MAJOR PROJECTS
ASSOCIATION

THE CHANGING FACES OF PROCUREMENT

Seminar 151 held on 3rd November 2009
at 4 Hamilton Place, London

SUMMARY

KEY CONCLUSIONS

- Project finance deals are being closed and added to, but local authority projects dominate.
- Sector specific, rather than generalist PPP teams have made a difference.
- Less appetite for private sector risk leads to joint commissioning and more complex contracts.
- Key sectors will now be water, waste, telecoms, energy and transport.
- Market prioritisation into essential (capital), social (schools, hospitals) and economic (road/rail).
- Water Regulator is seeking efficiencies of between seven and forty per cent.
- Clients have to create a market for success and compete for the best contractors.
- In addition to time, cost and quality, clients want contractors to address health and safety, environment and reputation.
- Continuity of relationships drives down accidents, and keeps them down.
- Changing from pain/gain to lump sum under financial pressure has changed behaviour for the worse.
- Internal 'approvals' processes often slow down delivery programmes.
- Sustainable procurement can be driven by values or risk mitigation.
- Procurement can create leverage of spend to generate new markets or products.
- Understand why you are procuring and be aware of issues, impacts, risks and the supply chain.
- Procurement can be influenced by why you want the project, the type of client, funding, and availability of the right resources.
- Understand what will start or stop the project. For projects of long duration you need to be able to modify the procurement as (external) changes occur.
- The recession presents opportunities to reshape the business around the customer(s).
- Client sector collaboration brings all suppliers together for leadership and innovation.
- Culture and behaviour are 'long burns'.
- Values and doing it right first time matter.

INTRODUCTION

Procuring the best consortium or supply chain organisation and negotiating the contract is perhaps more important to a successful outcome for a major project than the design and construction phases.

Chaired by Graham Dalton, Chief Executive of the Highways Agency, this full day seminar considered a number of questions. For instance, to what extent do personal relationships matter more than the procurement route? Do clients get the contracted suppliers they deserve? What have been the benefits and shortfalls in recent procurement experiences? What form will future government procurement take to maximise private sector skills and access to financial models? Has the current recession led to less emphasis on sustainability?

Presentations included predictions on future mechanisms for the involvement of private commercial skills by the Government; lessons in driving forward and procuring major rail contracts; engaging the supply chain in meeting the requirements of the overall client; how to address the issue of sustainability at the procurement stage; and examples of how the private sector is changing procurement and contracts to obtain best outcomes.

WHAT FOLLOWS PFI?

At a time when infrastructure can be viewed as an asset class with many different forms of delivery, Partnerships UK examined what will come after PFI and PPP arrangements. The presentation looked at existing signed and operational contracts, the current infrastructure pipeline and future developments in the wider infrastructure and public services markets.

Currently around 80% of PPP projects are local authority related, for example schools, waste, housing and street lighting. There are fewer large central government programmes, and in general there has been a shift from large projects to a greater number of smaller programmes, something to which the market has had to adapt. As a result, more investment is going to flow through local communities, who will play a larger part in public service delivery.

One consequence will be a wider range of procurement methods and more complex procurement models, which could put pressure on procurement skills at a local level. The aim will be to make better use of existing budgets and a focus on multi-sector projects, with key initiatives such as 'Total Place'. There will also be more emphasis placed on outcome rather than output.

Over the next few decades the UK will need to make significant investment in strategic infrastructure to ensure that it remains competitive, in a world where there are continuing concerns about capacity in the funding market, and capital and revenue budgetary constraints.

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The challenges this presents include the need for strategic infrastructure planning, how infrastructure will be funded and financed in the future, and the development of new procurement models. Prioritisation of spend between different sectors is another issue, where there is likely to be a clash between spending on strategic and social infrastructure. It was explained that the Government has announced that it is setting up a new body called Infrastructure UK, designed to provide the policy design and planning capability for long-term infrastructure worth £500 billion over the next 5 to 50 years.

The presentation concluded with consideration of the wider public services market and how very large markets such as community health services, social care and welfare-to-work should be managed. In general the policy involves creating a clear separation between the commissioner and the provider, seeking alternative forms of provision and improving the quality and professionalism of the commissioner.

ALLIANCING – CAN IT SURVIVE IN AMP5?

The water industry in England and Wales is regulated by Ofwat, the organisation charged with ensuring that the water companies provide household and business customers with a good quality service that is value for money. Ofwat requires a price review to be undertaken every five years to set price limits for customers' bills. Called Asset Management Plans (AMP), the forthcoming AMP5 covers the period April 2010 to 2015.

During 2009 Ofwat led a tough review of the water companies' business plans. This presentation from United Utilities, one of the major practictioners in the industry, explained the process of approving the business plans, and outlined how the companies have been reviewing their procurement strategy for capital programme and project delivery.

Previously, some programmes have been outsourced to contractors within a given framework, and the contractor has created alliances to meet the demand for providing programme and project management, as well as design and construction services, under a single delivery vehicle. It is generally accepted that alliance contracting is suited to projects with complex and unpredictable risk, or those with complex interfaces. Complex interfaces may occur in design and construction operations, whilst complex risks may include management of stakeholders, regulators, communities, the environment or political opposition. In addition there may be very tight timeframes or complex interactive approval and consent issues.

However, in today's financially challenging environment, where clients may be tempted to switch to competitive tendering, the question was posed as to whether alliancing could survive in AMP5. The conclusion was that if the desired outcomes include improved health and safety, surety of delivery to meet demands, controlled cost, and effective environmental and service improvements, then alliancing must survive. Putting relationships at the centre of a programme brings the added value that customers, the regulator and shareholders require, sets the benchmark for value and drives other forms of delivery to improve.

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Amongst other benefits, alliancing enables:

- Alignment of client's objectives with commercial issues: brings high performance and delivers value and reward.
- Management of risk: sharing, collaboration and managing at programme level rather than at individual project level can make a big impact on project costs.
- Integration of teams: reduces resource burden.
- Earlier participation of expertise: early involvement of contractors is important.
- Time management: an alliancing contract provides the opportunity to concertina some of the project management tasks.

SUSTAINABLE PROCUREMENT

Action Sustainability is a small not for profit social enterprise with a specialist niche in sustainable procurement. This presentation outlined what is meant by sustainability and why it is important, looking at some of the key conclusions from the Stern Report and the 2007 Intergovernmental Panel on Climate Change report.

A key challenge in the sustainability debate is understanding and interpreting the data and the terminology. For instance, the term 'embodied carbon' takes into account the carbon emissions embodied in the manufacture of a product. Who should own these emissions: the organisation that made it or the organisations that bought it? Do organisations have a responsibility for the carbon in imported goods? How is the responsibility for the sustainability to be apportioned further down the supply chain?

There are many different reasons why organisations are driven by sustainability objectives. Companies need to consider carefully what sort of organisation they are and what sort of organisation they need to be. Delegates were asked to think about their own organisations, for example how to take responsibility for sustainability impacts and why it is important to decide how carbon footprints should be calculated. There are no right or wrong answers, but thinking about the issue will help to decide business strategy. Some companies look at carbon footprinting not only from the perspective of the supply chain, but in terms of what their customers do with products after purchase, for instance how they wash, dry and iron garments. Organisations need to decide what carbon impact they are going to take responsibility for, because it will affect their whole approach to sustainability.

A major issue for the construction industry is the combination of natural resource use and embodied energy – the energy required to make and transport material. In outlining some examples of sustainable procurement strategy it was explained that the Olympic Delivery Agency (ODA) is changing the construction industry with the standards being set for the London 2012 Games: the ODA is signalling to suppliers of concrete, brick and timber at an early stage that they want more sustainable products, more sustainable value and more sustainable performance for the Olympic Park.

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The presentation concluded with five tips for sustainable procurement:

- Be aware of the issues: sustainability is a constantly evolving agenda and it takes time to address issues in complex supply chains.
- Understand the 'why': look back to your organisational goals.
- Understand the impacts and risks: robust analysis will lead to a clear understanding of what you are trying to achieve and why.
- Understand the supply chain: good purchasers know where excessive costs may lie within their supply chain, but should also think about excessive risk or environmental impact.
- Make a plan: plan for the medium and long term and take suppliers and stakeholders with you. Be flexible and do not be tempted to find a 'one size fits all' solution.

LESSONS IN PROCURING RAIL PROJECTS

Drawing on four recent rail projects in the UK and Hong Kong, the presentation from Crossrail painted a picture of how very large projects may require different procurement models, and explained that the model can change over the lifetime of a project.

The four schemes are most notable for their differences rather their similarities, for instance in terms of issues that are important to the client, and the objectives driving the programme. Some of the key drivers were discussed in detail, including the reasons behind why the project exists, what type of client you aim to be, sources of funding, human resources, risk management and procurement models.

Before deciding on a procurement approach the parameters and determining factors for a project must be fully understood, and the following questions answered:

- What is vital for success?
- What is the funding?
- What are the possible risks to success?
- How will those risks change, or how can they be changed or mitigated over time?
- What provision can be made for other parties to manage risk and what reward/commitment incentives can be put in place?
- What risk must be managed by the organisation?

Whatever procurement model is adopted, make sure that:

- The model is developed with all parties.
- You know what each party needs and is capable of giving.
- Everyone continues to be clear about the operation.
- Everyone continues to see benefit in doing more and working better for delivery.
- Checks are implemented to ensure that the business case remains valid, the model is still relevant, the funding stream will continue and the understanding of risk is kept current.

SUPPLY CHAIN ISSUES

Some industries are seeing green shoots of business recovery in the current economic climate, but others are not. Carillion, the second largest infrastructure business in the UK, provided an insight into how the recession has affected the construction industry and its impact on customer and supplier behaviour. In particular, the presentation looked at the degree of partnering and collaboration that can take place during a time of recession and how that can be used to deliver value to both customer and supplier.

The construction industry is facing its sharpest decline on record, with employment set to fall even further in 2009 and 2010, and significant positive growth only expected during 2012. In a recession there is often a short-term focus on immediate gains, loss of sustainable improvement and even loss of emphasis on health and safety.

Customers and suppliers tend to develop certain behaviour patterns with respect to their treatment of each other and their attitudes towards risk and opportunity. There is a real danger of both sides regressing into adversarial behaviour, which can destroy the collaborative approach that has driven added value over recent years.

Continuous improvement in efficiency of production and working hard at the cost base in collaboration with the customer is important. This can be difficult to achieve during a recession, when there is the tendency for customers to take a short-term approach and force down margins instead of looking for other ways of reducing the cost base. As the competition gets fiercer contractors take a similar approach, which sets up a vicious circle of decline in which looking at what could be done better and more efficiently is lost.

Innovation and continuous improvement are dependent on the amount of effort and resource put into them. Carillion explained that they have invested time in their supply base. In conjunction with customers a long-term strategy has been developed to realise performance and cost benefits, and it was emphasised that the recession is not the time to stop.

Collaboration can enable intelligent risk allocation, continuous improvement to generate cost reduction and aligns the supply chain for efficient resource utilisation. The alternative leads to the transfer of risk down the supply chain regardless of a subcontractor's ability to mitigate it. It also drives down margins without first addressing the cost base to see how to make savings, which is not the way to deliver successful projects.

CONCLUSION

In the current economic climate and with political uncertainty about how the next government will shape the world of major projects after the General Election in 2010, this seminar provided a timely opportunity to take stock of procurement both now and in the future.

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