

# How to Justify Increased Profit/Fee

**Small Business Technology Council (SBTC)  
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# PROFESSIONAL EXPERIENCE & QUALIFICATIONS

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- **Retired Navy Commander**
  - Administrative Contracting Specialist
  - Deputy Procuring Contracting Officer F/A-18E/F Super Hornet Program (ACAT 1D)
  - Business Financial Manager (CFO) F/A-18 Program
- **MS Acquisition & Contracting, Naval Postgraduate School (NPS) Monterey**
- **MBA Faculty - NPS Graduate School of Business & Public Policy**
  - Developed and taught defense focused acquisition, contracting, program management, and business financial management courses
- **Independent Acquisition & Contract Management Consultant & Expert Witness**
- **Part Time Senior PTAC Procurement Counselor/Specialist**
  - Two time APTAC Economic Impact Award Winner in 2015 & 2017
  - APTAC 2020 Betty McDonald Outstanding Member Achievement Award Recipient
- **Professional Designations**
  - Certified Professional Contracts Manager (CPCM)
  - Certified Federal Contracts Manager (CFCM)
  - Certified Schedules Contracts Manager (CSCM)
  - Certified Procurement Professional (CPP)
  - DAIWA Level III – Contracting

# PRESENTATION OUTLINE

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- **Federal, SBIR & DoD profit policies**
- **Negotiation strategies to justify increased profit/fee**

# TOPIC RELEVANCE

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- Trend of de facto profit/fee caps ranging from 5% to 7% on SBIR & other high tech Defense R&D contracts

**Runs counter to FAR, DFARS & SBA SBIR Program profit policies**

- Why are small businesses accepting 5-7% fee on a CPFF R&D contract with significant technical performance risk?

**“The CO told me that is the maximum profit/fee they could offer!”**

- How can small & large businesses justify increased profit/fee?

**Understand Federal, DoD & SBIR profit policies**

**Apply profit factor analysis principles & concepts in your proposals**

**Develop negotiation strategies that justify & support higher profit/fee**

# POTENTIAL IMPACT FOR YOUR BUSINESS

**“Jeff, We won. See email below. Thanks for your help!**

I will look forward to working with you on more profit/fee proposals from here forward!

Regards, Xxxxxxx”

----- Forwarded Message -----

“Subject: FW: Add Work FAXXXX-16-C-XXXX Request for Government’s Weighted Guidelines Fee Analysis

Date: Tue, 14 Jun 2016 19:54:58 +0000

From: XXXXXXXX, TRISHA L GS-12 USAF XXXX

XXX/XXXXX <trisha.XXXXXXXXXX@us.af.mil>

To: xxxxxx@xxxxxxcorporation.com

Xxxxxxx,

Government has reviewed the information supplied below and we accept the following for the ADD WORK effort:

Total Cost \$821,425

Fixed Fee \$98,571

Total CPFF \$919,996

**Fee Rate 12.00%**

Please acknowledge acceptance and close of negotiations. If so, please send me a [certificate of cost and pricing data.](#)”

## Negotiations Summary

	Air Force Offer	Negotiated Agreement
ADD Work Effort	2-Jun-16	14-Jun-16
Total Cost	\$ 821,425	\$ 821,425
Fixed Fee	\$ 53,394	\$ 98,571
Total CPFF	\$ 874,819	\$ 919,996
Fee Rate	6.5%	12.0%

**12% Fee was fully justified based upon Weighted Guidelines Profit/Fee Factor Analysis & supporting information supplied by the contractor**

# FEDERAL PROFIT POLICY

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- Applies to price negotiations based upon **cost analysis**
- Profit/Fee objectives **do not necessarily represent net income**
- It is in the Government's interest to provide **sufficient financial rewards**
  - Stimulate efficient contract performance
  - Attract best capabilities of industry
  - Maintain a viable industrial base
- It is **NOT** in the Government's best interests to
  - Conduct negotiations aimed merely at reducing prices by reducing profit
  - Negotiate extremely low profits
  - Use historical profit/fee averages
  - Automatically apply predetermined profit/fee percentages

FAR 15.404-4 -- Profit

# FEDERAL PROFIT POLICY

A reasonable profit/fee is determined through use of a **structured methodology**, if applicable, **or via analysis of the profit analysis factors** listed under FAR 15.404-4(d)(1)(i) – (vi)

## Common Profit Analysis Factors

### Contractor Effort

- Work complexity
- Material acquisition
- Conversion of Direct Labor & Indirect costs
- General management

Contract Cost Risk    Capital Investments

Federal Socioeconomic Programs

Cost Control & Other Past Accomplishments

Independent Development    Other Agency Factors

# FAR STRUCTURED PROFIT METHODOLOGY

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“FAR 15.404(b) Policy.

(1) Structured approaches (see paragraph (d) of this subsection) for determining profit or fee prenegotiation objectives provide a discipline for ensuring that all relevant factors are considered. Subject to the authorities in 1.301(c), agencies making noncompetitive contract awards over \$100,000 totaling \$50 million or more a year—

(i) Shall use a structured approach for determining the profit or fee objective **in those acquisitions that require cost analysis**; and

(ii) May prescribe specific exemptions for situations in which mandatory use of a structured approach would be clearly inappropriate.

(2) Agencies may use another agency’s structured approach.”

Federal Agencies with Structured Profit/Fee Methodologies per respective Agency Federal Acquisition Supplement:

**DoD, USDA, DOE, DOI, HHS, EPA, FEHB, GSA, LIFAR, & NASA**



# FAR PROFIT ANALYSIS FACTORS

Profit/Fee Factor	Provide Greater Profit/Fee to Contractors who:
<p><b>Contractor Effort</b></p> <p><i>Complexity of work &amp; resources required for contract performance</i></p>	<p>Undertake contracts requiring a high degree of professional &amp; managerial skill and whose skills, facilities, and technical assets can be expected to lead to efficient contract performance</p>

## When developing a profit/fee objective for Contractor Effort COs should consider:

<i>Material acquisition</i>	<ul style="list-style-type: none"> <li>• Complexity of items required</li> <li>• Number of purchase orders &amp; subcontracts ordered/administered</li> <li>• Need for source development</li> <li>• Complexity of purchase orders (POs) &amp; subcontracts</li> </ul>
<i>Conversion direct labor</i>	<ul style="list-style-type: none"> <li>• Diversity of labor types required</li> <li>• Amount &amp; quality of supervision &amp; coordination required</li> </ul>
<i>Conversion-related indirect costs</i>	<ul style="list-style-type: none"> <li>• Indirect labor evaluated the same as direct labor</li> <li>• Evaluate other indirect costs on complexity &amp; contribution to performance</li> </ul>
<i>General Management</i>	<ul style="list-style-type: none"> <li>• Evaluate efforts on complexity &amp; involvement required</li> <li>• Evaluate other cost elements on contribution to contract performance</li> </ul>

Adapted from FAR 15.404-4(d)(1) & Contract Pricing Reference Guide Vol 3, Chapter 11.1.3

# FAR PROFIT ANALYSIS FACTORS

<b>Profit/Fee Factor</b>	<b>Provide Greater Profit/Fee to Contractors who</b>
<b>Cost Risk</b>	Assume a greater degree of cost responsibility & associated risk considering contract type, reliability of cost estimate in relation to the complexity & duration of the contract
<b>Federal Socioeconomic Programs</b>	Have displayed unusual initiative in support of socioeconomic programs (SBCs, SBs owned & controlled by socially & economically disadvantaged individuals, WOSBs, handicapped sheltered workshops & energy conservation)
<b>Capital Investments</b>	Make Investments that will facilitate efficient & economical contract performance
<b>Cost Control &amp; Other Past Accomplishments</b>	<ul style="list-style-type: none"><li>• Demonstrated an ability to perform similar tasks effectively &amp; economically</li><li>• Adopted measures to improve productivity</li><li>• Implemented cost reduction accomplishments that will benefit follow on government contracts</li></ul>
<b>Independent Development</b>	Undertake relevant independent development that will benefit the contract end item considering whether the development cost was recovered directly or indirectly from Government sources
<b>Additional Agency Factors</b>	Agencies may include additional factors in its structured approach or take them into account in the profit analysis of individual contract actions

Adapted from FAR 15.404-4(d)(1) & Contract Pricing Reference Guide Vol 3, Chapter 11.1.3

# SBIR PROFIT POLICY

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“Fee or Profit. Except as expressly excluded or limited by statute, awarding agencies must provide for a reasonable fee or profit on SBIR funding agreements, **consistent with normal profit margins provided to profit-making firms for R/R&D work.**”

SBA SBIR & STTR Program Policy Directive § 7.(g)(2)

# STATUTORY CPFF FEE LIMITATIONS

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- For **R&D** work performed under a CPFF contract, the fee shall not exceed **15%** of the contract's estimated cost, excluding fee
- For **A&E** services for public works or utilities, the contract price or the estimated cost and fee for production and delivery of designs, plans, drawings, and specifications shall not exceed **6%** of the estimated cost of construction of the public work or utility, excluding fees
- For **other CPFF contracts**, the fee shall not exceed **10%** of the contract's estimated cost, excluding fee

FAR 15.404-4(c)(4)(i)(A) through (C)

# Do You Agree with DOT's Profit Policy?

The screenshot shows the Volpe website header with the logo and navigation menu. A sidebar on the left contains a 'Work With Us' dropdown menu. A red arrow points from the 'Work With Us' menu item to a FAQ entry. The FAQ entry consists of a question and an answer.

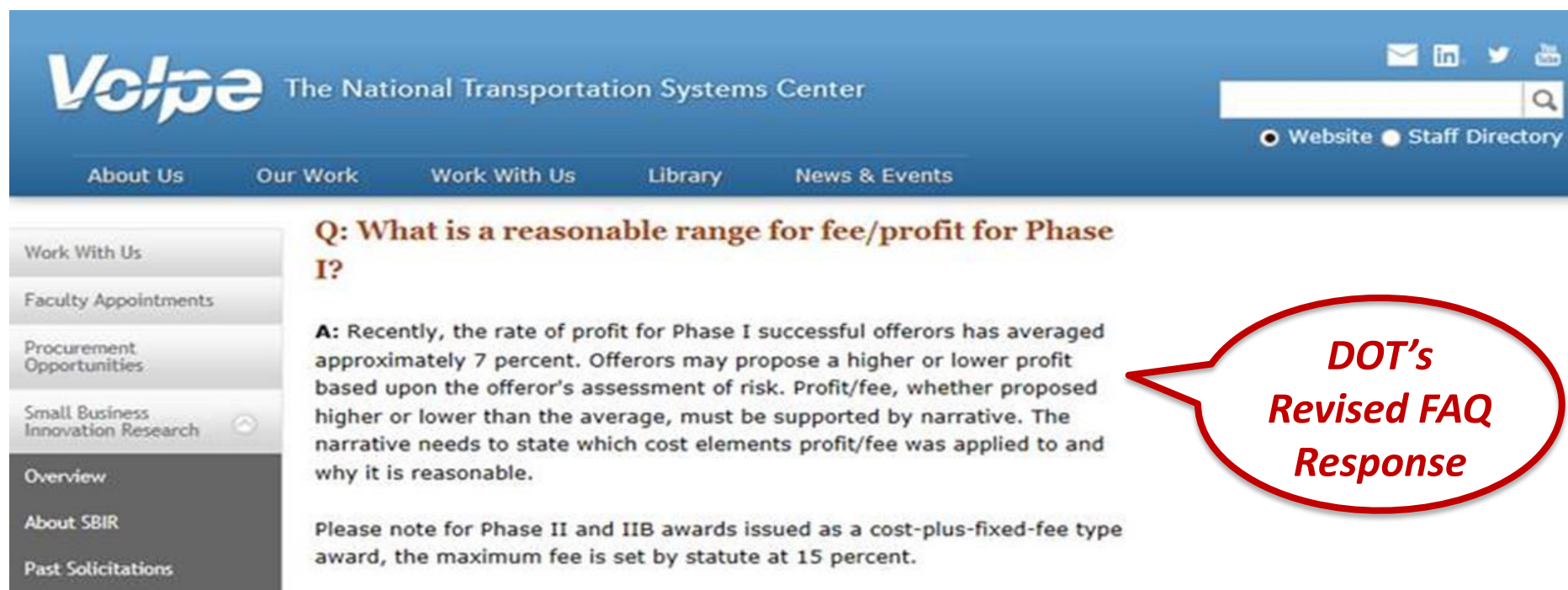
**Q: What is a reasonable range for fee/profit for Phase I?**

**A:** The statutory limit for profit for Fixed Price R&D contracts is 15 percent. Phase II and IIB awards that are Cost Plus Fixed Fee type contracts are limited to a 10 percent fee. For both cases, a reasonable amount of 7 percent is suggested. Proposed profit and fee percentages proposed must be accompanied by a narrative explaining why a percentage was applied to the proposed costs and why it is reasonable.

DOT SBIR FAQ Response accessed on 1 July 2016

# Analysis of DOT's Profit Policy

- ✓ No statutory profit limit on **fixed price** contracts
- ✓ SBIR Phase II and IIB contracts are **for RDT&E** (SBA SBIR Policy Directive)
- ✓ Statutory fee limit for **CPFF RDT&E** contracts is **15%** (FAR 15.404-4(c)(4)(i)(A))
- ✓ Agencies should not establish **pre-determined profit/fee** objectives (FAR 15.404-4(a)(3))
- ✓ A reasonable profit/fee is determined through use of a **structured methodology**, if applicable, **or via analysis of the profit analysis factors** listed under FAR 15.404-4(d)(1)(i) – (vi)



The screenshot shows the Volpe website header with the logo and navigation menu. The main content area displays a question and answer regarding profit/fee for Phase I contracts. A red speech bubble highlights the text 'DOT's Revised FAQ Response'.

**Q: What is a reasonable range for fee/profit for Phase I?**

**A:** Recently, the rate of profit for Phase I successful offerors has averaged approximately 7 percent. Offerors may propose a higher or lower profit based upon the offeror's assessment of risk. Profit/fee, whether proposed higher or lower than the average, must be supported by narrative. The narrative needs to state which cost elements profit/fee was applied to and why it is reasonable.

Please note for Phase II and IIB awards issued as a cost-plus-fixed-fee type award, the maximum fee is set by statute at 15 percent.

**DOT's Revised FAQ Response**

<https://www.volpe.dot.gov/work-with-us/small-business-innovation-research/frequently-asked-questions#Q: What is a reasonable range for fee/profit for Phase I?> (Accessed on 1 August 2016 & **Verified again on 26 June 2017**)

# DoD Profit Policy – DFARS 215.404-4(b)(1)

(1) Contracting officers shall use a **structured approach** for developing a prenegotiation profit or fee objective on any **negotiated** contract action **when certified cost or pricing data is obtained**, **except** for cost-plus-award-fee (CPAF) contracts (see 215.404-74, 216.405-2, and FAR 16.405-2) **or** contracts with Federally Funded Research and Development Centers (FFRDCs) (see 215.404-75). There are **three structured approaches**:

(A) The weighted guidelines method;

(B) The modified weighted guidelines method for contract actions with nonprofit organizations other than FFRDCs; and

(C) An alternate structured approach



**How is this  
materially  
different from  
the FAR Profit  
Policy?**

# Certified COPD Exceptions

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- Acquisitions at or below simplified acquisition threshold (SAT)
- Prices based upon adequate price competition
- Prices set by law or regulation
- Acquisition of **commercial** items
- When a waiver has been granted
- When modifying a contract or subcontract for commercial items
- Exercise of a prospectively priced option
- Proposals used solely for overrun funding or interim billing price adjustments

FAR 15.403-1 and 2



# Record of Weighted Guidelines DD Form 1547

RECORD OF WEIGHTED GUIDELINES APPLICATION					REPORT CONTROL SYMBOL	
1. REPORT NO.		2. BASIC PROCUREMENT INSTRUMENT IDENTIFICATION NO.			2. SPIIN	4. DATE OF ACTION
		a. PURCHASING OFFICE	b. FY	c. TYPE PROC INST CODE	d. PRISM	e. YEAR
3. CONTRACTING OFFICE CODE		ITEM	COST CATEGORY		OBJECTIVE	
6. NAME OF CONTRACTOR		12. MATERIAL				
7. DUNS NUMBER		14. SUBCONTRACTS				
8. FEDERAL SUPPLY CODE		15. DIRECT LABOR				
9. DOD CLAIMANT PROGRAM		16. INDIRECT EXPENSES				
10. CONTRACT TYPE CODE		17. OTHER DIRECT CHARGES				
11. TYPE EFFORT		18. SUBTOTAL COSTS (13 thru 17)		0.00		
12. USE CODE		19. GENERAL AND ADMINISTRATIVE				
		20. TOTAL COSTS (18 + 19)		0.00		
WEIGHTED GUIDELINES PROFIT FACTORS						
ITEM	CONTRACTOR RISK FACTORS	ASSIGNED WEIGHTING	ASSIGNED VALUE	BASE (Item 20)	PROFIT OBJECTIVE	
21.	TECHNICAL	%				
22.	MANAGEMENT/COST CONTROL	%				
23.	PERFORMANCE RISK (COMPOSITE)			0.00		
24.	CONTRACT TYPE RISK			0.00		
25.	WORKING CAPITAL	COSTS FINANCED	LENGTH FACTOR	INTEREST RATE		
				%		
CONTRACTOR FACILITIES CAPITAL EMPLOYED		ASSIGNED VALUE	AMOUNT EMPLOYED			
26.	LAND					
27.	BUILDINGS					
28.	EQUIPMENT					
29.	COST EFFICIENCY FACTOR	ASSIGNED VALUE	BASE (Item 20)			
		%	0.00			
30.	TOTAL PROFIT OBJECTIVE				0.00	
NEGOTIATED SUMMARY						
		PROPOSED	OBJECTIVE	NEGOTIATED		
31.	TOTAL COSTS					
32.	FACILITIES CAPITAL COST OF MONEY (DD Form 1081)					
33.	PROFIT					
34.	TOTAL PRICE (Line 31 + 32 + 33)	0.00	0.00	0.00		
35.	MARKUP RATE (Line 32 + 33 divided by 31)	%	%	% %		
CONTRACTING OFFICER APPROVAL						
26. TYPED/PRINTED NAME OF CONTRACTING OFFICER (Last, First, Middle Initial)		27. SIGNATURE OF CONTRACTING OFFICER		28. TELEPHONE NO.	29. DATE SUBMITTED (YYYYMMDD)	
OPTIONAL USE						
98.	99.	98.	99.			

Acquisition Info  
Blocks 1-12

Contract Type Risk  
Block 24

Facilities Capital  
Employed  
Blocks 26-28

Negotiation  
Summary  
Blocks 31-35

Cost Objective  
by Cost Category  
Blocks 13-20

Performance Risk  
Blocks 21-23

Working Capital  
Adjustment  
Block 25

Cost Efficiency Factor  
Block 29

Total Profit/Fee  
Objective  
Block 30

CO Approval  
Blocks 36-39

# Normal & Designated Profit Range Values

- CO assigns percentage values to each profit/fee factor
- (Profit/Fee (%) value X \$ cost base) = profit/fee objective in \$ for that factor
- Except for Cost Efficiency, each profit factor has a **normal value & designated range of values**
- Normal value is representative of average conditions on prospective contract when compared to all DoD procurements
- CO assigns Cost Efficiency factor based upon sound business judgment
- **Designated range** provides values based upon **above normal or below normal** conditions
- CO does not have to justify assignment of Normal Value; **must justify assignment of other than the normal value**
- DFARS 215.404-71-1 & CPRG Vol 3, Chap 11 provides **guidance on when to assign below normal, above normal & maximum values**

**What strategy would you use to maximize profit/fee under Weighted Guidelines?**

# Technical Risk

## Assigning a Profit/Fee Value for Technical Risk

**Maximum Value** Contract effort requires development or initial production of a new item, particularly if performance or quality specifications are tight; or effort requires a high degree of development or production concurrency

**Significantly Above Normal Value** Contract effort involves extremely complex, vital efforts to overcome difficult technical obstacles which require personnel with exceptional abilities, experience, and professional credentials

**Above Normal Value**

- The contractor is either developing or applying advanced technologies;
- Items are being manufactured using specifications with stringent tolerance limits;
- Contract effort requires highly skilled personnel or the use of state-of-the-art machinery;
- Services and analytical efforts are extremely important to the Government and must be performed to exacting standards;
- The contractor's independent development and investment has reduced the Government's risk or cost; contractor has accepted & accelerated delivery schedule to meet DoD requirements; or has assumed additional risk through warranty provisions

**Below Normal Value** Contract is for off-the-shelf items; requirements are relatively simple; technology is not complex; Contract efforts do not require highly skilled personnel; contract efforts are routine; programs are mature; or contract is a follow-on effort or repetitive-type acquisition

**Significantly Below Normal Weight**

- Contract is for routine services; production of simple items;
- Contract is for rote entry of Government furnished information; or simple operations with GFP

Ref: Contract Pricing Reference Guide (CPRG) Vol 3, Chapter 11.1

# Technical Risk – Technology Incentive Range

## Assigning a Profit/Fee Value for Technical Risk Using the Technology Incentive Range

### Use the technology incentive range only for the most innovative contract efforts

Innovation may  
be in the form of . . .

Development or application of **new technology** that fundamentally **changes the characteristics** of an existing product or system and that **results in increased** technical performance, improved reliability, or reduced costs; or

New products or systems that contain **significant technological advances** over the products or systems they are replacing

Generally use the normal value of 9%. However . . .

**Consider using values above the norm when:**

The innovation will have a **major positive impact** on the product or program

**Consider using values less than the norm when:**

The innovation represents a **minor benefit**

# Profit/Fee Strategies

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When price negotiation is based upon cost analysis, FAR 15.404-4(c)(2) requires COs to use

Structured approaches to analyze profit, if applicable to the Agency, or

Consider common profit analysis factors when developing pre-negotiation profit/fee objectives

Push back & elevate, if necessary, when an Agency

Conducts negotiations aimed merely at reducing prices by reducing profit

Attempts to negotiate extremely low profits

Has an arbitrary cap on profit/fee

Uses a historical profit/fee percentage

Automatically applies a predetermined profit/fee percentage

Fails to justify their profit position during negotiations

Attempts to get you to accept a lower profit/fee by stating they need to obtain higher level approval for your proposed (justified) profit

# Profit/Fee Strategies

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## Use Weighted Guidelines to develop proposed profit/fee

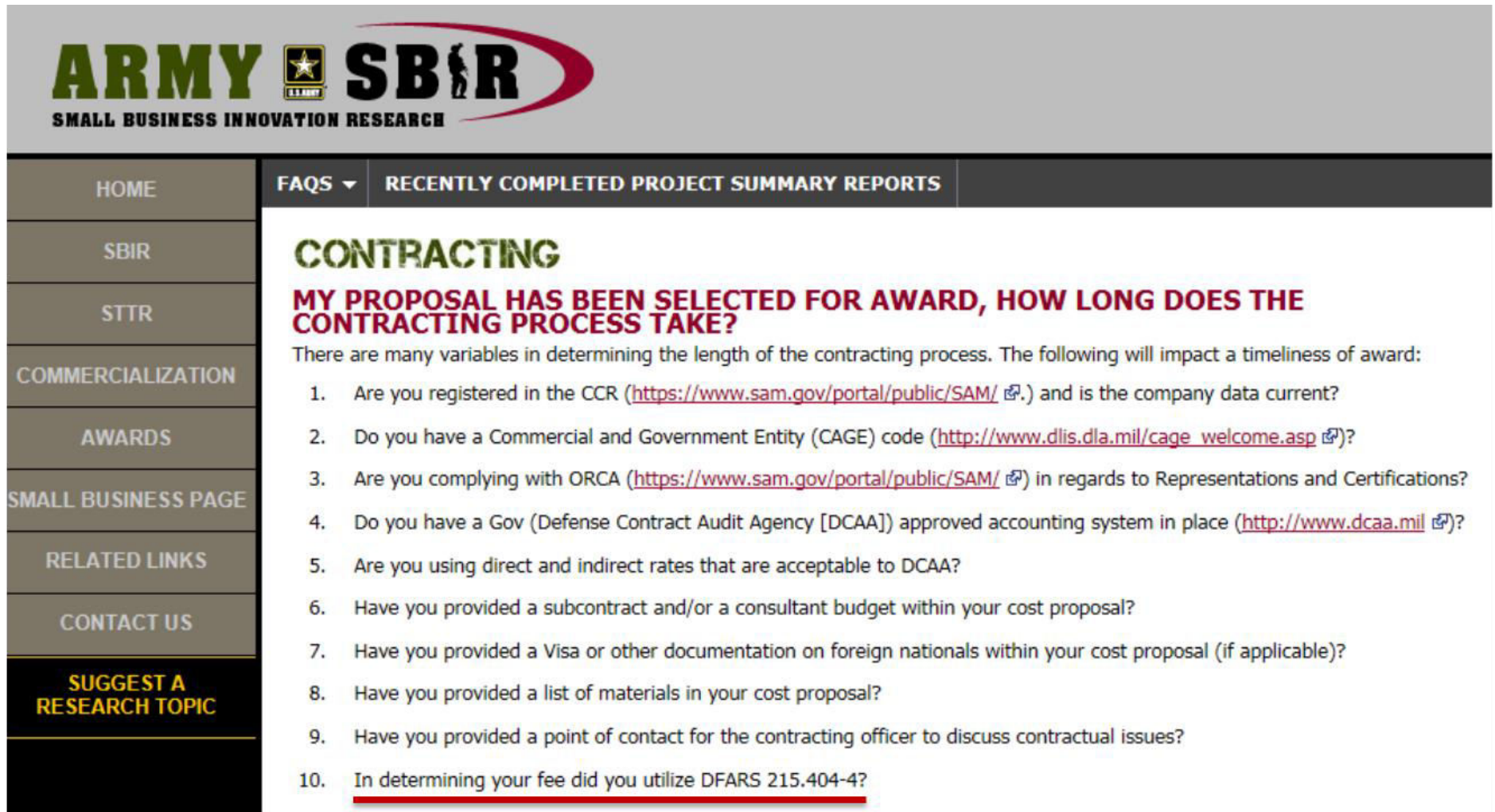
- Based upon the company's insight into the profit analysis factors affecting the pending contract
- Ask CO to show you how they developed & supported their profit objective
- Counter by showing your profit analysis & justifications

“Although specific agreement on the applied weights or values for individual profit factors shall not be attempted, the contracting officer may encourage the contractor to

(A) Present the details of its proposed profit amounts in the weighted guidelines format or similar structured approach; and

(B) Use the weighted guidelines method in developing profit objectives for negotiated subcontracts.” (DFARS 215.404(c)(5))

# Profit/Fee Strategies



The screenshot shows the Army SBIR website header with the logo and navigation menu. The main content area displays a FAQ titled "CONTRACTING" with the question "MY PROPOSAL HAS BEEN SELECTED FOR AWARD, HOW LONG DOES THE CONTRACTING PROCESS TAKE?". Below the question is a paragraph explaining that many variables affect the timeline, followed by a list of 10 questions that impact the process.

**ARMY SBIR**  
SMALL BUSINESS INNOVATION RESEARCH

HOME | **FAQS** | RECENTLY COMPLETED PROJECT SUMMARY REPORTS

**CONTRACTING**

**MY PROPOSAL HAS BEEN SELECTED FOR AWARD, HOW LONG DOES THE CONTRACTING PROCESS TAKE?**

There are many variables in determining the length of the contracting process. The following will impact a timeliness of award:

1. Are you registered in the CCR (<https://www.sam.gov/portal/public/SAM/>) and is the company data current?
2. Do you have a Commercial and Government Entity (CAGE) code ([http://www.dlis.dla.mil/cage\\_welcome.asp](http://www.dlis.dla.mil/cage_welcome.asp))?
3. Are you complying with ORCA (<https://www.sam.gov/portal/public/SAM/>) in regards to Representations and Certifications?
4. Do you have a Gov (Defense Contract Audit Agency [DCAA]) approved accounting system in place (<http://www.dcaa.mil>)?
5. Are you using direct and indirect rates that are acceptable to DCAA?
6. Have you provided a subcontract and/or a consultant budget within your cost proposal?
7. Have you provided a Visa or other documentation on foreign nationals within your cost proposal (if applicable)?
8. Have you provided a list of materials in your cost proposal?
9. Have you provided a point of contact for the contracting officer to discuss contractual issues?
10. In determining your fee did you utilize DFARS 215.404-4?

<https://portal.armysbir.army.mil/Portal/SmallBusinessPortal/Portal/Contracting.aspx>

# Profit/Fee Strategies

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- Make it easy for the CO to understand & concur with your proposed profit positions
  - CO must develop a pre & post business clearance to justify negotiation positions, including profit/fee
    - Pre-negotiation positions are based on preliminary proposal analysis
    - Post-negotiation positions should be based on knowledge learned during fact-finding & negotiations (discussions)
- Your profit positions/justifications should mirror the reasons & language cited in DFARS to warrant assignment of normal, above normal or maximum values
- An experienced & reasonable CO will change their position only if given a valid & supportable reason to do so



# Other Contract Applications

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WG methodology & concepts can be used

- Below Certified COPD threshold
- Other price negotiations based upon cost analysis
- Other Federal Agencies that use a structured methodology to develop profit/fee objectives
  - [USDA, DOE, DOI, HHS, EPA, FEHB, GSA, LIFAR, & NASA](#)
- To relate & justify profit percentages to FAR common profit analysis factors
- [Provide structure to profit/fee negotiations](#)
- [Ensure CO considers all relevant profit factors](#)

# Summary

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- Profit is not a four letter word – it is In the Government’s best interests to provide contractors fair & reasonable profit
- COs are required to analyze profit factors when conducting price negotiation via cost analysis - DoD & some other Agencies use Structured Profit Methodologies
- Profit/Fee is negotiable
- Understand the FAR & DFARS & SBIR Profit policies
- Push back when a CO does not provide justification for their profit/fee position
- Use FAR Profit Policy & DFARS Weighted Guidelines Tool, principles & concepts to develop defensible profit positions
- Make it easy for a CO to understand & accept your proposed profit/fee position
- Tie profit justifications & objectives back to language cited in FAR or DFARS to warrant assignment of normal, above normal or maximum values

**Bottom Line: Profit/Fee is negotiable & requires an understanding of the Government’s Profit/Fee Policies & Analysis Factors to support higher profit or fee!**

# Parting Comments & Questions

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- The type of funding instrument does not diminish the inherent risks associated with SBIR/STTR RDT&E
- Nor does it decrease the value of the technological innovation provided to society, government agencies and commercial customers
- SBIR/STTR firms should be adequately rewarded for developing innovative, high risk technologies that provide order of magnitude improvements over existing technologies and capabilities

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