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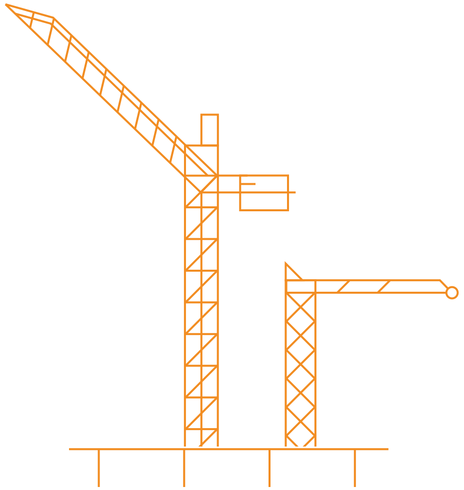
As construction insolvencies hit their highest level in a decade, building a resilient market is the responsibility of all of us.

Insolvencies are hitting the construction sector at a record rate. We look at what the industry can do to protect itself – and share risk in a way that helps prevent, rather than accelerate, the threat of further insolvencies.

Construction has been the worst hit UK sector for insolvencies this year, with 4,370 businesses going under in the year to November 2023. This is an increase of 7% on insolvencies reported to November 2022.

The big-picture influences behind this spate of insolvencies are many – the lingering impact of COVID-19, shrinking credit and credit insurance availability, the Russia-Ukraine war, soaring inflation and low availability of labour –all wreaked havoc on previous ways of working. We investigate the underlying reasons in detail in our Q4 2023 Market Update.

Many of these factors are beyond the construction industry's control to influence or change, but which can be mitigated, and what behaviours can we take to strengthen our collective resiliency in this complex, unpredictable period we find ourselves operating in?



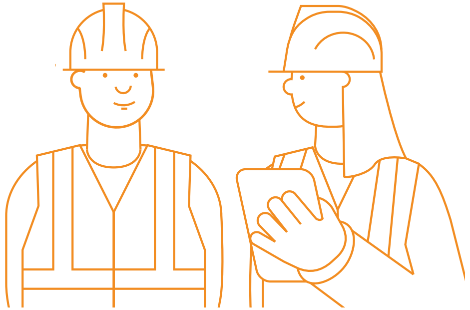
Protecting and enabling cash flow is crucial

Other aspects of company balance sheets can take a hit – profit and dividends, for example – but for any business to remain a going concern, cashflow is essential. Furthermore, we are part of an ecosystem, and insolvencies hurt the entire industry: if a single large firm goes bust, its supply chain will also experience interrupted cashflow, with all the damage that entails.

Earlier engagement, greater collaboration and better communication and integration with supply chains and supply chain mapping, will help everyone survive periods of instability. Providing shorter or bespoke payment terms, advance payments, or escrows can improve cashflow management across the board. Flexibility and a willingness to think of solutions outside of outdated norms is key.

For example, can limited fluctuation clauses be considered in a contract? Would just-in-time procurement be more cost effective on a project, even if it means slightly less cost certainty? Why are we buying packages sometimes years in advance – in a volatile environment?

Contracting flexibly, pragmatically, and with the unique needs of the project and players in question being front of mind, can help drastically reduce the risk.



The importance of understanding the risks involved in projects – through data and a closer relationship with the supply chain

Understanding how the players in a supply chain operate creates deeper knowledge, which in turn drives foresight and the ability to anticipate problems before they arise.

Better communication extends itself to conversations around each player in a project's capacity and ability to fulfil their role. We need to be mindful about who we are appointing to roles, and why. Do they have the capacity to undertake it successfully? What is their motive for taking on a job? How well do their practices and availability integrate with other parties involved in the project? These might sound like obvious questions, but they are not always asked – nor the answers taken heed of. As ever, providing lowest cost should not be the deciding factor in appointing a party to a role.

The undertaking of financial due diligence into main contractors and their supply chains are imperative to ensure employers understand the risk profile of an organisation they are entering into contract with. Our own contractor database, for example, is linked to Creditsafe providing us with real time updates of parties' financial health. Alternatively, for a more thorough analysis of a company's financial health, the employer can request an accountant to undertake a review of their current management accounts.

Transferring appropriate levels of risk at the appropriate time should be a core value of any project. Flexibility and ensuring contracts are fit for purpose is vital from a risk-sharing perspective. For instance, on longer contracts, we can consider incorporating budgets or Notices to Proceed for later packages, which shares the risk with the contractor/client.

Recent resources outlining best practices in this current unstable environment are available for anyone, operating in any part of the industry, to adopt. The Private Sector Construction Playbook, issued by Be the Business in November 2022, affirms that fair terms, appropriate risk sharing and proper due diligence are core business competencies.

Three of the ten success factors from The Private Sector Construction Playbook

Allocate risk appropriately and fairly

The allocation of risk needs to be decided by evaluating the project, using experience, expertise and knowledge. The party best placed to manage the risk should take the leadership role and should also encourage collaborative thinking among all parties.

Contractual arrangements should be flexible enough to transfer the risk at the right time where applicable. This will mitigate the financial stresses associated with onerous contracts and should also include appropriate recourse or review if risk transfer is not suitable or agreeable for all parties.

Pay fairly

Payment mechanisms must be put in place right at the start and have buy-in from the supply chain. Trust and collaborative partnerships can only be established if fair payment is in place. Best practice, as set out in the Construction Act 2011 amendment, should be adhered to at the very least, and embedded in all construction contracts, with any amendments taking into consideration supply chain implications and risk allocation.

Well-known mechanisms, such as advance payments and bonds, should be reviewed and applied throughout the supply chain. But other mechanisms should be considered to incentivise parties to promote better outcomes and benefit project culture.

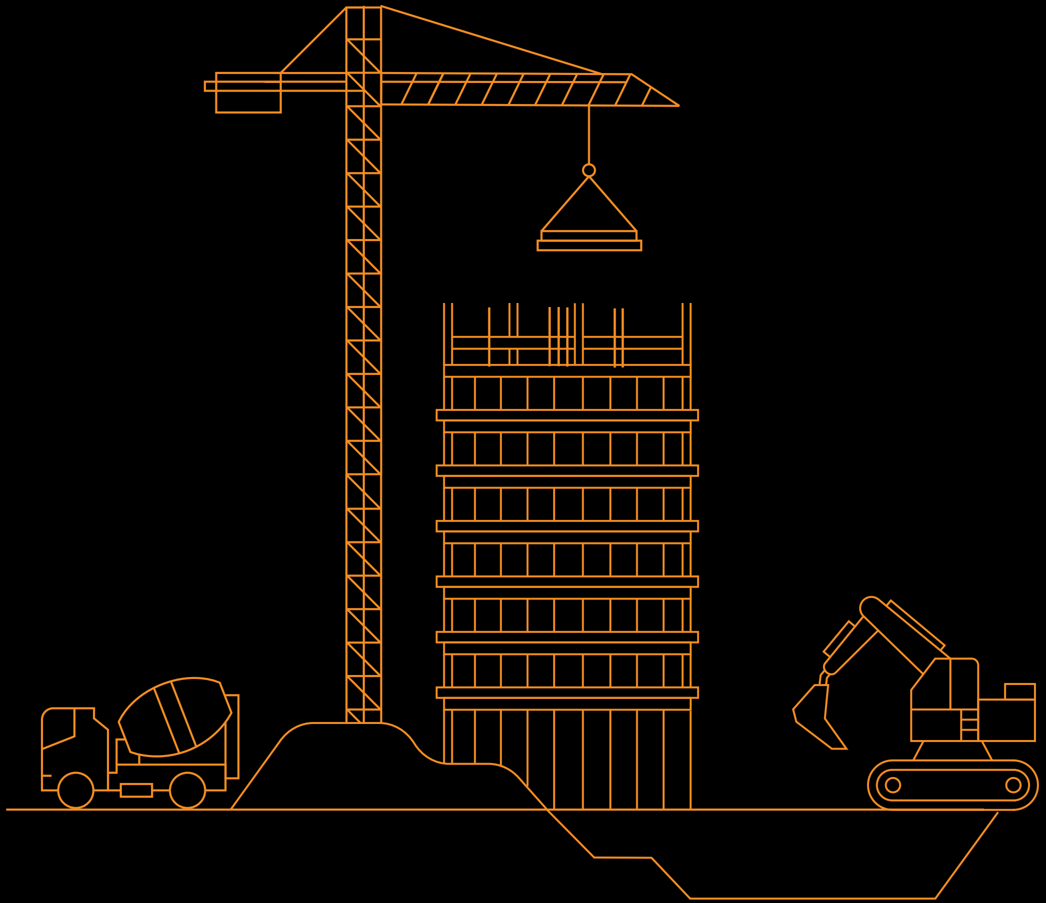
Assess the economic and financial standing of suppliers

Minimising the risk of failure in the supply chain is crucial for the efficient delivery of a project. The financial strength of all supply chain partners should be assessed during the selection process. Assessments should be transparent, objective and non-discriminatory.

Where required, the project should consider appropriate risk mitigation through measures such as guarantees, escrow accounts and insurance protections.

Source: Trust and Productivity, The Private Sector Construction Playbook (November 2022)

In short – contract fairly, carefully, and in conversation with your supply chain



When companies can no longer fulfil their contracts and/or become insolvent – many of which provide specialist work that cannot easily be re-assigned – their supply chain, and other parts of the industry are left to pick up work and contracts that have been left unfulfilled. The knock-on consequences on reputation and on availability to meet the demands of other projects can be long-lasting. We should also remember that rumours can be damaging to a business' reputation, we all have a responsibility to ensure that we deal in facts at all times, rather than hearsay and hyperbole.

No business is invulnerable to the challenges that have taken down some of the construction industry's best-known names. We are operating in an unpredictable, deeply challenging environment. Across the industry, there is a need for a mindset shift, and more pragmatic, proactive behaviours to prevent further insolvencies.

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+making projects happen

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