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## How will the UK construction supply chain reset and reinvent itself as it emerges from the ravages of COVID-19?

At the turn of 2020, COVID-19 was a largely unknown term, and one that barely featured in the vocabulary of the political and commercial world, let alone being a factor that determined strategic direction and attendant operational activities; now we hear of little else.

The construction sector, characterised by long and fragmented low margin supply chains, was a part of the economy likely to be quickly and heavily impacted by the pandemic outbreak. This proved to be the case, with construction activities hastily suspended and many sites closing voluntarily to meet social distancing requirements.



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The sector is widely known for having systemic weaknesses including fragmentation, a multi-tiered structure, low net profit margins, poor cashflow and generally weak balance sheet strength. The high level of intellectual property often locked in lower levels of the supply chain, together with a slow adoption of digital technologies and other factors, has left the sector poorly equipped to handle the pandemic and any future significant downside events.

In addition, with no clarity as to a definitive time point when operations can return to a comparative normal, this will inevitably catalyse changes in ways of working and behaviours across the sector to enable short-term survival and hopefully longer-term prosperity. Though the unprecedented circumstances mean that it would almost be foolhardy to try and predict what a new normal will look like, the situation perhaps does provide an opportunity to redefine strategies and roles that can be enacted by members of the supply chain that will ideally offer greater resilience to the sector at large.



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The fundamental issues affecting the sector have been brewing for a while, and this paper sets out some of our collective views and ideas on how resilience in the sector can be addressed. To bring such resilience, there are three headline factors that the construction sector would benefit from examining:

1. **Defence:** the end client could use these circumstances to guard against relying on too few suppliers. Diversifying its supply chain and increasing the rigour used to assess the capacity, capability and robustness of suppliers prior to awarding contracts, will become ever more important (though consideration needs to be given to supply chain capacity of capability in light of the potential for some entities to go insolvent).
2. **Prediction:** in-flight assessment of projects, to provide trigger warnings of potential supplier distress once projects are progressing will be a key role for end clients to focus on; this element of quasi-collaboration will protect the supply chain and bring greater surety to the end client that projects will actually get completed without suppliers failing.
3. **Client assistance:** the nebulous issue of confidence is one that can, in no small way, be assisted by private sector end clients and the public sector furnishing the supply chain with a pipeline of work that can be relied on. Complementing the pipeline with access to expedited payment to assure the supply chain of cashflow should also work on the clear understanding that such

support must flow down to all players supporting project delivery.

The importance of these factors is reinforced by reference to the work of The Institution of Civil Engineer's Project 13 and precursor studies from Sir John Egan<sup>1</sup> and Sir Michael Latham,<sup>2</sup> which indicate that they can be addressed as the construction industry resets and reinvents itself,<sup>3</sup> with activities undertaken by different parties to ensure the sector is restructured to secure a sustainable future.

### **The sector reset**

Despite all the obvious negative consequences of the pandemic, the seismic nature of its impact perhaps offers the opportunity for the construction sector to do more than revert to former ways of working. Can the period of the next 12 to 24 months mark the beginning of a sea change in behaviours borne of actions to drive new ways of working and greater resilience?

For the public sector, there are suggestions that practical measures need to be set in place to encourage a determination in the private sector to continue with new innovations that will enable real productivity improvements (e.g. through modular construction) and sustainable technologies to be brought to bear, for example to support the Green Agenda/Net Zero. Incentives to invest in recruitment, training of home grown talent and research and development – especially important in light of Brexit looming – complemented by the extension of the apprenticeship levy beyond December 2020, will all assist in bringing such confidence, when coupled with a well-structured pipeline of forthcoming work.

Though regarded as counter to encouraging the natural patterns of market behaviour, there may be scope, on large public sector projects, for public sector bodies to monitor major tier 1 and tier 2 suppliers of UK construction materials and products, to ensure fair payment and contractual treatment. Measures such as government-backed loan facilities (albeit this may have the unintended consequence of eroding private sector influence over time) to enable the use of advanced or shorter term payment schemes may also build on the confidence afforded by an increased use of project bank accounts.

A significant cost to parties across the supply chain is, of course, the threat of dispute or litigation. Is there potential for a government mandate for a defined period for parties to public sector contracts to adopt the RICS Dispute Avoidance Service, or the use of Independent Facilitators? Such facilitation services could then be called on to de-escalate contractual issues before they cause programme prolongation or cost escalation.

These changes might also serve to complement parties actively seeking to adopt an ethos of responsible and fair behaviour, where parties do not rigidly apply contract terms and are prepared to request/give reliefs for impaired performance so that all parties can make an ethical profit.

<sup>1</sup> Rethinking Construction – Sir John Egan - 1998

<sup>2</sup> Constructing the Team (review of Procurement and Contractual arrangements in the UK Construction Industry – Sir Michael Latham [1984]

<sup>3</sup> Reset and Reinvent – acknowledged as terms adopted by the Construction Leadership Council to describe construction sector recovery

This need not mean that parties should not always seek to understand and administer contracts fairly and in accordance with the terms and conditions (and due consideration would need to be given to how such arrangements would be policed). Indeed, it does suggest that at such a time and so that agreement can be readily reached, there is even more value in all parties keeping consistent records. That is, keeping records of agreement on any intended deviation from previously agreed contract terms is essential in the event that one of the parties may choose to deny agreement or develop interpretation of this later. This will help move towards a position where the parties should be of equal bargaining power, to avoid challenges on the basis of duress; a factor of particularly relevance for small subcontracts.

These market dynamics could also be assisted by end clients seeking to broaden the base of suppliers that they engage with to support project delivery. After all, a wider number of suppliers would reduce dependency on the few and broaden resilience. If the government's mantra of "Build, Build, Build" and the "levelling-up" agenda comes good, this may well mean that a larger array of suppliers regionally spread will anyway be required.

In addition, early collaborative engagement of suppliers and clients, though not new, could be espoused more broadly. This could promote the development of component parts using sustainable techniques earlier into the project development lifecycle. With designs confirmed for standard components, to be delivered by a larger pool of suppliers, this would potentially help increase consistency of quality and would assist with achieving higher volume off-site manufacturing. By turn, this could flow through to on-site assembly and be part of assisting driving productivity gains and bringing projects to completion on time and to budget.

Easily said, but perhaps more difficult to achieve, though does this mean that the sector should balk at such concerns? Rather, should the situation offer the chance for the supply chain to really examine some key questions:

- What should we have done to have prepared for the pandemic and what will we do to prepare for one in the future?
- Where does adaptive capacity already exist in the supply chain and where does it need strengthening?
- How can interdependent supply chain activities be maintained through collaboration?
- Which activities in the supply chain are absolutely critical, and therefore how can they be protected during a shock such as the pandemic?

Answering such questions, through pan-sector, neutral bodies such as the Construction Leadership Council is critical, because the clear recurrent factor in addressing these issues is the need for honest, open communication.

Communication can support collaboration, which has been much vaunted as a means of helping to bring changes in ways of working but it needs to be acknowledged that it is often far harder to achieve. To cite just one issue: the background intellectual property of a niche third tier supplier may be a large part of such a company's inherent value. Why, without the appropriate commercial incentives, contractual certainty and reciprocity of sharing from others engaged in a given project, will

such a company be willing to share innovation, as part of a collaborative endeavour that it has spent many years inventing and proving? Such an example, together with the sharing of staff input and proper risk-reward are not insurmountable, but perhaps do pose challenges that need to be addressed.

Communication across the supply chain can, however, bring significant benefits in enhancing confidence. As noted earlier, clarity and certainty of a pipeline, for example, can of course help bring certainty to sites opening, ensuring that builders merchants remain open, flowing back to continuity of supply from manufacturers, operating confident in the knowledge that there is an outlet for materials that they produce.

Communication about the real rules of the game underpinning procurement by employers from its supply chain is also essential. What outcomes does the employer really want, that will be rewarded when delivered by the supply chain? Will the employer really honour the 'Most Economically Advantageous Tender' as the one that offers value and quality beyond the parameters of price alone? If so, how?

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#### **Can the client assume a different or enhanced role?**

To bring unity to the ways of working amongst the various companies across the tiers of the supply chain, especially in longer-term complex projects, another factor to consider is whether the end client could assume a greater role in integrating itself and other members of the supply chain. That is, rather than relying on the supply chain from configuring itself alone, it is contended that there would be potential benefit from end clients (in both the public and private sectors) from understanding the capacity and capability of its supply chain better, so as to draw different parties together.

Considerable benefit could accrue from the use of supply chain analytics tools to understand strengths, vulnerabilities and risks of the supply chain such to understand, for example:

- the historic financial stability of the supply chain;
- key risks such as inflation and exchange rate risk; and
- spend analysis with specific suppliers, to gain an appreciation of any instances where there is over reliance on too few suppliers.

A specific issue associated with COVID-19 in performing supplier financial checks is that pre-COVID-19 financial accounts are likely to paint a very different picture of a company's financial health to that during the pandemic. Thus, it is suggested that such analysis may need to be enhanced by appraisal of the current and forward looking factors which provide indicators of financial health including:

- instances where the market is looking to short the shares of a given company in the supply chain;
- any proposed changes to supplier payment terms, indicating fragility of cashflow;
- reduced credit ratings;

- adverse media reports;
- deterioration in forecast pipelines of work; and
- over-commitment of resources.

Though such data is likely to be available for publicly listed and larger private companies, it may not be available in relation to SMEs, meaning that systems of self-reporting of financial distress may need to be implemented. However, these may need to be incentivised and the SME in question convinced that it will not be treated negatively, and its reputation is not damaged, but that it would be supported (perhaps through shorter payment terms) where legally possible.

Such activities by the client should, in part, help play a part in the client configuring its supply chain to deliver its project's outcomes and be resilient to shocks through the duration of the project and, where relevant, to the ongoing benefit of the end users of infrastructure.

### **What might longer-term reinvention bring?**

Though an understanding of the capacity and capability of the supply chain by the client will help bring greater resilience, as well as helping to pre-emptively signpost indications of distress, are there perhaps other factors that will start to drive sustained change?

In planning large scale programmes and projects, does scenario planning, in consultation with the supply chain need to occur, thus providing increased transparency about the implications of both High Impact, Low Probability events (such as COVID-19), as well as high-impact, high-probability events (such as a no-deal Brexit)?

Such planning may help launch programmes with far greater supply chain resilience, especially if, in the public sector, there is a great emphasis through the HMT Green Book of launching projects and programmes with this firmly in mind. This could be done through demonstrating through the business case that a project and its supply chain is configured to deliver the outcomes set-out in the strategic case; the economic case recognises such benefits to UK plc, and the commercial and management case addressing how the downside scenarios set-out above would be managed through the project structure and its supply chain.

Practical changes to early project set up perhaps also need to be underpinned by other complementary operational and commercial changes, such as:

- different procurement strategies, which focus less on margin and more on outcomes;
- a willingness to reward outcomes achieved against realistic milestones, rather than the whole programme, which may finish way after the input of a given supplier's input is complete;
- an acknowledgement that risk needs to be shared proportionate to the reward and benefit that will accrue to each part of the supply chain;
- the use of insurance-backed alliances where this offers benefits;
- the mandated and properly administered use of project bank accounts to bring assurance of faster payment and better cashflow to lower supply chain tiers;
- an acknowledgement and acceptance of co-dependency between tier 1 suppliers and other tiers of the supply chain. Here,

this might drive tier 1s to buddy with smaller suppliers allowing them to be properly rewarded and supported to innovate and develop new intellectual property; and

- access to open source data for all.

Such changes, however, require a willingness for pan-construction sector change in behaviour and culture, as well as an acceptance of the need for change from investors in supply chain companies. This will help play a strong part in giving permission to drive new working practices.

To catalyse this, it is suggested that a critical mass of pathfinder projects to test these new ways of working will be required. An acceptance of mistakes and learning between projects will potentially help create sufficient consensus to drive adoption of new ways of working in what remains a fragmented market. Ultimately, this will need clear leadership to drive change from all parts of the supply chain, where the client acknowledges itself as an integral component part of the supply chain.

In preparing such pathfinder projects and to avoid the potential for reversion to type, early planning could include consideration for:

- low-probability/high-impact and high-probability/high-impact event scenarios;
- the setting up and running of rehearsal of scenarios arising from these circumstances;
- understanding the critical activities in such crises;
- understanding the knock-on effects of alternative ways of working, so these can be addressed; and
- establishing what factors need to be addressed during early project set up in the instance of a crisis; and
- identifying opportunities that can be adopted to manage ongoing changeover the duration of a project.

Clearly, this is not an exhaustive approach, but does highlight the fact that regardless of the approach adopted, the new norm is not yet established and is arguably some way off. Further, the new norm should be a developing target which will continue to evolve in the quest for continual improvement. Therefore, there remains a huge opportunity to help define it, such that greater resilience can be brought to bear across the construction sector so that it can play its critical role in driving the recovery and delivering government policy.

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