

Procuring in a downturn

This is a guide for those procuring construction works during the current downturn who wish to obtain the best possible value from their investment.

The current downturn has placed pressure on procurers to reduce their outlay on construction while maintaining the level of outputs delivered.

In this economic environment, industry clients may mistakenly be tempted to select construction partners exclusively on the basis of the lowest tender for a contract. This drives bids down across the sector and forces suppliers to become engaged in a 'race to bottom'.

Selecting construction partners on the basis of unrealistically low and unsustainable bids has negative short and long-term consequences.

Projects attempted at these budget levels may contain a high number of defects, abandon whole-life value and fail to deliver the desired outcome for end users. In addition, unrealistically low prices can create tension among supply chain partners. This can create a lack of trust between firms which diminishes cooperation, and leads to costly legal disputes.

In recent years the construction industry has developed improved working methods that have raised standards, fostered better working relationships between industry and clients and drastically reduced litigation.

The net effect has been the creation of a more efficient, collaborative and integrated industry, better able to deliver greater value for clients.

Now more than ever procurers must look to strategies that will help to maximise the value they can extract from their construction partners, and at the same time safeguard against a decline in standards.

Such strategies are characterised by early engagement, good dialogue, trust and cooperation. They can take the form of frameworks and partnerships to deliver complex workstreams, or come together to facilitate one-off projects. Either way, these best practice strategies will encapsulate all the gains made by the construction industry over the past number of years to raise standards and deliver consistently better outcomes for clients.

Why is the construction industry important to the government and to the economy?



2.8m

The construction industry provided jobs for **2.8m** people last year

£100bn+

The sector contributed **8.7%** of the UK economy's gross value-added (GVA) in 2008 worth over **£100bn**

£10bn

Construction generates some **£10bn** of exports each year, with design alone contributing **£3.8bn**

£3.8bn

70%

The built environment represents about **70%** of our country's manufactured wealth

- The Construction industry plays a key role in the wider economy; where many other sectors outputs depend on the timely efficient and successful delivery of construction projects. The health of this sector is therefore of utmost importance to the UK economy as a whole
- Looking to the future, the construction industry will play an ever more important role in delivering responses to climate change, our future energy security, and the creation of new transport infrastructure
- "The construction industry is of vital importance, not only because of the sector's size, representing one twelfth of the value added in the UK, but also because its output – the built environment – underpins most other economic activity, as well as contributing to the delivery of the government's social and environmental objectives." *Business and Enterprise Committee Construction matters report, 2008, p8.*

The recession in the early 1990s and the current downturn

Construction was hit hard by the previous downturn.

When the economy falters, construction projects are often the first to be cancelled.

Recession early 90s;

- 39%** Construction industry output fell by 39%
- 0.5m** Half a million jobs were lost
- 35k** 35,000 firms were declared insolvent
- 50%** Spending on training staff reduced 50%.

Source: Construction UK

From November 2007 to August 2009:

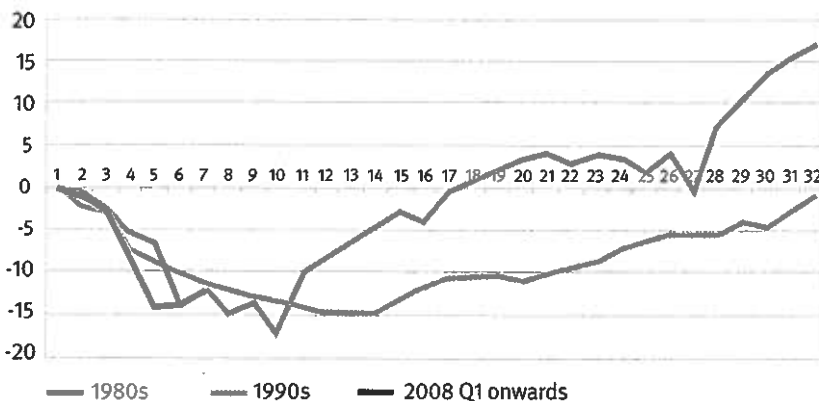
- Orders for private housing are down**
– 93% in south east England
- Government planning to cut expenditure**
on new infrastructure by half
– £20bn reduction in capital spending
- Total orders at the start of '09 compared to the start of '08 are down 38%**
- Industry projected to lose over 600,000 jobs.**

- 93%**
- £20bn**
- 38%**
- 600k**

The worst is yet to come for the construction industry. The delay between falling demand and falling workloads creates a false impression of industry performance. In the coming months, order books will decline dramatically.

Source: Office of National Statistics

Exhibit 1 Construction output in three recessions



Source: CBI

-11%

The total volume of construction output in the 12 months to the end of the third quarter of 2009 fell by 11% compared with the previous 12 month period. Construction Products Association (CPA).

Consequences of a recession... Cost bottom tendering

Due to the recession there are fewer clients in need of new buildings, and the clients that are present have smaller budgets.

Clients demand high standard building or better – but often they don't want to pay more, they want to pay less.

The downturn has reduced the number of projects being taken to market. Order books are diminishing and firms are under pressure to maintain cashflow.

The competition for contracts has increased dramatically. Some firms are increasingly willing to tender at unrealistically low levels in order to secure work.

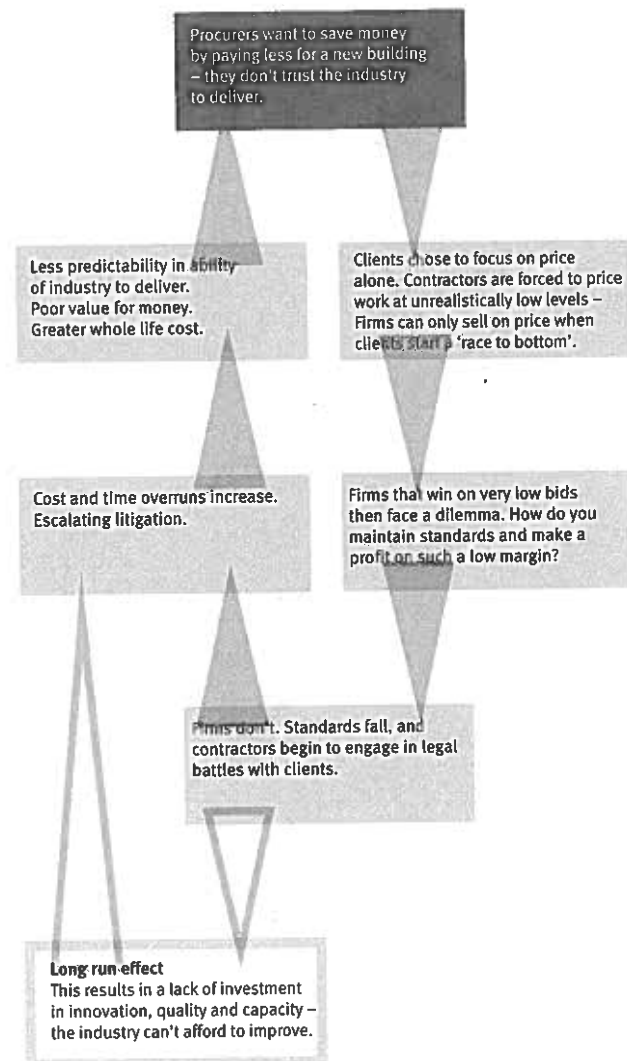
Under pressure to reduce expenditure, clients perceive unusually low bids as offering the best solution to their own budgetary constraints.

Selecting a construction partner on the basis of lowest cost is short sighted and in the long term the costs incurred from poor project delivery can far outweigh any savings made during the awarding of the original contract.

Lowest-cost tendering can reduce the quality of builds and force upward repair and maintenance costs. In addition, lower margin bidding can increase legal disputes among firms and encourages the hard-management of contracts.

Past experience has shown that many firms will be unable to bear the pressure of unrealistically low bidding. Often, only one or two contracts that will not yield a return are enough to bring a firm to collapse.

Exhibit 2 **Lowest cost spiral**



-6.4%

Tender prices have fallen 6.4% within one year

What is whole-life value?

Now more than ever procurers must embrace whole-life value – engaging in a cycle of good practice that promotes their best long-term interest.

Collaborative efforts at the design stage which focus on the full occupational and use profile of the building will help identify how to reduce long-term running costs associated with the build. Savings can be made through considering costs relating to the cleaning, repair, maintenance, heating and lighting of the build over a significant time and then developing design strategies that help to reduce these costs.

Long-term value is created through client and contractor working in early partnership to maximise the functionality of the build for end users. Focusing on technology, design and the specifics of user need will create buildings that are better tailored to the requirements of the client – thus enhancing value and cost savings.

Exhibit 3 Whole-life cost ratio

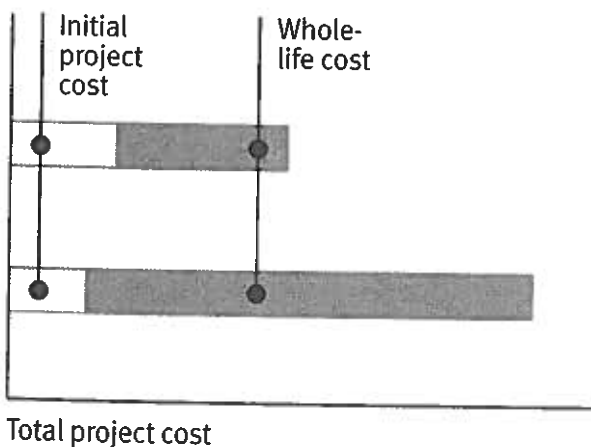
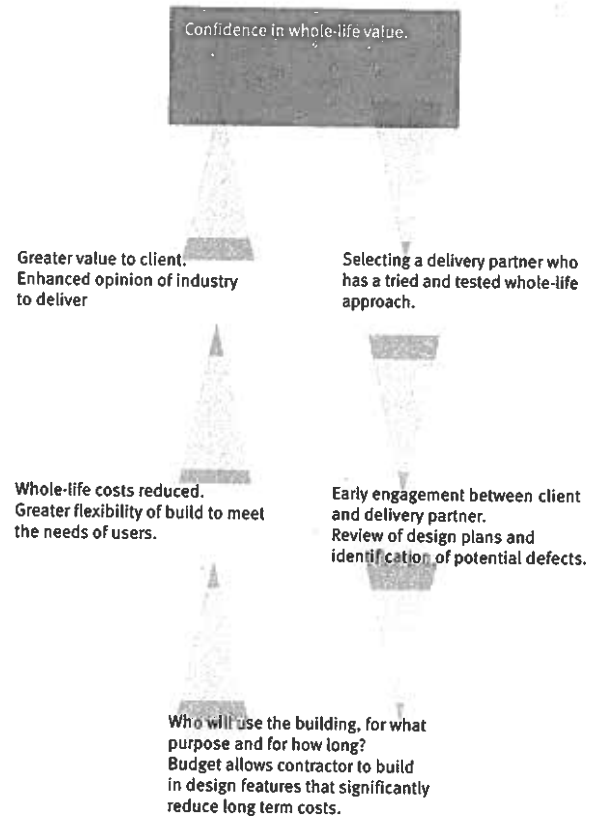


Exhibit 4 Whole-life



The top bar illustrates reduced long-term running costs. These result from an initial budget intended to deliver whole life value.

The bottom bar indicates the much greater long-term outlays that result from cost-bottom budgets.

Strategy to combat the downturn... better ways of working

Integrated and early engagement maximises client benefit.

In the past, the construction industry suffered from a lack of dialogue and early engagement between the supply chain and the client. Deviations from the original brief would be identified late on, and would be costly to rectify. The lack of communication between stakeholders fostered a climate of mistrust that often ended in legal dispute.

In recent years there has been a 180-degree shift in client and supply chain management. Design teams and delivery partners engage with clients early on to clarify understanding of project requirements. This builds trust and cooperation. Potential design defects are identified early, and corrected at greatly reduced cost. Since 1996, construction litigation has reduced by two thirds.

A framework is an agreement between a client who often wants to deliver many projects over time, and a limited number of construction firms each capable of completing the required workload. Clients agree to offer the work only to these firms. In return, contractors will repay the company by delivering each project in the work-stream at progressively lower cost, leveraging the efficiency savings generated from early engagement and integrated working.

Many large organisations currently use frameworks to reduce costs. Such organisations are benefiting from persisting with the framework model as it is helping to relieve pressure on their procurement budgets during the current downturn.

Frameworks do not mean the end of competition – firms still have to work hard to offer competitive deals to the client. If firms that are part of a framework perform badly, they face the risk of being removed from the arrangement.

Partnering is a practice whereby clients and contractors form relationships that encourage all of the positives promoted by the framework approach. When clients and their service providers partner, they agree to cooperate and work together as closely as possible in order to save time and money on a building project. The partners work to both maintain and drive upwards overall delivery standards.

Frameworks and Partnerships can deliver better client value. In addition to these arrangements – a well managed and well integrated delivery team can also deliver enhanced value for one-off projects. Such teams that come together outside of a formal arrangement can also produce cheaper, more timely and better quality builds through early engagement, reduced duplication and man-marking, right-first time decisions and better managed contracts.

Exhibit 5 The outcomes of best practice

Key performance Indicator	Trend in performance			
	Baseline		Latest performance	
	All public & private 2000	Central government 1999	All public & private 2004	Central government Apr 03-Dec 04
Percentage delivered to budget	50%	25%	50%	55%
Percentage delivered on time	28%	34%	44%	63%

Source: National Audit Office: Improving public services through better construction.

Note: The table opposite illustrates the improvements in build time and cost reliability that result from the adoption of improved working practices.

Methods of best practice

Collaborative

Must involve continual design/project programme/budget discussion between client and contractor.

Competitive

Procurement process must maintain competitive tension to avoid price inflation and stick to tight timetable.

Open book

Costing transparency to maintain realistic price maximum at end of procurement process.

Whole-life value

Client must assess bids on basis of whole-life value, not just lowest price.

Early engagement between client and supply chain.

Sub contractor/supply chain involvement

Integrated procurement process, involving contractors and supply chain to achieve most accurate project costing and project timescale.

Risk management

Client and contractor should assess their risk capacity and how to manage it.

Timescale

Procurement process should include the above, but should not be so long as to become unnecessarily expensive and jeopardise project momentum.

Procurement and integration

A successful procurement policy requires ethical sourcing, enables best value to be achieved and encourages the early involvement of the supply chain. An integrated project team works together to achieve the best solution in terms of design, buildability, environmental performance and sustainable development.

Commitment to people

Valuing people leads to a more productive and engaged workforce, facilitates recruitment and retention of staff and engages local communities positively in construction projects.

Client leadership

Client leadership is vital to the success of any project and enables the construction industry to perform at its best.

Sustainability

Sustainability lies at the heart of design and construction. A sustainable approach will bring full and lasting environmental, social and economic benefits.

Design quality

The design should be creative, imaginative, sustainable and capable of meeting delivery objectives. Quality in design and construction utilising the best of modern methods will ensure that the project meets the needs of all stakeholders – functionally and architecturally.

Health and Safety

Health and safety is integral to the success of any project, from design and construction to subsequent operation and maintenance.



...the world's largest energy
 ...the world's largest energy
 ...the world's largest energy

**INVESTORS
 IN PEOPLE**

...the world's largest energy
 ...the world's largest energy
 ...the world's largest energy



...the world's largest energy
 ...the world's largest energy
 ...the world's largest energy

E.ON

...the world's largest energy
 ...the world's largest energy
 ...the world's largest energy