The Shared Risk/ Reward Business Deal a.k.a “The Deal”

“THE EMPHASIS SHOULD BE ON WHY WE DO THE JOB.”

| W Edwards Deming |

1.0 Why

2.0 What

3.0 How

4.0 When

References/ Sources
1.0 Why

“The Deal” is a unique business construct in the Lean/IPD environment that attempts to align all project participants to a shared project goal, called Conditions of Satisfaction. The Deal ties the profits of several project participants to the outcome of the entire project rather than to individual performance. The intent is to open the eyes of the participants to the waste that has been generated by the silos of previous contract forms. It also encourages participants to act as one entity, thus optimizing the entire value stream rather than focusing on individual piecework. It is best when a wide variety of project participants participate because they can offer project-wide design and build perspectives to solve problems faster and with greater success.

The construction industry typically contracts for work in a way that rewards and punishes individual companies for their individual performances. The traditional contracting system is inefficient – so much so that owner/operators typically expect that projects will be late, over budget, and inaccurate. The contracting strategy is at odds with the desired outcome. However, despite this dysfunction, not much has changed over at least the last fifty years because everyone who is not an owner/operator in the team has learned how to make money from a dysfunctional system. Contractors often must choose between supporting a project’s success or supporting their company’s success.

This dysfunction causes project participants to choose between behaving in a way that supports project success and behaving in a way that supports individual companies’ success. If the behavior that will help the project will cost a company money and the contract they are under does not allow them to be compensated for that effort, the project manager is often forced to choose between helping the project or getting a bad performance review and losing a salary bonus. If the behavior were aligned, we would not have this problem.

In contrast, The Deal encourages collective teamwork to achieve collective success. The financial logic of a shared risk/reward deal reinforces the culture of a single team having a single focus. The Deal also reinforces all the other characteristics of the Lean/IPD model. It encourages the team to collaborate particularly during a project’s challenging or difficult stretches.
Below is the ideal situation that is available under an IPD-contract. The intent here is to present a goal to which a project can strive with other contract models. The difficulty in achieving the ideal situation varies dependent on the contracting model in place. Here is a rough guide to degree of difficulty to construct a business deal that supports everything that needs to happen on the project.

• Integrated Project Delivery Contract – EASIEST OF ALL
• Design-Build Done Right (IPD-like) – FAIRLY EASY
• Multiple Prime or CM At-Risk – MODERATELY CHALLENGING
• Design-Build Done Wrong (Des/Bid/Build-like) – HARD
• Design / Bid / Build – HARDEST OF ALL

The intent of the business deal is to directly motivate the business owners, key project team leaders and financial managers to achieve project goals. It is not to directly motivate last planners and support staff. By motivating the business owners and key team leaders, they then become a resource and advocate for changing and aligning the behaviors of their staff with the needs of the project. A top down buy-in from each organization makes adoption much easier. The team established four buckets of cost:

• Owner direct cost not at risk to the team
• Total project hard and soft costs including home office overheads
• An appropriate project management team contingency
• Aggregated team profit

The last 3 buckets combine to become the Current Working Estimate (CWE).
THE DEAL | 4

Most Lean/IPD teams solicit business terms input during the Partner Selection process. This helps define profit needs and personnel unit costs in a competitive environment even though the details of the project are not sufficiently mature to transfer risk.

It is crucial that the project risk/reward criteria link directly the project scope in the project Conditions of Satisfaction. This is a critical timing issue among all parties. If a project is not sufficiently defined, partners may be subject to undue risk, resulting in inflated contingencies and unwanted protectionist practices.

Teams should create the target and associated profit pool ownership as soon as there is validation around the CWE. By doing this, teams can define the individual ownership of the profit pool, thus clearing the way for partners to assess the project costs. By doing this, teams minimize scope hoarding and scope avoidance. The best project partners assume the appropriate work without concern for impact to profit. This helps align scope with capability, allows scope to be aggregated and to be shifted as the needs change.

Project teams new to partner selection should seek advice from companies experienced with Lean/IPD and consult with legal and insurance experts.

3.0 How

One key dynamic to create is to have the designers to be at risk for project failure during construction and for builders to be at risk for not informing the design well enough during design. This will create a significant need for collaboration among all partners and will require input and respect across traditional responsibility boundaries. This is a key benefit to the owner as the team is now responsible for improving the communication between designers and builders to avoid the typical causes of project change orders and delay. This risk structure can be particularly challenging for a Design/Bid/Build contract, as the team is not complete during the design phase.

4.0 When

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The owner/operator should set a project investment threshold from which the team creates a target cost and can use Target Value Design to meet the target. The collaborative team works together to discover the detailed project requirements and meet this target through innovation. A detailed CWE is established and validated between owner/operators and partners. An initial target is created that is a meaningful stretch, yet attainable.

Stretch goals embedded in the business deal create tension that drives innovation. These goals should be significant and not limited to 2% or less. The goals should recognize the significant waste embedded in the system and encourage partners to think differently about the way they do business, both individually and jointly. The shared savings should be commensurate with the willingness to take risk and the effort required to meet those goals.

Contingency should be determined based on risk, not historical experience. Teams should strive to identify and create mitigation strategies for any known or perceived risk. A portion or all remaining contingency should be shared with the partners to incentivize all parties to efficiently resolve risk issues.

While the premise of this article is that the owner be fully involved and engaged with the partners in all aspects of the delivery, the owner does not always need to be a participant in the business deal. There are contract models where the above structure is entirely within a GC-led progressive Design-Build structure. However, the owner/client still needs to be an engaged participant in the project, and it is particularly vital that before the final cost is agreed to the owner must have a clear, robust project Conditions of Satisfaction.

Return to Learning Laboratory >>