



ARTICLE FOR "NZ CONTRACTOR" MAGAZINE

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The Cost of Cheap

We heard at the recent Roothing New Zealand Conference in September how to improve the productivity of the sector, particularly the delivery of roading work. There were examples from Europe and Japan, maintenance and construction, local roads and highways.

One of the presenters, Peter Cunningham from Constructing Excellence, reported on the "Cost of Cheap" and how it often works against improved productivity. He presented clear evidence to show that as a sector we should avoid procuring construction and other work on the cheap if we want improved productivity and value for money.

So what is the "Cost of Cheap" and what is it typified by?

Peter Cunningham set out the following 5 characteristics of the "Cost of Cheap"

- Tenders awarded on the basis of lowest price
- Business process based on lowest cost
- User/customer needs often neglected
- No real promotion of innovation
- Sub optimal process and results

He states that the main driver of the "Cost of Cheap" is the traditional linear model of procurement. This model starts with project brief, moves into the design phase and is then followed by the appointment of a main contractor to carry out the work who engages subcontractors and suppliers. Once the work is complete the asset management or maintenance phase begins.

Peter claims that often the final design is often different from the design that would arise from the project brief and what is actually build is often different to the original brief and final design. These changes lead to contract variations, delays, disputes, cost blow outs and a loss of productivity.

There are a number of ways to overcome these problems. The most obvious way is to focus on selecting contractors based on their value and not the lowest price. This approach cannot only be used for collaborative procurement it can also be used for traditional contracts. It is the most basic way of avoiding the "Cost of Cheap" and it avoids unsustainable tender prices.

The other suggested ways do not work for the linear traditional model. They require a collaborative approach which includes

- Early contractor involvement

- Common processes and tools across the supply chain from the Principal to Supplier
- Continuous improvement through measurement of performance and long term relationships
- Modern commercial arrangements

Collaborative contracts turn procurement processes upside down. Unlike a traditional contract, collaborative contracts keep the pressure on all the parties to add value to the client during the contract itself. The shared pain/gain environment applied to all parties in a collaborative model creates a continuous improvement process which incentivizes adding value for the client through the entire duration of the contract.

Under a traditional model adding value for the client usually stops at the tender box.

Over the last nine years it's been great to see New Zealand embrace a transition from traditional contracts to collaborative ones and the number of Alliances and Early Contractor Involvement (ECI) contracts while small has increased. It is concerning to see that as the recession bites there is a trend back to awarding contracts on lowest price on many traditional contracts. If this trend continues it will set the industry back a number of years as occurred in the 1990s.

Let's not make the same mistake twice.