

Mining Misfits – Roundtable Discussion: Contractor Incentives

Discussion Overview & Debrief of Major Topics/Themes

The Mining Misfits are composed of an intimate group of global leaders in mining and metals who want to make our industry better and more sustainable for everyone. Every month Prime Contract Solutions hosts a round table discussion with a pre-determined topic or industry challenge which is deliberately explored with an aim of identifying viable solutions and sharing them in our industry.

1.0 Introduction

We started this chapter of the Misfits Roundtable Discussion with the summarized data findings from the Independent Project Analysis (IPA) on the topic of contractor incentives. These findings reveal that incentive programs based on fixed criteria and calculated results, be it Key Performance Indicators (KPI's) or otherwise, generally do not provide the desired results which the program is designed to achieve.

The experience of those Misfits joining us this week, as both Owner and contractor representatives and seasoned veterans, tends to align to this finding by the IPA. In order to understand why calculated fee programs have a tendency to dis-incentivize (or mis-incentivize) the contractor, we must first answer two questions: What is driving the contractor's behaviors, and does this driver align to the needs and objectives of the project?

In other words, how do we truly incentivize the contractor to those same goals and objectives which make the project itself successful?

2.0 Failed Incentive Models

As the Misfits shared their experiences, it became evident that there were a number of recurring faults in those commonly applied incentive models.

One of these pitfalls is that the incentive models structured to provide a fee and profit to the contractor organization, often do not directly affect the contractor site personnel who are responsible for delivering the project. As such, these front line supervisors are not incentivized to care if the contractor organization achieves 100% of their fee, or 50% of their fee, their salary remains the same. The "incentive" program, provides no real or direct incentive for site personnel to perform well.

Another reason KPI's and calculated incentive programs fail is because the criteria become diluted. Typically contractors will look at a project with a dozen KPI criteria and know right away they will not achieve 100% of their available fee. This can act as a disincentive, or cause the contractors to focus on the criteria they are most likely to achieve, rather than the collective criteria geared at achieving the project's unique objectives.

In other words, contractors will position themselves to achieve the most likely criteria with the greatest potential for payout while giving a lower priority to other criteria. This is not a behavior that aligns well with project objectives.

Possibly the greatest challenge for any incentive model is what it does when performance criteria are not being met, when the contractor's fee is at risk, and the impact this has on the project. Often, when a contractor is at risk of losing a portion of its fee, a commercial battle ensues, and resources are shifted to mitigate the commercial impacts rather than focusing on technical solutions to advance the project.

When contractor personnel are focusing time and energy on commercial matters, then projects tend to suffer as this diverts critical resources away from achieving technical results. One of the Misfits shared a best practice in this regard. First and foremost, put commercial aside, and instead focus on the best technical solution. Once there is alignment on the best path forward, then, and only then, you can address the commercial or cost implications.

3.0 Contractor Behaviors

The objective is clear: execute a successful project. When the contractor wins, the owner wins. It is the overwhelming position of the Misfits, that they want their contractors to be successful. More than that, to secure the best contractors and the best contractor performance, they want to see contractors making above-market profits.

Contractors tend to staff the best personnel on the best earning projects. Meanwhile, owners often look at the incentive program as a commercial weapon instead of a motivating factor. Owners cannot punish the contractor until they focus on the project and improve performance, this has been proven to be dis-incentivizing.

Throughout our Misfits discussions, we keep coming back to the importance of having the best people on the job. That was true this roundtable as well, with one new flavor mentioned above: owners want the best contractor personnel, and they want them focusing on advancing the project.

When good project personnel are focusing on commercial matters to secure the largest amount of an already presumably slim margin available to them, it distracts from the real work.

Another point mentioned was that contractors send their best people to the best projects. Considering these dynamics, why would owner teams not want to pay their contractors better, and keep their technical personnel driving the project rather than managing commercial aspects? Nobody from either the owner or contractor organization wants to be on a dog of a project; therefore it is important for owners to acknowledge what type of behavior is expected with adversarial contract relationships. One Misfit implicitly stated that as a contractor responsible for multiple projects at any given moment the best people are put on projects with the best margins. It only makes sense.

Much of what we are discussing is Psychology 101. The carrot and the stick incentives. And yet, so much of the industry is practicing adversarial relationships and repeating the same commercial battles over small dollar fees. As an aside, one aspect that the Misfits and Prime Contract Solutions are going to dive deeper into is basic psychology and how mindset ultimately impacts project performance (or lackthereof). It seems much of the industry has ignored the basic principles of how the human mind works and why people make the decisions they do. More to come, but I, personally believe a more robust understanding could be a game changer in our industry! It's time for us to elevate our thinking and evolve as an industry!

One Misfit in particular made two points that are not common thought in the industry amongst owner personnel: contractors are not getting rich off one job, they are not looking to take advantage of owners, nor can they absorb financial risk on one contract that would take the margin of ten projects to cover!

It should be of no surprise that relationships, honesty, and trust were central in this conversation about contractor incentives. It is interesting that so many industry leaders can agree to the importance of these components, yet the overwhelming majority of relationships in the industry continue to be combative.

It would seem that paying contractors fairly and incentivizing their great performance would yield better results than setting them up with slim margins, and then taking away every component of the fee that the owner is able to. This fee structure is not an incentive, that is a disincentive, and surely yields the opposite behaviors than intended.

As one Misfit representing the owners frustratedly called out:

"There is a fundamental philosophical misunderstanding with certain owners that I'll never ever get my head around. Which is the inherent view that somehow profit and incentive is is a bad thing!"

4.0 Alternate Incentive Models

The one incentive model discussed by several Misfits was a fixed fee plus a behavioral based fee program, where the fixed fee assures the contractor will earn a comfortable margin, and the behavioral based fee offers potential upside for good performance against pre-determined criteria.

While this model seems like it would incentivize the right behaviors, it must be structured appropriately, and also there must be a great understanding of the program, and trust between the organizations. The owner must trust the contractor is going to place its efforts in the right areas to advance the project successfully, and the contractor needs to trust the owner is going to evaluate them fairly and award on a periodic basis the pre-determined criteria (often discretionary) of the fee accordingly.

Possibly the greatest benefit of this model is not just the potential for above-average fee being awarded, or that it is driving good behavior rather than defensive behavior, but rather that it allows for frequent feedback between the owner and contractor parties throughout the project.

The Misfits agree that if the owner and contractor can give professional and honest feedback as to the overall performance to-date on a project, then they should be able to work together to improve in areas most critical to the project's success. Without this open and honest communication, the contractor is left again trying to decide for itself how to recover as much fee as possible, but not necessarily aligning to the owner's expectations for the project.

We cannot have a conversation about the right fee program to employ without addressing the importance of an accurate budget estimate. If a good budget cannot be established, then the fee amount and model is insignificant. If the estimate is wrong, then commercial battles will ensure, once again diluting from the objective of project success. Several misfits emphasized this point of getting the budget right, ensuring its checked and achievable.

If the budget estimate is not achievable, then the owner is setting its contractors up for failure from day one. This point cannot be understated.

Another incentive model that many Misfits found effective was direct payouts to contractor site personnel. As mentioned above, many site personnel are not affected by corporate margins, and as such many fee programs are not incentivizing the people who have the greatest impact on the success of a job. One concept worth noting here is the belief that both owner and contractor site personnel should optimally be driving to the same objectives and incentive model. Not taking into account this important distinction and philosophy can cause disparagement (or worse) on the project.

If a component of the fee were payable to front-line supervision for good performance, would those personnel not want to strive to make the project more successful? Pride in performance is an important quality to any trade. Knowing that you can be rewarded for great performance sure sounds like a better incentive than being punished for missing calculated targets.

The true question, is as an owner, do you want to manage a contractor through punitive financial liabilities, or rather reward them for good performance and behavior. From my fanstage point it seems pretty straight forward, yet this belief is often met with resistance in the industry. Why?

5.0 Conclusion

The best incentive models should promote good performance and good behaviors, not punish for commercial gains.

Further to this, projects are most commonly successful when the owner and contractor have a good relationship, not an adversarial position from the very onset of the project.



Owners want contractors to perform exceptionally on their project, yet often refuse to pay margins that would promote that. Our most commonly applied fee programs are often disincentivizing, and the data has proven it time and again. It should also be noted that IPA's data reflects that projects in our industry with hard-wired KPI's for cost and/or schedule actually cost the project more!

It should be clear that owners want the best contractor and the best contractor personnel on their jobs. Contractors typically send their best personnel to the jobs run by their favorite clients and with the largest margin potential.

Owners win when contractors are successful. Contractors are successful when they staff the best personnel on a job that is attractive to the company, key personnel are not engaged in commercial battles or positioning, and the owner acts to empower the contractor rather than to distract and punish them every chance they get.

The selection of fee programs in part is driven by the contract type (reimbursable, lump sum, etc.), as well as the scope of work (underground mining, site-wide EPCM, etc.). Where there is opportunity, however, it would be in owners best interest to develop incentive programs that attract the best contractors in the industry.

As a closing thought to this Misfit roundtable discussion, the author believes its time to eradicate antiquated thinking of the past. Time and time it's been proven over and over it doesn't lead to a successful outcome. From my vantage point until we evolve as an industry we will continue to deliver 9 out of 10 mega-projects over budget!

If you are a progressive owner with a mega-project portfolio and you want to apply industry best practices to your project our proven framework guarantees achievable and sustainable success! Our clients obtain the best contractor teams available and deliver substantially higher value for their shareholders!

Many thanks, and much appreciated.

Jason Fearnow, Founder & CEO – Prime Contract Solutions