Types of Contracts in an RFP and their differences.

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Types of Contracts in an RFP:

Contract type is an important legal document that must be present in the procurement process. It determines the costing agreement between the client and the contractor. There are various types of contracts that a client may decide based on certain factors. This essay will provide more insight on the contract types and their differences in detail.

Types of Contracts:

The contracts are majorly classified into three, fixed price, Cost-Plus or Cost-Reimbursable and Time and Material contracts.

In fixed price contracts, the client will pay a fixed amount to get the work done, no matter the time and effort incurred for the project. The contractor needs to bear the additional expenses if the project overshoots the fixed price. So, in this type of contract, the contractor's profitability at stake if the project exceeds the fixed budget. The client enjoys the benefit of having a fixed cost.

For Fixed price contracts, the scope of the project must be known in precise and in case of any scope ambiguity, the client needs to re do the contract again.

Here are the fixed price contract variants.

1. Fixed total cost contracts
2. Fixed contracts with price adjustments
3. Fixed price contracts with Incentives
4. Fixed Unit price contracts

If the scope of the project is not well known ahead then a cost-plus or cost-reimbursable contracts are preferred. In this type of contract, the contractor will be paid for the cost incurred for completing the job and mostly an incentive in addition. The client's budget will increase if there is an increase in the effort, scope and time. The vendor's profit will stay the same.
The contractor will be motivated less to cut costs since he is going to get the reimbursement for the costs incurred.

Here are the Cost-plus contract types.

1. Cost reimbursable contract with fixed fee
2. Cost reimbursable contract with percentage fee
3. Cost reimbursable contract with incentive fee
4. Cost reimbursable contract with award fee

If the scope of the project is limited and if the client pays for the hourly rate for the contractor and agrees for the material costs then they may go for Time-Material Contracts. In this type of contract, the contractor's profit increases if the time of the project increases.

Let's take a look and the contract types in detail.

Fixed price contracts:

Fixed total cost contracts:

If the vendor takes responsibility of costs for the project including their profit by accepting the risk for any increase in costs for the efforts and time.

Fixed price with price adjustments:

If a project unusually takes a longer time and during the course the cost and materials may go up due to inflation and in that case the contractor's price will be adjusted with inflation.

Fixed price with incentive fees:

These types of contracts will award an incentive for the contractor if he meets the milestones and provide value addition or completes the project way ahead of the timeline. This also comes with a penalty clause, in case the vendor takes more time to complete the task or miss an important timeline. They may be penalized for a daily amount until the work is complete.

Fixed unit price contract:

If the deliverable or task be measured as units and paying a contractor based on the units consumed or services is termed as fixed unit price contract. The clients must take the ownership of identifying the number of units to be serviced. The contractor will get more money if he processes more units. A typical example would be contracting the maintenance of IT equipment such as laptops, printers and so on. The contractor will be paid on visits he makes to fix the equipment and each visit is considered as a unit. (Please refer the link #5 provided in the reference)

Cost-Plus contracts:

Cost-plus fixed fee:

It pays the vendor the cost incurred along with a fixed fee which will not be changed and the fixed price will be well documented in the contract.

Cost-plus percentage fee:

It is similar to the "cost-plus fixed fee", but the difference here is the contractor is going to get a percentage of the cost incurred, for instance 10% of allowable costs which will be documented in the contract.

Cost-plus incentive fee:

This contract will motivate the vendor to reduce costs for the projects and they will get an incentive based on the saving he is going to provide the client. More the savings, more the incentive for the contractor.

Cost-plus award fee:

This is similar to "cost-plus incentive fee". The contractor will be motivated to save the costs by setting up award criteria based on goals on objectives to be reached on the project. If the contractor delivers more values and cost savings then the award fee will go up.

Time and Material contract (T&M):

T&M contracts applies if the scope of the project is small and uncertain. The contractor must assume a risk and will add a contingency in the bid. There will be "not-to-exceed" clause in the bid from the contractor. T&M contracts will shape itself if more information is available during the project course.

References:

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