

Key Takeaways

- Recession saw strained supplier relationships in the construction sector.
- Many firms extended payment terms, putting pressure on smaller suppliers.
- As the economy slowly recovers, construction firms are struggling to find suppliers.
- The construction industry is now looking at longer-term solutions.

Rebuilding project



The pace of growth in construction is being hampered

Calling in the military can seem a drastic measure. But that's just what house builder Persimmon did earlier this year.

To alleviate a skills shortage it has started to train former military personnel to become part of its team. The upsurge in the housing market has left construction firms struggling to meet demand and holding up supply.

Jeff Fairburn, Permission CEO, told UK newspaper The Guardian: "Because all the developers are pushing hard.... there's going to be a squeeze on skills – bricklayers, joiners and the like. All the trades are affected. We are not building quite as fast as we'd like to."

Permission, taking matters into its own hands, is indicative of supply problems across the construction industry, not just house building. Balfour Beatty, the UK's largest construction contractor, which operates across major infrastructure and building projects, is also seeing some tightening of supply.

Procurement and supply chain director Martin Chown says: "It is not across the board, but we are seeing in certain areas, and with some skills, constraint in supply."

Supply problems

Statistics back this view. In September, the Markit/CIPS UK Construction PMI showed the pace of growth was causing supply problems, as the availability of materials and subcontractors dropped at record rates.

Markit stated: "Subcontractors were

able to charge more in the face of such strong demand, and average rates levied rose to the greatest extent seen in the survey's history. Material costs meanwhile showed the largest jump for just over three years as demand outstripped supply."

For an industry often reliant on long-term projects, it is a rapid change in events. In the third quarter of 2012, the Office for National Statistics said output was at its lowest level in more than ten years, while in January 2013, the Construction Products Association forecast a 2% contraction for the year, with no growth until 2014. Now it expects growth of 4.8% in 2014 and 5.3% in 2015.

Currently supply difficulties are as a direct result of the way the industry supply chain was managed during the period of deep recession, when contractors and clients tended to push out payment terms on smaller suppliers to improve their cash position. Scarcity of credit made matters worse.

In 2013, the report Supply Chain Analysis into the Construction Industry from the UK's Department for Business, Innovation and Skills found payment performance to subcontractors was getting worse.

"Payments periods are being extended as a result of current market conditions; payment delays reduce contractors' liquidity and in turn industry capacity and output," it stated.

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Rob Alexander, a partner with procurement consultants Occumen, and former global sourcing director with construction firm Carillon, says: "There are definite constraints that were put on by the main contractors that had an impact on the viability of smaller suppliers."

"Unfortunately that is big business setting policies and becoming slightly inflexible and not nimble enough to

recognise the changes in the economy and implementing those changes to policy rapidly enough."

In April 2012, for example, administration specialist Begbies Traynor revealed a 104% rise in the number of UK construction companies suffering financial distress in the first quarter of 2012 as the sector reeled from the blow dealt by public spending cuts.

Andy Haworth, an industry consultant and former CPO at Balfour Beatty, says that the supply chain may have lost 30 to 40% of its capacity during the recession. "As we have come out of the downturn, there has been a significant increase in the volume of new orders and we are very quickly seeing a saturated supply chain. That is creating a lot of pressure. We have seen cost inflation."

Meanwhile, security of supply is becoming a major risk, he says. "There is a scarcity of materials, things like bricks and blocks. We see longer lead times

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By Lindsay Clark on 16-Jan-2015

and that takes some adjusting to."

But Balfour Beatty's Chown says the firm was not caught out by the turnaround in the market and planned for shortages in skills and raw materials, even as the downturn lingered.

"We started capacity planning in the supply chain two years ago while we were still in a restricted market with not much growth. We were already looking at which trades would be restricted. It has not caught us out but, with some of the materials, capacity got closed down with the economic cycle."

"The key to that, as always, is good planning. Not only do we look to the market well in advance, but also specify two or three types of material and agree that with the client in advance. Then, should shortages or long lead times come into play, we have somewhere to go. It is not just about procurement, it is a business issue."

Balfour Beatty also avoided industry practices such as extending payment terms, which can tempt large firms during difficult times. Instead, it sought to improve supplier relationships during the downturn, Chown says. "As far as we are concerned, extending payment too far is negative. When you come out of recession into growth - and that is a position that suppliers are in - they may not be pleased", he adds.

In fact, Balfour Betty has been trying to curry favour with its suppliers for some time, increasing spend with small and medium-sized enterprises and schemes to boost chain finance, provide greater visibility of work, help with understanding of health and safety and other important criteria.

Greater aggregation

The firm has also completed a procurement transformation programme, started in 2011, which has seen a move away from project-by-project buying towards greater aggregation of spending.

The recession has coincided with changes elsewhere in the construction supply chain. Tony Roberts, procurement director at Lafarge Tarmac, which supplies building materials to contrac-

tors such as Balfour Beatty, says, "What I have seen is a change in focus that is a result of the lessons learnt in the recession."

Before the merge with Lafarge, Roberts was in a commercial role with Tarmac, selling to contractors during the worst of the downturn.

He says, "It was a period of oversupply and short-termism from buyers which meant that procurement decisions appeared to be a bit more one dimensional than, as a seller, we thought they should have been."

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Roberts adds that buyers couldn't see the potential in higher-value products that could save time and money in the long term. "During that time it was difficult to get customers to recognise that

value. It became a short-term tactical adversarial approach, in procurement, that is something we are focusing on moving away from", he says.

"If I think now about scarcity of service or capacity in our suppliers, a lot of that has been brought about because of a lack of investment in capacity during

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"Short-termism - that singular dimension of procurement - cannot survive in the upturn. We have to have a holistic view of what value can be brought from our suppliers and what we can offer our customers. A long-term view will become increasingly important as we step into a new phase of construction procurement."

Lack of investment

Roberts says that short-term buying during the downturn has extenuated the problems the industry now faces.

the recession, so we are facing the consequences in constraining the supply chain from end-to-end," he says.

Lafarge Tarmac has products and services, such as fibre reinforced concrete, that allow customers to be more efficient and effective, says Roberts. The problem is these technologies were not brought to market as quickly as they could have been, and valuable lessons in working with them have not been learnt."

He adds: "Had we been able to see the

£1bn
Amount Balfour Beatty said it would spend with SME suppliers in 2014

SUPPLY CHAIN FINANCE IN ACTION

Balfour Beatty, the UK's largest building contractor, is more than a year into a supply chain finance programme. The scheme, which enables suppliers to receive payment weeks faster, is part of a range of measures designed to assist vendors as the industry emerges from recession.

The finance scheme aims to help the small and medium-sized businesses (SMEs) that work with Balfour Beatty to alleviate potential cash-flow issues by providing access to low-cost finance. At a small cost, suppliers will be able to access funds as soon as invoices are approved, within their existing payment terms.

Balfour Beatty CPO Martin Chown says the scheme can act as a form of short-term finance for smaller firms in the supply chain. "If they want to take £100,000 a couple of weeks early, it will cost them £150. It compares well with other kinds of short-term finance. They will not be able to get those kind of terms in any bank or financial institution."

Between 40 and 50 firms have so far taken up the offer, most of them SMEs. Balfour Beatty is not making money from the scheme and has had to invest in its administration, says Chown.

The contractor is also trying to develop better relationships within its supply chain by offering more detailed and longer-term visibility about its work pipeline, thereby helping suppliers understand when and how to invest.

Chown says the approach has been tried in a few pockets of construction, including work on the London orbital M25 motorway and student accommodation projects.

"We are just trying to do that in a more structured way. We are looking at how we can do that across the business so suppliers can see a good pipeline, know how many people to employ and how much money is going to be coming in, more or less. That is the key: listening to subcontractors," he adds.

SME suppliers

In recognition of the fragmented and localised nature of the construction industry's supply chain, Balfour Beatty announced in May that it planned to spend £1bn with SME suppliers during 2014. This represents a 33% increase in spend with suppliers compared with 2013. The spending will contribute to supporting around 200,000 jobs within smaller businesses, 50,000 more than in 2013.

Chown says that by the end of June the scheme was on target, and the company had spent around £483m with SMEs.

The company is also helping suppliers by supporting the Supply Chain Sustainability School, which is backed by 21 of the UK's top contractors and construction clients. The school offers open access to its health and safety policies to allow firms to understand the supply chain qualification process and cut the cost of developing their own policies.

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value of collaboration and innovation to get us through that recession, we may not have had some of the problems that we have today."

However, the building materials firm has been introducing a new approach to managing its suppliers to avoid the effects of such short-termism. "As our

customers demand more innovation from us, we do from our suppliers," Roberts says.

Lafarge Tarmac has now formalised measures of supplier performance, which not only include costs savings, but also quality and safety, reliability, sustainability and innovation. The firm

also created a more consistent approach with its top suppliers so both parties share their expectations of the relationship in order to foster innovation.

Roberts says: "We are challenging suppliers on what innovation they can bring and we are going to increase that.

We have to look at ways to get suppliers involved in helping us solve customers' problems, and that is going to need a change in the ways the business interacts with suppliers."

"We need to be more open and have more trust. We have to share forecasts and share intellectual property. Those challenges are going to become increasingly prevalent, but meeting them is the only way that we are going to solve the problems that we have going into an upturn."

Pressure on the construction supply chain is unlikely to abate any time soon. The UK housing market requires 240,000 new homes a year to meet demand, and in the summer of 2014 the government increased its construction pipeline by £13bn, to reach £116bn by 2020 to fund HS2, a high-speed rail link between London and the north of England, and nuclear power schemes.

Procurement will have its work cut out ensuring suppliers can meet demand.

**BALFOUR BEATTY:
TRANSFORMING
THE FUNCTION**

Balfour Beatty has finished a procurement transformation programme to move away from project-by-project buying to a more aggregated approach.

The firm started the programme three years ago with a £12m shared service centre in Newcastle upon Tyne to focus on indirect spend, in categories such as IT and fuel, that resulted in savings of around £15m in 2012.

Procurement chief Martin Chown says: "That transformation is complete. It has been successful, but we are not just running one central office. We have Newcastle, Scotland, Manchester and London as our main procurement hubs."

The contractor now has more than 100 aggregated deals in place for direct materials spend, and is expected to announce the savings achieved.

With a career spanning procurement in the automotive and pharmaceuticals sector, Chown has seen the benefits of aggregated spend management that are now being driven through Balfour Beatty's buying. But

this must be balanced against other priorities, he says.

"The project-based nature of construction is complex. We have around 1,000 sites across the UK in operation, from small to large. We have to decide where it is right to centralise and aggregate and get the best deal you can. We have been driving that hard and will continue to do so. But we have a strong commitment to local spend and SMEs and it is a mix of the two that is successful for Balfour Beatty. That is different in the construction industry compared with pharmaceutical or automotive." Chown adds.