

Performance Based Contracting

Measuring and rewarding
performance in an alliance
framework

Premise

- ▀ What we've learned in measuring and rewarding performance in alliance contracts has wider application

Outline

- Sydney Water's alliances
- Evolution of performance measurement
- Evolution of performance incentives
- Current approach
- Principles for performance measurement and incentives
- Learnings
- Issues for the future
- Where we're headed

Sydney Water's alliances

- Northside Storage Tunnel 1997-2001 (\$466m)
- SewerFix Pumping Stations Program 2001-05 (\$230m)
- Priority Sewerage Program 2002-07 (\$260m)
- Bondi STP RIAMP 2003–06 (\$75m)
- Water & Sewer Mains Renewal Program (NetWorks Alliance) 2005–09 (\$300m)
- SewerFix Wet Weather Alliance 2007-10 (\$200M)
- North Head STP PARR Alliance 2007-09 (\$50M)
- Water Distribution Infrastructure Alliance 2007-09 (\$600M)

Evolution of performance measurement

- Northside Storage Tunnel
 - 1st alliance in Australian Public Sector
 - developed as we went along
 - notion that project objectives and performance measurement should be determined jointly
- SewerFix Pumping Stations
 - lessons from NST, but still no structure and limited expertise
 - more awareness of the impact of pain/gain

Evolution of performance measurement (cont)

- Priority Sewerage Program
 - first application of performance measurement expertise, but loose structure
 - beginnings of notion that client should determine project objectives and how performance will be measured – but done jointly anyway
 - strong reliance on process measures

Evolution of performance measurement (cont)

- Bondi RIAMP
 - performance measurement expertise applied in a structured way
 - started by putting heavy emphasis on clarifying client's objectives for the project – **a breakthrough**
 - SW proposed a measurement framework and developed it with the alliance
 - fewer KPIs and less reliance on process measures

Evolution of performance measurement (cont)

- Water and Sewer Mains Renewal Program
 - structured approach refined
 - few KPIs and almost no process measures
 - SW proposed a detailed measurement framework and required final 2 to tender on that basis
 - overly tough targets threatened the alliance from the start

Current approach

- Draws on some painful lessons
- Reflects learnings rather than dogma
- Client determines objectives (**key step**) and firm ideas on how performance should be measured
- Decides where performance above and below minimum expectations would add to or diminish value to client and, therefore, warrant incentives
- Discusses performance measurement framework prior to selection of preferred participants and refines as necessary

Performance measurement principles

- Performance measurement is most relevant when it relates to the desired outcomes
 - rather than how we got there
- Superior performance should only be rewarded when the outcome is valuable to the client
 - and vice versa

Evolution of Performance incentives

- Originally, incentives struck at levels without great regard to value of performance (+ or -)
- Incentives then seen as more appropriately reflecting added or foregone value to the client, based on actual outcomes
- View emerged that potential upside may not be the same as the downside value to the client – and that incentives should reflect this
- Recent view that incentive amounts must represent a viable commercial opportunity for the NOPs

Evolution of Performance incentives (cont)

- Difficult to suggest typical quanta for incentive pools – depends on project, objectives, risks
- Sydney Water has proposed upsides of up to 5% of project value for outstanding non-cost performance
- Typically don't limit upside from good cost performance – has led to significant rewards from outstanding cost performance
- Downside typically capped at corporate overhead and profit of NOPs – typically greater \$ than potential upside

What we've learned

- The most skilfully drafted contract and the most sophisticated incentive framework will not lift an ordinary team to outstanding results
- Limited evidence that KPIs are effective at 'driving performance'

What we've learned (cont)

- Just as contract terms and incentive frameworks should be proposed by the client, so should KPIs and targets and the amounts on offer and at risk
- they reflect what the client wants out of the project and the value to the client
- commercially naive to jointly develop them

What we've learned (cont)

- Rewards should only be available when the outcome is valuable to the client (and vice versa)
 - this may mean potentially more non-cost performance related downside than upside for non-client members
 - in some areas we're happy with current performance levels and don't want to raise the bar if there's little value

What we've learned (cont)

- Process KPIs haven't proven useful in focussing people on the desired outcomes
 - instead, lots of effort on ensuring the boxes are ticked
- Less is better, simpler, clearer, cheaper
 - fewer KPIs, reliance on data already collected
 - more KPIs mean each one means less
- Not everyone is good at developing KPIs and targets that are suitable for linking to pain/gain – very helpful to use experts

Issues for the future

- Influence of incentives on performance still not well understood
 - what works and what doesn't
- Should safety performance that doesn't achieve 'nil harm' be rewarded?

Where we're headed

- New alliance projects
 - North Head STP PARR
 - Power Generation Project under our Energy Partnership
 - Water Distribution Infrastructure alliance
- Will continue to evolve application of performance measurement and incentives

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