GovCon 101: Contract Pricing

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Agenda

- What is Price?
- Market Research
- Approaches to Contract Pricing
- Price and Cost Analysis
- Elements and Factors Impacting Price

Simple enough question . . .

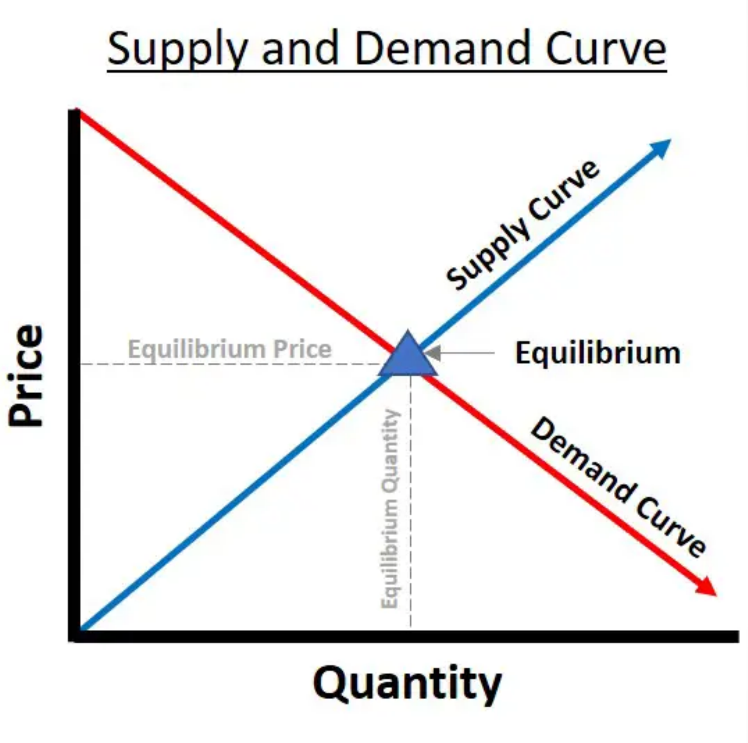
What is Price?

Price Defined

- Price –
  - General Business - The amount a willing buyer pays a seller for the delivery of a product or service
  - ASPM - A fair and reasonable price is one that is fair to both parties to the contract, considering the quality and timeliness of contract performance
  - FAR 15.401 – cost plus any fee or profit applicable to the contract type
- Contract pricing - gathers, assimilates, evaluates and, in establishes objectives, brings to bear all the skills and techniques needed to shape the eventual pricing arrangement

Pricing Tools

- The CO is responsible for evaluating the reasonableness of offered prices
- Proposal analysis techniques (FAR 15.404-1)
  - **Price Analysis** - used when certified cost or pricing data are not required
  - **Cost Analysis**:
    - Must be used to evaluate the reasonableness of individual cost elements when certified cost or pricing data are required.
    - May be used to evaluate data other than certified cost or pricing data to determine cost reasonableness or cost realism when a fair and reasonable price cannot be determined through price analysis alone.
  - **Cost Realism Analysis** – Used to make sure cost estimate is realistic.



Studying the market is the first step to successful contract pricing . . .

Market Research

Market Research

- Defined as collecting and analyzing information about the capabilities within the market to satisfy agency needs
- Thoroughly executed process will provide information on:
  - Existing products
  - Capable sources – including small businesses
  - Competitive market forces
  - General pricing information
  - Varying levels of products and performance
  - Commercial practices
  - Support capabilities
  - Successful acquisition practices of other organizations

Market Research Techniques

- Surveillance – a continuous process to keep up with technology and the market-place – not generally tied to a specific acquisition
- Investigation – a specific and comprehensive research in response to definite Government requirements

Other Uses for Market Research

- Determine appropriate procurement strategy
- Provide insight into available price information
- Determine the scope of technical proposals and other submissions
- Develop appropriate contract terms & conditions
- Determine appropriate financing payments

How is a company supposed to determine an appropriate price?

Approaches to Contract Pricing

Pricing Approaches (Methods)

- Market Based Pricing
  - Competition
  - Commercial Products and Services
- Cost Justified Pricing
  - Allowable Cost
  - Profit / Fee

Market-Based Pricing Decisions

- Competitive marketplace affects decision
- Seller sets price relative to others offering the same or similar products or services
- Premium prices charged only for premium products
- Prices reflect factors such as quality, service, features, brand image, and product differentiation

Cost-Based Pricing Decisions

- Absence of competition allows for more analytical approach
- Seller sets price based on an analysis of the firm's cost to produce a product or perform a service, plus the addition of a reasonable profit
  - Seller cost depends on many factors, including production methods and product sales volume
  - Definition of a reasonable profit also depends on many factors, including competition, objectives of the firm, necessary investment, and risk involved

Pricing Objectives - Seller

- Cover costs
- Contribute to corporate operational goals:
  - Short term/long term profitability
  - Market share
  - Long term survival
  - Product quality
  - Technological leadership
  - High productivity

Pricing Objectives - Government

- Pay a fair and reasonable price
  - Fair to the buyer
  - Fair to the seller
  - Market Conditions
    - Supply and Demand
    - General Economic Conditions
    - Competition
- Price each contract separately
- Exclude contingencies

Economic forces such as supply, demand, general economic conditions, and competition change constantly. Hence, a price that is reasonable today may not be reasonable tomorrow . . .

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Fair and Reasonable

- Fair to the buyer
  - The **fair market value** of the contract deliverable given the prices of market transactions between informed buyers and sellers under similar competitive market conditions for deliverables with similar product, quality, and quantity requirements.
  - The (1) **total allowable cost** of providing the contract deliverable that would have been incurred by a well-managed, responsible firm using reasonably efficient and economical methods of performance plus (2) a **reasonable profit**.
- Fair to the seller
  - realistic in terms of the seller's ability to satisfy the terms and conditions of the contract

Source: Contract Pricing Reference Guide – Volume 1 - I.2.1

Pricing Perspectives

- Buyers and sellers look at the same price from different perspectives. Each party to a sales transaction has unique pricing objectives.
  - Sellers in different markets often have different approaches to contract pricing.
  - Different sellers in the same market may have different pricing objectives and approaches.
  - A single firm may have different objectives and approaches in different contracting situations.

Approaches to Pricing - Sellers

- Market-based Pricing
  - Profit-maximization pricing
  - Market-share pricing
  - Market skimming
  - Current-revenue pricing
  - Promotional pricing
  - Demand-differential pricing
  - Market-competition pricing
- Cost-based Pricing

How do you determine if a price is fair and reasonable?

Price Analysis Approaches

Contract Pricing Tools

- Price analysis considerations
- Cost analysis considerations
- Cost realism analysis considerations

Price Analysis Considerations

- Price Analysis:
  - is the process of examining and evaluating a proposed price to determine if it is fair and reasonable, without evaluating its separate cost elements and proposed profit.
  - may be, when necessary, supplemented by evaluation of cost elements.
  - must be performed for ALL procurement to ensure that the overall price is fair and reasonable.

Price Analysis

- The process of examining and evaluating a proposed price without evaluating its separate cost elements and proposed profit.
- May include evaluating other than certified cost or pricing data
- Buyer may use many different types of price analysis techniques and procedures to ensure a fair and reasonable price.
- Most are comparison of proposed prices to:
  - Other proposed prices received in response to the solicitation
    - Normally, adequate price competition establishes a fair and reasonable prices
  - Historical prices paid
  - Competitive published price lists, published market prices of commodities, similar indexes, and discount or rebate arrangements
  - Independent Government cost estimates
  - Prices obtained through market research for the same or similar items

Basis for Price Analysis

- Price analysis always involves some form of comparison with other prices such as:
  - Proposed prices received in response to the solicitation;
  - Commercial prices including competitive published price lists, published commodity market prices, similar indexes, and discount or rebate arrangements;
  - Previously-proposed prices and contract prices for the same or similar end items, if you can establish both the validity of the comparison and the reasonableness of the proposed price;
  - Parametric estimates or estimates developed using rough yardsticks;
  - Independent Government Estimates; or
  - Prices obtained through market research for the same or similar items

Cost Analysis Considerations

- Definition of Cost Analysis. Cost analysis is the review and evaluation of the separate cost elements and proposed profit/fee of:
  - An offeror's or contractor's cost or pricing data or information other than cost or pricing data and
  - The judgmental factors applied in projecting from the data to the estimated costs.
- The purpose of the evaluation is to form an opinion on the degree to which the proposed costs represent what the cost of the contract should be, assuming reasonable economy and efficiency.

When to Perform Cost Analysis

- Perform cost analysis in either of the following situations:
  - When the Truth in Negotiations Act (TINA) applies, and the offeror is required to submit cost or pricing data. In this situation, the offeror must provide complete, accurate, and current data to support all proposed costs and profit/fee.
  - When you require an offeror to submit cost information other than cost or pricing data to support your decision on price reasonableness or cost realism.
  - Require only the information necessary to determine price reasonableness or cost realism!

Cost Realism Analysis Considerations

- Definition of Cost Realism Analysis. Cost realism analysis is the process of independently reviewing and evaluating specific elements of each offeror's proposed cost estimate to determine whether the estimated proposed cost elements:
  - Are realistic for the work to be performed;
  - Reflect a clear understanding of the requirements; and
  - Are consistent with the unique methods of performance and materials described in the offeror's technical proposal.
- When to Use Cost Realism Analysis
  - All cost-reimbursement contract offers to determine the probable cost of contract performance
  - may be used in evaluating competitive offers for fixed-price incentive contracts or, in exceptional cases, on other fixed-price contracts.

There is no single, one-size-fits-all approach to pricing.

Elements and Factors Impacting Price

Acquisition Strategy

- Promote competition
  - Acknowledged as the best way to encourage firms to offer a quality product at a reasonable price
  - Strong evidence to support price reasonableness
  - Simplify procurement – TINA not applicable
- Impact of terms and conditions
  - How can terms and conditions could impact the price?
- Publicize the bid

Impact of Contract Type

- Significant impact on price and competition
- Most contracts fit into one of two broad categories:
  - Fixed Price - the contractor is required to deliver the product specified and there is a maximum limit on the amount of money the Government must pay.
  - Cost Reimbursement - the contractor is required to deliver a "best effort" to provide the specified product. All allowable costs must be reimbursed, regardless of delivery, up to the level specified in the contract.

Impact of Payment and Finance Terms

- Payment at completion may severely limit competition or result in higher prices
- Types of financing
  - Advance payments
  - Public Vouchers
  - Progress payments
  - Milestone billing
  - Provisional billing

Summary of General Pricing

- Definition of price
- Two perspectives on price mean two interpretations of fair and reasonable pricing
- Industry pricing strategies vary widely but are generally designed to cover costs and/or attain corporate objectives
- Industry pricing strategies may be market based or cost based

Review - question #1

- Pricing a government contract is always simple and straight-forward?

1. True
2. False

Review - question #2

- Which of the following factors may have an impact on contract price?

1. Contract type
2. Economic conditions
3. Packaging and shipping requirements
4. Exclusivity of product or service
5. All the above

Review - question #3

- The process of defining, collecting and analyzing information about the capabilities within the market to satisfy agency need, is known as

1. Price analysis
2. Contract negotiation
3. Market research
4. Market based pricing

Review - question #4

- The government has the right to audit costs incurred on every contract.

1. True
2. False
3. Trick question?

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