

“Pulling on a String” – Pricing for Value

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Overview

- Is there common ground between us?
- Pulling on a String
- Background - Canada's Pricing Regime
- Pricing Risks
- Building Better Contracts
- The Journey Ahead
- More Questions?

Is there common ground between us?

- What drives the contractor's costs?
- What drives the price?
- How is the price constructed?
 - What makes up the contractor's overhead?
 - What is the Impact of volume variances on pricing?
 - How much profit is too much? What's fair?
 - When & how should profit be shared?
- Is the contractor's business solution sound?
- How much of the price is due to the choices Canada makes?
- Does pricing drive performance?

Pulling on a String

- The Dilemma of the *Cost & Profit Assurance Program – a short history*
- Why is there no apparent interest to recover “excess” profit? *The Myth of the Clawback*
- Time & Materials, 1031-2 and Performance Based Contracting – *There has to be a better way.*
- *The Review of the Canada’s Contract Cost Principles & PSPC’s Profit Policy*

Background - Canada's Pricing Regime

- What is it?
- What does it seek to achieve?
- How is price determined?
- What is negotiated to arrive at the price?
- How does it work?
- Is pricing the problem?

Canada's Pricing Regime

What is it?

- A proxy for a “competitive” price, when market pricing is not available.
- Pricing is said to be negotiated within PSPC's parameters for cost-plus profit pricing,

What does it seek to achieve?

- To limit the price, not to exceed “a fair and reasonable cost of performing the contract together with a fair and reasonable profit.”
S.24 Defence Production Act.
- *This is a cost of production pricing model.*

Canada's Pricing Regime

How is price determined?

By formula:

- Cost – Contract Cost Principles (SACC 1031-2)
- Profit – US-based *Weighted Guidelines Method*
 - Return on Capital calculations
 - Set Risk Premiums – *Business Risk* (cost elements) & *Contract Risk* (basis of payment)

What is negotiable? What is negotiated?

Is pricing the problem? What's the contract?

Pricing Risks – Acceptable Costs?

Gaming the Cost-base

- Padded estimates/contingencies in cost-base.
- Non-compliant or unsupported overhead costs
- Profit-on-Profit (transfer pricing; subcontracts)
- Over-absorption of overheads (budget & actual)

Examples:

- Management Fees
- Executive Compensation
- Phantom costs (severance provisions)
- Use of Actual versus Normal Capacity
- Full Absorption of Fixed Costs by Canada

Pricing Risks – What's the Contract?

Price Administration?

- *Cost Validation* (claims verification of costing)
- *Duplicate Compensation*
- *Profit, Gain-sharing, Earned-value, Incentives?*
- *Cost Performance & Continuous Improvement?*
- *Off-ramps?*
- *Price Reset? Business Solutions?*

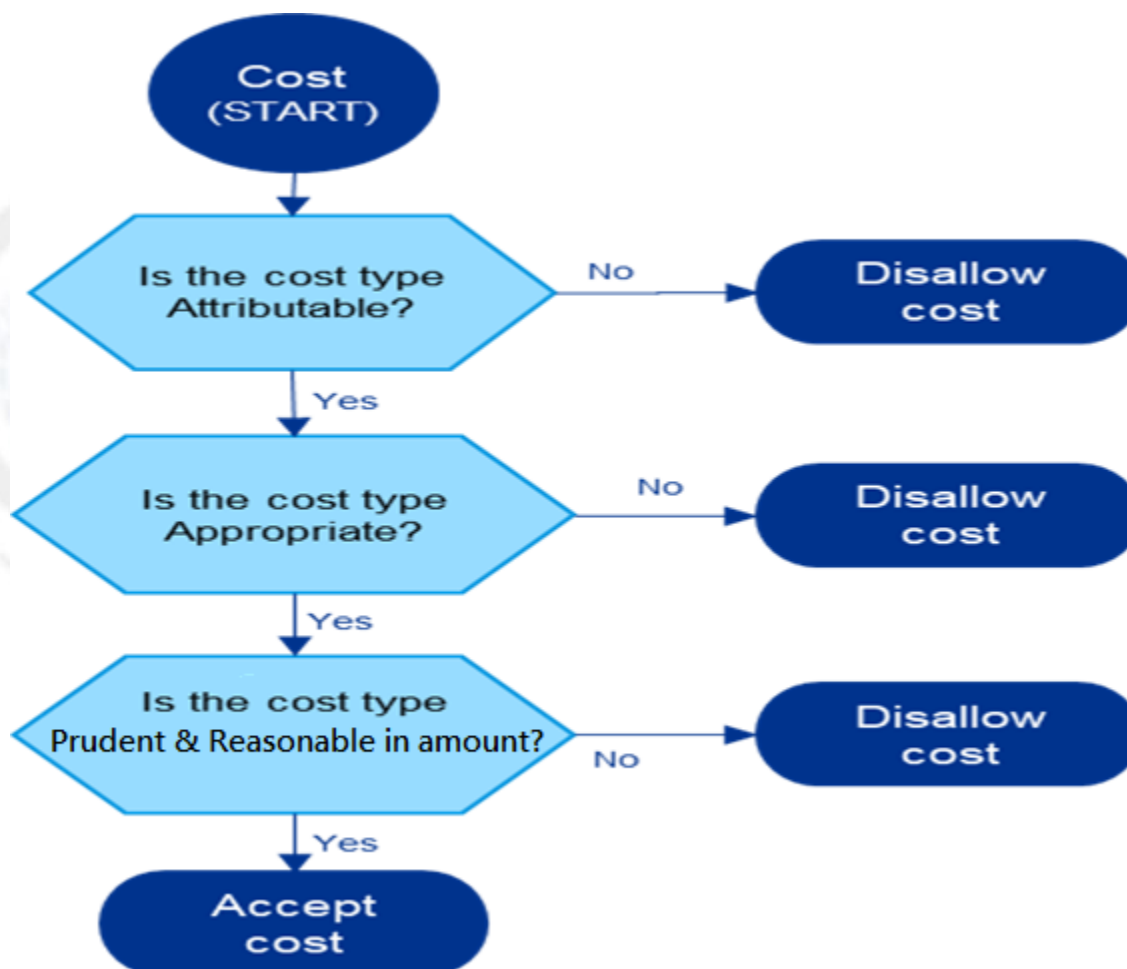
Examples:

- Direct subsidies for capacity
- Value Propositions
- Risk premiums already embedded in cost-base
- Profit/Gains not reported; not shared

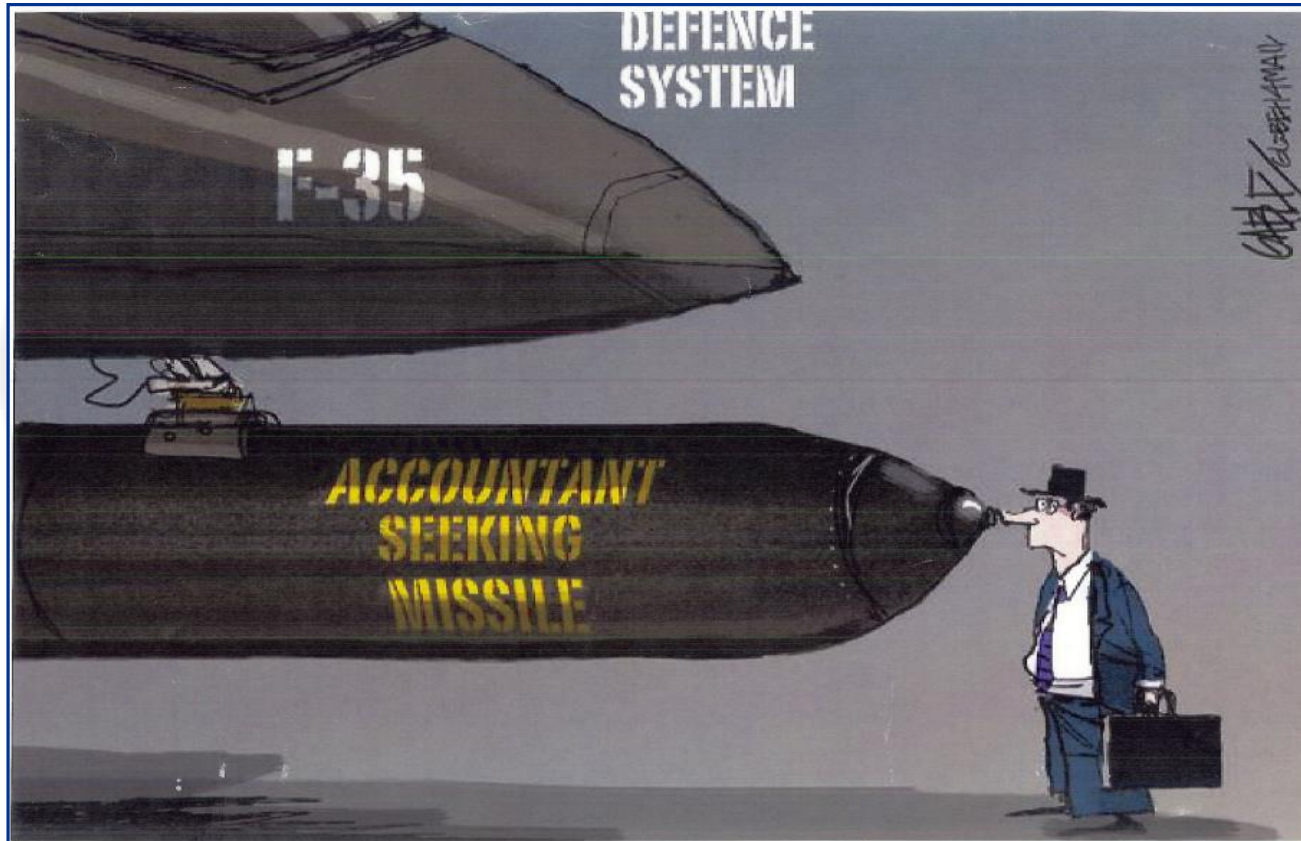
Building Better Contracts

- ***Cultural Shift*** – Linking Pricing to the sourcing and the procurement strategy.
- ***Pricing for Value*** – Emphasis on “Value” to the Buyer and use of pricing as an enabler to drive value.
- ***Exercise of Judgment*** – Informed choices, where professionalism & access to expertise are essential.
- ***Respect for Integrity of Procurement*** – Open, fair, honest processes and adherence to PSPC Guiding Principles.

Contract Cost Acceptability - Decision Tree



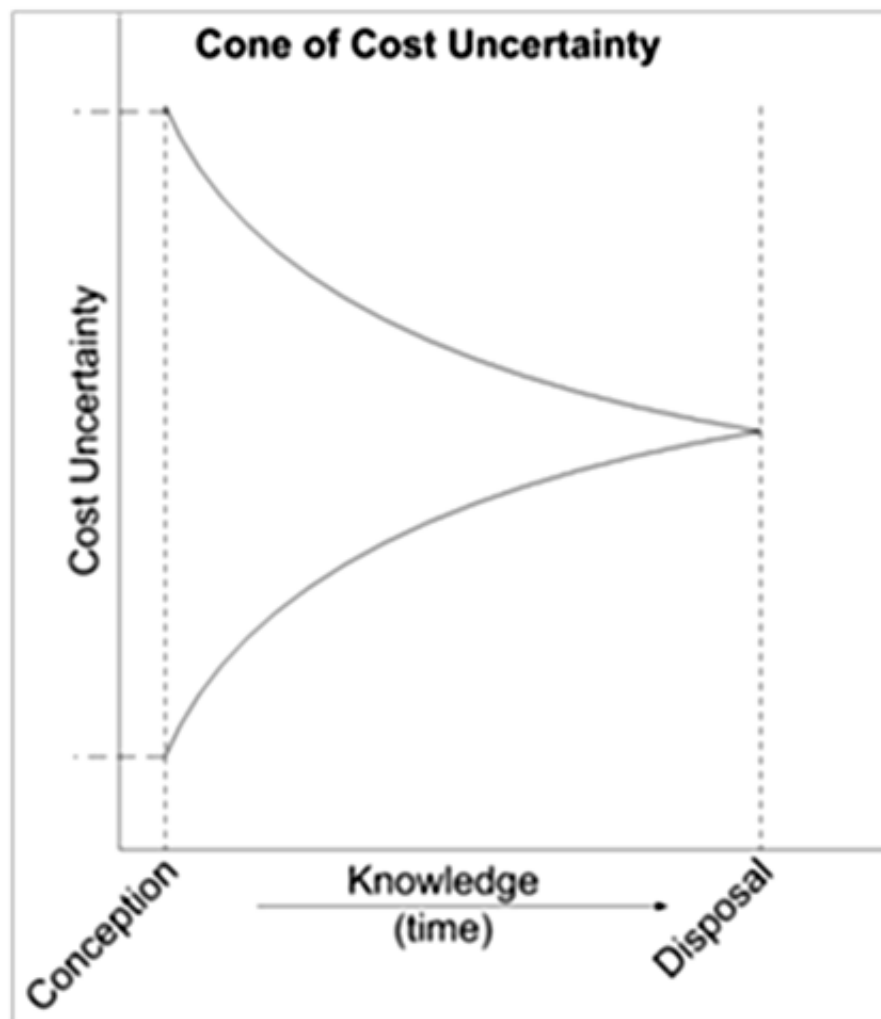
Costing is NOT the Enemy of Price



The Globe and Mail, June 2, 2014.

The Need for Rigorous Cost Estimates

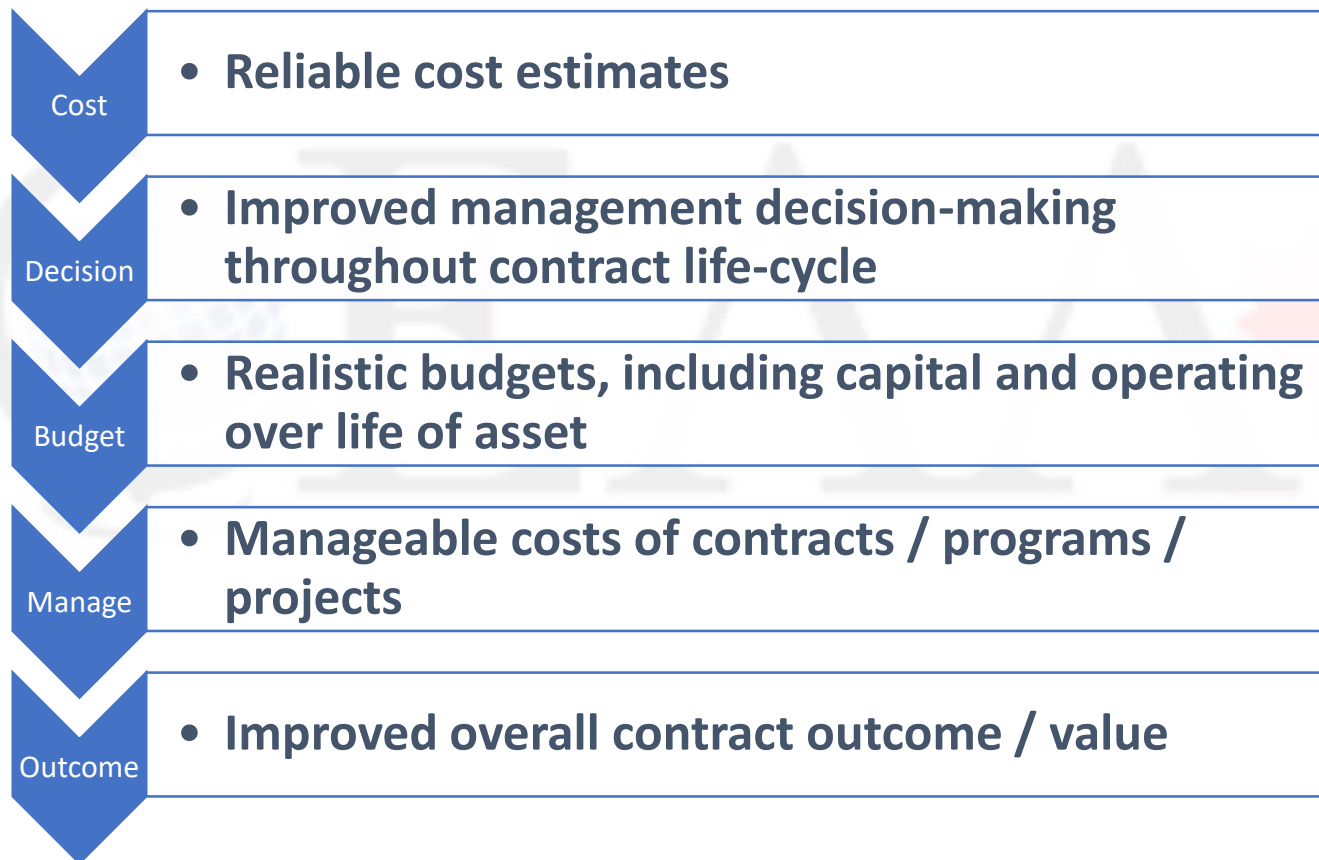
- Rigorous cost estimates are an important precondition for successful capital projects.
- Although cost and budgets will change throughout contract, better to know and manage – don't shoot the messenger.



Risk-based Resource Allocation

- Many public sector jurisdictions apply a one-size fits all approach to project development
- Relatively simple, low cost projects inevitably
 - Lose out in the competition for review/approval causing delays
 - Cost more than they should (due to extended time lines and reporting burden)
- Mega projects that require special attention
 - May become lost in the shuffle or be under-resourced
- Successful jurisdictions tend to:
 - Actively manage an integrated portfolio of projects
 - Scale governance based on the nature of the project
 - Share resources and lessons learned

Costing – Driving Better Contract Outcomes



The Journey Ahead

- Access to KPMG Discussion Papers
- Completion of the *Practitioner's Guide* (Version 1)
- Moving Beyond Version 1 – training, access to support, certification?
- Acting on Recommendations on the Organizational Design



More Questions?