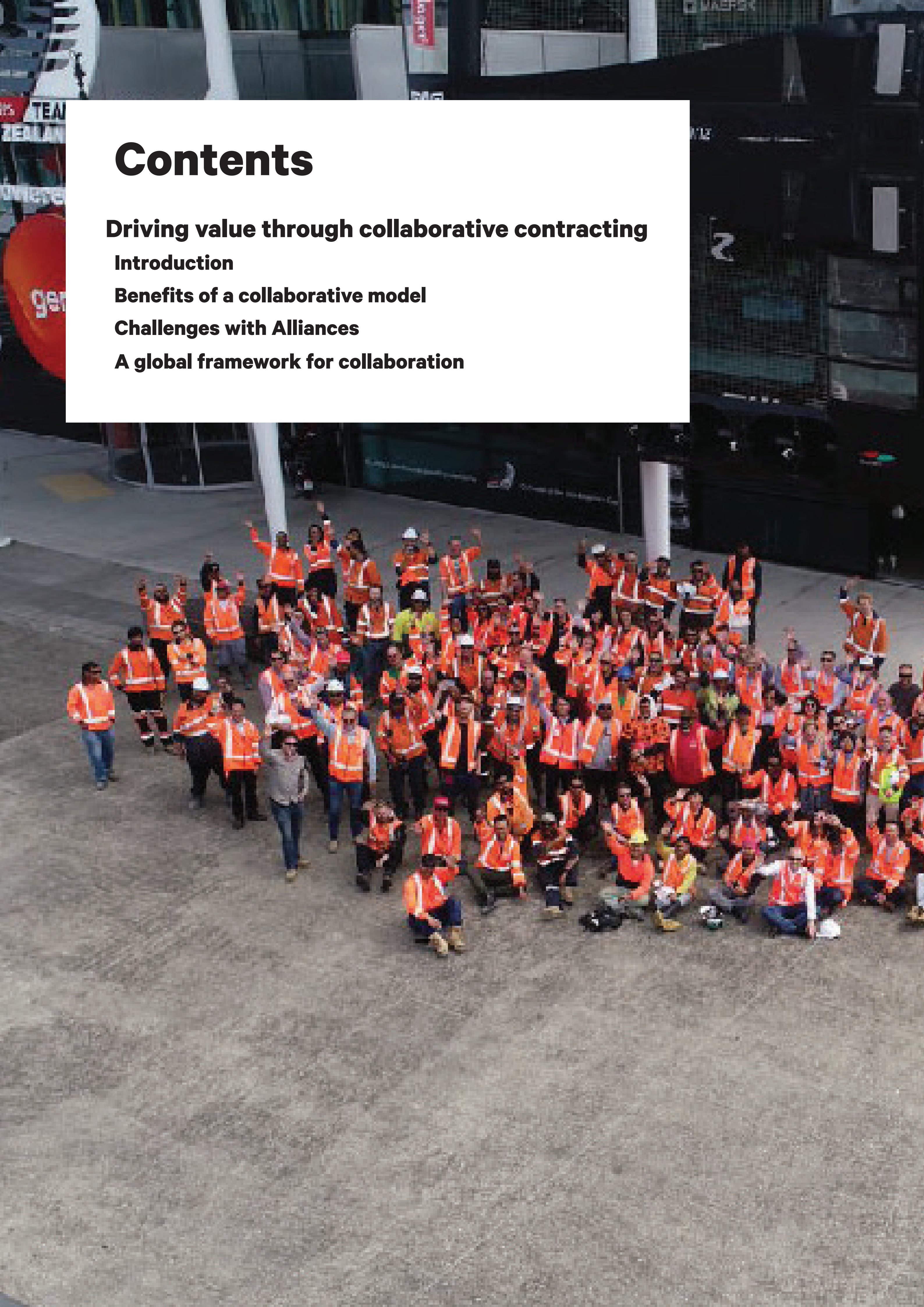
Downner
Mā te whanaungatanga ka angitū
Relationships creating success

Driving value for money through collaborative contracting

October 2022



Contents

Driving value through collaborative contracting

- Introduction
- Benefits of a collaborative model
- Challenges with Alliances
- A global framework for collaboration

Collaborative Contracting

Introduction

In an increasingly budget constrained and heated market, clients and contractors are frequently seeking innovative solutions to balance significant risk and nominal margins to secure and construct quality projects.

If you lead a large council organisation, manage procurement, or are just concerned with New Zealand's future infrastructure success, you may already be thinking: 'How can we achieve better price certainty and value with the challenges we face in 2022 and beyond?' You will likely be concerned with cost escalation challenges and risk allocation, and seeing the resource squeeze and economic uncertainty influencing decisions and future outcomes. This paper explores these issues and the answers we can find through collaboration and collaborative contracting to achieve the outcomes we all desire.

There is mounting evidence that procurement managers should consider alternatives to traditional adversarial contracting practices, particularly in the current environment. A current and topical challenge is escalation impacts on contract types where the philosophy that neither party should win or lose from escalation risk is considered as being the fair and right approach. Alliances allow valuable flexibility in a time of fiscal constraint, enabling both client and contractor to work collaboratively to agree how and who is best placed to manage risks.

The scale of projects coming to market is also increasing and resource availability will continue to be an issue for the next few years. In our experience, collaborative contracts attract the best people, while also boosting staff satisfaction and retention. Our collaborative contracts have a higher net promoter score (NPS) of any contract type (over 40 compared to +7 NPS for traditional contracts), which is linked to a higher client and employee satisfaction and productivity among other benefits).

Traditional, adversarial contracting practices limit the contractor's ability to respond to market challenges. On the other hand, collaborative working arrangements can help client and contractor teams manage uncertainty and risk and undertake larger and more complex tasks.

The purpose of this paper is to analyse and provide Downer New Zealand's perspective on key considerations for client and contractor teams to effectively manage the transition toward more collaborative approaches, with a focus on road maintenance alliances, but relevant to other collaborative contracts. We also outline a structured methodology for realising and sustaining long-term collaborative advantage across various contract models and business relationships.

Authors

Dave Nicholls
Whanganui Alliance Manager

Chris Edsall
Regional Director - Waikato

The traditional contracting approach

The construction industry has historically employed somewhat adversarial contracting practices with conflicting objectives and no genuine sharing of commercial risk and reward to incentivise collaborative working. This traditional client-contractor relationship can lead to inefficient delivery of projects, with opposing philosophies (win-lose mentality).

Simplistically and at the extreme end of traditional contracting approaches:

- The client's drivers are maximise the work done while minimising the amount of expenditure, with sometime limited regard for the future health of the industry.
- The contractor's drivers are to acheive the minimum required standard, in the least possible time, unless there is an opportunity to improve margin from either client or consultant directed changes.

Moving toward a world of collaborative contracting

In its most simple form, collaborative contracting is the transformation of confrontation into collaboration. Collaborative contracting attempts to optimise risk, price, and control (i.e. best value).

Different collaborative models include:

- **Alliancing** - specific Alliance contract model with cost and pain/gain share
- **NEC** – includes a key principle of working together in a spirit of mutual trust and cooperation, with an early warning mechanism to collaboratively mitigate emerging risks
- **Partnering** - relationship provisions as overlay to more traditional contracts (e.g. embedding ISO44001 principles in delivery)
- **Early Contractor Involvement (ECI)** – two or three stage contract with transition provisions (discussed in a separate paper **here**).

A key consideration is the application of the right delivery model (traditional and/or collaborative) depending on the level of complexity, risk value, etc, as illustrated in Fig 1 below[1]. In our experience, all contract models can be equally successful if you have the right people with the right attitudes and behaviours involved.

For Asset Improvement projects the NZ Transport Agency's delivery model selection is based on a number of factors. In Figure 1 these factors are shown graphically with the preferred delivery model.

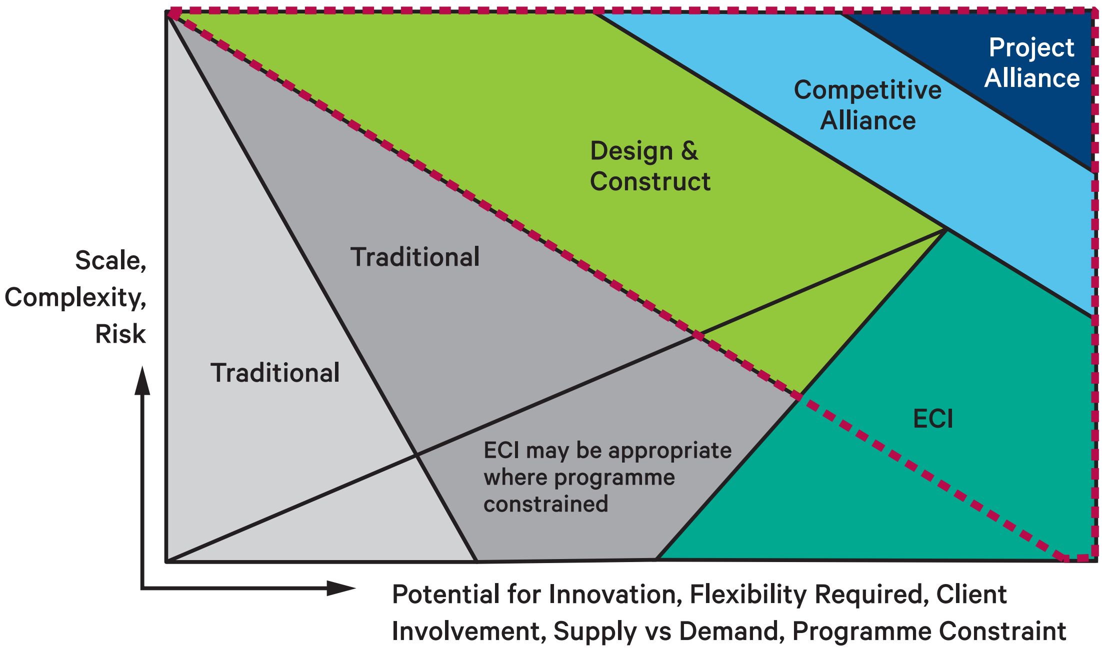


Figure 1: Delivery model selection graph – adapted from NZ Transport Agency

1 https://ir.canterbury.ac.nz/bitstream/handle/10092/100015/Peterson%2C%20Bradley_Master's%20Thesis.pdf?sequence=1&isAllowed=y

Alliancing

Alliances are a common form of collaborative contract that our clients are exploring with a greater level of interest. Alliancing is an alternative win-win approach to contracting that results in both parties benefitting from collaboration. An Alliance is typically founded on the following principles:

- All parties are working towards the same goals under a single delivery team model
- All participants win or lose, depending on the outcomes achieved
- The participants have a peer relationship, with encouragement to bring innovation to the table, and collectively agree on the best way to deliver the project efficiently and to the agreed scope and quality
- Accepted risks and responsibilities are shared and managed collectively, rather than allocated to individual participants
- Risks and rewards are shared equitably.

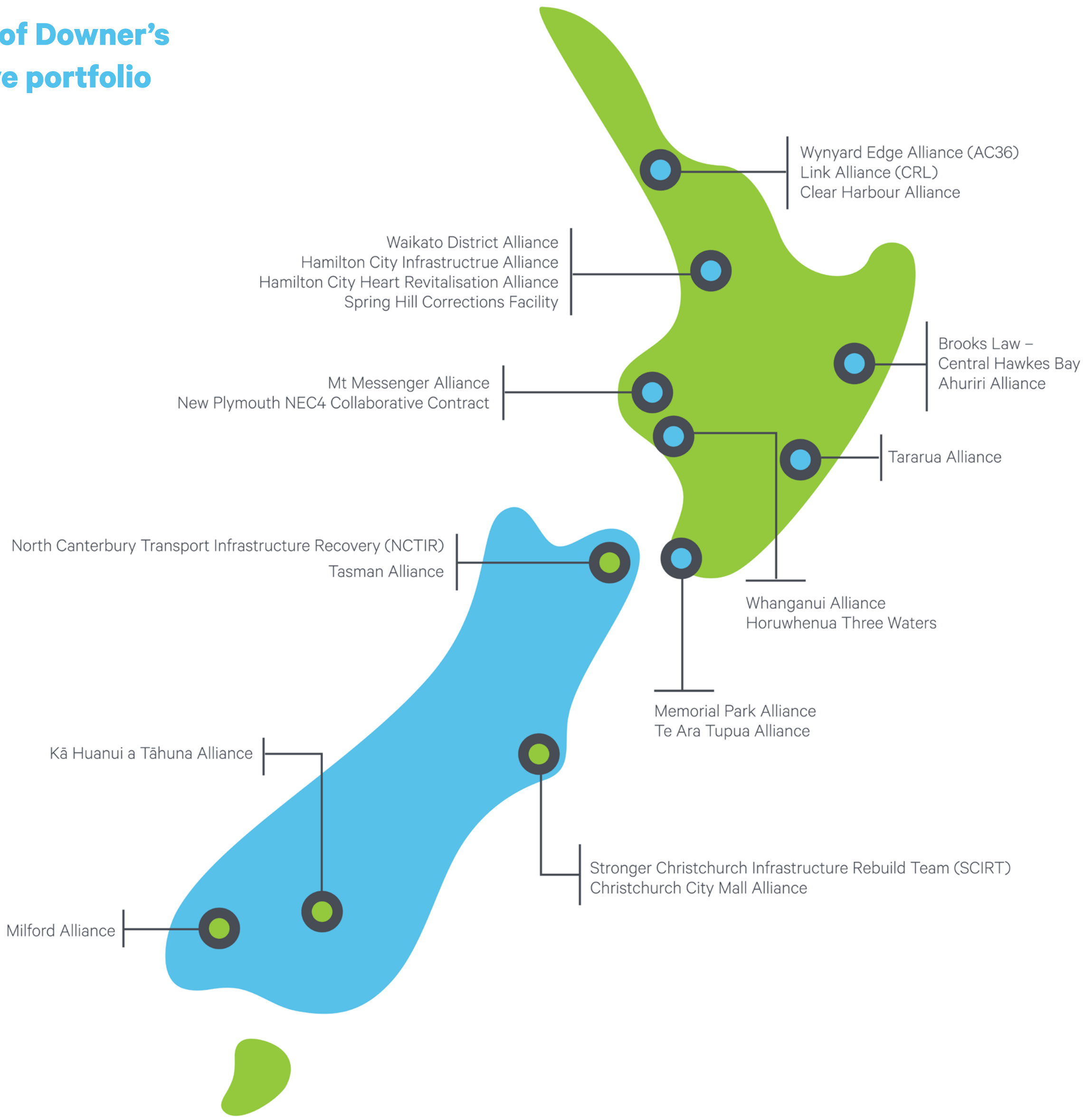
Target cost estimate vs. actual costs is the key mechanism the Alliance uses to measure improvements in efficiency, productivity, and cost savings (value). The Target Cost Estimate is the agreed quantum for the contract, compiled with a build up of agreed rates and volumes and a margin on top. Payments are based on the actual costs incurred

In the road maintenance space, new target cost rates are developed jointly on an annual basis using historical productivity values and applying current actual cost rates.

Downer's recent history of collaborative working

Downer has participated in over 30 collaborative working arrangements through the maintenance and construction sectors, including the first Alliance Maintenance Contract in New Zealand in Whanganui in 2008.

A selection of Downer's collaborative portfolio



Benefits of a collaborative model

Collaboration provides greater certainty and flexibility

Alliances can adapt easily to political, financial, design scope or customer needs, due to a direct connection to the actual costs incurred and the ability for the Alliance Board to simply agree changes in scope without lengthy contractual dispute. Our collaborative contracts provide sustainable budgets and secured revenue, which enable us to make confident investments in plant, technology, and our people.

Relationship quality

Alliances provide an environment to build high performing teams with shared objectives that encourage people to stay. Work opportunities for the team are not restricted by parent organisation, including significant opportunities for client secondment. The team works in a single location with no organisational boundaries.

Shared innovation and risk management

In an Alliance, innovation is a two-way process, unlike a traditional contract where the adversarial positions often lead to complex risk allocation reducing the ability for good ideas to be adopted quickly. The Alliance commercial model encourages open conversations around risk (no blame culture) and reward, which helps create an environment that enables greater innovation.

Under traditional contracts, risks are carried by each party and the contractor prices certain risk into their rates. Under the Alliance model, all accepted risk is shared between both parties, enabling significant savings to be invested back into the network. Projects can also move forward within allocated timeframes without risk discussions delaying procurement.

Efficiencies (eliminating duplication)

Under a single management structure you can achieve greater efficiencies, with all reporting and activities consolidated and enhanced. There are no "checkers checking the checkers". The team concentrates on solutions for the community and network stewardship rather than contractual issues and administration.

Transparency of costs – challenging actual costs

In an open book environment, where actual costs forms the basis for payment, Alliance partners are able to see the real cost of activities and can make best for project decisions (e.g. allocate work to the partner who is best placed to deliver the work or, on road maintenance contracts, grouping repairs to achieve cost savings). Profit and offsite overheads (margin) is negotiated, agreed, and ring fenced, which allows the team to focus on actual component costs. This open book approach gives greater budget certainty and allows the team to focus on improving productivities, efficiencies, and supply chain initiatives rather than being encumbered by contractual disputes and margin protection through risk transfer.

The cost recoverable and shared risk model means that it is not a "race to the bottom". However that does not mean that Alliances do not have any cost tension applied. In setting the Target Cost Estimate (TCE), an Independent Estimator is usually assigned to undertake a parallel price estimate to ensure that the agreed TCE is representative of the cost of the project and is fair.

On Whanganui Alliance, over the life of the contract we have been able to realise $7.2M in savings, which have been invested back into the network.

Our road maintenance alliances set new TCEs annually, against which our performance is measured. We benchmark costs against other contracts and rates tendered on the open market. This model enables sustainable pricing and a fair and reasonable market tested margin.

On Whanganui Alliance, there are no longer any NTCs and NTEs. All decisions are made collectively by the team, focusing on best for network decisions rather than contractual issues. In the initial two years, we were able to reduce the amount of FTEs from both organisations by six. **This equated to approximately $1.2M in savings we could invest back into the network.**


Downer
CAT

Challenges with Alliances

Alliances also involve challenges that have to be resolved efficiently to ensure longevity and success of a contract.

Understanding of alliance principles

A challenge is a lack of understanding of alliancing principles. People are generally suspicious of cost recoverable contracts where they think that it is all just cost plus and there are very few controls in place. This is certainly not the case and there is a comprehensive performance framework that sits behind the scenes ensuring that the deliverables are achieved.

Understanding of risk at different levels of the customer organisation

In general, all participants win or lose, depending on the outcomes achieved. However, higher levels tend to focus more on reputational risks and operational levels on the triangle of time, cost, and quality – so depending on which risks are valued more, there can be disproportionate winners/losers.

Complacency – collaborative inertia

Key to any collaborative contract is not becoming complacent or defensive when the model or the relationship is challenged. It is easy to forget the improvements that have been made, so it is important to benchmark at the start of the contract and then measure the change in value or improvement over time.

It can also be easy to fall into the trap of ignoring the health of the relationship as you get more comfortable with one another. Having a mechanism that formally encourages you or forces you to re-examine the vision, values, outcomes to meet the changing needs of customers and participants is critical.

Every area of a collaborative contract needs constant tensioning. Treating this type of model with a "sinking lid" approach regarding cost inputs and continuing to ratchet up the performance framework as improvement becomes BAU is really important. It requires constant pressure, enthusiasm, and the right mind-set to operate in this type of environment.

Protecting business in future

Loss of IP and staff to external organisations is a concern to some clients and a barrier to transitioning to more collaborative, open book contracts.

A global framework for collaboration

About ISO44001: Collaborative Business Relationship Management Standard

To address some of these issues and create additional value within our collaborative contract portfolio, Downer embarked on a journey to become ISO44001 certified in 2007.

Whanganui Alliance was the first contract to implement the CBRMS and a key contract that enabled Downer to achieve certification at the end of 2019 - the first business in New Zealand to do so and the only infrastructure business in Australasia to gain certification based on its collaborative contract portfolio.

Downer has held the Whanganui maintenance contract since 1988. Initial contracts were managed traditionally until 2008 when the first Alliance Maintenace contract was let in New Zealand. Downer successfully retained the contract at tender in 2018 which sees the contract term extended to 2028.

> **"As one of the first Local Authorities to consider and enter into an Alliance Maintenance Contract, the Whanganui District Council (WDC) was always open to partnering for success. Formalising and aligning our partnership to an international standard like ISO 44001, seemed like the logical next step."**
>
> *Mark Hughes, WDC*

A key aspect of any collaborative contract is not becoming complacent. Due to the nature of the model, we made significant gains in the early years of the contract, but over time it became more difficult. As a result, we needed to find new and innovative ways of demonstrating value for money. People are at the heart of all relationships and when people change in organisations for various reasons, it takes significant effort and cost to on board new members and explain the intricacies of the contract and mechanisms for measuring and demonstrating value.

Benefits

The CBRMS framework was identified as an opportunity to add value to the long-term contract and sustain the relationship as the business environment, people, political, and context changes, while addressing issues such as protection of IP.

77% of the active ISO44001 clauses are about risks and challenges (collaborative inertia and collaborative advantage). It provides a mechanism that formally encourages you or makes you re-examine the vision, values, behaviours and outcomes to meet the changing needs of the customers and participants. Using the CBRMS has meant we now have a robust process and framework to measure our relationship. We have a good understanding of each other's businesses and what is important to both.

Other benefits include:

- A **structured approach** to sustaining collaboration throughout a contract and mitigating collaborative inertia (joint development and maintenance of a Relationship Management Plan and issue resolution process)
- Third party verification of collaboration managed through a **self-assurance regime** with practical tools to assess collaborative maturity / capability, health of relationship / behaviours, and improvement areas
- A **clear remit** / commitment from senior executives to prioritise the health of the relationship
- Creates a **neutral platform** from which to work and **clearly defines roles and responsibilities** to improve decision-making processes
- Supports training and interchangeability of staff (succession planning) and successful transitions (Exit Strategy)
- Provides a framework for continually monitoring collaboration over the whole life of the relationship and not leaving collaboration to chance.

Challenges to implementation of ISO44001

It takes effort to educate and align people on the standard. Although ISO44001 is one of the most flexible standards, there are misconceptions around it creating unnecessary documentation (and added cost for limited value). Education, awareness, and genuine buy-in from all parties is key.

It is also important to tailor the processes to the organisation. It is difficult to show a financial benefit for cost avoidance (e.g. avoiding litigation and/or adopting the small good ideas that evolved because of the inclusive and non-adversarial environment created).

ISO44001 is underpinned by 12 international principles for collaborative working:

1. Aligned vision and values
2. Collaboration and business objectives
3. Supporting governance and processes
4. Collaborative competence and behaviour
5. Value creation approach
6. Information and knowledge sharing –rules for communications and stakeholders
7. Exit strategy
8. Relationship management system
9. Collaborative leadership
10. Trust and commitment to mutual benefit
11. Relationship measurement and optimisation
12. Risk management –interdependency and relationship risk.

These principles can be overlaid to traditional contracts to help with the transition to a more collaborative way of working.

To find out more, please get in touch with Chris Edsall and Dave Nicholls.

Downer

Mā te whanaungatanga ka angitū
Relationships creating success