Australian Constructors Association

Commonwealth procurement: Inquiry into Auditor-General Reports 6, 15, 30, 42 (2021-22) and 5 (2022-23)

October 2022

The Australian Constructors Association (ACA) welcomes the opportunity to make a submission to the Joint Committee of Public Accounts and Audit's Inquiry into Commonwealth Procurement. We welcome the Joint Committee's interest in ensuring the rules and guidelines governing the Australian Public Service maximise value for the Australian community.

While we note the Terms of Reference do not explicitly mention Commonwealth procurement of construction projects, ACA considers the built environment to be a key asset class characterised by high complexity and risk. We therefore encourage the Joint Committee to have regard to the challenges experienced by agencies and contractors in maximising the return on public infrastructure investment.

About us

Established in 1994, ACA is a trusted voice for the construction industry. We are the only representative body covering the three key sectors of the industry—vertical, horizontal and services. Collectively, our members construct and service over 90 per cent of the value of major infrastructure projects built in Australia.

The burning platform

There is an urgent need for reform in the procurement of construction projects. This need arises from the reality that the demand for construction services is outpacing the industry's capacity to deliver.

The development sector, both public and private, is now suffering from diseconomies of scale. That is to say, as population density increases, we are spending more per capita to deliver built environment outcomes. These diseconomies are most visible in the large and complex 'megaprojects' that require expensive delivery strategies (such as tunnelling) in Australia's major cities.

Yet as the industry struggles to simply keep up with population growth, it also faces a whole new set of demand drivers. Chief among these is the renewables transition. On any estimate, the goal of net zero implies a colossal amount of construction activity over the coming decades. That is to say nothing of other demand-side shocks, such as the 2032 Olympics or the renewed focus on Defence investment.

ACA is conscious that the public sector is a significant contributor to the increased demand for construction services. Public sector spending now drives 44 per cent of all engineering

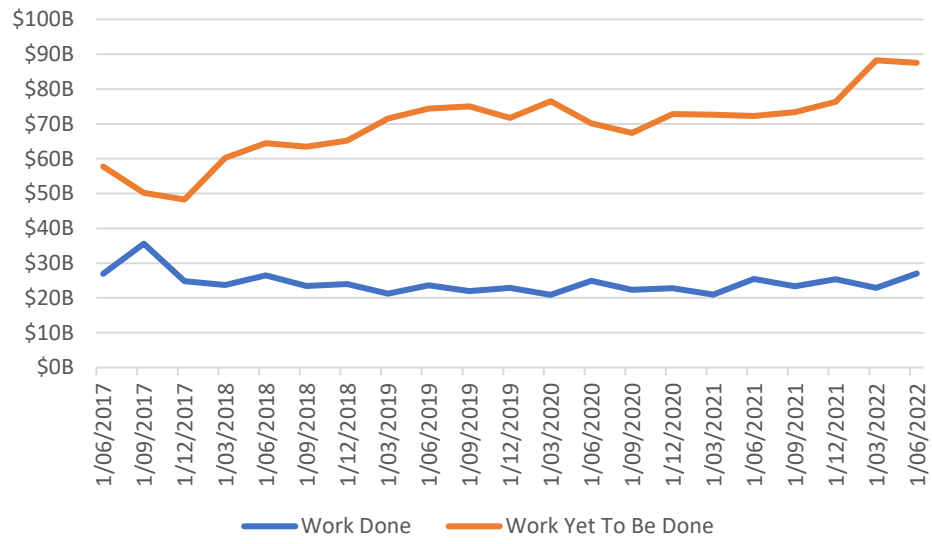
construction activity in Australia – more than double its share in 2014.[1] For example, we are aware that the Department of Defence plans to deliver a record volume of major projects across the Defence Estate over the next decade. Much of this investment is slated for delivery in regional Australia where supply constraints are particularly acute.

As it stands, the industry will simply not be able to keep up with this demand.

In fact, the aggregate data suggests we are already falling behind (Figure 1). Over the last five years, the forward pipeline of committed works increased from $50 billion to $90 billion. Yet the amount of work actually done stagnated at around $25 billion per quarter. In other words, the volume of work being commissioned every year is increasing but the industry has been unable to lift its work-rate to accommodate this extra demand.

Figure 1: Not Keeping Up

Engineering Construction Activity, Qtly, Australia



Source: ABS

The industry has limited scope to absorb this increased demand simply by scaling its operations. Labour markets are already very tight—and were so even before the pandemic—and the market is stretched to capacity. This leaves only one option: a material increase in productivity. Quite simply, we need to find ways to deliver built environment outcomes with much fewer inputs.

Reducing waste and inefficiency is one proven way to improve the productivity of any production process. Construction is no different. There are several important sources of inefficiency in the dominant models of construction delivery, particularly in large infrastructure projects.

[1] ABS Cat. No. 8762.0, Table 3.

The key is to place more emphasis up-front. The more we invest in collaborative planning and design, the fewer risks we encounter in delivery. Sufficient investments in early planning incorporating the input of all parties—clients, contractors and consultants—have been shown to raise productivity substantially. One survey of megaprojects found those with high levels of up-front planning were 62 per cent less likely to experience cost overruns than those with poor levels of up-front planning.[2]

The critical role of procurement

Procurement practices are among the highest-leverage opportunities for improving construction productivity and we believe the public sector can play a leading role.

One major opportunity is to replace the hostile contracting environment that characterises many construction projects with more collaborative models focussed on shared accountability and problem solving between all parties. Streamlined tendering processes based on best value and past performance are far superior to transactional models based on cost alone—indeed, initial 'costs' can be spurious, often being based on partial design and mispriced risk.

It is time to break the tendering mould and rebuild around alternative contracting models focussed on long-term collaborative relationships. ACA is not alone in this view. Recent reports from Infrastructure Australia and the McKinsey Global Institute, for example, have highlighted the need to fundamentally change the contracting paradigm.[3] The message is clear: sustainably meeting the built environment demands of the future will require that relational contracts become much more prevalent than transactional contracts.

In pursuit of real value

ACA understands the core principle of the CPRs is to achieve value for money. This is an entirely appropriate proposition which we do not contest. We also note the CPRs require that assessments of value consider both the 'financial and non-financial costs and benefits associated with procurement.'[4]

A core concern of industry is that procurement assessments often interpret 'value' through the narrow lens of initial cost estimates. A strict emphasis is often placed on the immediate financial costs of the tender without sufficiently considering the broader context of the project and its risks and uncertainties.

This is not unique to Commonwealth procurement; it is representative of a procurement paradigm that has pervaded the industry for decades. Yet there is increasing acceptance among many purchasers—private and public—that the paradigm needs to change. The simple calculus of 'lowest compliant tenderer' has incentivised a 'race to the bottom' mentality in the industry. This mentality is the direct cause of the dysfunctional and risk-laden contracting environment in which we now find ourselves.

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[2] Merrow, E, Industrial megaprojects: Concepts, strategies, and practices for success, Wiley, 2011

[3] Barbosa, F, Woetzel, J, Mischke, J, Ribeirinho, MJ, Sridhar, M, Parsons, M, Bertram, N and Brown, S, Reinventing construction: A route to higher productivity, McKinsey Global Institute, 2017; Infrastructure Australia, Australian Infrastructure Plan, 2021

[4] Department of Finance, Commonwealth Procurement Rules, Finance, Canberra, 2020, para. 3.2 and 4.4.

The first step is to realise that construction projects fundamentally differ from other types of procurement. The assets we create are not akin to standardised off-the-shelf products or even customised manufactured goods or IT services. Construction occurs not in factory-controlled conditions or in 'the cloud.' Every construction project occurs in a unique environment characterised by significant complexity and third-party dependencies.

This has significant ramifications for the way projects are priced and bid. Appropriately pricing a construction project requires properly quantifying and pricing the project's risk. In most cases this demands significant early investigations. Conventional competitive tendering processes, including those contemplated in the CPRs, do not allow contractors to undertake this work sufficient to setting a realistic price.

As a result, contractors effectively gamble on a risk outcome. The lowest price at the tender box is often the tender that simply placed the largest wager. If the realised risks in delivery are material enough, the contractor inevitably finds itself in a contest with the client.

The industry's notorious budget blow-outs and adversarial nature are the inevitable consequences of this dynamic. Indeed, as the Grattan Institute noted in a review of cost overruns in transport infrastructure[5], these consequences are often traceable to the speciousness of the initial cost estimates upon which contracts are awarded.

Another consequence of the current procurement paradigm is a lack of innovation. The lack of time and investment available for front-end engineering limits the opportunity to develop creative solutions collaboratively with clients, consultants and suppliers. This sort of collaborative approach—sometimes called an 'enterprise model'—is the only way to deliver the innovation needed to raise industry productivity.

While it may be tempting to lay the blame for this situation at the feet of the industry alone—and there is no doubt it shares some responsibility—it is clear the root cause of the problem lies in the way projects are procured and tendered. Moving forward will require a significant transformation in attitudes, culture, and contractual obligations among all participants in capital projects.

Better paths to value

Globally, the construction sector is increasingly adopting several alternative contracting strategies that promote higher levels of collaboration and risk sharing among involved parties. These 'enterprise' approaches to delivery bring together the entire construction network—asset owners, constructors, consultants and suppliers—to work in a more integrated and collaborative way.

This may include engaging a contractor and a design consultant upfront—in a model known as Early Contractor Involvement—to identify project risks and resolve third-party dependences. Other models select the preferred contractor at the start of the project, based on capability and skillset, to collaboratively develop the engineering solutions and price with the client. ACA is also of the view that Commonwealth procurement practices would benefit from more routine consideration of potential sole source and enterprise delivery models on projects with appropriate risk profiles.

[5] Terrill, M, Cost Overruns in Transport Infrastructure, Report No. 2016-13, Grattan Institute, 2016

These more collaborative models have been shown to deliver excellent value for money—without relying on competitively tendered fixed prices—by linking the contractor's fee to the client's project objectives. These models also deliver more holistic benefits to the community. Longer-term collaborative procurement models can be a key innovation enabler by underwriting investments, driving better supply chain collaboration and relationships, sharing learnings across projects and stakeholders, and more transparent performance measurement.

That said, there is no one 'silver bullet' model that suits all projects. Indeed, traditional price-focused models are still appropriate for many projects, particularly where risks and engineering solutions are well known. Yet the reality is construction projects are becoming more uncertain, as they are increasingly likely to involve major brownfield works with more 'below ground' risk and multi-stakeholder complexities.

The key point is that this environment demands a more agnostic and risk-based approach to procurement. What is needed is a culture of contracting whereby mature clients and contractors can have sophisticated conversations about project risk and outcomes.

As it stands, the CPRs institutionalise a degree of rigidity in contracting that leads many agencies to adopt a narrow range of approaches that are often ill-suited to the complexity and risk embedded in modern infrastructure projects. One live example of this is the inability to accommodate within contracts the unprecedented price escalation currently experienced throughout the industry—eg. through so-called 'rise and fall' provisions.

The most efficient procurement process for many construction projects would be some form of 'limited tender' as defined in the CPRs; however, the pre-conditions for this approach are perceived to be so narrow that this approach is rarely even considered. It would be unsurprising in this context if agencies were tempted to subvert the strict letter of the CPRs.

Despite these constraints, ACA considers the CPRs could be realigned to better empower Commonwealth agencies in creating a best practice contracting environment for major construction projects. Several examples are available from other jurisdictions to address these challenges, including the Major Roads Panel Victoria program or the Collaborative Project Agreement model employed by the Queensland Department of Transport and Main Roads.

The importance of agency capability

ACA observes that the capability and capacity of agencies to efficiently procure construction projects is highly variable. While some agencies (notably Defence's Security and Estate Group) enjoy mature institutionalised practices and relatively high levels of experience, others appear far less capable and disciplined in their procurement processes. This variability can be explained by significant differences in the need for different agencies and Departments to undertake major capital projects. These issues have been exacerbated by the recent and ongoing labour and skills shortage across the construction industry.

Variable procurement capabilities across Commonwealth Departments result in an inconsistent application of the CPRs and widely variable procurement processes and outcomes. There is very little harmonisation in forms of Contracts and commercial models

across projects, clients and jurisdictions. Understanding and implementing multiple bespoke contract forms creates an administrative burden that has become more onerous over time. The cumulative effect of this has been to introduce substantial duplication and waste into the delivery of built environment outcomes in Australia.

In some cases, a process that was considered appropriate for one procurement may be summarily ruled-out in another for no other reason than the experience or opinions of the procuring officers. For example, there are significant differences in procurements across agencies in the extent and method of use of the Australian Government's procurement information system, *Austender*.

Notwithstanding the intention of the CPRs to provide officials with flexibility in developing and implementing procurement processes, this arbitrariness introduces uncertainty and limits the scope for innovation. From a system-wide perspective, it works against the Commonwealth realising its desired outcomes in the most efficient manner possible.

Going forward, ACA considers the capability and capacity of agencies to undertake procurement will emerge as an even greater constraint on delivery. The Commonwealth has an ambitious forward capital portfolio and is operating in a very thin and hotly contested market for procurement talent.

In this context, we urge agencies to consider creative solutions to accessing high quality procurement services. Construction procurement, particularly for larger and more complex projects, is an increasingly sophisticated domain. Good end-to-end outcomes require the application of specialist expertise.

This need not imply direct recruitment of procurement specialists. We believe Commonwealth Departments and agencies could make better use of procurement consultancies to steer more efficient processes, while also establishing more effective and transparent knowledge-sharing arrangements between them.

Recommendations

Public procurers hold the levers to change the construction paradigm from one focussed on compliance and self-preservation by transferring risk and litigating to cover losses, to one driven to maximise ‘total-value’ built environment outcomes for the community. The CPRs provide an opportunity to institutionalise a more constructive, collaborative and risk-based procurement environment that can significantly enhance the value for money achieved on Commonwealth construction projects.

To this end, ACA recommends the establishment of a centralised Commonwealth construction procurement office with a mandate to develop, promulgate and assist in the use of a risk-based and agnostic procurement framework under the auspices of the CPRs.

The office would provide agencies with a dedicated source of expertise in best practice construction procurement. It could provide training and undertake a range of activities to drive efficiency and innovation in procurement practices across government, including maintaining a standard suite of contracts and ‘practice notes’ (based on lessons learned)

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covering different procurement models, as well as providing cross-departmental and -agency assistance with quality assurance functions.[6]

Further, ACA recommends the Commonwealth considers amending the CPRs to provide clearer and wider pathways for the use of limited tenders and exemptions inclusive of tailored procurement processes for different asset classes. Specific consideration should be given to accommodating procurement models that enable agencies to collaborate directly with a single contractor early in the procurement process. This could include, for example, wider use of single source procurement models, or multi-phased processes that select a preferred contractor much earlier in the procurement process than currently contemplated in the CPRs.

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[6] Noting the unique and specialist circumstances of Defence capital projects, we would not envisage this centralised procurement office taking on the work of the well-established Security and Estate Group.