PROJECT CONTRACT TYPES

Introduction

In the world of business, contracts are used for establishing business deals and partnerships. The parties involved in the business engagement decide the type of the contract.

Usually, the type of the contract used for the business engagement varies depending on the type of the work and the nature of the industry.

The contract is simply an elaborated agreement between two or more parties. One or more parties may provide products or services in return to something provided by other parties *client*.

The contract type is the key relationship between the parties engaged in the business and the contract type determines the project risk.

Let' have a look at most widely used contract types.

Fixed Price *LumpSum*

This is the simplest type of all contracts. The terms are quite straightforward and easy to understand.

To put in simple, the service provider agrees to provide a defined service for a specific period of time and the client agrees to pay a fixed amount of money for the service.

This contract type may define various milestones for the deliveries as well as KPIs *KeyPerformanceIndicators*. In addition, the contractor may have an acceptance criteria defined for the milestones and the final delivery.

The main advantages of this type of contract is that the contractor knows the total project cost before the project commences.

Unit Price

In this model, the project is divided into units and the charge for each unit is defined. This contract type can be introduced as one of the more flexible methods compared to fixed price contract.

Usually, the owner *contractor/client* of the project decides on the estimates and asks the bidders to bid of each element of the project.

After bidding, depending on the bid amounts and the qualifications of bidders, the entire project may be given to the same service provider or different units may be allocated to different service providers.

This is a good approach when different project units require different expertise to complete.

Cost Plus

In this contract model, the services provider is reimbursed for their machinery, labour and other costs, in addition to contractor paying an agreed fee to the service provider.

In this method, the service provider should offer a detailed schedule and the resource allocation for the project. Apart from that, all the costs should be properly listed and should be reported to the contractor periodically.

The payments may be paid by the contractor at a certain frequency *suchasmonthly, quarterly* or by the end of milestones.

Incentive

Incentive contracts are usually used when there is some level of uncertainty in the project cost. Although there are nearly-accurate estimations, the technological challenges may impact on the overall resources as well as the effort.

This type of contract is common for the projects involving pilot programs or the project that harness new technologies.

There are three cost factors in an Incentive contract; target price, target profit and the maximum cost.

The main mechanism of Incentive contract is to divide any target price overrun between the client and the service provider in order to minimize the business risks for both parties.

Retainer **Time and Material - T&M**

This is one of the most beautiful engagements that can get into by two or more parties. This engagement type is the most risk-free type where the time and material used for the project are priced.

The contractor only requires knowing the time and material for the project in order to make the payments. This type of contract has short delivery cycles, and for each cycle, separate estimates are sent of the contractor.

Once the contractor signs off the estimate and Statement of Work SOW, the service provider can start work.

Unlike most of the other contract types, retainer contracts are mostly used for long-term business engagements.

Percentage of Construction Fee

This type of contracts is used for engineering projects. Based on the resources and material required, the cost for the construction is estimated.

Then, the client contracts a service provider and pays a percentage of the cost of the project as the fee for the service provider.

As an example, take the scenario of constructing a house. Assume that the estimate comes up to $230,000.

When this project is contracted to a service provider, the client may agree to pay 30% of the total cost as the construction fee which comes up to $69,000.

Conclusion

Selecting the contract type is the most crucial step of establishing a business agreement with another party. This step determines the possible engagement risks.

Therefore, companies should get into contracts where there is a minimum risk for their business. It is always a good idea to engage in fixed bids $fixedpriced$ whenever the project is short-termed and predictable.

If the project nature is exploratory, it is always best to adopt retainer or cost plus contract types.