Synopsis of The Department of Homeland Security's
"DHS Pricing Strategies and Consumption-Based Pricing Methodologies"
February 24, 2016 – Homeland Security Acquisition Institute

Introductory Remarks

Speakers: Soraya, Correa, Chief Procurement Officer, Office of the Chief Procurement Officer (OCPO); Harrison Smith, Industry Liaison, OCPO

The Department of Homeland Security's (DHS) Pricing Strategies and Consumption-Based Pricing Methodologies event was a Learning Event under the auspices of the Acquisitions Innovation in Motion (AI*i*M) initiative. Designed to promote an open discussion about issues that concern both industry and federal personnel, this Learning Event focused on challenges of how and when to use consumption-based pricing and as-a-service priced offerings, how they are priced, and the perceptions of consumption-based and as-a-service offerings from both an industry and DHS perspective. A common understanding/usage of terms and differentiating between consumption-based and as-a-service was an important step to begin the conversation. This was done using the "Pizza as-a-Service" analogy to illustrate different levels of as-a-service models. It is important to note that as-a-service models do not necessarily have to be consumption-based. For this discussion, we defined a consumption-based offering as one that ties cost for the customer to the level of actual use, or the level of actual use with excess capacity built (and priced) in.

Consumption-Based and As-a-Service Pricing Methodologies – Panel Discussion

Panelists: Jared Townshend, Deloitte; Andy Flick, ViON; Mark Hudak, OCPO; and Robin Jones, Office of Procurement Operations

The panel provided interesting views from both industry and government parties. From an industry perspective, significant effort is involved in trying to identify how exactly the government would like to make purchases; industry can be rather flexible/creative once that is made clear. Considering the "Pizza" analogy: when you order a whole pizza you pay for the whole pie, it is not consumption-based; consumption-based would be paying for each slice of pizza, if and only if you eat it. Industry prefers to avoid prepaying for too much, this makes the “by the slice” option ideal; however, requirements and the expected timeline are not always clearly defined. The government is looking for the efficient delivery of high quality products/solutions. If the government were able to define needs more clearly (e.g., sharing forecasted needs or historical expenditures) or clearly state that it is open to different offerings, industry could respond more efficiently.

The importance of this information to industry is difficult to overstate. Under as-a-service models (including consumption-based), the customer is shifting a portion of its risk to the provider. Risk to the provider almost always results in increased cost to the customer. A very specific example that was discussed was that with sufficient information about DHS’s anticipated needs, unit prices (storage, bandwidth, etc.) can be established with costs and profit spread out over a period of time. Without sufficient information, those costs are often front-loaded, and/or industry takes a more aggressive (read: risky) approach to the project. Another thing for government personnel to consider is the increased ability of the contractor to maintain staffing for future needs if there is more clarity in the requirements. This clarity can be provided via requirement-specific estimates or historical burn rates, or through publicly available information (budget submissions, for instance).

As-a-service providers look at several factors including contract risks (e.g. delivery schedule, maintenance/repair/restoration of service, operational execution and support, and financial considerations), contract type, contract funding, unit pricing, and the government’s requirements. The panel discussed the topic of differing opinions on what is an appropriate amount of risk for a vendor? Pricing and contract type are closely related as the contract should have a reasonable level of contractor risk and provide the contractor with the greatest incentive for efficient and economical performance. The *type* of funding has a large impact on level of risk to the contractor and how it plans: is there measured funding versus billing for what has been ordered? Are there Contract Line Item Numbers (CLINs) for recurring charges and non-recurring charges? Does the government order from the contract using Sub-Contract Line Item Numbers (SLINs)? Is the contractor required to provide a monthly contract funds status report as a means to evaluate and forecast funding consumption? These questions are all considered when measuring risk and in establishing pricing.

From a government perspective, the focus should be on matching the contract type and pricing approach to commercial buying practices and having personnel who can converse with industry on a technical level to build appropriate requirements and pricing models. Contracting Officers (COs) also need to be creative with their techniques. The Federal Acquisition Regulation (FAR) is not limiting; rather, it provides room for many flexibilities. COs are expected to use personal initiative and judgment to find the best price for the government.

There are many paths to using consumption-based methodologies including drawdown accounts, ordering officials, and tier-based pricing. Under a drawdown account, the CO negotiates fixed unit pricing on a contract/order, obligates the not-to-exceed ceiling, and authorizes certain technical personnel to request deliveries. The contractor invoices at the negotiated unit pricing based on what is actually consumed. Deliveries may be requested from the contractor up to the cap established and funded by the CO, and additional quantities may be available if options were established at the time of award. Drawdown accounts are beneficial with well-defined services, supplies, limited storage capacities, and when the level of demand is not consistent. It is important to know that drawdown accounts do have their drawbacks; they should not be used in conjunction with amorphous requirements, the not-to-exceed ceiling should be set carefully to avoid either over-obligating (i.e., not being able to expend all obligated funds during the contract period) or creating too many option quantities, and maintaining oversight may be more difficult than with traditional methods. Ordering officials are similar to drawdown accounts, but allow a Certified Ordering Official to place orders using a purchase card instead of having the CO obligate funds. The CO may establish a cap to ordering and payment follows the normal purchase card method. Tier-based pricing provides several ways to make purchases, most notably, the use of buckets based on current purchases and of buckets based on historical purchases. A tier-based pricing approach allows the government to take advantage of quantity discounts. The government should define in advance, or be prepared to negotiate, how and when to measure consumption and to adjust the tiers accordingly, as well as whether to either aggregate quantities across an organization or set office specific tiers.

The event concluded with a networking session where industry and government attendees were able to discuss additional questions and concerns.