right performance based arrangement for each unique task order deliverable.

C.2.4 Post-Implementation Phase

There is a wide variety and a broad range of objectives that a customer may want to see realized from the ERP implementation. Performance based metrics after implementation are important to verify that benefits in the business case are in fact realized. Since IBM may or may not manage the business processes after implementation (depending upon the customer's preference), it is important to establish a framework to insure compliance with new ways of doing work so that benefits are achieved. IBM has methods to accomplish the development of performance-based metrics which can be integral to the overall project work plan and approach. Examples of the work that is required to establish this framework are:

- Define shared risk contracts
- Identify operational obstacles
- Define team incentives
- Create realization charter
- Define operational measurements
- Define ownership succession plan
- Update business case based on current project scope/direction
- Communicate realization process

IBM experience has helped our clients develop tangible and quantifiable measures to monitor internal performance. IBM is prepared to discuss methods to incorporate these types of metrics into a performance-based contract. The following are examples within different industries of the categories around which performance based metrics can be developed.

- Brewery/Metal Fabrication/Glass Manufacturer: Savings of over \$75 million USD in inventory reductions, scrap and waste reduction, purchasing price and overhead, and efficiency in administration, manufacturing, and maintenance.
- Tape Storage Manufacturer: \$120 million USD improvement in profits from service revenue and cost of service, order to cash, cycle time, inventory reductions, supply chain costs and general administration reductions.
- Chemical Manufacturer: Improvement in inventory turns, cost reductions, purchase price, administrative and manufacturing efficiencies.
- Telecommunications Solutions Provider: Savings of over \$165 million USD in three years in working capital, revenue, operation expenses, information systems, and productivity improvement.
- Consumer Goods Manufacturer: \$17 million USD in annual cost reductions and avoidance and reduction in working capital by \$63 million USD.
- Silicon Wafer Manufacturer: Inventory and cycle time reduction, manufacturing and inventory cost reduction, and productivity improvements.

IBM can assist you in developing appropriate performance based contracting criteria. They will be happy to meet with potential clients and share their "Benefits Realization" approach presentation. This outlines the IBM process for identifying the desired metrics and Service Level Agreements (SLAs) that can be included in a performance-based ERP contract. Note that this would normally be performed as a separate consulting engagement/phase prior to the ERP implementation.

Once the Government has identified the desired objectives, there are many ways to tie contractor performance to achievement of those objectives. One alternative would be a "Shared-Savings" approach where the Government would pay a reduced price during implementation and the Contractor would receive a percentage of the savings as a residual payment as the cost of operations is reduced.

As every ERP project is different, so are the specific customer objectives, IBM will work with the Government on a project-by-project basis to structure the appropriate performance-based pricing and appropriate contract terms to tie performance to objectives.