

Construction:

Not an industry for the faint-hearted?

"It is far better not to do the work than to lose money doing it..."

In a nutshell

Shifts in the dynamics of the construction industry are forcing even the largest main contractors to battle for private sector work that used to be below their notice. This is exposing smaller sub-contractors to a tough payment culture, in which they often have to pay their own suppliers substantially before receiving what they are due.

Into this environment drops the new Construction Supply Chain Payment Charter, which has been greeted with derision in some quarters of the industry. Will it help beleaguered sub-contractors? Many don't believe it will...

"With less than a third of the Council's members committing to the Charter, it may feel like another toothless instrument to SMBs working within construction supply chains."

The Cash Protection Agency

The commercial hangover is still a headache for sub-contractors...

If anyone were to believe some of the noises coming from the Office for National Statistics (ONS), they could be forgiven for thinking that the UK construction industry was once again in rude health.

However, recent figures that highlight the heightened activity among UK house-builders take no account of the depressed state of the commercial construction market. This includes the singular absence of major government schemes that have historically provided the vast bulk of business for the industry's giants.

1. Adverse Impact

This is currently having a critical effect on the structure of the industry. Those main contractors that under more normal circumstances would only focus on the very largest, often state-funded, infrastructure contracts are now stepping down a tier or two to smaller schemes. In addition, the fall-off of public sector contracts also means that fewer schemes are underpinned by the 30-day payment limit that public authorities are obliged to observe.

These trends are not only creating a new competitive environment for those smaller companies that more usually occupy this niche – it is also introducing sub-contractors to a radically different payment culture as they start dealing with the industry's giants. For many who have been used to receiving payment on 60, 45 or even 30 days, this is an extremely serious shift as they start dealing with organisations whose practices more usually involve paying in 90, 120 or even more days.

2. The shocking truth

Some may regard the recently launched Construction Supply Chain Payment Charter as a possible answer to this situation – but this appears to be far from the truth. The shocking fact is that only nine of the 30 construction companies that actually drew up the Charter have committed to meeting its pledges.

At first sight, these pledges appear to be significant, most particularly the promise with immediate effect to pay for all work and materials on new contracts within 60 days; this moves to within 45 days from January 2015 and to within 30 from 2018.

The pledges to which signatories have committed:

1) We will make correct full payment as and when due for all work properly carried out, or products supplied, in accordance with the contract. We will ensure any withholding of payment due to defects or non-delivery is proportionate, and clearly, specifically and demonstrably justified in line with the arrangements set out in the contract.

2) We will not deliberately delay or unreasonably withhold payment.

3) For all new contracts we will ensure that payments are made to our supply chain not more than 60 calendar days from the end of the Calendar month in which the work is carried out or products are supplied. From June 2015 we will ensure that payments are made to our supply chain not more than 45 calendar days from the end of the calendar month. From January 2018 that will decrease to not more than 30 days.

4) Public authorities are already required to pay within 30 calendar days. On central Government contracts, payment will be made to Tier 1 within 14 days, to Tier 2 within 19 days and to Tier 3 within 23 days of the due date, which will be 7 days after the common assessment or valuation date established by the client in the Tier 1 contract.

5) We will either not withhold cash retention or ensure that any arrangements for retention with our supply chain are no more onerous than those implemented by the client in the Tier 1 contract. Our ambition is to move to zero retentions by 2025.

6) We will issue any 'pay less' notices at the earliest opportunity and no later than 7 days prior to the final date for payment.

7) We will have processes in place to enable the effects of contract variations to be agreed promptly and fairly and payments for such variations to be included in the payment immediately following the completion of the varied works.

8) We will make payments electronically unless agreed otherwise.

9) We will use Project Bank Accounts on central Government contracts unless there are compelling reasons not to do so and on other contracts where appropriate.

10) Where Supply Chain Finance schemes allowing members of the supply chain to secure earlier payment are offered, we will not impose fees or costs for receiving payment within the terms set out in the contract.

11) We will adopt a transparent, honest, and collaborative approach when resolving differences and disputes.

As the widespread disregard of the Charter suggests, however, it is widely regarded as being less than a significant addition to the landscape of the construction industry. Besides, it is voluntary, with no substance in Law. This means that even those who have signed up can, if they wish, quite legally choose to ignore their promise with no negative impact other than upon their reputations.

Why it matters

Little tangible effect

To make the situation even more farcical, those companies that have signed up are mainly those that are already widely regarded as having the best payment records, meaning that this move will have little tangible effect on the industry as a whole.

Of course, some main contractors will tell you that they already guarantee to make payment within 30 days, but this is only when the sub-contractor agrees to making an 8% discount. Clearly, this is a sheer impossibility in these days of highly competitive quotes and wafer-thin margins. Indeed, for most, accepting such terms means agreeing to lose money on the job.

So where does this leave the real victim of the industry's poor payment culture, the sub-contractor who seldom has the luxury of paying suppliers in anything more than 30 days? For such businesses and their employed or casual staff being paid in anything up to 120 days – and sometimes over – is a recipe for disaster.

The companies that have signed up to the Charter to date:

- Barratt Developments
- Berkeley Group
- British Land
- Imtech UK
- Kier
- Laing O'Rourke
- Skanska
- Stanford Industrial Concrete Flooring
- Stepnell

Bridging the gap?

They will find their options for protecting cash flow relatively limited. For most, bank borrowing is no longer a realistic means of navigating the tough times that come with an erratic cashflow. The days of overdraft funding from tier-one banks are long gone for anything but the largest organisations – asset-based finance options such as invoice discounting are more prevalent than ever before. While these ensure rapid payment, typically on the first day of the following month, they again require the sub-contractor to take a financial hit – typically of around 10%.

And if the end-client has not paid within a set period of time, usually six months, the invoice discounter will reclaim the 90% from the sub-contractor.

This will leave them in the worst possible situation – having settled all the costs of doing business, including the payment of their own people and suppliers, they ultimately have nothing from the contract than a catalogue of cost and lost opportunities to service other, potentially lucrative, contracts.

Where bank-borrowing is possible, it is often from tier-two or tier-three lenders – the commercial equivalents of the consumer-targeted 'pay-day lenders' – at interest rates (typically between 10% and 20%) that again erode already scanty margins at an alarming rate.

The need for cultural change

In Graydon's view, sub-contractors have to make educated decisions based on detailed knowledge of a company's payment record. For this to become an accepted practice, those organisations that employ contractors need to recognise the importance of payment transparency. In turn, this will force them to pay more rapidly, as it becomes a competitive factor that determines whether or not they win contracts – after all, few if any would be capable of delivering against the demands of a contract without the support of sub-contractors.

This is where a Credit Reference Agency has a significant role to play. Historically, organisations like Graydon have been able to support clients in making decisions about whether or not to enter a contract. This is based on verifiable data related to a prospective client company's credit-worthiness. Before recession struck some five or six years ago, few companies would be willing to release financial information other than the set of accounts they filed most recently at Companies House; these can easily be up to two years old. In those days, any request for more recent information, such as this month's management accounts, would be met with scornful rejection.

But the world has changed. Credit decisions – by banks and partners as well as suppliers – need to be based on the here and now, not historical data. After all, any number of County Court Judgments might have been issued in recent months that two-year-old accounts would not even hint at.

Client companies know this, and understand that if they are to benefit from positive business relationships they now need to share up-to-the-minute data that reveals their financial health.

What else?

Grasping the nettle

A similar cultural shift is required in the area of speed of payment. The construction giants need to be taught that unless they pay on time, it will be impossible for them to find sub-contractors to work for them.

This will only happen if all sub-contractors recognise that it is far better not to do the work than to lose money doing it. This takes courage and determination, but in the absence of stringent Government legislation with real teeth it is the only way of assuring permanent positive change

In the meantime, of course, it is recognised that sub-contractors do need to work. Until the changes that have to happen are with us, there are several "rules of engagement" that every sub-contractor needs to apply with real conviction before entering into any contract.

The Graydon "rules of engagement"

- Establish the client's credit-worthiness
- Understand its payment terms
- Price the job accurately, with a realistic margin that delivers profit
- Negotiate terms strictly
- Include the Government's 8%-above-base-rate penalty in your terms
- Ensure that payment keeps to those terms
- Don't be afraid of imposing the 8% levy for late payment
- Don't be afraid of taking the client to court if payment is slow or not forthcoming

Graydon can help with the groundwork that must be done before you enter a contract. Contact us today, and minimise the risk of late payment.

Colophon

Editor

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Realisation/Formation of publication

When compiling this eBook, Graydon conducted market research through a combination of secondary information sources and input from research specialists at Graydon. The results of which were used as the basis for this publication.

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