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INNOVATIVE CONTRACTOR
COMPENSATION

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Innovative Contractor Compensation

**Prepared by
The Construction Industry Institute
Contractor Compensation Research Team**

**Research Summary 114-1
September 1998**

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The University of Texas at Austin.

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Printed in the United States of America.

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Executive Summary

The Contractor Compensation Research Team was established to develop breakthrough approaches to contractor compensation. Founded on the premise that traditional engineering and construction contracts perpetuate competing interests between owners and contractors, the team began with the goal to rethink contractor compensation in order to align contractor performance more closely with owner objectives. Compensation was interpreted broadly to include reward, recognition, money payment, future opportunities, expanded roles, and reduced risk.

The team found innovative contracting strategies that go well beyond traditional concepts of alliances, team autonomy, and incentive contracting. No single breakthrough strategy or set of metrics, however, was applicable to all projects.

The development of contractor compensation plans that lead to owner success is highly individualized to the specific project and the personalities and philosophies of project leaders that craft the contract. Timing of development of the contracting strategies, however, is not as important as establishing: (1) a trust-based relationship among project team members and (2) the willingness to develop the compensation plan jointly. These two factors are most important in establishing innovative compensation plans, but are often the largest barriers to success.

The application of innovative contractor compensation strategies should not be considered an “end all” solution to project performance improvement. Such strategies instead should be considered one more important tool in a project team’s “tool kit” to be applied in conjunction with other CII best practices such as partnering, team building, team alignment, open communications, setting project objectives, and pre-project planning.

Introduction

The Contractor Compensation Research Team was charged with “developing a breakthrough approach to compensate contractors based upon the overall business success of the venture.”

“Breakthrough” was defined as a dramatic improvement, a step change in performance, and/or the fundamental rethinking of concepts. “Compensation” was defined as reward, recognition, a money payment, future opportunities, expanded roles and/or reduced risk. The term “contractor” includes constructor, designer, and/or principal subcontractor and supplier.

This research project was conducted using a team of senior owner and contractor managers who served as a panel of experts.

Survey of Literature and Current Practice

The research team reviewed literature and collected examples of compensation plans to provide an overview of current industry practices. Summary documents from the literature survey, covering topics such as incentive contracting and economic models of the owner/contractor relationship, were developed and provided to research team members for review.

Survey of Industry for Innovative Practices

Ninety CII member companies were forwarded questionnaires exploring project objectives, communication of objectives to project teams, relation of objectives to compensation terms, performance measures, and influence of compensation terms on contractor performance. Fifty responses were received, analyzed, and summarized to identify compensation strategies believed to be potential breakthroughs by the team. Fourteen project or alliance relationships correlating to those strategies were then selected as candidates for further study through interviews of the respective owner/contractor teams.

Structured Interviews of Selected Project Teams

Fourteen case study interviews were conducted at owner or contractor facilities and involved two to four research team members. The interviews explored:

- Business objectives of the project.
- Mechanisms used to communicate objectives to project personnel.
- Development of compensation plan.
- Details of compensation plan, including contract terms.
- Impact of compensation scheme on performance.
- Views on compensation method effectiveness and improvements.

Examination and Ranking of Innovative Strategies

Twenty-six compensation strategies were compiled from the structured interviews. Individual research team members then ranked each strategy as “common practice,” “innovative,” or “breakthrough.” The strategies were sorted in descending order for innovation and were then used to plan the owner/contractor workshop.

Owner/Contractor Workshop

A national workshop was conducted by the research team to share findings and to obtain additional input and feedback. Eighty-two people attended. Based upon the workshop, six additional compensation strategies were added to the list of innovative strategy candidates.

Quantification of Benefits

To quantify benefits of the compensation strategies and to characterize their relationship to owner objectives, the research team contacted case study project team participants for additional information on the benefits of specific strategies in areas of primary project objectives. The 32 strategies, grouped into 10 major categories, and the benefits achieved by the project teams from application of the strategies are described in the next chapter.

Case Study Analyses

Fourteen case study projects were examined by the Contractor Compensation Research Team. These case studies are described in detail in CII Research Report 114-11, “Innovative Contractor Compensation Strategies.” An analysis of these case study projects resulted in 26 compensation strategies. In addition, the workshop yielded six more for a total of 32. All of these strategies have been successfully implemented within the setting of the case studies. The 32 different strategies are grouped into the following 10 categories, which are lettered from a through j.

a. Development of Incentive Plans. *Joint development of the incentive plan promotes sharing of information and leads to more efficient contracting relationships.*

1. Fee-at-Risk Proposals Solicited from Contractors During Bidding.

As opposed to an incentive scheme proposed unilaterally by the owner, solicitation of contractor suggestions during bidding allows the contractor to examine factors that would influence results and to suggest an arrangement with more likelihood of success. To induce attractive alternatives, however, the owner should clearly articulate objectives for the project in the RFP and in pre-bid meetings.

2. Incentives Developed During Project Kickoff and Team Building.

Since incentives should focus on the performance areas most important to the owner, this is a natural setting for development of incentive measurement areas and targets.

3. Incentive Plans Introduced During Project Execution.

Often, teams assembled from owner and contractor organizations have little prior experience working together,

and therefore the critical trust element may be absent. As a result, the project team may be handicapped in development of alternative compensation plans. In this case, conditions may not be ripe for innovative compensation strategies until some specific event or condition evolves during the course of a project, such as a change in personnel or changing owner priority. Plans developed during a project after early uncertainties become known have been effective in soliciting improved performance.

4. Standard Framework for Incentive Plan Development. In order to avoid an excessive amount of time required for the development of incentive plans, one owner has standardized incentive plan development by implementing an incentive plan framework that can be used by project teams to tailor compensation plans to their unique needs. These frameworks may contain checklists and guidelines, and reduce time and resources required to develop an incentive plan.

b. Selection of Performance Measures. *Performance areas selected for inclusion in an incentive plan should correlate to key results for the owner and must sufficiently span the contractor's performance so that important aspects of performance are not neglected.*

1. Benchmarking to Set Performance Targets. Using information and results of projects recently executed by the owner or on other projects can provide targets that become the basis for incentive fee contracts.

2. Incentives Related to Joint Performance of Designer and Constructor. Where separate contractors are hired for design and construction, owners have based fees for both the