



INCENTIVE PLANS: DESIGN & APPLICATION CONSIDERATIONS

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**Incentive Plans:
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Contracts Task Force**

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SUMMARY

Contract incentive plans are considered by many owners and contractors to be valuable mechanisms for enhancing project success. Their application is recommended by The Business Roundtable's Construction Industry Cost Effectiveness (CICE) Project¹ and the Construction Industry Institute (CII).^{2,3} Nonetheless, use of incentive plans by the construction industry is mixed. Increased knowledge of successful incentive plan designs and applications could foster broader acceptance and use with substantial resulting benefits.

This publication presents the results of a CII Contracts Task Force study designed to assess the incentive plan experience of CII member companies. Objectives of the study were to: (i) provide a better understanding of the values and limitations of various plans, (ii) identify a broadened array of options for specific plan designs, and (iii) offer guidelines for plan application and administration. The study focuses principally on cost reimbursable contracts because they represent the preponderance of data available. Also, reimbursable cost contracts are amenable to a broader variety of incentive plan approaches than fixed-price contracts. A small number of fixed-price contract plans were reviewed, however, and comments are included in the report when appropriate.

The research methodology used for this study involved collection and examination of specific plans and follow-up discussions with key owner and contractor participants. In all, the study team reviewed 19 applications and received input from 26 member companies (representing 15 owners and 11 contractors). Analysis concentrated on individual features of the various plans, as opposed to total designs, to provide the broadest basis for "building" or "tailoring" future designs.

This publication presents and compares the following considerations or characterizations:

Primary Features

- Unilateral vs. negotiated plans
- Positive vs. negative incentives
- End-of-project vs. milestone determination

Secondary Features

- Quantitative vs. qualitative yardsticks
- Parameters
- Offsite vs. onsite determination
- Win/loss vs. conditional awards
- Bonus flowdown

An expected range of potential benefits of incentive plans, as experienced by owners and contractors who have used such plans, is also presented. A report prepared by the University of California, Berkeley, contains further details about this study.⁴

INTRODUCTION

Project success is highly variable, whether it is measured in terms of cost, schedule, quality, safety, or any other typical parameter. Results are influenced by many factors, including: (i) the characteristics of the project, (ii) the prevailing marketplace and other environmental conditions under which it is to be implemented, and (iii) the performance of the participating organizations and key personnel. A major challenge for CII is identification, development, and promotion of practical ways to increase construction cost effectiveness. Properly designed and administered incentive plans represent such a mechanism.

The benefits of incentive plans derive from a number of significant aspects. First, the potential for additional monetary reward enhances the contractor's motivation, which influences performance. Additionally, incentive plans often will increase the level of management attention and may influence the selection of key personnel assigned to the project by both parties.

Another important aspect of incentive plans is that they provide a mechanism for achieving closer correspondence between the owner's and contractor's objectives. In this regard, incentive plans require that owners define their objectives more clearly. They also encourage owners to communicate their objectives more effectively, both within their own organizations and to their contractors. Finally, most incentive plans rely upon existing project control systems and information. Thus, incentives stimulate a more disciplined approach to using those systems and information results. This, in turn, should yield a better managed project.

Incentive plans function by: (i) fitting performance criteria to key project objectives and priorities and (ii) measuring actual performance against those yardsticks. To be effective, each plan must be tailored to fit the peculiarities of the specific application. Many different features and combinations of features can and should be considered. The more prominent and innovative features are presented and discussed in the following sections.