

## **STAKEHOLDERS**

### **Full Paper**

## **THE DEMANDING AND REWARDING CLIENT**

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### **ABSTRACT**

We have seen it again and again: unacceptable behaviour, conflicting business objectives, uncooperative relationships and, poor management practices by clients and service providers alike. We have all tried to change this situation. In Australia we have had two Royal Commissions, some 10 years apart, which have recommended surprisingly similar strategies. A major thrust of these strategies being that the client must demand improved performance, with the threat of loss business if the standard of performance is not achieved – is this enough?

To answer this question we need to understand the motivators of change and how these motivators must be adapted over time. We need to understand that success is only sustainable when all parties succeed. This means that if the client demands something, that same client must give something back. In other words if you demand superior performance, then you must reward that performance – what then are the implications for clients in terms of their own performance?

In this paper we use the NSW Government as a major client as the case study.

**Keywords:**

## SETTING THE SCENE

In Australia construction industry activity which is expected to reach \$A86.4 billion in 2003-04 is regarded as an important indicator of the health of the economy. In 2002-03 the industry accounted for 6.3% of Gross Domestic Product (A\$46 billion) and over 7% of the national labour force (730,000 in 2002-03).

The industry is comprised of residential building (houses, flats, units and alterations to existing dwellings), non-residential building (shops, offices, hotels, factories, educational facilities and hospitals) and engineering construction (roads, sewerage, energy, etc). It includes architectural and engineering services and construction trades (bricklaying, plumbing, electrical, etc). The industry is extremely diverse, and activity is highly cyclic. The engineering construction sector is highly concentrated and features increasing foreign investment in the larger end of the market.

New South Wales (NSW) is the largest state, has the largest population, the largest economy and approximately one third of Australia's construction industry. Construction activity in NSW in 2003-2004 is expected to reach \$A26.1 billion. The NSW industry represents about 10% of Gross State Product and about 8% of the total workforce of the State.

In most years half the construction expenditure in NSW is in the residential building sector, a quarter in the non-residential building sector and the remaining quarter are in engineering construction. The NSW industry employs 260,000 people, which is about 33% of the national industry total. Businesses in NSW employ on average 2.5 people, with a turnover \$A278,100 and a profit margin of 10%. Subcontractors provide 90-95% of the labour for construction work. Head contractors provide between 5-10% of the labour, but manage the construction process.

The NSW Government is the major client of the industry. It is also the regulator of the industry. Its annual capital works and maintenance program (includes hospitals, schools, public housing, roads, bridges, railways) is approximately \$A6 to 7 billion, which is 25-35% of total expenditure in NSW. This investment will sustain around 96,000 direct and indirect jobs and represents between 50-70% of non-residential building and engineering work done.

During the 1980s, the Australian construction industry was at a low point in its performance. In NSW it was characterised by unethical and sometimes illegal activities and conduct, lack of customer focus, organisational fragmentation, lack of co-ordination and communication between key parties, adversarial contractual relationships, reduction in skills in critical areas for example inexperienced site management, inferior working conditions, industrial relations, adversarial relationships, fragmented practices and processes that were found to significantly affect productivity and efficiency.

Since the early 1990s considerable attention has been focussed on improving the efficiency and operation of the construction industry in Australia. This focus commenced in NSW with the Royal Commission into Productivity in the Building Industry in NSW (Gyles Royal Commission) which was established by the Liberal Coalition Government in 1990.

## Using Client Buying Power

It would be fair to say that the Gyles Royal Commission Report 1992 was a turning point for the industry in NSW. The Gyles Report emphasised that the NSW Government should use its power as the major client and its regulatory responsibilities to bring about reform in both the public and private construction sectors. The NSW Government's response was to embark on an aggressive program of reform which had two strands:

- Re-establishment of the rule of law;
- Use the Government's buying power to force change, in other words act as a demanding client.

Central to the buying power strategy was the NSW Government Code of Practice and Code of Tendering for the Construction Industry (the Codes). The Codes originally released in October 1992 established the minimum standards of behaviour required of service providers (i.e. contractors, subcontractors, consultants and suppliers) seeking to do business with government. The Codes were supported by a compliance regime in which the NSW Government pursued its right as a client to choose with whom to do business.

The Government's buying power led program for industry improvement can be understood as a series of development phases. The successive industry improvements in NSW have recognised the need to modify the approach to suit changing environments, the emergence of new issues and practices, the changing needs of industry and progress made towards improvement.

The development phases reflect a movement from government direction and imposed standards to shared values and a shared vision and then to industry ownership and self-sustainability.

## The Journey – From reform to incentive

*Did the standards demanded or rather imposed by the government client get traction as quickly as they did because they were put in place at a time when the construction industry was desperate for work?*

*In the early nineties with a recession looming, the government client was the only show in town. This meant that the industry was captive to its demands. As the market started to move the reform agenda had to be adjusted to get Industry buy-in.*

*What does this mean for the current nationally driven reform agenda in Australia?*

## Imposed Standards — Reform Phase 1992 to 1996

While the right of the client to choose with whom to do business had always existed, the post Gyles environment saw the NSW construction agencies who were responsible for

more than 85% of government construction like public works, roads, rail, public housing, water and power authorities and utilities marshal that right with a single reform focus. Features of this client driven reform phase can be summarised as:

- standards imposed by Government on industry service providers;
- aggressive compliance focussed implementation by government construction agencies.

Initially this reform phase was somewhat one dimensional and dominated by an industrial relations focus. The primary aim during the early to mid 1990's was to change the industry's confrontational relationships and adversarial culture with the objective of improving productivity, time, cost and quality performance. However it was quickly recognised by the government construction agencies implementing the program that this was not meeting the whole of project needs and that there should be a wider agenda. This wider agenda was to address business relationships and practices; organisational systems and standards; project planning and management, workplace reform as well as time, cost and quality outcomes.

### **Shared Values — Cooperative Phase 1996 to 1998**

A change to a Labor Government in 1995 in NSW saw a change of emphasis from an imposed Code of Practice to development of a new Code based on extensive consultation with industry.

The result was endorsement by the major stakeholders of the core principles and values in the Code of Practice and Code of Tendering, released in July 1996 and undertakings by them to establish mechanisms within their organisations to deal with non-observance of the Codes. NSW government construction agencies integrated Code requirements in all aspects of project delivery, in particular tendering, contractor selection and performance management.

Features of the cooperative phase can be summarised as:

- shared ownership of core values
- cooperative approach to implementation by major stakeholders

### **Shared Vision — Development Phase 1998 to 2000**

In many ways the development phase was an extension of the cooperative phase. However it also represented a clear change of focus from imposed reform to shared core values and vision. The development phase needed a high level of cooperation and willingness to participate by all sectors of the industry. This was facilitated by a green paper released in October 1996 entitled, *The Construction Industry in New South Wales, Opportunities and Challenges*, and a discussion paper released in April 1997 entitled, *A Perspective of the Construction Industry in NSW in 2005*.

The green paper dealt with a range of issues including industry structure and relationships, training and skill formation, occupational health and safety issues, industrial relations, sustainable development and industry process improvement. The discussion paper provided a view of the industry as it could be in the year 2005.

The focus of the vision is based on four characteristics, which industry participants are encouraged to achieve:

- Seamless – Client and service focussed enterprises that deliver value added solutions;
- Efficient and profitable – Financially robust enterprises that employ a skilled and flexible workforce;
- Innovative – Clever and adaptive enterprises that are high users of technology;
- Environmentally responsible – Committed to sustainable development and sustainable construction.

This vision underpins *Construct New South Wales*, the NSW Government white paper released in July 1998 which challenged industry to:

- Shed its inward focus and become outwardly oriented, and create an integrated structure and a cooperative production process;
- Build and maintain long-term quality relationships that rest on outstanding performance and better alignment of all participants' objectives;
- Offer clients complete solutions;
- Improve business management skills through better strategic planning and market positioning, new product development, training and continuous education and improvement;
- Invest in people training to improve OHS, workforce flexibility and diversity;
- Improve its environmental management performance; and
- Acquire a competitive advantage through the use of technology;

in order to service their clients better and enhance their efficiency and profitability. The features of the development phase can be summarised as:

- shared vision;
- Government leadership and support;
- mutual respect of stakeholders;
- recognition by construction enterprises of the contribution they need to make to realise their full potential;
- Government construction agencies becoming *rewarding clients* by providing superior performers with more opportunities to do business.

### **Learning and Growth — Sustainable Phase 2000 to 2003**

By the end of 2000 the Government was well advanced in the implementation of *Construct New South Wales*. By November 2003 a final key action was completed with the adoption of a new common form of cooperative contract known as GC21 by the government construction agencies.

The goal in this phase was to make the development program self-sustaining by working with industry to produce collaborative solutions which facilitate industry improvement.

The NSW Government maintained its leadership role during this period but progressively relied more on demanding higher commitment and performance improvement from its service providers and rewarded superior performance.

## **Client and Construction Industry Outcomes**

The cumulative effect of this client led program over a 10 year period in NSW created significant improvements. These include:

### **Reducing the cost of doing business**

- Public sector annual saving of \$A50m – equivalent to one major hospital or 3 colleges;
- Private sector annual saving of \$A430m;
- Consistent construction agency practices for business in dealing with Government - annual savings to Government of \$A1.4m;
- Adoption of improved procurement methods and contract management on government projects resulting in lower failure rates compared to private sector construction; and
- Improved security of payment for subcontractors which has been estimated to save the construction industry \$A10 m per year.

### **Improved Industry Productivity**

- Improved productivity enabled the NSW industry to manage the peak levels of Olympic activity in 1999 and 2000 better than before. An assessment by the National Institute of Economic and Industry Research indicates an average productivity increase of 0.6% per year in the period 1990 to 1999, from \$A102,000 to \$A108,000 of construction output per person;
- At the workplace level, improved industrial relations management and relationships in NSW facilitated lower rates of industrial disputation which were below the national average in each year from 1994 to 2001. These lower rates were achieved despite record levels of construction activity in NSW;
- Government client requirement that service providers implement a managed systems approach to occupational health and safety (OHS) significantly improved the industry's OHS performance. The incidence rate for NSW decreased from a 10 year high of 58% in 1995/96 to 40% in 1999/2000, a reduction of 31%. This rate of decline in the incidence rate was greater than any other Australian jurisdiction in the earlier 5 years.

## **Can Client Buying Practices Change Performance?**

*So a major client calls on its service providers to improve performance and innovate. So easy to say. So difficult to do?*

*Demanding this sort of performance requires a client with a capacity that matches their service providers. This is in terms of expertise, systems and tools. A focus then needs to*

*be maintained on seeing that the demanded performance is delivered – what is the point of asking for and paying for something if you don't know if you get it?*

*The other side of the story is that the service provider is going to expect reciprocal standards. They will ask what are they going to get in return, will they enjoy the sort of cooperative treatment that is being demanded of them, and will they be acknowledged for superior performance?*

## **Principles for Superior Performance**

The framework for doing business in a way, which motivates service providers towards superior performance, is underpinned by the following principles:

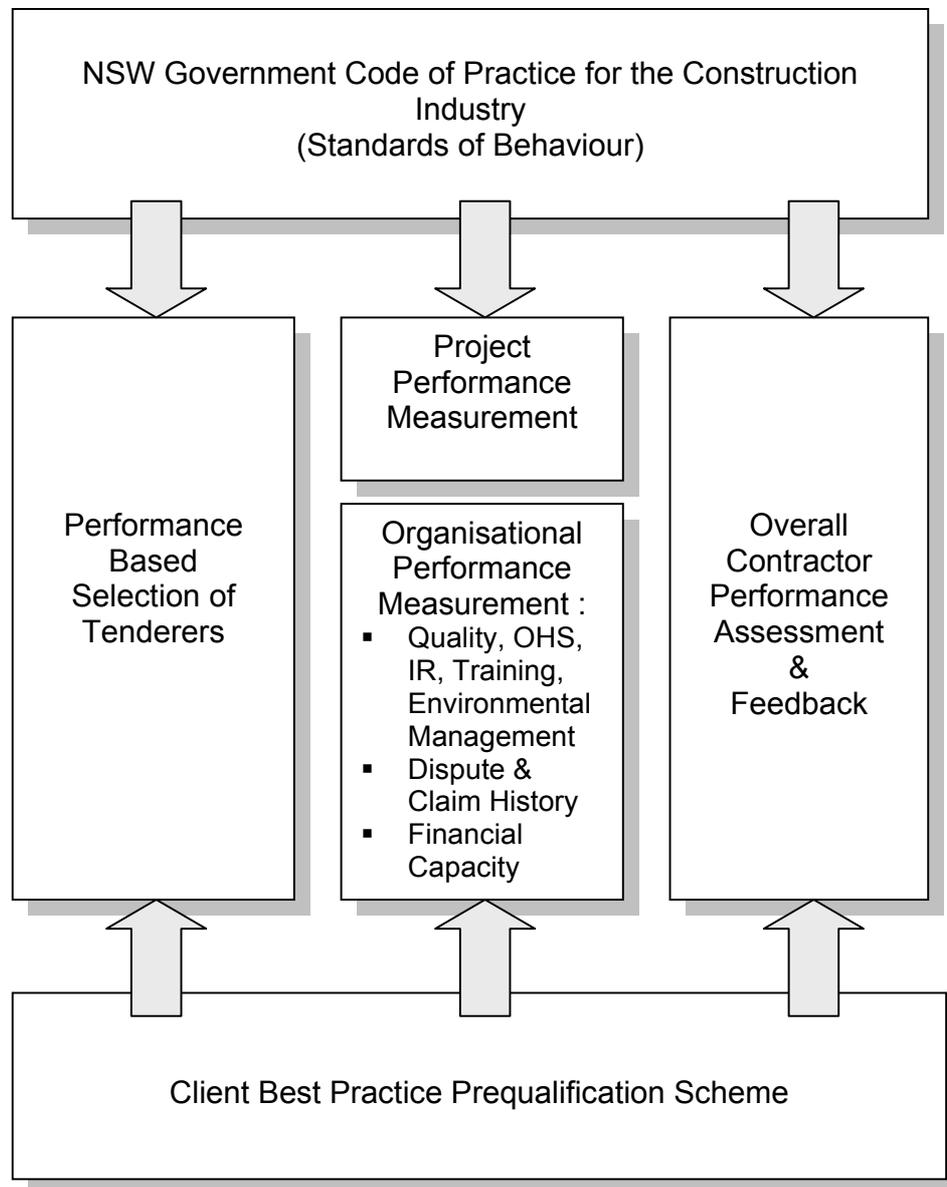
- **Principle 1:** Service Providers need to clearly understand what constitutes best practice and superior performance.
- **Principle 2:** Performance of service providers must be rigorously assessed using criteria developed from a common set of principles.
- **Principle 3:** Performance will be a primary driver in tender selection with service providers competing on quality of performance. Clients may reward superior performance on the part of service providers by improving their chances of winning work.
- **Principle 4:** Clients will reward superior performance by service providers by offering them improved terms of trade.
- **Principle 5:** Superior performance does not remain static and the expected standards must be continuously reviewed and adjusted.

## **Case Study**

This case study outlines key components of an approach adopted by a client of the industry, the NSW Department of Public Works and Services (DPWS) to achieve superior performance by its construction contractors. In April 2003 this organisation was incorporated into the new Department of Commerce together with other departments in the portfolio of the Minister for Commerce.

The design objectives for this approach was to:

- eliminate any incompetent, insufficiently financed and inexperienced contractors from tendering and contracting opportunities;
- deliver superior outcomes for clients by directly linking the tender opportunities offered to contractors with the level of performance they had achieved; and
- include ongoing performance measurement and control processes to minimise the risk of deteriorating performance on projects.



The above schematic represents a total system approach to achieving contractor superior performance. The following are key implementation components:

- Best Practice Prequalification Scheme for construction contractors which assesses capability in: business relationships and practices; organisational systems and standards; people management policies and practices; and time, cost and quality outcomes.

- Tendering/selection of tenderers with increased opportunities based on contractor performance.
- Contractor Performance Measurement and Monitoring System which includes project specific and organisational performance measurement and feedback against the average scores of their peers in the Scheme.
- Continual improvement by regular review and raising of Scheme performance benchmarks.

Contractors accredited under this Best Practice Prequalification Scheme were given twice the opportunities to tender and won 75% of the contract value of contracts let in comparison with contractors pre qualified with DPWS but who were not in the Best Practice Prequalification Scheme.

The client benefited as the measured performance of accredited Best Practice Contractors consistently averaged 11% above contractors not in the Scheme.

The ratio of the amount paid for claims and disputes with contractors against the original amount claimed fell by approximately 30% since the Scheme was first introduced in 1996.

In 2001 an independent survey of contractors in the Best Practice Prequalification Scheme concluded that “accredited companies see value in the Best Practice scheme and have experienced improvements in their business, which exceeded the expectations of those seeking accreditation”. These improvements are likely to have an ongoing benefit with those contractors attracting new clients.

## **The Challenge for National Reform**

*The Australian national reform agenda seems to be moving towards a regulatory or compliance biased approach. Is this “demanding agenda”, too one dimensional, will it work in isolation?*

*Sustainable outcomes need an integrated and cooperative approach i.e. there must be positive incentives that will encourage all parties to strive for success. It is simply the win-win scenario!*

The Cole Royal Commission into the Building and Construction Industry presented its final report on 24 February 2003. The Report comprises 23 volumes and makes 211 recommendations for reform and while there is a primary focus again on industrial relations, there are a number of reforms based on using client buying power to force change.

The recommendations involve wider application of the National Code of Practice for the Construction Industry in terms of standards of behavior required of service providers coupled with the more effective use of prequalification and improved tendering practice.

In the context of the foregoing, it all sounds fairly familiar; however the challenge is to decide what approach will be taken. Will they be?

- Imposed – or the one-dimensional approach. The problem here is that the big stick or compliance approach will only work for so long. Ultimately the performance improvement available through this process is limited by the negative overtures that adversely affect the business relationship.
- Co-operative – whereby client and service provider work to common goals. This effectively represents the half way house but at least the parties have consistent business goals. Depending on the size and sophistication of the client, this may be as far as they can go.
- Development and/or Sustainable – which involves the multi dimensional approach of the *demanding* and *rewarding* client. The focus here is clearly on the sustainability of both the client's business and that of the service provider i.e. you only have true success when both parties succeed.

The overriding difficulty is that the latter approach requires clients to have in place processes that manage performance. At one level this may seem obvious as why demand higher levels of performance if you have no way of assessing if you are getting what you pay for. To be able to judge performance you need to have in place a fair and robust performance management process that facilitates continuous improvement. This should be aimed at exceeding the minimum standards set by a regulatory approach.

## What does it all mean?

The goals of construction industry reform and development in NSW as in other Australian jurisdictions in the last decade have been broadly similar to those of the UK and Singapore and have been driven by concerns over relatively low productivity, cost efficiency and performance. The aim of the reforms in each country has been to produce a construction industry that has a high level of productivity growth, is competitive relative to other industries and is capable of competing in a global market.

Generally Australia, the UK and Singapore have focussed on improving productivity and cost effectiveness through greater attention to prequalification contractual reform; quality management ; process improvement; innovation and take up of information technology; training; more flexible working practices and improved industry relationships.

In 2004, the construction industry continues to be an enigma. Much work and study indicates that we should all still have concerns over low productivity, cost efficiency and performance. Most informed industry observers and participants continually echo these concerns.

The industry in its structure is highly disaggregated and this creates communication and coordination difficulties. In many instances this is the weakness that is most directly linked to productivity difficulties.

At the same time this structure can be its strength because it allows the industry to rapidly scale up (and down) to meet changes in market demand. In support of this

strength the industry is capable of spectacular success - dare we forget the Sydney Olympics Construction program in the lead up to 2000. The message here is that there is a strong commitment by many in the industry to not only do a good but to do a superior job.

This paper presents strong evidence that well designed, well managed and championed industry reform and development programs, which are supported by reward based buying practices, are capable of significant improvement in industry output. The underlying requirement is to harness that desire to do a better job.

The issue then is for public sector policy setters, regulators and clients of the construction industry to understand and harness this ethos. To paraphrase something Gary Sturgess, Executive Director of The Serco Institute once said, that this requires a considerable degree of skill is obvious but then delivering high quality outcomes always does.

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