

UK Construction 2019

WHAT NEXT?

Prepared by

EXPLAIN THE MARKET

Contents

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Foreword

By Shona Frame

Partner, CMS



The construction industry has recently seen more than its share of turbulence and change. The liquidation of Carillion showed that the concept of “too big to fail” does not hold good in construction.

This appeared to inject fresh urgency to discussions as to payment security. At a political level we have seen consultation processes (yet again) around retention and the payment provisions of the Housing Grants Act as well as a number of other initiatives.

Fair payment measures continue to be pressed in public sector contracts with calls for reduced payment terms and use of project bank accounts. However, the key issues of tenders being decided on “lowest price” and contractors operating on cut-throat margins do not yet seem to have changed and we continue to see attempts to deal with risk by passing this down the supply chain.

It is clear that there are many challenges for contractors but there are complex interactions between these and tensions with the counterpart issues for public and private sector employers.

Add to that the further layer of the increasing pace of technological innovations which are impacting on the contracting sector such as use of BIM and new construction methods and materials and the increasing calls for collaboration between all members of the design and construction

team supported by the increasing number of collaborative and multi-party standard forms in the market, albeit not yet being widely adopted.

We wanted to explore with those at the sharp end in the main contractor market what challenges they face. However, recognising that construction is a sector which remains resilient and rises to the challenges presented to it, we also wanted to understand what technological, commercial and contractual solutions are being developed to respond to these.

There were common themes emerging from those consulted but what is very apparent is the number and complexity of the issues and the need for an industry-wide approach.

We plan to take the themes arising and develop those into conversations at all levels of the contractual supply chain. We look forward to working with you as we move that forward.

Please get in touch if there are areas you would like to discuss, and get involved through our dedicated web page: www.cms.law

Shona Frame

Challenges

One year after Carillion

One year on from the administration of Carillion, UK contractors continue to be challenged on many fronts.

From continuous pressure on margins and cash flow, to political and economic uncertainty, quality and supply chain issues, contractors are being forced to respond and adapt to the climate they now find themselves in.

This report details findings of independent research commissioned by international law firm CMS and undertaken by the research group ExplainTheMarket.

This work is part of a long-term initiative by CMS to understand the realities of the challenges faced by the contractor market. Ultimately the objective is to help us develop the conversation on these issues and to allow us to better support clients and the sector.

Research Approach

CMS commissioned independent researchers ExplainTheMarket to canvass views from senior decision makers representing 150 companies from across the UK contractor sector. Interviews were carried out in accordance with the Market Research Society Code of Conduct.

150

Companies

Findings

Despite a challenging year the majority (52%) of sector leaders have a high degree of confidence in the UK contracting sector.

However, closer analysis reveals that this is likely to be caused by a longer-term view indicative of an enduring commitment to the success of the sector – rather than any widespread enthusiasm about the last 12-month period.

52%

Confidence

Confidence

A race to the bottom

When it comes to issues impacting on market confidence, respondents cited a blend of factors.

Larger companies interviewed for this research have reported the success of improved use of analytical tools and improvements to enhance bid planning and reduce financial risk. However, the majority of participants reported concerns that the market remains a tough place to resist the culture of suicide bidding. Even the largest firms report concerns about the sustainability of the wider sector. Those firms where capital strength and heritage has provided insulation against the temptations of projects with non-existent margins still worry about the health and sustainability of the whole market.

A small cohort of leaders interviewed highlighted how capital strength has allowed their firms to break free from the negative cycle of 'recklessly low bidding'. However, even in these cases respondents felt that major structural changes remained essential for the market to thrive in 2019 and beyond.

Suggestions for structural changes range from a blanket ban on lowest price bidding across the UK, to new guidance on how firms can share knowledge on productivity, innovation and analytics without falling foul of anti-competitive regulation. New freedom to share and learn is regarded as particularly important for smaller players in the sector who are often searching hard for any advantage to leverage against the more established incumbents. However, concern for the smaller companies is also apparent from their very largest competitors.



A culture of suicide bids and contractors left to always bear the lion's share of commercial risk - this creates an insidious race to the bottom.



We are proud not to compete on a lowest price basis... but in general I'm afraid this is simply unavoidable for many decent firms out there.

Innovation

Collaboration and Risk

70% of contractors revealed that approaches to technology and innovation have changed over the last 12 months.

Respondents taking part in our research also clarified how technology is shaping the future of the sector along with the new challenges and opportunities it presents.

Many of the sector leaders interviewed pointed to learnings from other markets that had evolved from traditional supply chains into more modern ecosystems. Industries such as retail banking were cited as examples where incumbents had received many benefits from more open minded approaches to partnerships.

Joining forces with “two bright young things running the bedroom tech start-up in Wolverhampton” might be more likely to deliver process or engineering efficiencies sufficient to boost margins and make previously untenable projects sustainable.

There is a prediction particularly amongst the incumbents in the UK contractor market that the rules of the game when it comes to partnership risk management will need to change to accommodate highly innovative partners with untested track records and often poor capital adequacy. The burden on analytics therefore increases along with the breadth and type of potential partner.



The rate of change in technology is so huge. The next 20 years will see 20 more major technology changes all happening simultaneously.



We're heading towards a technology fueled ecosystem rather than an old-fashioned supply chain. It means our culture must evolve. Training engineers and students to collaborate needs to happen. Bringing everything together is going to be more and more important.

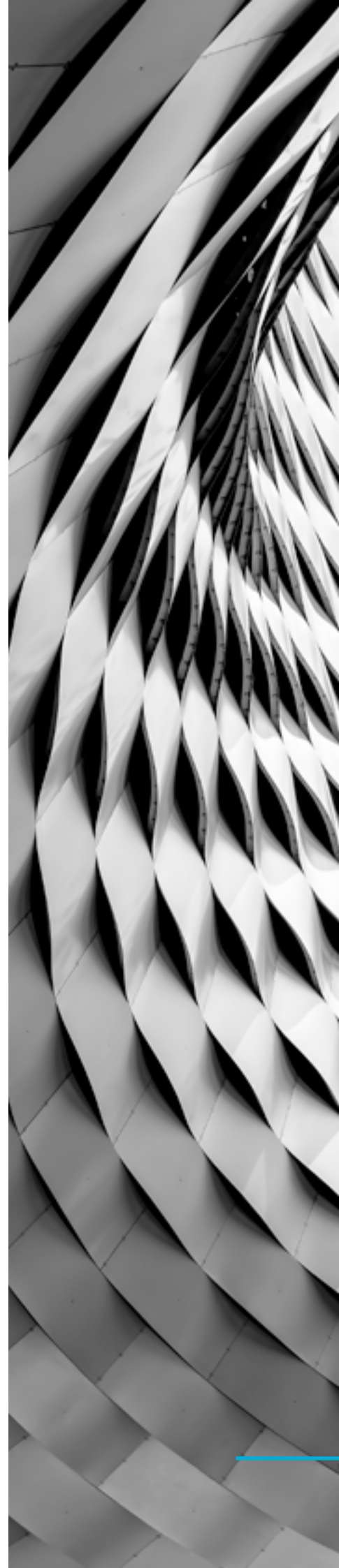
Collaboration in 2019 looks set to get more complex - with greater risks but substantially higher potential rewards.

Sector leaders interviewed also explained how risk management practices have developed over the last year.

Four key changes

Four key changes are being reported by sector leaders when it comes to managing risk in the post-Carillion period.

- 1** Market share improvement opportunities have created a need to manage the risk of onboarding work picked up from Carillion.
- 2** Main contractors continue to shoulder most of the risks. Risk management strategies need to factor this as a key working assumption.
- 3** There has been a greater emphasis on the financial security of main contractors.
- 4** There are now enhanced contractual protections for the client if the main contractor goes out of business - this needs to form an active part of any risk management process.



Partnerships

The path to viable margins

Smarter partnerships provide part of the answer when it comes to how to solve the margin challenge in 2019.

The demand for professional services support is growing ever more specific and practical. Analytics proficiency to enhance project forecasts and planning; support to increase the speed of financial diagnostics across multi-partner projects; reliable relationships across the increasingly multifarious stakeholder map of local, national and UK wide government agencies - 2019 is set to be the year when the return of investment for advisory services requires total transparency.

One year on from Carillion, a cohesive sector wide plan to move margins and make the market healthy again remains elusive.



60%

60% of UK contractors have reported changes to partnership and collaboration since the collapse of Carillion.

BB

A path to something more viable can only come through working together - but anti-competitive concerns constrain reasonable attempts at creativity. We have to work harder and smarter at how we problem solve together.

The year ahead

Market complexion shift

Perhaps unsurprisingly caused by the wake of an unprecedented year of challenge and with anticipated pace of technology change ahead, leaders are expecting the complexion of the market to shift before the end of this year.

60% of the sector leaders believe the market will look different by the end of 2019.

However, the real question is whether all stakeholders can form a cohesive, appropriate way of creating a healthier way forward for the sector?



Government has a lot to answer for. Local and national. We can't go on being expected to take all the risk on our shoulders.

60%

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Disruption

Challenging the established learning culture

One of the critical areas of challenge divulged during our sector leader interviews is the need for innovation in education, management and training.

60% of leaders disclosed this to be critical to the long term health of the sector and many believe a radical shift in thinking is required in terms of the way UK contractors develop talent and drive better productivity through smarter management systems.



As an industry we rightly value education targeted at technical skills but we have perhaps not recognised that it is equally important to provide training that prepares individuals for leadership, team-working and innovation.

We can learn a lot from other sectors where the development of young talent provides a broader skill set. We need to coach and mentor our young talent to be brilliant collaborators so that they are prepared for the challenges the industry may face in the future. In this way we can ensure construction remains a great place to work.

- Martin Pitt, Commercial Director of Sir Robert McAlpine

Best value

Misses the mark with margins

The theme of best value as a 'blunt instrument' was expressed in many of our interviews with UK contractors.

There is a common sense emerging from this research that UK contractors shoulder a share of the collective project risk that is dysfunctional.

A similar sense of the importance of dealing with complexity emanates from interviews with leaders about the relationships with government, regulation and planning authorities.



There has been so much noise since Carillion about 'improving' but absolutely no change in the way the public sector procures construction services. Best value still means lowest cost which keeps us stuck and holds the sector back.

- Bruce Dickson, Regional Director of BAM Construct UK

The way forward

Support with nuance and detail

Sector leaders cite complexity as one of the most important issues requiring help and support in 2019, and beyond. Context, nuance and speed are presented as critical elements for sector success.

Many interviewees explained that current low margin conditions make the business case for advice and support tough despite demand also being great. This intensifies the need for any professional support services to be justified in explicit terms tailored to the particular operating circumstances of each business.

Sector leaders highlighted how the generic provision of knowledge was becoming increasingly insufficient and impossible to justify. The ability to help contractors enhance systems in order to increase productivity including specific experience of negotiating with particular cohorts of local authorities or other individual government stakeholders - this is where partners can make a major impact.

2019 is already becoming the year when support services must specify a detailed return on investment for contractors.



It's not about 'dealing with government'. It's more about dealing with a multitude of phenomenally different actors all at the same time and in sequence. We deal with 27 local authorities, all very different, all with different established relationships, different preferences, different visions for the area.

Then we have national governments and then London which is a separate ecosystem on its own. Sequential planning, deep relationships, cultural nuances and speed of execution - it all requires the right type of support.

About CMS



Law . Tax

CMS is a future-facing, global law firm well equipped to help clients confront challenges and seize opportunities with confidence.

We put the interests of clients at the heart of everything we do across our 70+ offices in 40+ countries in the UK, Europe, the Middle East, Asia and South America. With more than 1,000 partners and 4,500 lawyers we work in cross-border teams to deliver top quality, practical advice no matter how complex the situation.

The firm is recognised for its sector excellence and focus in consumer products, energy, financial services, hotels & leisure, construction, infrastructure and project finance, life sciences & healthcare, real estate, technology, media & communications. Our legal expertise is therefore matched by real world, commercial understanding of the markets in which our clients operate.

CMS has a team of 100+ lawyers specialising in all aspects of construction law, helping to support clients with their projects across the globe.

As a future-facing firm, we embrace technology and are committed to new ideas that challenge conventional ways of doing things if we can find a better solution for clients. Our aim is to anticipate and create sustainable and rewarding futures for our clients, our people, and our communities.

About ExplainTheMarket

ExplainTheMarket is proud to be one of the most trusted and reliable economic research agencies.



Our analytical expertise is based on over 20 years leading market analysis for some of the world's biggest companies. Research expertise is based on leading some of the largest and most complex projects ever done in both qualitative and quantitative research.

Our CEO is a Market Research Society Awards Finalist. The Explain the Market team is headquartered in London and also operates from our global hub in New York.





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