Fixed Price Incentive Successive Targets Contract

Idea In Short

In other words, the client may undertake one or more revisions to the engagement targets during engagement delivery.

An fixed price plus incentive successive targets (FPI ST) model resembles the fixed price plus incentive contract in several aspects. The only difference between the two models is that the FPI ST contract allows some adjustments during engagement delivery. This contract works under the assumption that additional reliable information will be available at a relatively early stage in the engagement to permit negotiation of either a fixed price or fixed price plus incentive contract. The client and service provider also establish the final profit and price targets that will provide equitable incentives to both parties.

Client perspective

Clients prefer such contracts when they cannot negotiate the target performance indicators before initiating engagements. Hence, they prefer to make contract amendments reflecting the target performance indicators, either upfront or retroactively. Correspondingly, this leads to two types of price adjustments:

1. Forward price re-determination
2. Backward price re-determination

Forward price re-determination

In this model, the engagement commences with an initial fixed price for a certain initial duration. Subsequently, the contracting parties make periodic price adjustments to the contract. Use such contracts when it is impossible to foresee price movements upfront. However, for such contracts to work, both the client and the service provider should agree

upon a fixed price for an initial, foreseeable period.

Backward price re-determination

In this model, the engagement commences with an initial fixed price for a certain initial duration. The client and service provider, however, agree upon the price ceiling at the start of the engagement. Subsequently, they adjust the prices backward to reflect the actual costs.

Adjustments

When the engagement reaches the revision points specified in the contract, the contracting parties negotiate the contract. The client and service provider consider the incurred costs and other relevant factors, such as target profits. At this point, the parties have two alternatives:

- Negotiate a fixed price contract, using the target cost plus target profit
- If negotiation of a fixed price is inappropriate, then negotiate a formula for establishing the final price using the target cost and target profit

The final cost is the negotiated cost at completion. The final profit is established using the formula as with the fixed price plus incentive contract.

Usage

This contract type is suitable for situations where a fixed price contract cannot be established. This usually happens when the contract size is too small or the project duration is too short. Hence, using any other contract type is impractical or entails significant overhead.

Summary

Price revision, in this model, also takes management effectiveness, innovation and ingenuity into consideration after the project is completed.