

Economic Task Group

final report



Introduction

In September 2009 the membership of Constructing Excellence identified five key strategic issues for the sector on which there was a common belief that there would be value in new knowledge being generated for member companies and the wider industry. Task Groups were formed on each of these areas enabling Constructing Excellence to consider each topic in a strategic way.

Nuclear
Lean
Asset Management
Building Information Modelling
Economy

The Constructing Excellence Economic Task Group, chaired by Steve Vickers of Birmingham City Council, identified that in the current market conditions there is a significant risk of sub-contractor and supplier insolvency, especially amongst SME businesses (and that this risk could worsen when the upturn comes due to sub-economic bidding and rising labour and material costs). It was recognised that this issue could have a direct impact on all Constructing Excellence members involved in project delivery. The negative impact that insolvency can have on a project is significant both in terms of cost and programme.

In the last year, the number of insolvencies has risen dramatically (figures from PwC showing a 15% increase in 2010 compared with 2008 levels), with recent casualties including Dorval Construction, Archial and Weldon Plant and most prominently, Connaught in September 2010 and Rok in November of the same year. The knock-on effect of these major companies going down is that significant pressure is placed on their sub-contractors and suppliers. This can also have a deleterious effect on other clients, contractors and their projects as sub-contractors and suppliers tend to have relationships with multiple parties. With £11bn of public sector construction spending cuts coming during the first two months after the 2010 General Election many analysts see a bleak outlook for the sector. Private sector spending is increasing but certainly not to the level required to replace the loss of Government money. This is sure to mean that more companies will go to the wall.

The Economic Task Group identified that there are certain steps that different organisations can take to overcome the risk of SME insolvencies and this publication lists actions that responsible clients, tier one contractors, and SMEs themselves can take to mitigate this risk.

The document is not designed to provide all the answers – we recognise that a significant amount of work has already been done in this area – but rather seeks to signpost to existing sources of information where they exist and use the knowledge gathered over the last twelve months to produce guidance that will benefit the sector. In light of recent company failures we believe there are significant lessons for the industry contained within this report and commend it to you.

We would like to thank the following members of the Economic Task Group for the significant amount of work they have done to deliver this document and its associated outputs.

Steve Vickers	Birmingham City Council (Chair)
Riz Cader	Rider Levett Bucknall
Matt Cunningham	Bardon Contracting
Justin Hopkins	Astins
Tony Hyde	Thomas Vale
Bill Kiely	Kier Moss
Brian Kilgallon	Rider Levett Bucknall
Lawrie Newton	GF Tomlinson
Gary Pearce	Kier Moss
Angelique Runnalls	Willmott Dixon
Paul Sanders	Deloitte
Michael Thompson	WMCCE

We also recognise that it is important that this report is published and not left static and so a number of further actions are planned to embed the lessons. These are listed below:

In addition, we would like to thank those who attended the SME workshop on 12 May 2010 and the Constructing Excellence Members' Forum on 19 May 2010 without whose input this report would not have been possible. Our special thanks go to Richard O'Connor of Thomas Vale Construction who facilitated the former session. A full list of those that have been involved in the activities of this Group are contained in Appendix A.

- Constructing Excellence will work with a number of stakeholders to take forward the recommendations within this document.
- Constructing Excellence will work with Deloitte to put on a learning day for the industry to share knowledge on how issues could be avoided...
- Constructing Excellence will work with FMB, NFB, NSCC and SEC Group and other relevant trade bodies to disseminate the work from this Group
- The members of the Economic Task Group have offered to act as champions for the dissemination of this work and have offered to present at future meetings of the Constructing Excellence Clubs
- Constructing Excellence will use its relationship with Government to ensure that public sector clients are aware of the lessons contained within and also disseminate this through the Construction Clients' Group
- Constructing Excellence will work with the Office for Government Commerce to embed the new fair payment KPI

Actions for Clients

Clients have a significant impact over the way in which a project is set up and through procurement can either limit or increase the risk of insolvency amongst their project teams.

Below are five key actions for clients that can reduce the risk of insolvency on a project.

Action	What to do next
<p>Promote modern commercial arrangements</p> <p>Modern commercial arrangements will ensure that all parts of the supply chain will have timely access to capital. Clients have a major role to play in ensuring that no one part of the supply chain abuses its position by preventing payments reaching those delivering work.</p> <p>Project Bank Accounts will ensure that payments reach all parts of the supply chain in a timely way whilst project insurance facilitates a transparent approach to risk sharing.</p> <p>The holding of retentions during a long-term relationship is unnecessary. The potential damage to a client relationship will ensure that any remedial works are carried out by contractors.</p> <p>Requiring measurement of timeliness of payments will ensure that supply chains are aware that payment is a client driver and should help to prevent cashflow issues. The Office of Government Commerce has developed a fair payment KPI that will be rolled out across the public sector.</p> <p>Working with contractors to minimise, mitigate and allocate risk to those best placed to manage it has significant benefits to all parties.</p>	<p>Read the Office of Government Commerce Guide to Best Fair Payment Practices and sign up to the Fair Payment Charter</p> <p>Understand the Fair Payment Campaign from the National Specialist Contractors' Council</p>
<p>Understand how any project or programme that you are looking to procure will impact on the market</p> <p>Clients with large scale construction programmes should identify whether sufficient resource exists within the supply chain to deliver their work without impacting on labour or material costs. The Office of Government Commerce has developed a supply and demand model to assist public sector clients with this. Client best practice groups, such as the Construction Clients' Group, can also support clients in understanding other clients' activities.</p>	<p>If you are in the public sector, contact the Office of Government Commerce for information on the Public Sector Construction Demand Database (PSCDD).</p> <p>All clients should engage with local and/or sector-based clients groups to share information. The Construction Clients' Group can assist.</p>

<p>Be prepared to pay for early supply chain engagement</p> <p>Clients can benefit from engaging early with sub-contractors and suppliers by drawing down their expertise in order to make better design and buildability decisions. Clients can alienate potential supply chain partners by engaging them early on an unpaid basis, taking advantage of their knowledge and embedding any innovations in the brief and then appointing an alternative contractor based on cost. Clients should commit to either working with supply side companies that add significant value during the pre-construction phase of a project or pay them a consultancy fee for their early involvement.</p> <p>Clients should also shy away from this approach as single stage, lowest price, lump sum tendering has been shown to be inefficient – the tender price is rarely the outturn cost. Contractors will be forced to financially exploit gaps in the brief rather than working collaboratively to reach the best solution.</p>	<p>Access information on Demonstration Projects from Constructing Excellence</p> <p>Read the ‘Business Case for Lowest Price Tendering’ produced by Constructing Excellence and CIPFA, to be published in February 2010</p> <p>Read the Collaborative Working Survival Guide produced by Constructing Excellence’s Collaborative Working Champions</p>
<p>Limit the impact of prequalification and tendering</p> <p>The plethora of prequalification systems used by clients has a major impact on supply side companies, requiring numerous audits and memberships to be paid for. There has also traditionally been a huge burden in time for suppliers in filling out numerous similar but slightly different questionnaires. PAS 91 is a new standard which seeks to ensure that pre-qualification systems start from a common base which should somewhat ease the burden on the supply side. As such clients should ensure that any system used is PAS91 compliant to avoid this duplication.</p>	<p>Download the report on PAS 91 from the Department for Business website</p>
<p>Consider how to directly engage SME trade contractors</p> <p>Where possible, determine whether it is possible to let work directly to small or medium sized contractors, in line with the recommendations of the Glover report. If letting a framework, value bands should be considered for different sizes of project. Numerous good examples of where this approach has been employed exist, most recently in the letting of the North West Construction Hub which separated projects into three value bands, enabling SMEs to access numerous local opportunities.</p>	<p>Download the Glover report</p> <p>Read the ‘How SMEs can become successful framework contractors’ report from the Local Government Task Force</p> <p>Download the report from the National Federation of Builders, ‘Procurement: The roadblocks to success’</p>

Actions for contractors

By working closely with their supply chain partners, contractors can draw down expertise and exploit innovation to benefit a project and delight clients. Poor communication and exploitative practices can risk this relationship and put even well run businesses at risk.

Below are five key actions for contractors that can reduce the risk of insolvency on a project.

Action	What to do next
<p>Provide greater certainty to your supply chain partners</p> <p>During the consultation carried out by the Constructing Excellence Economic Task Group in developing this guidance it was clear that greater certainty from tier one contractors would be of huge value to their supply chains.</p> <p>The first area considered was that of payments, with sub-contractors stating that timely payment is much more important than prompt payment (although, clearly, both would be nice). Withholding payment from sub-contractors and suppliers has a significant impact on their cashflow and increases the likelihood of insolvency. In turn, this can significantly impact on project delivery.</p> <p>Secondly, sub-contractors and suppliers can more readily meet the needs of the tier one contractors that engage them if they have visibility of future workloads. This enables them to business plan with greater confidence and means they are more likely to be able to add value to projects.</p> <p>Finally, the financial security of an organisation is an important factor when appointing supply chain partners. Openness about your own procurement processes and the ways in which financial information is vital to engender trust between parties.</p>	<p>Understand the Fair Payment Campaign from the National Specialist Contractors' Council</p>
<p>Avoid suicidal bidding</p> <p>When this report went to press the construction sector was still suffering the impact of the recession. Many clients have sought to exploit the market conditions by returning to traditional (potentially adversarial) procurement practices and, in order to win projects, many contractors have sought to bid sub-economically to buy work.</p>	<p>Access information on Demonstration Projects from Constructing Excellence</p> <p>Read the 'Business Case for Lowest Price Tendering' produced by Constructing Excellence and CIPFA, to be published in February</p>

<p>The significant work done by Constructing Excellence over the last 12 years and evidence from previous recessions shows that those companies that use this approach are more likely to perform poorly. Recent insolvencies make this clear.</p> <p>There is a better way of getting cost out of projects and that is to embrace the principles of lean, value management, integrated and collaborative working. Rather than insisting on standard levels of reduced costs across the board from supply chain partners, engage them early to understand how cost can be taken out whilst ring-fencing profit and overhead. Contractors should be more sophisticated in understanding where unnecessary cost lies rather than using blanket approaches which don't allow for the different costs and overheads that sit within different parts of the supply chain.</p> <p>Similarly, risk dumping should be avoided. When risk is passed down the supply chain it often results in it having to be managed by those that are not best placed to do so. This has an impact on costs as contingencies are built into prices.</p>	<p>2010</p> <p>Read the Collaborative Working Survival Guide produced by Constructing Excellence's Collaborative Working Champions</p>
<p>Nurture your good supply chain partners</p> <p>Tier one contractors are utterly reliant on having good supply chains which can deliver to time and budget and understand the contractor's ethos. The cost of replacing a preferred supplier should not be underestimated and the process brings with it significant risk.</p> <p>As such contractors should recognise that nurturing the companies with whom they work can pay dividends. Firstly, medium and large tier one contractors will often have a greater understanding of business process than trade contractors who are much more likely to be SMEs and have less resource to devote to management of the business. Contractors should assist or provide guidelines to sub-contractors to help them with business planning and business planning.</p> <p>Secondly, contractors should ensure that they provide opportunities to train or upskill their supply chains, especially when seeking to break into new markets or when employing new processes or technologies. The</p>	

<p>construction sector has historically been averse to change and it is important that sub-contractors and suppliers are able to move forward with their tier ones.</p>	
<p>Remove the mote from your own eye...</p> <p>Contractors themselves should ensure that their business processes are fit for purpose and can also meet the needs of different clients. For instance, if a client insists on prompt payment can the accounts team hit the required target?</p> <p>Furthermore, anecdotal evidence suggests that many contractors fail to reclaim retention moneys owed to them after the completion of a project. Businesses should have systems in place to monitor and collect retention payments.</p>	
<p>Limit the impact of prequalification and tendering</p> <p>The plethora of prequalification systems used by clients has a major impact on supply side companies, requiring numerous audits and memberships to be paid for. There has also traditionally been a huge burden in time for suppliers in filling out numerous similar but slightly different questionnaires. PAS 91 is a new standard which seeks to ensure that pre-qualification systems start from a common base which should somewhat ease the burden on the supply side. As such clients should ensure that any system used is PAS91 compliant to avoid this duplication.</p>	<p>Download the report on PAS 91 from the Department for Business website</p>

Actions for SMEs

To a certain extent sub-contractors and suppliers, many of which come from the SME end of the market, can be the masters of their own destiny if they ensure that their businesses are well run and that they understand their customers and changes in the market.

Below are five key actions for SMEs to ensure they continue to survive and thrive.

Action	What to do next
<p>Business planning at a macro level is vital...</p> <p>We were very grateful to Royal Bank of Scotland and Deloitte for their input into the consultation for this report. Both gave a number of useful suggestions for ways in which SMEs can better manage their businesses.</p> <p>There have been complaints that banks are no longer lending to SMEs. The evidence gathered by Constructing Excellence suggested that this is not necessarily true. However, there are now more checks and balances before lending can take place. SMEs are advised that at least 25% of working capital should be kept within the business if they wish to borrow.</p> <p>Businesses should ensure that billing processes are efficient so that invoices are produced in a timely way and also, if they have not already done so, set up a BACS payment facility. This may seem simple but our evidence showed that many SMEs have not taken these steps.</p> <p>Ensure that a rigorous 13 week cashflow forecast is in place. Deloitte, through their work with Constructing Excellence are developing a model that will be made available through the Constructing Excellence website.</p> <p>SMEs should regularly review their credit rating through agencies such Experian and Dun and Bradstreet to understand how the market perceives them.</p> <p>Most importantly, professional advice is usually a good investment. Bank managers are also often happy to help answer questions and are keen to avoid businesses failing.</p>	<p>Business support can be accessed through the Constructing Excellence regional centres</p> <p>Business Link provides generic support for all companies (not construction specific)</p>

<p>...as is understanding how to financially manage projects</p> <p>There was evidence during our consultation that many SMEs do not regularly build milestone payments into projects. This should be done as a matter of course.</p> <p>Again, there was evidence that many sub-contractors fail to reclaim retention moneys owed to them after the completion of a project. Businesses should have systems in place to monitor and collect retention payments for each project.</p>	
<p>Understand the market</p> <p>Companies need to understand how the market is changing at a macro level and adapt their businesses in advance of these changes occurring (including formulating a strategy or business plan). For example, businesses should be able to spot emerging markets and new trends and position themselves to meet the needs of clients and tier one contractors. It is better to show leadership than be led.</p> <p>SMEs should also market what they have to offer in a way that reflects their clients' needs. Sub-contractors and suppliers should understand their end clients' drivers rather than employ a 'one-size fits all' approach. For example, when working with the public sector especially, businesses should ensure they understand the principles of the Construction Commitments. Often SMEs feel that packaged or framework contracts exclude them because of size or lack of some experience/expertise. SMEs should examine the opportunities to work together and form consortia in order to bid for larger contracts. Many clients encourage and welcome this approach.</p>	<p>Sign up to the Construction Commitments on the Strategic Forum website</p> <p>Sign up to Glenigan to understand how the construction market is changing and to get access to new tendering opportunities</p>
<p>Evidence is key</p> <p>The construction market, especially at the current time, is crowded with large numbers of firms chasing opportunities. In order to stand out SMEs should collect evidence of what they've done previously and provide this information when bidding for work.</p> <p>Business should ensure that a post-project review is carried out after each project to gather any learning and also collect objective data on performance. Constructing Excellence publishes industry standard performance</p>	<p>Collect performance data on your projects via the Constructing Excellence KPIzone</p>

<p>indicators through its KPIzone and KPI Engine allowing companies in the construction sector to measure their own performance and benchmark themselves against their peers.</p>	
<p>Learn from others</p> <p>Engage with other companies within the sector to increase the scope for learning, to understand how the market is changing and to build networks. There are numerous trade associations within the sector which companies can join. Constructing Excellence also has a network of 44 Constructing Excellence Clubs around the country which exist to support local construction communities.</p>	<p>Join your <u>local Constructing Excellence Club</u></p> <p>Take the time to digest '<u>Opportunity in Austerity</u>' from WMCCE and Constructing Excellence in Wales' '<u>No Turning Back</u>' report</p>

Appendix A

We are grateful to the participants in the Constructing Excellence BIM Task Group who have contributed significantly to this report:

6ix Consulting
Bardon Aggregates
Birmingham City Council
Central Site Accommodation
Coalway Limited
Deloitte
Dodd Group
E H Smith
EMR
Fitzgerald Civil Engineering
G F Tomlinson
Image Styles
John Thorne Architecture
Kier
Locks and Fittings Limited
Midlands Erection
Moss Kier
Parkstone Group
Prolec
R D Jukes
R S Miller
RBS
RLB/OGC
Rosemont Plastering
S P Faizey Chartered Architect
SPI
Thomas Vale Construction
Torclad
Unique Industrial Roofing
WMCCE



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