



1.1 The client/contractor relationship in labour-based construction and maintenance

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INTRODUCTION

It is a mistake to imagine that labour-based technologies are easy to introduce. Change always involves extra work as well as possible trouble, and the extra work (as well as the blame, if things go wrong) will usually devolve on the senior or middle ranking engineers in the Ministry of Works or highways agency. When the change also involves the use of contractors rather than direct labour (force account), they have to face the further dimension of change and disruption to their established work patterns and authority.

This helps to explain the caution and conservatism in experimenting with simpler and more appropriate forms of contract. Contractor-executed labour-based projects, like all projects, are vulnerable until the procedures are well understood, and the risk of failure is significantly increased when they are introduced without adequate preparation. There are two main reasons why failure can occur:

- planners tend to set over ambitious physical and employment creation targets, which disregard the fact that a certain amount of time is needed to build up local capacity and to develop a new technological approach; and
- labour-based work tends to be seen as simple and straightforward by people who are more used to dealing with large-scale, equipment-intensive operations, so it is entrusted to supervisory staff with no relevant knowledge or experience.¹

If poor quality, slow work and high costs are the results, the reaction is 'We tried it and it didn't work'. To minimise the risk of failure, the relationship between contractor and client must be spelled out in clear and equitable contract documents. Equity is important, and one-sided documents are not really beneficial to the client in the long run because the reputable and competent contractor really has the choice - "To bid or not to bid." Clients who alienate this group are doomed to rely upon contractors who are both incompetent and disreputable, and in performance terms they will get what they deserve!

THE CONTRACTUAL RELATIONSHIP

The relationship between the contractor and the client is governed by the contract itself, so it seems logical to start with the basic question, "What is a contract?". A contract can be simply defined as *an agreement between two or more parties which is intended to be legally binding*.² It apportions responsibility and apportions risk between the parties. Standard contracts



have obvious advantages, in that the clauses have been tried and tested over the years, so their interpretation becomes easier and there is less need to become involved in costly litigation.

The most common international standard contract is that issued by the Federation Internationale des Ingenieurs Conseil (FIDIC). The conditions do at least recognise that there are different circumstances in different areas of the world, and there is some scope for modification to meet these. The first part, the general conditions, are designed to be “general” and should not be modified. The second part, the conditions of particular application, are specifically written for each contract, and sample clauses are provided to guide the user in tailoring their use to each specific situation.

On large projects where the responsibilities are onerous and the risks are great, detailed FIDIC contracts are needed and well justified. On small jobs executed by labour-based contractors, it is open to question whether complex contracts are really needed to protect a relatively wealthy and powerful client from a relatively poor and weak small entrepreneur. Contracts do not *have* to be complex. The following box provides a fictional, but typical, account of just how easy it can be (or used to be) to negotiate a simple labour-based road contract.

Although verbal contracts of this kind can valid in law, they are usually too elementary to provide any kind of protection to the parties if things go wrong. However, the example is worth including to show that there is a spectrum of contractual complexity that is appropriate in any given case. Indeed, for those who accept the logic of Fritz Schumacher’s argument that in development terms “small is beautiful”, there is no reason why the principle should not extended to designing small and simple (if not necessarily beautiful!) contract documents.

Fixing a price for the road to the rice mill (Burma, 1974)

Three men in *longyis* had appeared, and squatted down upon their haunches on the path in front of the steps..... A slow conversation developed, evidently punctuated with jokes and repartee. After ten minutes there was a final sally, and the three got up and went away. Nevil Shute, *The Chequer Board*³

This leads to the proposition that the ideal contract document in any given case would be the simplest formulation that will permit effective accountability. It is also worth noting that clients are able to safeguard themselves in a variety of non-contractual ways, such as pre-qualification of acceptable firms or individuals with good track record and a refusal to sanction payment for unsatisfactory work. The likelihood of a small contractor attempting to obtain legal redress against a public sector client is remote, even where the contractor has a good case in law.

RISK TRANSFER

Inevitably, all contracts involve risk. Apart from mobilising the managerial and technical expertise – and the entrepreneurial drive – of the contractor, the main reason for a client employing a contractor is simply to pass on the risk to someone else. The reward for carrying the risk is the



profit which the contractor will expect over and above the estimated costs plus a reasonable commercial return. The higher the risk, the higher will be the profit that will be needed and expected. If the ratio of the expected risk to possible reward is unacceptably high, the intelligent contractor will keep clear of the project altogether.

In our book *Foundations for Change*⁵, Geoff Edmonds and I argued that, in developing countries anxious to encourage their fragile domestic industries, excessive risk transference is definitely counter-productive and noted that:

“the would-be developing country contractor remains at the mercy of a formidable array of endemic and imposed risks that he is frequently unable to understand, let alone evaluate. The client, meanwhile, continues to decide which bid is most favourable on price grounds alone, providing that he is satisfied that the bidder is financially solvent and offers to complete within the desired contract period. Accordingly it is only the financial area that any effective discretion is available to the contractor at the bidding stage. Even this discretion is effectively limited for neophyte bidders by the problems they experience in mastering the somewhat esoteric estimating techniques that are demanded by the traditional system incorporating a bill of quantities.”

Before deciding upon the optimum level of risk transference, it is helpful to define risk itself and to examine ways in which it can be analysed and assessed.

DEFINING RISK

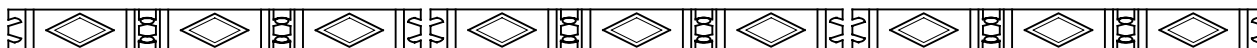
It is important to remember that risk can rarely be eliminated from any aspect of human endeavour, since risk is inherent in any attempt to commit present resources to achieve some form of future benefit. So no contractual system, however complicated, can ensure a risk-free project. Risk can however be identified and analysed, and it seems sensible to base a study of client/contractor relationships on a realistic diagnosis of the worst sort of risks that are likely to arise on typical contracts for labour-based construction and maintenance. The process of risk determination is commonly undertaken as a three-stage process:

- *Risk identification* - developing an understanding of the nature and impact of risk on the current and potential future activities of the organisation.
- *Risk measurement* - the assessment and classification of risky situations.

Risk evaluation and re-evaluation - the judgement about actions to handle risk and the possible need to re-evaluate risk options.⁶

Table 1 sets out typical risks on a construction project as set out in a standard text on risk management in the construction industry⁷, together with the author's assessment of the need for the client to expect the contractor to accept (and price for!) the risk in a typical labour-based construction project.

Most of the risks are not serious for the client, and they are risks that the client is better placed to bear than is the typical small domestic contractor. For the client they are what Tom Peters (quoting the late W. L. Grove) describes as 'above the waterline risks'.⁸ The metaphor is that of



modifications to a ship. If you drill holes above the waterline, there is little danger and the resulting problems can be corrected. If you drill below the waterline, you need to think long and carefully about what you are doing. Tom Peters' message is "Experiment (and risk failure) as long as the issue is trivial."

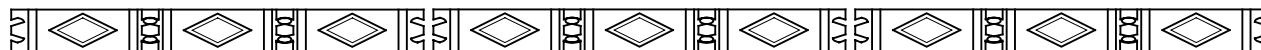
MINIMISING PROJECT RISK

If the minimisation of project risk is in the interest of both the contractor and the client, how is it to be achieved in practice? Having reviewed the ILO experience in supporting the introduction of labour-based road construction techniques, with a view to proposing the general lessons for engineers involved in international technology transfer, the author proposed the following list:⁹

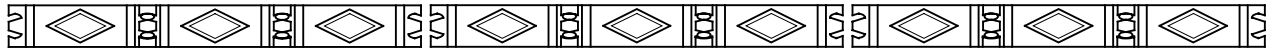
- the need to take account of the local administrative, social, cultural and regulatory environment;
- the need for a sensitive assessment of the 'software' factors governing the host organisation (skills, knowledge, experience, together with suitable organisational and institutional arrangements);
- the need for an open – minded approach to the choice of technology, taking account of national priorities in employment creation and the use of local resources;
- the importance of the principle of sustainability;

Table 1: Risk acceptance on labour-based projects

Typical Risk	Risk to Client	Implication
Failure to complete within stipulated period	Limited	Contractor should normally bear risk, but cost of delayed completion is usually not great
Failure to obtain statutory approvals	Not usually relevant	Client could take responsibility
Unforeseen adverse ground conditions	Limited	Not likely to occur on simple projects. Relatively easy to calculate, providing client is willing to bear the risk
Delays due to exceptionally inclement weather	Limited	Contractor should normally bear risk
Strikes and labour force unrest	Depends on area	Risk must be transferred to contractor
Price escalation in labour and/or materials	Depends on local inflation rate & contract duration	Relatively easy to calculate, providing client is willing to bear the risk



Failure to let to tenant on completion	Not relevant	Not relevant
Site accidents	Limited in most labour-based tasks	Risk must be transferred to contractor
Defects due to poor workmanship	Limited in most labour-based tasks	Poor workmanship can usually be detected during measurement inspections. Long term indemnity by contractor rarely needed
<i>Force majeure</i> (flood, earthquake, etc.)	Limited	Little benefit in transferring risk to contractor
Claim from contractor for loss and expense due to delayed delivery of designs	Not likely to occur on simple projects	Simple clause required
Failure to complete project within client's budget allowance	Limited	Scope of labour-based road projects can usually be reduced without significant cost implications



- the inseparability of technical and managerial innovation;
- the need to work with and through the local private sector, including initiatives to create a contractual and regulatory environment which favours the development of small enterprises; and
- the need to provide an appropriate mix of technical and managerial training to small enterprises, including cost accounting, estimating and bidding, and understanding contract documentation such as design specifications, drawings and payment procedures.

The essential message for the client is that the minimisation of project risk is a benefit for all concerned. Once this has been achieved, the next stage should be to decide how much of the *residual risk* is to be transferred to the contractor. Transferring risk always incurs a premium. In principle it is best to transfer the minimum realistic level of risk, but to ensure that the contractor is properly accountable for performance.

ADVERSARIAL RELATIONSHIPS

In the traditional British system the promoter of the project (or client) employs a consulting engineer and bears the overall design risk, except for those specific areas of risk which may result from negligence on the part of the consultant. At the operational stage, however, the contractor is expected to bear most of the construction risks, except those which may be taken by materials suppliers or sub-contractors. The traditional system has the *potential* advantage for a client that the competition between would-be contractors should result in their offering the lowest prices in order to be chosen, and that the price tendered by the chosen contractor is all that the client will have to pay.¹⁰

Whether these advantages are gained in practice may depend upon a number of factors, the most important of which stem from the separation of responsibilities for design and for construction. The supposed advantages that stem from this rigid separation of roles is increasingly questioned, leading to experimentation with various types of teamwork or 'partnering' approaches in which the contractual relationship is deliberately structured to foster collaboration rather than competition.

THE PRINCIPLE OF PARTNERING

The idea of partnering starts with the proposition that the construction industry world-wide is frequently confrontational and conflict prone, and has been generally slow to adopt the principles and practices of quality management. Conflict and confrontation are in fact built into standard contract procedures, and partnering has been defined as *choosing to live by the spirit rather than the letter of the law..... It is going back to the way people used to do business when a person's word was their bond and people accepted responsibility. Partnering is not a contract, but a recognition that every contract includes an implied covenant of good faith*¹¹

Reciprocity and Trust

Law, contract, and economic rationality provide a necessary but not sufficient basis for both the stability and prosperity of post industrial societies; they must as well be leavened with reciprocity, moral obligation, duty toward community, and trust, which are based in



habit rather than rational calculation. The latter are not anachronisms in a modern society but rather the *sine qua non* of the latter's success.

Francis Fukuyama, *Trust*¹²

In his book on project partnering, Ron Baden Hellard suggests that the parties should consider establishing a *partnering charter*, identifying mutual objectives for the various stakeholders. A set of typical partnering goals is set out in the following box.

Typical partnering goals

- achieving specific value engineering savings
- limiting cost growth
- limiting review periods for contract submittals
- early completion
- no lost time because of injuries
- minimising the generation of paperwork
- no litigation
- other goals specific to the nature of the project

SELF-ENFORCING AGREEMENTS

The attachment to detailed and formal contracts is to some extent a cultural phenomenon. Charles Handy described an early experience of negotiating an agency agreement with a Chinese dealer in South Malaysia. When, after the negotiation, he asked for signatures to a formal agreement, the reply was “In my culture, a good agreement is self-enforcing because both parties go away smiling and are happy to see that each of us is smiling. If one smiles and the other scowls, the agreement will not stick, lawyers or no lawyers”. He goes on to argue that what he describes as *the Chinese contract* embodies a principle which goes far beyond the making of lasting commercial deals.

It was about the importance of compromise as a prerequisite of progress. Both sides have to concede for both to win. It was about the need for trust and a belief in the future. Writ large, it was about sacrifice, the willingness to forgo some present good to ward off future evil, or, more positively, it was about investment-spending now in order to gain later.¹³

This paper has deliberately been limited to a discussion of broad principles. It has argued for an understanding of cross-cultural differences and an acceptance of the value of fostering trust through some form of partnering arrangement. There is now an urgent need to draw lessons from practical field trials of simple contracts based on these principles, in order to ensure that contractual relationships achieve an equitable spread of risk and enable contractors to establish themselves as worthwhile and sustainable businesses.

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