Harmony and Profit in SMEs: The Possibilities and Limitations of Building Partnerships

HARMONY AND PROFIT IN SMEs: THE POSSIBILITIES AND LIMITATIONS OF BUILDING PARTNERSHIPS

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ABSTRACT

This paper aims to identify opportunities to assist small and medium sized construction companies work in partnership with clients and increase their effectiveness through the exploitation of communication procedures and technologies. A review of the literature highlighted the importance of partnering approaches. The results showed that small and medium construction companies who participated in the research were reluctant to work for main contractors, but welcomed opportunities to work with and form partnerships with blue chip companies and public sector clients. Construction companies were concerned that the continued use of competitive tendering to establish project partners would undermine the process by preventing them from contributing to the design stage and by rewarding firms who submit low bids, only to claw back profit later. They also objected to being denied opportunities to continue working with clients with whom they had established a strong relationship and understanding of the service required. A strategic partnership combined with involvement in an action learn set prompted one medium sized construction company to produce a detailed report about the management of maintenance defects. We plan to run workshops to promote good practice concerning the management of maintenance defects and the introduction of new technologies.

KEY WORDS

Partnering, construction, action research, workshops.

INTRODUCTION

Increasingly, government and private clients are putting pressure on construction companies to produce higher standards of building, meet the needs of the social infrastructure and reduce costs (The Housing Corporation, 1997; West, 1997). Identifying and responding to these pressures requires construction companies to increase their sensitivity to the environment, offer innovative solutions to problems and develop collaborative styles of working (Construction Innovation Forum, 1997; The Housing Corporation, 1996; Weaver, 1997).

'Partnering' is a recognised method of improving communication mechanisms and technologies, responding to innovative construction projects, creating a less stressful working environment and reducing transaction costs resulting from uncertainty, competition and information asymmetry (European, Construction Institute, 1997); Loraine, 1994; Construction Industry Board, 1997). The approach can be used to achieve a range of client objectives including equality, training and employment for local people and services for tenants (Davey *et al*, 1998). The extension to relationships with sub-contractors has helped large contractors achieve more compliant bids, less confrontation and lower tendering costs from their subcontractors (Mathews *et al.* 1996).

Research to identify and develop opportunities for partnering has mainly targeted large construction companies and clients involved in large-scale projects (e.g. redesign of bank branches for NatWest). Indeed, Sir John Egan (1998) urges large companies to ensure that they are at the forefront of changes to improve productivity. However, small and medium sized construction companies comprise the bulk of the construction industry and are well positioned to take advantage of new market opportunities arising from collaborative building programmes (Davey *et al*, 1998). The primary aim of our research project was to assist small and medium sized construction companies establish and work in partnership with public and private sector clients based in the North West of England and diversity into new business opportunities. The project also sought to encourage companies to increase competitiveness through more effective exploitation of communication procedures and technologies. The 8-month project called *'Building Partnerships'* was funded by UMIST, The Manchester Federal School of Business and Management and the European Regional Development Fund.

LITERATURE REVIEW

Partnering is one of several strategies being proposed by practitioners, academics and managers (Cook and Hancher, 1990) and draws heavily upon lessons learned from Japanese manufacturing. It is defined by the Reading Construction Forum (1995) as:

"a management approach used by two or more organisations to achieve specific business objectives by maximising the effectiveness of both parties. The approach is based upon mutual objectives, an agreed method of problem resolution, and an active search for continuous measurable improvements".

In Europe, there are basically two types of partnering: project partnering, where the parties come together for the duration of the project; and strategic partnering where the parties develop a longer term relationship over a series of projects for which contracts are usually negotiated. The former is recommended for public sector clients who have to use market testing in order to comply with EC procurement regulations, usually through the competitive tendering process. Nevertheless, public sector organisations are allowed to use partnering criteria to select and award contracts (Loraine, 1994; European Construction Institute, 1997).

A partnering relationship is only recommended where the management teams of all parties involved display a fundamental commitment to partnering and where companies share a common culture (Smircich, 1985). The partnering process involves allocating time to agree objectives, establishing an open style of communication, developing a mechanism for problem resolution and identifying measures designed to monitor and help improve performance (CIB, 1997).

While partnerships are an effective method of helping construction companies strengthen links with clients, diversify into new projects and enhance competitiveness, they are potentially undermined by the construction industry's existing 'macho' and adversarial culture and its widespread use of short-term, legalistic approaches to procurement and contracting. Partnerships are also difficult to implement and maintain in a system characterised by indirect linkages between clients, contractors, subcontractors, consultants, suppliers, employees and end-users. As a result, industrialists and academics have found it necessary to adapt partnering methods to specific contexts and to build upon success factors, rather than relying entirely upon prescriptive models. They also warn that the benefits of partnering are not necessarily immediately apparent (Barlow *et al.*, 1997; Mathews *et al.*, 1996).

METHODOLOGY

An action research methodology was employed where researchers and participants work together to identify and define problems within the industry, develop solutions and bring about improvements through the implementation of good practice. Action research is used to instigate and learn from the process of change, rather than simply explain problems or provide theoretical insights (Easterby-Smith *et al.*, 1991). It is an educational process capable of changing the researchers, participants and the situation and requires the people being studied to be involved in thinking, planning, implementing and disseminating research as well as a willingness on the part of the researchers to learn and change. The process of gathering data, reflecting upon the findings and forming insights, integrating insights into theories and creating closure on discoveries in order to plan action is undertaken together (Reinhardtz, 1981).

We began the research process by eliciting assistance and participation from contacts gained during previous allied research designed to help senior managers from housing associations (Davey *et al*, 1998). Housing associations are charities (i.e. not for profit organisations) funded by grants/loans from central government. They are responsible for providing housing for people in social need, for rent or sometimes for sale, and for improving the wider social fabric through employment and the purchase of goods and services (Council of Mortgage Lenders, 1997).

So far, empirical data has been collected from in-depth semi-structured interviews with 8 managers from 5 construction companies and 5 managers from 4 public sector organisations. The interviews with construction companies covered the following topics: choice of clients and projects; methods of gaining business; successes and problems; future plans; methods of assessing performance; good practice; and relationships with subcontractors, consultants and suppliers; views on partnering; and details of partnering projects. The clients were asked to give similar information, but related to the business available to contractors and methods of procurement. The format was adapted to the specific interests and needs of the participants, and action taken following the interview to help participants develop solutions. Information was also gained from a seminar run by the housing associations, two large contractors, the Chamber of Commerce, the university and a network for women property professionals.

The comments from the interviews and seminars were classified into categories. The categories were initially similar to the topics covered during the interviews, but were adapted to fit participants' comments, the literature and our analyses of the data. Although informed by our personal experiences and knowledge (Marshall, 1981), our insights into the research process and outcomes were discussed and developed with members of an action learning set comprising 3 academics, 6 managers from housing associations and 2 from a medium sized construction company. The set resulted from collaboration between UMIST, the University of Salford and the Revans Centre for Action Learning. It provided regular information, feedback and practical support.

RESULTS OF THE RESEARCH

The research revealed that clients and contractors were interested in more cost-effective procurement, improved design and contractual arrangements, achieving higher standards of quality on projects and getting involved in 'added value' projects. It also found commitment to the principles of partnering or forming partnerships amongst some of the participants. The findings from workshops and further research to help strengthen links between clients and improve competitiveness amongst SMEs is detailed below:

SMEs welcomed opportunities to work in partnership with public sector clients and blue chip companies, but were reluctant to work as subcontractors.

A construction manager survey showed that large contractors were obtaining 10% to 70% of turnover/contracts from partnerships and the majority forecasted increases in revenue from partnering relationships (Walter, 1998). However, some small and medium sized contractors expressed reluctance to partner with main contractors due, in part, to the fact that sub-contractors are unable to increase their profit margins by negotiating favourable rates from suppliers, but mainly due to fear of litigation and non-payment. A marketing executive said that he would not want to work for a main contractor because the company's last contract with a large construction company looked likely to result in litigation. Even a manager from a large construction company acknowledged that large firms delayed payment to increase profit, with the unscrupulous failing to pay within the time agreed in the contract or not paying at all:

"Cash management is the way that [large contractors] make money. SMEs get hammered…. Certain contractors are unscrupulous because they delay or don't pay at all" (business development manager, large construction company).

While reluctant to work as a subcontractor for a main contractor, contractors were keen to collaborate with blue chip companies. Blue chip companies were perceived to offer large contracts, reliable payment and high rates of quality work completed within a short period of time, as well as professional conduct and experience at partnering relationships. An alliance with a blue chip company also appeared to enhance a contractor's standing amongst its clients. A development director from a housing association believed such an alliance demonstrated the company's professionalism and trustworthiness.

Although profit margins offered by public sector clients were relatively low, the contractors welcomed opportunities to collaborate on projects run by public sector clients such as housing associations and local authorities. These clients provided a steady source of income, which maintained turnover, along with reliable payment. Indeed, a housing association had introduced a payment scheme that guaranteed payment within one week of receiving the invoice in order to attract contractors and obtain value for money. One marketing manager highlights the benefits of work offered by educational authorities:

"The outcry over education has led to money in building schools. Money is spread fairly thinly amongst local authorities. Some of the work is of interest. It's below average in value, but local [to the company's offices]. The work keeps staff and teams together and keeps management on site" (marketing manager, SME).

Although the housing associations were a significant client group in the North West spending over one billion pound in the last five years (Davey *et al*, 1997; Lunney 1996), a marketing manager of a medium sized construction company pointed out that companies bid for projects within their capabilities in terms of size and often specialised in certain types of work (e.g. New build, refurbishment or maintenance) or contracts (e.g. Design and Build or standard contracts). He therefore found it difficult to determine funds available for refurbishment work from capital spending figures for public sector clients. In his view, the clients were unwilling or unable to share information with contractors, perhaps due to lack of knowledge.

SMEs wanted to get onto public sector clients' approved lists and be invited to tender.

While construction companies wanted to work for public sector clients, they sometimes found it difficult to take advantage of specific opportunities. The public sector clients generally restricted opportunities to tender to contractors from their approved lists who complied with their specific criteria (Commission for Racial Equality, 1995; Nicholson, 1998). The construction companies were able to gain membership of approved lists by either applying directly to client to an independent body responsible for assessing applications. Several managers from housing association and universities admitted that they were reluctant to consider applications from new contractors, however, because they were happy with existing companies and the process of evaluation for initial applications and annual review was time consuming and costly. Nevertheless, managers were prepared to consider applications from companies who presented a professional image and/or offered something special.

Housing associations and university clients said they offered opportunities to tender to contractors with whom they had established good working relationships, developed an understanding of the standards required and were likely to get value for money. A development officer from a housing association said that he considered contractors who had successfully completed construction projects in the past for the company, but that only a limited number of construction companies were eligible for contracts involving the provision of training and employment opportunities for local people. A university maintenance manager offered opportunities to contractors approved by the manufacturers to use their materials. Other contractors had simply stopped undertaking work for the university. He believed that this meant that the contractors working for the university all understood the quality required and could therefore price accordingly.

The contractors attempted to increase their chances of being invited to tender by ensuring that they performed well on current projects and through the use of marketing activities. A marketing manager of a medium sized company said he placed advertisements in trade magazines, though he complained that this was costly and the frequent calls from trade magazines were disruptive. The majority attempted to establish personal links with clients. One large company had appointed a business or marketing manager with budgets to cover expenses, but two small companies relied upon directors to gain business and one said he found it difficult to commit time to establishing and maintaining new contacts.

SMEs welcomed opportunities to partner with public sector clients and one firm wanted assistance with a application for project partnerships.

The construction company managers were generally positive about the prospect of working in partnership with public clients. A contracts manager said that partnering improved the quality of the relationship and enabled his firm to meet the needs of the clients in terms of the quality of the product and budget, whilst still making a profit.

A marketing manager from a medium sized company thought that partnering would help the contractor and client talk through and resolve problems together, without resorting to litigation. Nevertheless, the fact that public sector clients can use partnering criteria to select potential partners and award contracts (Loraine, 1994; European Construction Institute, 1997) required new knowledge and skills from construction companies and some managers welcomed assistance in acquiring them. For example, a marketing manager of a medium sized company had received a letter from the a local authority informing contractors of their intention to enter into a partnership arrangement. The letter included the following:

“This initiative is intended to enable a co-operative style of management for the execution of the works, whereby all the parties to the contract can work together without affecting the contractual requirements and obligations... it will include establishing a forum at the post tender stage for identifying possible cost savings and solving areas of potential difficulty or conflict before they impinge on the programme and/or cost of executing the works” (technical services director, local authority).

The company had not yet formally established a partnering relationship, and therefore wanted help in responding to the selection procedure of the local authority. He pointed out in a letter to us that the company’s “experience of the partnering process is very much on a learning curve” and that a “contribution towards understanding the procedures is much appreciated” (marketing manager, SME).

Alternatively, construction companies could identify land and property themselves which could be presented to clients as opportunities for collaboration. Although speculative work yielded higher profit margins and enabled companies to increase their control over the building process by employing more staff on permanent contracts, the risks and the difficulties were considered too great for one medium sized company:

“If a Local Authority has land, but no money our organisation could come in and develop the land. It is very complicated for tax, rebates and grants. Often need something special – commercial input. For example, shops or housing for sale, rather than just social renting… I can come up with a site and take it to a housing association. I lose money by chasing sites” (marketing manager, SME).

SME felt that the process of competitive tendering used for project partnering undermined the potential benefits of the approach.

Although SMEs were interested in partnering and often positive about the potential benefits, they were concerned that the process of competitive tendering undermined the potential benefits. Construction managers complained about clients failing to comply with codes of practice governing the length of time allowed to prepare and submit tender documentation. A director of a medium sized company pointed out that they had traditionally been given four weeks to price design and build contracts, but three weeks had apparently become the norm and around 15% of clients were asking contractors to return tender documents within two weeks. In one instance, he telephoned to ask whether the deadline had been extended and was told that he was the only one to complain, but later discovered from other contractors that they had also contacted the client. In one instance, despite allowing only two weeks to submit a tender, the client apparently delayed opening and assessing the bids for several months, by which time the figures were out of date.

The managers pointed out that awarding contracts to the company who offered the lowest price encouraged firms to submit a low bid, but to then claw back profit by claiming for items not specified in the contract or specifying overpriced materials. An interviewee explains how the process works:

“If I give a low bid. I then have to get it back. I say I want to know the colour of the curtains required. They go on holiday. I charge extra. I then offer gold braid curtains” (construction company manager).

The process of clawing back money was perceived to increase the likelihood of litigation and break down trust. The lack of trust was symbolised by the client’s appointment of a quantity survey to oversee the project and ensure budgetary control:

“Everyone is suspicious of everyone’s motives. The client appoints a surveyor because he does not want to get ripped off. He has to protect his price margins” (contracts manager, SME).

A business development manager pointed out that in project partnerships the design and price for the building have already been fixed which, in turn, reduces opportunities for innovation and cost saving. He would like the opportunity to negotiate contracts during the early stage of the design process:

“We want the opportunity to negotiate on what they want to achieve. We don’t want to be given a fixed project with a given price. If they bring this to the table, it’s too late. Where is the innovation? Partnering means discussing the site layout, subcontractors and suppliers” (business development manager, large contractor).

The majority of contractors wanted to continue working with clients with whom they had developed a strong relationship, where they understood the service required and had already overcome initial problems. They often objected to procurement mechanisms that broke up relationships. For example, a contracts manager complained about a random systems of selecting contractors to tender used by a local authority, even though it guaranteed work and had previously enabled him to diversify into building schools:

“It’s a lottery [the tendering process]. It’s perceived as fair, but isn’t. The local authority has 20 contractors and randomly selects 6. The client wanted us, but couldn’t have us because we weren't selected. What's the incentive to be good? At least we are still on the list! Partnering then goes" (contracts manager, SME).

The construction companies welcomed opportunities offered by public sector clients to circumvent the competitive tendering process. A contracts manager from a medium sized firm extended his contract with a local authority by, for example, remaining on site to complete further work and thus providing better value for money:

"The number of return clients we have is substantial, but we still have to tender. We built a [public building] for the --- ---- Authority. We had already shown our ability. We said that if we could do the two together, we could do it cheaper" (contracts manager, SME).

Nevertheless, a group of managers from the housing associations informed us that they were under pressure from their regulatory body to ensure work was evenly spread amongst contractors and to minimise risk by avoiding over reliance on a small number of contractors. They also felt under pressure to use competitive tendering, rather than negotiated contracts.

SMEs involved in strategic partnerships were under pressure to demonstrate good performance.

Despite being discourage from relying upon a small number of contractors and negotiating contracts by regulatory or governing bodies, three public sector organisation had established a minimum number of three contractors with whom they do business and/or regularly negotiated contracts. Although the housing associations had formally selected partners, the university had simply relied upon a select list of companies who met its requirements. Choosing only a small number of partners enabled a housing association with a relatively small construction budget to offer a significant amount of business to those construction companies and thus increase their likelihood of being considered a valued client. A development director of the housing association said that choosing mainly small and medium-sized contractors enabled him to deal directly with the managing director, guarantee the availability and commitment to their projects and influence their organisational strategies and practices. The use of preferred contractors was also intended to reduce costs, maintain strong relationships and improve the quality of service provided, especially during the post-construction phase of the project.

A contractor who was working in partnership with a client had joined a subcommittee designed to improve quality had been prompted by his involvement in the action learning set to produce a comprehensive report about the management of maintenance defects. The report outlined the problems and potential solutions. It also provided examples of reporting forms, schedules, meeting agenda and quality assurance information (McDonald, 1998).

The allocation of work to partners meant that other construction companies appeared unwilling, however, to bring new business opportunities to the clients. One client was considering paying a fee to companies who identified new opportunities. The difficulties were compounded by pressure from the regulatory body to demonstrate the effectiveness and fairness of partnering relationships compared to standard relationships with contractors who have been selected through competitive tendering. Construction companies were also concerned about the consequences of strategic partnerships both for their firms and the industry. A director of a construction company that prided itself on the quality of its workmanship, but which had not been considered for partnering, was unhappy about not being selected as a partner. Several construction managers were also concerned that by reducing competition partnering would prevent new companies from entering closed markets.

CONCLUSION

The construction companies who participated in the project welcomed opportunities to meet public sector clients and to address some of the problems within the industry. We plan to run a series of workshops designed to facilitate the process of change both through their format and content. The workshops will involve representatives from public sector clients, construction companies and academia. The workshops will enable the researchers to introduction the research project, present detailed information about the problems encountered, recommended solutions and discuss the role of the client in promoting good practice. Small discussion groups will be used to determine the applicability of the recommendations within the delegates' own organisation and to gain more detailed information. The discussion groups' findings will be presented to the entire group during a plenary session.

The subject of the first workshop will be the management of maintenance defects. Initial recommendations include: the joint inspection of the property by the client, main contractor and maintenance manager prior to its hand-over; setting the date for handover at the beginning of a contract; and the use of a standard form to record information from tenants about problems encountered, the form would then form the basis of a formal maintenance/defect tracking system. It is anticipated that the form should also enable maintenance managers to record instances where problems have arisen not from defects, but from other factors such as tenant damage, tenant lack of knowledge or lack of routine maintenance. The information should be recorded and used for monitoring the performance of all parties. The second workshop on communication procedures and technologies will involve demonstrations of video conferencing equipment, maintenance management software and digital cameras.

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