

Ai GROUP SUBMISSION

**House of Representatives Standing Committee on
Infrastructure, Transport and Cities**

**Inquiry into Procurement Practices for
Government Funded Infrastructure**

16 July 2021



HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON INFRASTRUCTURE, TRANSPORT AND CITIES

INQUIRY INTO PROCUREMENT PRACTICES FOR GOVERNMENT-FUNDED INFRASTRUCTURE

SUBMISSION BY AI GROUP

OVERVIEW

General Comments

The Ai Group and its Construction Supply Chain Council (CSCC) appreciate the opportunity to make a submission to this very important inquiry being conducted by the Committee.

At the outset, we wish to reiterate our support of the content and positions advanced in the recent letter to the Committee that was endorsed by peak industry associations, including the Ai Group. The letter and support by the associations demonstrate the industry's collective preparedness to work with government and private sector clients and stakeholders to achieve lasting reform in a range of areas.

The industry's support for change is based on both the need for industry participants to operate sustainably with businesses across the value chain being able to survive and prosper, but is predicated on the basis that a successful and sustainable industry adds significant value to communities and the country's economic position as a whole.

Clearly, there have been many independent reports and parliamentary and other inquiries (including Productivity Commission inquiries) into the building, construction and infrastructure industry over the last decade and more. An examination of the reports of those inquiries and reviews tends to identify the same regularly raised common themes and areas for improvement.

Unfortunately, while various governments and the industry have made significant attempts from time to time to change the way the industry and its stakeholders operate, fundamental, harmonised reform has not been achieved across the country although it is fair to say that a number of improvements have been achieved in various jurisdictions at various times.

So, the question may be put as to why the current inquiry has the potential to achieve a different outcome to what has gone before and whether there is a will on the part of governments and industry to implement improvements to ensure that important community infrastructure funds are spent wisely and projects are completed on time and within budget.

The industry's letter to the Committee should be seen as industry letting the Committee know that now is the time to make some long-lasting improvements to the way the industry and its stakeholders function, especially in those areas the subject of the Committee's terms of reference, and the industry is ready and able to commit to change in a coordinated way.

Why Is Change Important Now

Ai Group and its CSCC submit that fundamental changes in the way building, construction and infrastructure projects are developed and delivered across the world has significantly changed

over recent years and Australia now needs to change if it wishes to be part of the world as it will look post the current COVID-19 pandemic.

While it may be said that the pandemic is changing the way people and countries will operate in the future, reform of the construction sector has been underway overseas for some time. Nevertheless, the pandemic is adding to the need for governments and industries to re-think how they will operate and what they will look like in the next decade and beyond.

For Australia, the pandemic has shown up various threats and weaknesses in our construction industry and its supply chain, just as it has identified threats and weaknesses for other industry sectors. The pandemic has also confirmed what many in the industry and its supply chain already knew, and that is Australia's construction industry cannot continue to function efficiently on the basis that it operates on an island nation basis closed from what is happening in the rest of the world and with its local industries constrained from growing outside the country's borders.

By way of example, there are components of Australia's construction supply chain that are held back by government and industry red and green tape that does not have a parallel in external jurisdictions.

Likewise, Australia has not yet fully embraced the need to achieve consistency with overseas standards for construction products and systems, including standard form construction contracts, and has too many standards requirements that work to prevent the development of manufacturing opportunities here, or which potentially result in products acceptable in ninety nine percent of a world market but not acceptable in a country that often represents less than one percent of a world market.

While the terms of reference of the Committee, being focused on Federal Government funded infrastructure somewhat constrain what could be a wider ranging review of the industry, constrain the Committee's deliberations this submission will highlight some of the ways that a federal Government could achieve change and improvement in a number of areas.

What Drives the Industry in Australia?

The construction industry is a significant driver of economic activity in Australia. It produces the buildings and infrastructure that are essential to the operation of all other industries, adds to the wealth and capital stock of the nation and underpins the productivity improvements that are necessary to support our future prosperity and incomes.

Demand for construction activity is driven by economic factors including population growth, income growth, industry activity, technology changes, commodity cycles, consumer sentiment, interest rates and inflation. Government policies affecting residential building, pricing and infrastructure development (including taxation, land allocation, industrial and planning policies) are key influences.

The availability, price and location of resources, including skilled labour, building materials and building equipment are other key determinants of the pace of growth in the industry. The supply chain for construction is complex and strongly interrelated, encompassing manufacturing (materials, equipment components), services (engineering, design, surveying, consulting, lease management) and traditional construction trades.

The industry (especially infrastructure) has for many years been characterised by a boom or bust cycle with its stakeholders (including government clients) often operating on an adversarial basis each trying to avoid or shift project, legal and financial risk to whoever is

prepared to take it and so the issue often lands with those entities in the industry's supply chain who are least capable of dealing with problems if they emerge. This situation results in poor relationships within projects and is a key factor behind those projects that are completed over time and over budget.

Nevertheless, it is noted that in more recent times there have been some significant efforts, especially by the NSW and Victorian Governments and the Australian Constructors Association through the Construction Industry Leadership Forum, to address some of the more significant structural problems in project development and delivery. However, there is much more still to be achieved.

The Federal Government, being a major funder of infrastructure projects, has the unique opportunity to work with the industry and each jurisdiction to improve relationships and address a significant number of constraints that currently add cost or delay to projects and constrain the industry's development.

Ai Group Construction Supply Chain Council (CSCC)

Ai Group's Construction Supply Chain Council (CSCC) which comprises businesses from a broad cross-section of the industry's supply chain, was established to ensure that the industry's supply chain can achieve a greater voice in the way the industry operates.

The CSCC has identified three key areas where improvements could be made to achieve potentially significant increases in productivity and project outcomes for the benefit of the community and the industry alike. These are:

- Procurement Rules
- Capability and Capacity
- Sustainability

Key areas identified for improvement in procurement rules are as follows:

- Early supply chain involvement in projects
- Red and green tape (client and contractor generated)
- Compliance with procurement rules including input costs and duplication
- Local content rules
- Non-conforming products
- Ability for supply chain to develop alliances
- Clarity of regulatory systems and requirements to avoid confusion
- Input costs including cost of tendering
- Fair and reasonable risk allocation
- Break-up of projects into manageable work packages

Key areas identified for improvement in Capability and Capacity are as follows:

- Skills development aimed at increasing productivity
- Funding for sustainable job creation

Key areas identified for improvement in Sustainability are:

- Use of recycled materials and management of waste
- Innovation and new technologies
- Decarbonisation
- Enhancement of the involvement of the digital economy in construction

RESPONSE TO TERMS OF REFERENCE

a. Existing infrastructure pipelines and related supply requirements

Historically, industry has had to rely on what individual Australian jurisdictions published as their pipelines of infrastructure work without industry being able to be guaranteed the timing of projects coming to market. This had significant effects on forward planning by head contractors as well as the industry's supply chain.

While governments now regularly produce infrastructure plans and/or pipelines of projects that may span 20 or 30 year horizons, and this is a very positive approach, in practice infrastructure projects contained in pipeline proposals are often unfunded and are still subject to the electoral cycles of each jurisdiction.

There have been examples in recent times where electoral changes in state governments have resulted in announced projects not commencing, with some projects already underway being terminated. This situation has a deleterious effect on the industry and results in businesses losing confidence resulting in a lowering of investment in workforces and in embracing new technologies and systems.

Conversely, the industry and, in particular its supply chain, must make business decisions based on horizons that are much longer than the forward estimates of any government, and that is a potentially significant reason why productivity, investment in capability and capacity and in new technologies has been constrained for many years.

It may also be speculated that this situation has contributed to contractors and the supply chain:

- Looking to overseas markets for materials, products and skilled resources.
- Struggling to produce or make available the range and quantity of materials, products or workers required.
- Not investing in the expansion or upskilling of workforces.
- Not investing in business growth.

So, in conclusion any unreliability in the pipelines of infrastructure projects has an adverse effect on the profitability and sustainability of infrastructure contractors and their supply chains, or is one reason likely to result in the cost of construction in Australia being higher than it could be.

The Federal Government could assist in addressing the above difficulties by ensuring that its arrangements with state and territory jurisdictions results in federally funded projects being guaranteed to proceed.

The Federal Government could also address the issue through a different approach to skills and workforce development that could see a coordinated approach to areas like project management (both within and outside government) and greater focus on key skill areas for development that will be especially important if immigration is further constrained by ongoing COVID or policy issues.

The Federal Government could also address the issue through the operation of procurement rules which is addressed under the following paragraph of the terms of reference.

b. Challenges and opportunities with existing procurement practices, including frameworks, standards, rules and norms, and intersections between tiers of government and the private sector

Industry would welcome a wide-ranging review of procurement practices of governments because it is these practices that underpin the inability of the industry to achieve productivity gains, implement new technologies and to properly manage risk in relation to projects.

In practical terms, each jurisdiction in Australia operates pursuant to its own established procurement rules (including risk management, commercial and contract terms) even though attempts have been made to standardise where possible.

As previously indicated, the Ai Group CSCC has identified a range of areas that directly relate to the industry's supply chain. There are many other areas where improvement may be achieved, and we understand that other peak industry associations will raise these as they impact on the businesses that they represent. We would be pleased to elaborate on the areas identified by the Ai Group CSCC in the context of supply chains if that would assist the Committee.

From an industry perspective, there is scope for the Federal Government to drive reform through requiring a standardised approach to every publicly funded federal infrastructure project. There should also be a mandated commitment to industry and the community to proceed with each project in the forward pipeline.

The standardised approach was implemented in the UK some years ago through the operation of the Infrastructure and Projects Authority (IPA) and its predecessors and we invite the Committee to review the approaches taken.

Some examples of the activities of the IPA include standardisation of how projects are brought to market, are managed and how the relevant commercial terms are applied. Over the last 2 years the IPA has released fact sheets and guides relating to project development including a project development routemap for infrastructure projects.

The UK Project Development Routemap is a structured and tested methodology used to set up projects for success. It ensures best practice and learning about the most common causes of project failure and when they are likely to arise.

The preface to the handbook correctly identifies that Routemap principles are core to any infrastructure project, and especially helpful where project teams undertake complex projects that test the limits of their organisational capability. It is a structured approach that brings stakeholders together, to improve project-specific capabilities, enable governments and supply chains to maximise value for money and, where appropriate, increase opportunities for international investment. It gives confidence to people developing projects, those approving them, and those investing in them.

The UK Government also recognised that it needed to upskill its agency personnel in complex project management and commenced this through an alliance with Oxford University Said Business School in the development of a Major Projects Leadership Academy for government project managers.

We note that the Victorian Government has acted to establish a similar academy in Victoria that is also providing opportunities for NSW government agencies, but it would be preferable to establish a learning institution that provided learning opportunities for federal, state and local government project managers as well as joining private sector project managers in that process.

We also submit that there should be greater emphasis on the identification of what works for projects and how problems have been overcome. This could be achieved through publication of a case study immediately following completion of every federally funded project so that government, industry and the community are able to see a clear picture of how problems arose and how they were overcome.

An example of the case study approach was released by the UK Government on 14 June this year. The Report “Project Initiation: Lessons Learned Report” provides important commentary relating to 5 Defence Force projects.

The report highlights five key areas in which building trust is key to successful project initiation. These are:

- Leading with confidence
- Seeing the big picture
- Delivering through people
- Planning flexibly
- Making good investment decisions

To progress the opportunities, we have briefly outlined above will need commitment from both government and industry. We suggest that a model that already works in the UK is that which is managed by the Institute of Civil Engineers called the Construction Leadership Council.

In Australia we envisage that a similar approach could be taken through the Federal Government co-chairing with Infrastructure Australia and incorporating representatives from similar entities in each Australian jurisdiction and senior representatives from the private sector.

c. Challenges and opportunities to enhance australia’s sovereign industry capability, including for australian owned businesses

Businesses operating in Australia face many complex issues and challenges to maintain their sustainability.

In relation to infrastructure projects, there are already adequate major local and international head contractors operating in the marketplace.

However, it is evident that projects are becoming increasingly large in terms of funding and risk which is potentially having the effect of these contractors questioning project risk profiles and re-assessing their commitment to bid for specific projects.

There are significant grounds for reducing risk and improving project delivery by permitting large projects to be divided amongst a range of contractors each being responsible for specific aspects of a project.

This approach would have the benefit of assisting smaller/mid-tier contractors to develop their capability and capacity and thus ensure that there will always be sufficient local businesses available to bid for projects or be part of project alliances. However, it may be necessary for this approach to be achieved by mandating its applicability through procurement rule processes that would also address contractual and risk issues.

We have already outlined opportunities for improvement in the context of the industry’s supply chain.

In relation to this paragraph of the terms of reference we submit that there is further scope for improvement in the following areas that would collectively ensure that local businesses are more competitive but without adversely impacting Australia's free trade obligations.

- Increases in the number of free trade agreements to open up markets
- Greater reliability of throughput at Australia's seaports and airports
- Greater acceptability of recognised international standards ie if a product or system is acceptable under an international standard operating in similar countries in similar circumstances, Australia should accept that standard unless it can be demonstrated that adjustments are essential.
- Implementation of product assurance frameworks to address the influx of non-conforming products.
- Reduction in the cost of doing business through excessive administrative requirements caused by government procurement rules.
- Consistency in procurement rules across jurisdictions.
- Reduction in operational impediments to local industry investment in new technologies and systems

d. Lessons from other Australian jurisdictions and other portfolio areas, including defence's industry capability approaches

Ai Group has previously established the Defence Industry Council.

An important aspect of the Council's operations is the fact that government and industry work together in an open relationship intended to ensure that best practice outcomes are achieved.

We submit that this approach could also be applied to the involvement of the Federal Government in relation to the infrastructure projects that it funds and this approach is contemplated in the proposal that we advanced regarding the role of Infrastructure Australia referred to above.

We also wish to draw the Committee's attention to a concept known as Project 13 that has been implemented at Sydney Water. Further discussion of Project 13 is contained in our response to paragraph f. of the terms of reference.

e. How Australia can balance its international obligations with maximising local content opportunities, including by leveraging foreign direct investment

Our response to this paragraph of the terms of reference is essentially contained in responses to other paragraphs above.

f. Alternative procurement models, including reference to international examples

In Australia we have used or accessed most if not all the generally accepted procurement models for projects from most international jurisdictions.

However, unfortunately Australian governments and industry have not always adhered to the principles of those models and have also been somewhat reluctant to adopt new, innovative models that may be perceived as requiring the release of tightly held risk responsibilities.

In the UK we have seen the development and implementation of what has been called Project 13.

Project 13 was developed through the UK Institute of Civil Engineers, the construction industry and the UK Government and it represents a paradigm shift in the way that projects are developed and implemented.

The background to the development of Project 13 may be summarised as follows:

- Infrastructure projects the world over are notorious for completing late and over budget. Infrastructure developers have historically believed that true value is best derived from an open tender process that transfers as much risk as possible to the contractor whilst locking in a fixed price for delivery.
- Contractors seek to mitigate this risk by dividing the work into numerous trade packages and passing risk to the Subcontractors.
- All parties to these numerous commercial relationships are only incentivised to maximise value to their shareholders rather than to the infrastructure developer. Consequently, when project issues arise, focus turns first to protecting commercial positions rather than to finding best for project solutions.
- No organisation benefits from such an approach. Owners / Developers do not get value for their money and Contractors do not make enough of a predictable return to invest in the training and new technology necessary to improve the industry's productivity performance.

Project 13 seeks to establish a new approach to infrastructure delivery based upon a delivery enterprise rather than traditional transactional arrangements. The enterprise comprises:

- Owner – The organisation that owns and operates the infrastructure
- Integrator – The organisation that plans and delivers the infrastructure project or programme
- Advisor – An organisation that provides advice and professional services to the Owner or the Integrator
- Supplier – An organisation that supplies materials, services, construction or labour to enable the delivery of the project or programme
- Investor – The organisation that reviews the infrastructure project or programme for viability and secures funding (this could be a Government treasury department)

The main changes in this structure when compared to traditional structures are:

- The owner is central and leads the enterprise, defining long term value
- Suppliers and advisors have direct relationships with the owner
- An integrator actively engages and integrates all tiers of the market
- The key suppliers, owner, advisor and integrator work as one team to optimise value

In terms of the model itself, the main differences between such an enterprise model and a traditional transactional model are:

- The enterprise is rewarded based on increase in value provided rather than on services provided.
- There is a greater understanding of cost drivers and risk across all organisations in the enterprise with commercial incentives for collaboration to jointly mitigate risk, not transfer it.

One of the biggest differences between the Project 13 Enterprise Delivery Model and the traditional Transactional Model is the way it deals with project risk. The architects of Project 13 realised that ultimately most risk defaults to the owner and investor irrespective of whether they try to transfer it to other parties.

The model therefore incentivises other parties to mitigate these risks through the allocation of 'programme shares'.

The process for deciding how to allocate programme shares is as follows:

1. An understanding is gained of the value and risk profile of the project or programme of works.
2. Consideration is given as to who is best placed to maximise value and mitigate the risks
3. Risk shares are issued based on a function of (1) and (2) above
4. A forecast value profile is developed based on when benefits are realised, and shares will be paid out.

The Project 13 concept presents an opportunity for the Federal Government to implement the step change that the industry requires, and which will add significant community value to projects in addition to enabling the development of local businesses through supply chain involvement.

g. Other relevant matters

The Ai Group CSCC supports the actions of the NSW/VIC governments and the Australian Constructors Association established Construction Industry Culture Taskforce activities aimed at improving the culture of the industry and through that approach establishing a platform of change in the way the industry operates with respect to its workforce as a whole.

We see industry culture as a critical component of any step change/ paradigm shift in the way projects are developed and delivered.

The cultural changes could easily be incorporated into procurement rules for federally funded projects.

RECOMMENDATIONS

We make the following recommendations for consideration by the Committee:

1. The Federal Government should utilise its involvement in and funding of infrastructure projects to work with local, state and territory governments and the industry to implement a new approach to the development and delivery of infrastructure projects.
2. The arrangements in recommendation 1 should ensure that all federally funded projects are guaranteed to proceed in accordance with agreed priorities and timetables.
3. Procurement rules should be utilised to achieve a standardised approach to projects across all Australian jurisdictions and ensure that the industry's supply chain is supported through any procurement processes.
4. To assist in implementing recommendations 1 to 3, the Federal Government should establish a high-level group of government and industry representatives to develop the revised procurement rules and processes. The group could be led by Infrastructure Australia and be modelled on the UK Construction Leadership Council.
5. The Federal Government should, in conjunction with the Victorian and NSW governments, expand the existing Major Projects Leadership Academy to enable project managers and leaders from across the country (local, state and federal) to attend and the Academy should be open to private sector managers.

6. Action should be taken to identify the key skill shortages in those occupations that are central to infrastructure projects and those shortages should be the focus of joint industry and government action to address the identified shortages.
7. Action should be taken to break up projects into smaller packages to enable greater spread of work and support for smaller head contractors to build local capacity and capability.
8. The following areas should be examined for opportunities to improve Australia's sovereign capability:
 - Increases in the number of free trade agreements to open up markets
 - Greater reliability of throughput at Australia's seaports and airports
 - Greater acceptability of recognised international standards i.e., if a product or system is acceptable under an international standard operating in similar countries in similar circumstances, Australia should accept that standard unless it can be demonstrated that adjustments are essential.
 - Implementation of product assurance frameworks to address the influx of non-conforming products.
 - Reduction in the cost of doing business through excessive administrative requirements caused by government procurement rules.
 - Consistency in procurement rules across jurisdictions.
 - Reduction in operational impediments to local industry investment in new technologies and systems.
9. The Federal Government should support the UK Project 13 procurement model being implemented in all federally funded infrastructure projects.
10. Action should be taken to assist the industry to change its culture and, in this respect, the work of the Construction Industry Culture Taskforce could be used as a vehicle for progressing cultural change.

CONTACT

The Ai Group and its Construction Supply Chain Council welcomes the opportunity to discuss the matters contained in our submission and to provide further information to the Committee if that will assist its deliberations.