

Written submission from the Specialist Engineering Contractors' Group

1. SPECIALIST ENGINEERING CONTRACTORS' (SEC) GROUP

The Specialist Engineering Contractors' (SEC) Group represents a sector comprising 60,000 firms employing over 300,000 people. The sector accounts for the largest single component (by value) of construction output. The SEC Group comprises the construction industry's premier trade associations: Plumbing and Heating Contractors' Alliance, British Constructional Steelwork Association, Electrical Contractors' Association, Building & Engineering Services Association, Lift and Escalator Industry Association and SELECT (Electrical Contractors Association of Scotland). Many of the firms in these trade associations provide construction services to local authorities either directly or indirectly as sub-contractors.

2. ISSUES FOR THE COMMITTEE

The SEC Group represents a sector in the construction industry which, like most other sectors, is dominated by small businesses. For the most part these businesses carry out the physical works of construction as sub-contractors in supply chains. Many also work directly for local authorities under term contracts involving repair and maintenance of building services such as plumbing, lifts, electrical and mechanical installation. As far as construction procurement by local authorities is concerned we invite the Committee to consider the following issues:

- Procurement of construction by many local authorities has not fundamentally changed in decades with the result that it is generally inefficient and wasteful – for both council taxpayer and the supply side.
- Local authorities do not apply a standard approach to pre-qualifying firms for construction work.
- Construction contracts used by local authorities vary from one authority to another, which increases the cost to suppliers.

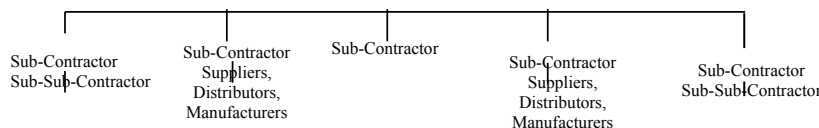
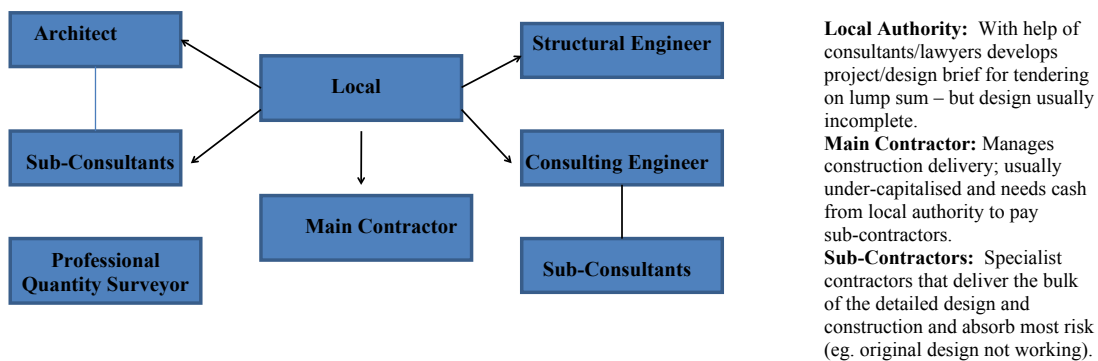
- Local authorities are not sufficiently proactive in improving the treatment of small firms engaged in supply chains on local authority works.
- There are too many different forms of construction contracts used by local authorities.

3. NEED FOR A RADICAL CHANGE IN PROCUREMENT PRACTICES

- 3.1 In spite of considerable progress made by many councils – especially city councils – to modernise construction procurement, most still procure in the way they did over 100 years ago. Traditional procurement begins by engaging architects and engineers to carry out the design which is then put out to competitive tender to main contractors. Tendering main contractors will, in turn, invite bids from sub-contractors who may also invite bids from sub-sub-contractors and suppliers. Main contractors will, then, submit lump sum bids – generally based on the lowest price.
- 3.2 Sub-contractors and suppliers will be specialist contractors such as foundations specialists, cladding and structural steelwork contractors, engineering services contractors and fit-out specialists. Over 85% of the value of the industry’s output is delivered by such specialists together with their suppliers and manufacturers. This includes a significant amount of design work as well as construction or installation works. They are also responsible for the repair and maintenance of the delivered product.
- 3.3 But, as the supply chain, they have little or no influence over the procurement process, especially the initial decisions affecting the planning of the project, the design, the management of the risks involved, and the costs. It is these decisions which will determine whether the completed building or structure will represent value for money. This factor alone represents the major fault line in the procurement of construction works by local authorities.

3.4 The traditional delivery process is fragmented and disjointed. There is very little (if any) dialogue on design solutions between architects, consulting engineers and key specialist contractors such as engineering contractors, the latter often carrying out a substantial amount of design work.

3.5 Specialist contractors and suppliers are frequently having to convert design concepts into practical and coordinated design solutions whilst at the same time absorbing most of the risks associated with the delivery process (including any shortcomings in the design they have inherited). As a result out-turn costs are usually much higher than the initial lump sum bid. **Consequently the council taxpayer is paying for the waste that is inherent in traditional procurement.**



Traditional Procurement: Key Features

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| Poor communication | No integrated working – everybody operates within “silos” |
| All risk transferred along supply chain | Hierarchical & sequential appointments |
| Adversarial relationships and disputes | Many interfaces |
| Lowest Price | Inefficient delivery (eg. re-design and re-work) |

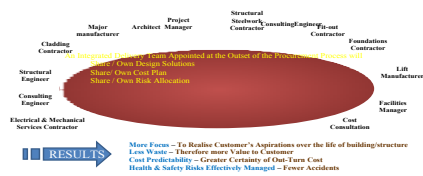
3.6 There are other consequences of having a fragmented delivery process:

- (a) Planning and design decisions often overlook health and safety issues arising in the construction (or production) process.

- (b) Sustainable construction becomes impossible; there is much waste:
- a delivery process based upon hierarchical and sequential appointments generates needless transaction costs;
 - a focus on lump sum, lowest price tendering ignores whole-life costs, e.g. maintenance and energy consumption over the lifetime of the building or structure;
 - there is a large amount of waste arising from duplication at all the different levels of delivery;
 - waste also arises through much re-design and re-work.
- (c) Above all else quality suffers. This is largely due to:
- the initial design solutions not being “bought into” or “owned” by those delivering the product.
 - a combination of the lowest price culture and ease of entry into the industry which deter reputable and established firms from investing in training and technology;
 - too many interfaces;
 - firms (particularly SMEs) absorbing a disproportionate amount of risk.

3.7. Local authorities should seek to engage the supply chain earlier in the procurement process as part of an integrated team. What is integration? It is the bringing together of all the processes involved in construction delivery – especially *design* and *construction* – into a seamless whole. This involves a flatter delivery structure with greater collaboration between the delivery team – consultants, project managers, specialist contractors, facilities managers and suppliers. The focus should be on identifying the local authority’s requirements or *value criteria* (relating to matters such as functionality and usage) and

the appointment of the team best suited to deliver against such criteria. Needless to say, the team should be appointed and actively involved at the outset of the procurement process to agree the design solutions, cost plan and risk allocation before construction begins.



3.8 As far back as 2005 the National Audit Office in its report *Improving Public Services through better construction* concluded that the public sector was wasting £2.6bn a year as a result of not modernising procurement practices, including engaging key suppliers earlier in the procurement processes. Central government has been addressing this issue through a change programme introduced under the Construction Strategy in May 2011. Under that Strategy there are now projects being piloted that involve the whole supply chain from the outset in the planning and designing of the project. The team is underwritten by Integrated Project Insurance (IPI) which provides comfort to the client that the project will be delivered in accordance with the cost plan which the client and team have agreed on. IPI places the focus on successful project outcomes and avoids the possibility of all the parties involved hiding behind their own insurance policies in the event of disputes arising. The first of these pilot projects has been taken up by the Defence Infrastructure Organisation.

3.9 Within the local authority sector, the body responsible for promoting best practice is the **National Improvement and Efficiency**

Partnership (NIEP). Whilst NIEP has been very active in encouraging local authorities to embrace best practice, it has limited resources. Improving construction procurement in the local authority sector is a mammoth undertaking since, to be effective, it should involve monitoring procurement practices and challenging those that seek to retain outdated and wasteful procurement approaches.

SUGGESTED RECOMMENDATIONS

We invite the Select Committee to recommend that the remit and resources of the National Improvement and Efficiency Partnership should be expanded so that it is able to take a more proactive role in both encouraging and challenging local authorities to modernise their construction procurement practices with a view to engaging the supply chain early in the planning and design stages.

4. PRE-QUALIFICATION

- 4.1 A major criticism of local authority procurement practices by small firms relates to the different requirements of local authorities with regard to the pre-qualification of contracting firms. The majority of local authorities maintain their own requirements relating to pre-qualification and have been very reluctant to standardise processes. The result is that firms dealing with local authorities have to comply with differing pre-qualification requirements or undergo different vetting processes. Understandably such duplication imposes a substantial burden on small firms. Often local authorities will rely on third party commercial organisations to provide the necessary accreditation.
- 4.2 Other than adding cost to suppliers, there is no evidence that the approach adopted by many local authorities as far as pre-qualification is concerned has added value to their operations. Many third party assessments comprise a desk-based process that checks availability of certain policies and procedures relating to matters such as insurance and health and safety, and various references. **The quality of the product or service is not audited or inspected.** On the other hand, the member trade associations in SEC Group have introduced “quality mark”

assessment procedures. They have made a substantial investment in developing schemes that are independently vetted and relate to firms' technical proficiency and financial standing as well as health and safety performance. Compliance with these requirements is regularly audited and monitored.

- 4.3 Recent research carried out by SEC Group revealed that the major cost to firms in pre-qualifying relates to the bureaucracy generated in fulfilling requirements of the various local authorities. Firms in membership of SEC Group's trade associations spend over 60,000 days a year on filling in questionnaires. The Welsh Government has estimated that the duplication involved in pre-qualifying in the Welsh public sector amounts to £20m a year.
- 4.4 In an attempt to standardise the process the Business Department together with the British Standards Institute published a standard for prequalification known as PAS 91. This is mandatory for central government construction clients and has to be applied to tier 1 suppliers and their supply chains. We believe that all local authorities should adopt it.

SUGGESTED RECOMMENDATION

We invite the Committee to recommend that all construction procurers in local authorities adopt PAS 91 as the standard for pre-qualification. Local authorities should also require that their tier 1 suppliers apply it to their supply chains. A target should be set so that all local authorities have adopted PAS91 by the end of 2014. For those local authorities refusing to adopt it is suggested that the Department for Communities and Local Government intercede with the local authority concerned to encourage it to adopt it.

5. STANDARDISATION OF CONTRACTS

- 5.1 In recent years central government have made significant strides towards using a standard suite of contract documentation across the

whole of central government procurement. The documentation used is the New Engineering Contract which is published by Thomas Telford. Previously central government procurers tended to use different types of contracts, which was wasteful, as each contractor had to price different sets of contracts on each project with each having different risk/reward profiles. The NEC contract has proved to be a resounding success because it promotes pro-active project management and requires parties to focus on the project outcomes. This contract was used for the Olympic projects where it was instrumental in ensuring that these projects were delivered within time and budget.

- 5.2 Some local authorities have already embraced the use of this contract but there is no reason in principle for the contract not to be used by every local authority. The NEC is a suite of documentation including a range of options for all procurement routes and pricing options such as lump sum and target cost pricing. The use by local authorities of a standard suite of contracts will, again, result in significant savings for both councils and industry.
- 5.3 Moreover there is a need for councils to insist on the use of standard contracts along the supply chain. Lead contractors often use their own bespoke sub-contracts which are aimed solely at passing all risk to their SMEs in the supply chain. The consequence of this is that disputes between the main contractor and sub-contractor add to the cost of delivery as well as impairing the health of local businesses in the supply chain.

SUGGESTED RECOMMENDATION

The Committee is invited to recommend that:

- **All local authorities seek to standardise contract documentation by using the NEC contract which has proved to be successful in use by central government procurers and on major construction projects such as the Olympics and CrossRail.**
- **Local authorities should insist that standard contracts are used along the supply chain to the exclusion of lead**

contractors' bespoke sub-contracts or amended standard sub-contracts.

6. IMPROVING THE TREATMENT OF SMEs ENGAGED ON LOCAL AUTHORITY WORKS CONTRACTS

- 6.1 Firms engaged as sub-contractors in the supply chain on local authority projects often complain about the treatment they receive from the tier 1 supplier to the local authority. All risks are passed down to the supply chain through the use of onerous contracts, and payment abuse is widespread. Central government has acted to address this as far as procurement by government departments is concerned. The current policy of government is to require that central government procurers establish project bank accounts on all projects unless there are compelling reasons not to do so. Progress payments are made into a ring-fenced bank account and are then paid out of that account directly and simultaneously to all those involved in delivering the project. This arrangement avoids the need for cash flow to be directed through a tier 1 supplier, then to a tier 2 supplier and then onwards to tier 3 suppliers further down the supply chain.
- 6.2 Central government has a target of £4bn of government construction being paid through project bank accounts by the end of 2014. Local authorities in Northern Ireland, Wales and Scotland are beginning to use project bank accounts following policy rulings by each of the devolved governments. In England only a small number of local authorities such as Sheffield City Council and Manchester City Council have taken this up.
- 6.3 On 16 March 2013 the Late Payment of Commercial Debts Regulations came into force. These regulations, in effect, require public bodies to discharge payment within 30 days. If payment is made late statutory interest is imposed on outstanding balances after this period. We suggest that this is encouragement to local authorities to insist that their tier 1 suppliers pay their tier 2 suppliers of sub-contractors within 30 days. The 30 day period should run from the due dates for

payments in the contract between the local authority and the lead supplier.

- 6.4. All local authorities should insist that, as a pre-qualifying requirement, all their suppliers should commit to paying their sub-contractors within 30 days of the due dates under their contracts with the local authority. In the event of non-compliance there should be a "yellow card" and "red card" system. A yellow card is a warning to the supplier or contractor to the local authority that it is in breach of the requirement to pay within 30 days. If this is repeated the issuing of the red card will make the firm concerned ineligible for working with that local authority for a period of 2 years.
- 6.5 A recurring complaint from small firms relates to the practice of retentions. This is particular to the construction industry. Ostensibly monies are deducted – usually 5% of the contract value – as security in the event of defects in the work. In practice retentions are primarily for improving the cash flow of the paying party. The House of Commons Business Select Committee has on, at least two occasions, condemned the practice of retentions as outdated and as constituting bad practice. A few years ago, SEC Group carried out a survey on local authorities to ascertain the use by local authorities of retention monies. Some of the responses are set out in the box below.

**SOME LOCAL AUTHORITIES REGARD RETENTIONS
AS CONVENIENT INTEREST-FREE LOANS**

"Reduces borrowing and aids cash flow" (Aberdeenshire Council)

"Retentions are not put to any 'use' as such. Budgets are allocated on the basis that retentions will be deducted so, indirectly, retentions are used to finance capital schemes". (Salford Council)

"held in capital project accounts. "Strabane District Council, Northern Ireland.

"Invested". (Poole Borough Council)

"Held in capital programme". (Barrow Borough Council)

The above quotations are extracted from a SEC Group report. *The Use of Retentions in Local Authority Construction Procurement* published in 2004 (available at www.secgroup.org.uk)

- 6.6. Furthermore, retentions are never released until two or three years have elapsed following completion of the work. This creates a major risk for firms in the supply chain. Tier 1 suppliers to local authorities providing retentions do not run the risk of losing the monies in the hands of the local authority; public bodies do not go into insolvency. But sub-contractors are at risk of losing their retention following tier 1 supplier insolvency. To ensure equality of distribution of insolvency risk in regard to retentions, local authorities should insist that their suppliers - if deducting retentions - provide a bank guarantee to ensure that the retentions are paid when due for release.

SUGGESTED RECOMMENDATIONS

In summary we invite the Select Committee to make the following recommendations:

- **Local authorities should insist that their tier 1 suppliers pay their sub-contractors within 30 days from the due dates for payments under their contract with the local authority.***
- **A commitment by tier 1 suppliers to discharge payment within 30 days should be made a pre-qualification requirement.**
- **A "yellow card" and "red card" system should be applied in the event that a tier 1 supplier does not honour the commitment to pay within 30 days; the company concerned would run the risk of becoming ineligible to bid for work from that particular authority.**
- **The most effective way to ensure payment along the supply chain is to establish project bank accounts; local authorities should be urged to adopt these on all their new projects.**
- **Local authorities should not be deducting retentions but, instead should ensure that they engage only competent firms.**
- **Where lead contractors on local authority works deduct retentions they should be required to provide a bank guarantee to ensure the release of retentions.**

* In May 2013 Lord Young, the Prime Minister's adviser on small business and enterprise, delivered a report to the Prime Minister entitled, **Growing Micro Businesses**. In that report he recommended that payment terms should be standardised across the whole of public sector procurement. [He also made a similar recommendation in respect of pre-qualification requirements.]

FURTHER EVIDENCE

In the event the Select Committee requires additional evidence SEC Group will be pleased to assist. SEC Group is also content to provide oral evidence to the Committee.

September 2013