Extract from: ***Constructing excellence in the Built Environment - Never Waste a Good Crisis (October 2009)***

Forward

I am glad to support this excellent report. At the present time, a number of clients are being led by their construction costs consultants to abandon frameworks and go back to lowest price tendering. That is a mistake. Partnering and close collaboration between the client and the whole construction team will mean that the project will come in to quality, time and cost, as Terminal 5 did at Heathrow under Andrew's leadership. But if lowest price is demanded by the client, the tender price will not be the actual financial outturn at the end of the project, because the supply side will be looking for claims and variations to make up for what was not in the tender. As I said in my report 15 years ago, best practice means "All have won and all must have prizes." – ***Sir Michael Latham***

Executive Summary

Looking ahead, there are major challenges on the horizon. Most clients have already cut their long term investment plans, and capital budgets will be at risk for many years to come as we anticipate a long period of recovery from the current recession.

We believe that an essential step is for suppliers, clients and Government to adopt a new vision for the industry based on the concept of the *built environment*. This means understanding how value is created over the whole life cycle of an asset, rather than simply looking at the building cost, which is only a part of the total equation.

Progress So Far

One particularly strong theme is that people often pay lip service to the Egan agenda and fail to engage in the true spirit of the report. Instead they cherry pick the behaviours they wish to adopt, based on their own self-interest. So, while many clients say they want a best value solution, they still start out by pursuing the lowest tender price, and end up paying a lot more as a result.

The most widely perceived benefit of *Rethinking Construction,* mentioned by over half of those who commented, is a greater emphasis on integration, collaboration or partnering, though many qualified their view by saying that the benefit was patchy and did not reach into the supply chain. Companies who say that they partner will still seek to retain profit for themselves and pass risk down the supply chain, rather than use shared profit to eliminate risk for the whole team.

The most obvious area which has yet to show any improvement is predictability. There is still only around a 50/50 chance of a project coming in on cost or on time. Client-approved changes account for up to half of this variation, with the remainder attributable to the industry's

variability. Clearly, there is still a need for major improvement by both clients and suppliers in this area.

Blockers to Progress

Business and Economic Models

Rethinking Construction was published when the economy was growing and therefore provided a favourable commercial environment for initial acceptance of its recommendations. The decade that followed was arguably a golden age for the UK economy and for construction. The effect of this, whilst clearly beneficial in many aspects, was that there has been no major imperative to seek radical transformation, such as occurred in the offshore oil or automotive industries in the 1980s. In the absence of any industry wide impetus for change, different sectors of the industry have progressed at varying rates.

So which sectors have shown improvement and how have they achieved it? Inevitably, it has tended to be the major clients with repeat construction business who have developed in-house 'intelligent client' teams. Successful teams have consistently integrated their processes and achieved results through a sustained programme of change - many adopting the Egan principles and adapting their business model to incentivise and promote best practice.

So what has so far stopped suppliers from taking the lead? A major problem is without doubt the lack of incentives currently provided by client business models for a supplier to innovate and deliver more sustainable solutions. As work becomes scarcer during a downturn, suppliers may become reluctant to offer a value-based solution through fear of being undercut by the competition on initial price.

Construction is Seen as a Commodity Purchase

Too many clients focus on the upfront costs of construction, rather than the value created over the lifetime of an asset. Few suppliers, other than those involved in PFIs, have any continued interest in the operation of the building and therefore no incentive to raise quality standards.

Industry Culture is Driven by Economic Forces
Even where clients plan for the long-term, few have avoided cuts during the current downturn. Many clients and suppliers appear to have abandoned partnering behaviour (if they ever adopted it in the first place) and returned to transactional relationships.

Delivery Model

The main focus of *Rethinking Construction* was to align the industry around a delivery model based on collaborative working and integrated, lean processes to improve performance. We have already seen, by comparing demonstration projects with the rest of the industry, that this

approach can deliver significant benefits. In spite of this firm evidence, the model has yet to be adopted widely in the industry.

The last eleven years of KPIs have shown that projects are still only 50% likely to come in on budget and the average cost overrun of the remainder in 2007 was 26%. Half of these overspends are down to the inefficiencies of the supply chain, the rest are due to client change. Authorised change or not, this data gives us some idea of just how poor client teams are at getting the brief right before the delivery process begins.

The ability to define and control the brief and the sponsorship of the right delivery environment are both critical elements of the client's role. Clients have much progress to make in delivering these critical inputs.

The absence of a major driver for change on the supply side resulted in clients seeking to drive improved performance through their procurement process in order to deal with their own financial pressures. Many big clients employed large in-house "intelligent client" teams, who recognised that market conditions pointed to partnering and framework approaches to secure good quality supply. However, other key industry processes did not change, and managing new arrangements in the same old way has left some clients and main contractors unconvinced that the benefits are sustainable.

The low penetration of cultural change has been exposed by the current economic downturn, with evidence that clients and main contractors are now reverting to type (if they were ever committed to partnering the supply chain in the first place). Instead of drawing opportunity up from the supply chain, there is a determination by main contractors in particular to tender every package, every time, and select on the basis of lowest price.

We are seeing a return to long tender lists, firms chasing work at unsustainable margins, cost and time overruns, jettisoning of quality or sustainability initiatives and more of a claims-orientated approach. One major contractor recently reported in private that their strategy was "to bid low and provide in the budget for a claims consultant". Other anecdotal evidence describe longer payment cycles, further fragmentation of supply chains and the practice of 'subbie bashing' by retendering sub-contracts.

It is ironic that this kind of behaviour is returning when there is now a body of evidence that lowest cost tendering does not equal best value output. This was clearly spelled out to the public sector back in 1999 when the Office of Government Commerce published *Achieving Excellence in Construction.*

Furthermore, first tier contractors still take on and charge clients for taking risk, then seek to pass this risk down the supply chain, without always developing a mature approach to risk mitigation. This inevitably leads to high levels of dispute when the risk materialises.

A fundamental problem in the industry is the lack of awareness of the whole life cycle concept and how the quality of the built environment impacts on the operating performance of the economy and quality of life in general.

The built environment sector covers the planning, design, manufacture and assembly/construction and commissioning of built facilities, to their subsequent operation, maintenance, refurbishment, deconstruction and re-use. As such, a case can be made for the sector accounting for almost 20% of GDP rather than the 6-7% GDP accounted for by construction output alone.

If more people in the industry (and outside) understood this bigger picture, it would have a huge impact on the delivery model. They would appreciate that our industry adds value in the use of facilities, rather than in the construction. Hence, getting the design stage right becomes critically important. Clients would understand that built asset solutions are a long-term strategic decision based on business and social return, rather than an occasional distress purchase when other options have been exhausted. Development of corporate real estate should really be a responsibility sitting alongside the IT Director or HR Director in terms of its relevance to business performance.

In most cases, however, those involved in the design and construction of buildings have left the project long before anyone experiences the building in use. As a result, there is poor understanding within the industry of how buildings actually perform, or how their quality brings value to future occupants. Evidence of change of thinking towards the whole life concept remains sparse. Although understood by many architects and engineers, it has not been widely adopted throughout the sector.

Part of the problem is a lack of long-term performance data which clearly needs to be addressed with better research and evaluation. Progress has been made in proving the case in the development of hospitals, where patients recover better; schools, where students learn better; offices, where people are more productive and leisure facilities where sales are improved, all because of the quality of the built environment. A major new driver of this approach is the requirement for environmental sustainability, e.g. for site waste management plans and for energy efficiency to reduce associated carbon emissions. The industry needs to learn from post occupancy evaluation of how well built assets perform in order to improve the planning and design process.

In the wider industry, procurement practice is not as professional as it could be. Tender processes focus on price, which destabilises the supply chain, rather than highest value with lowest waste and cost, which has a stabilising effect. Furthermore, the inability to assess non-compliant bids has stifled innovation. It has also made procurement more expensive as the client team needs to see a developed design before it can pick the winning bid.

Few Clients Demand a Best Value Solution

Clients struggle to articulate what value means to them, and too few projects develop a clear brief that defines their business, social and environmental requirements. Clients are unaware of the potential value that integrated supply chains can bring, and fail to engage them early enough, relying too often on consultants specifying traditional solutions through dated procurement methods.

Lack of an Integrated Process Results in Sub-optimal Solutions

Designers are appointed in isolation. Contractors are engaged late and with a focus on lowest price. Facilities management and operational integration are rarely considered at the design stage. As a result, there is a failure to develop a fully integrated design that reflects the whole life cycle of an asset.

Big Themes for Future Action and Some Quick Wins

Understand the Built Environment

Both clients and suppliers need a better understanding of how the relatively small up-front costs of design and construction leverage much higher costs downstream for end users in terms of facilities management, business costs and ultimate value.

Procure for Value

All customers in the chain need to professionalise their procurement to achieve best value, rather than focussing on lowest price. They also need to be more open to invite and assess innovative proposals by suppliers. The inability to assess alternative bids or those based on outcome specifications, or to take account of both capital and revenue expenditure let alone value, severely constrains innovation at the point at which team members are selected.

Suppliers to Take the Lead

In the current economic downturn, clients will struggle to lead the way - we need suppliers to show how they can create additional value. Industry firms and their clients have a strategic choice - turn back to the bad old ways of lowest-price tendering with negative margins and a subsequent claims battle, or embrace beneficial, sustainable change. This starts with proper collaborative working including integrated, lean processes. Evidence exists for this latter course of action, but Constructing Excellence needs to be more effective in presenting this data to persuade senior decision-makers.

Some Quick Wins - Clients

The supply chain wants your repeat business. An effective way to generate value is to incentivise real improvements in output in return for a 'pipeline of opportunity'. If you align longer term objectives in this way, you will create relationships based on trust with your consultant team and suppliers.

Few clients incentivise their teams to find radical savings in operating expenditure over the life of an investment - and yet business case to do so is compelling.

Safety - always act as if you are personally responsible for safety. Your behaviour and attitude as a client will be reflected by the project team. If the moral case for investing in an environment where everybody goes home safely is not compelling enough, consider the true cost of poor safety on your programme and the reputational damage to your company.