Choose your contract carefully ...

Contract type	How it works	Pros	Cons
Fixed price	Government agrees to pay a fixed amount of money for a product or service	Government knows how much it will spend on a project	High risk because agency and contractor agree to pay a specific price no matter what the real cost turns out to be; too much risk could scare off bidders
Cost	Government pays for all allowable costs and in most cases includes some kind of fee structure	Government assumes the risk, so more vendors will compete for contract	Cost could rise if project takes more time than expected; agency must perform a lot of oversight; very risky
Time and materials	Government pays the cost of employees, usually at an agreed-upon per-hour rate, and the cost of materials needed	Agency fulfills its needs quickly; has a lot of flexibility	Like cost contracts, the agency has heavy oversight responsibilities; must negotiate the contract carefully because time includes both fixed and variable costs; the Federal Acquisition Regulation says this is the least desirable type of contract
Labor hours	Government pays for the cost of employees over an agreed-upon number of hours for a project; does not pay for materials	A responsive contract vehicle with a lot of flexibility	Requires a lot of oversight from agency; contractor does not have incentive to control the number hours it takes on a project

... then find the best approach for modernization

Approach	How it works	Pros	Cons
Performance-based	The government dictates the final outcome without going into specifics on how to accomplish it; Bush administration is pushing for more of this approach	Government takes on little risk	Agency control is limited
Share-in-savings	Rather than paying directly for work, the agency and contractor split the savings from a project	Agency pays nothing up front for project	Limited control over contractor
Modular contracting	Used on larger projects, where agency completes project section-by-section; each section is funded by itself and can stand alone as an enhancement if no other modules are finished	Agency receives a upgrade no matter how much of the entire project is finished; this makes it easier to sell a project to agency chiefs and Congress	Hard to administer because the agency must manage each module; no guarantee funding will be available for an entire project

Three incentives that get the best from contractors

Incentive	How it works	Pros	Cons
Award fee	Could be a separate pool of money or part of contractor's profit; the contractor receives part or all of the fee depending on its performance, based on subjective or objective metrics	Provides a lot of incentive for contractors, who don't like to leave money on the table; has flexibility because the agency can change criteria on each task order, define what criteria are and how much money is put in for each period	Agency must have extra pool of money, have experience in managing this type of contract and perform extensive oversight
Award term	Agency offers contractor extra years on the contract if the contractor performs exceptionally well	The prospect of a contract extension provides incentive for the contractor	Agency must review the contractor's work often, and have an alternative plan in case of poor performance
Performance	Government defines performance parameters; used on development contracts	Provides incentive for contractor to achieve higher level of performance, requires less administration because the agency need only define the parameters and see if they are met	It can be hard to define levels of performance; the agency risks setting a performance standard that cannot be met; agency must define the benefits of each increment of performance