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Submission to the Senate

Parliament of Australia

Inquiry into

The scale and incidence of insolvency in the Australian construction industry

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Submission by;

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Senate Inquiry into - Australian Construction Industry Insolvency

Dear Senators,

I respectfully seek your consideration of this submission. It is intended to point the Committee's attention to the future rather than the past. All previous inquiries into the construction industry have focused on the here and now or trailing indicators. Issues have included productivity, building codes, compliance, builder licencing, warranty insurance, industrial relations and as set out in your terms of reference: the scale and incidence of insolvency. In most instances these issues have been left to state jurisdictions with Commonwealth intervention seen as a last resort.

This situation was reinforced in the Government's announcement following the December 2013 COAG[1] meeting of the state and territories. At that time a number of national construction industry related matters were disbanded and returned to the states to attend to.
This should be reconsidered. The reasoning is set out below.

The construction industry is undergoing rapid change. Construction is now a global business forecast to reach US$25 trillion by 2025. It is estimated that 60 percent of that activity will occur around the Asia Pacific Rim and India. By that time Australian and New Zealand construction turnover combined will be in the order of US$300 billion. While economic data is thin and ABS classifications somewhat out of sync when trying to describe the industry as a whole it is likely that 30% of Australia's construction inputs are now sourced off shore. Trends indicate that this penetration may exceed 40% by 2025. This will have a major impact on Australian construction businesses and jobs. These businesses, their workforces and those downstream are not being prepared for such an event.
The current contributors to insolvency will be outweighed by these events.

Australian construction as it stands in 2015 is unquestionably costing it customers at least 20% more than it should. Its delivery times are at least 40% slower than can be justified and on-site workforce inputs are at least 30% more than is sustainable. Its quality performances are mixed. Similar metrics can be applied to waste at all levels. A continued drift to off-shore sourcing will directly affect the number of people employed by Australia's 207,000 construction related enterprises. I estimate that in excess of 150,000 of Australia's 1,000,000 construction workforce could be affected, without taking into account the indirect impact on associated industries and jobs.
These are not issues that can be addressed in state jurisdictions. A national response is necessary.

Industrial relations and unlawful construction industry conduct across the nation is out of control. The current pattern bargaining by the CFMEU will raise the labour cost base of the industry by more than 25% over the next four years with no productivity trade-off. Construction wages and salaries have now grown by at least double inflation for 10 years. Competing nations around the Pacific Rim have achieved lower costs and smarter construction methods over the same period[2].
The Australian situation is unsustainable[3].

There has in the past been general acceptance that by stimulating the construction industry and in most instances via housing a direct economic benefit will flow to the economy as a whole. I believe this assumption should no longer be taken for granted. Business as usual will not be sustainable despite efforts to make it so. There are multi-factors at work here. The growing use for example of

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[1] See: https://sourceable.net/looks-like-the-construction-productivity-genie-is-now-firmly-back-in-the-bottle/#
[2] See: http://www.bca.gov.sg/newsroom/others/pr03032011_CPA.pdf
[3] See : http://constructionedge.com.au/construction-over-the-horizon-more-of-the-same-wont-work/

integrated computer technologies and B2B transaction platforms will redefine traditional commercial arrangements between contractors and their suppliers. In a global market the current issues affecting security of payment and insolvency as we regard them will be dealt away by new global transaction protocols and performance underwriting mechanisms. Some exist today.

Construction productivity and costs have a direct impact on the competitiveness of all traded goods and services due to the strong correlation of construction outputs and the cost of delivering those goods or services. Construction is an industry with long tail implications.

A useful snapshot of what may lay ahead for new constructors considering a career in Construction in 2015[4] may be instructive to the Committee. I believe this could provide a forward looking context for the Committee in considering construction insolvency and the many inextricably related issues.

Construction Insolvency in Australia is really just the tip of an Iceberg

In NSW the Collins inquiry into contractor insolvency determined that the annual cost to the construction industry to fund monies trapped in the system due to progress payments and insolvency accounted for approximately 2.3% of construction cost nationally. Mr Collin's proposed remedying at least part of this consequence by the use of Trust accounts for projects of $20m or more. This is at best a stop gap response to the condition rather than one that goes to root cause. It's the tip of an iceberg and it's time to consider the bigger picture.

Construction contracting in its raw form is about minimising risk and maximising margins. Typically contractors across Australia bid on margins of 2 to 5%. It's a fine balance between clients expecting and getting what they have contracted for, and contractors exercising their wit to meet those expectations as profitably as possible. In this process there is general acceptance that industry standards are good enough when these fall short of contracted or building standard requirements. The common defence when a gap is identified between what has been contracted versus what has been delivered is that the standard of trades is in decline or imported alternatives are what they are.

Evidence demonstrates that when construction non-compliance is identified the potential economic impact for the client to insist on rectification or for the contractor to rectify are not viable. As a result compromised buildings go into service with the effect of early increases to maintenance and operational costs. These issues relate as much to the cost of insolvency as do the actual events.

From a practical perspective the construction industry's procurement culture should be able to predict the misalignments that ought to be obvious from the outset. The industry is combative and defensive at every level. This is not the case for industrialised industries that have transformed from poor to best practice. In construction there is no supply chain sense of what the industry's customers can afford or should be paying. The custom and practice is to just absorb ever rising costs and expect to pass these on to the consumer. Any bidding pressure on price is specifically targeted at margins as opposed to cost. This erodes enterprise sustainability and influences solvency.

Construction clients and their consultants start the procurement process with a "bid shopping" mentality. It affects the engagement of all consultants, contractors, sub-contractors and suppliers.

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[4] See: http://constructionedge.com.au/so-you-want-to-be-a-constructor-in-2015/
(This is a four part series of conversations all of which are relevant to this enquiry.)

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The process of awarding contracts is mostly occupied by a cat and mouse game which sets aside good faith and fair dealing to squeeze out as much vendor margin prior to award as possible. In turn vendors replicate this behaviour when they achieve a construction contract in an effort to recoup what may have been given away in the prior “bid shopping” process. This culture then flows into the payments regime as contractors attempt to maximise progress claims to their clients and minimise the amounts due to the supply chain. Often this process is an essential practice to overcome poor initial business equity, profitability and as a result the solvency of contractors and suppliers.

An observed issue is fraudulent construction claims. The industry sees this as soft fraud and in most instances it is overlooked by those responsible for superintending contracts. In such instances contractors claim progress payments for work that has not been performed in accordance with the contracted design, specifications or the lawful requirements of building codes. Contractors and project certifiers thus induce clients to make payments for which there is not entitlement. This situation is exacerbated when insolvency occurs and prior declarations as to payment of wages and conformance of work done are found to come up short. There has been little appetite by clients or relevant authorities to seek remedy or to apply the law in these events. An alternate is required.

Other stresses are added when third party interventions such as those from unions play out. Save to say that the process of duress and then the resultant additional cost pressures further strain the economic viability of Australia’s construction industry. Independently verified productivity measures which align with a national construction strategy must precede future wage and salary growth.

The Committee is therefore urged to look at the bigger picture. In aggregate the issues outlined above and others all go to the root cause of construction industry insolvencies (reference c), the effects (reference b) and the impacts (reference e). The fringe issues of phoenix companies (reference d) and criminal conduct (reference f) would be substantially diminished in a more strategically directed and measured industry. Direct insolvencies are simply the tip of the iceberg.

Australia needs to Modernisation its Construction Procurement and Delivery Methods

All public and private construction projects exceeding $5 million should be required to conform to national construction productivity and modernisation strategy by 2020. The Commonwealth should negotiate with the states and territories via COAG that they lead the way by requiring all projects funded or facilitated by public investment to adopt and implement such a strategy by 2017.

The Committee could refer to the Singapore model where the Government’s Economic Strategies Committee (ESC) has implemented a Construction Productivity Roadmap[5] for some years now.

Australia’s construction industry representations often give voice to the need for change but in reality they are more comfortable with the status quo. Their membership bases comprise thousands of organisations whose business strategies are either non-existent or flawed. Their economic capacities and attitudes to investing in the future are similarly challenged. The reality is that many of Australia’s 207,000 construction related enterprises are unsustainable and simply represent terminal outcomes waiting to happen. More insolvency at a faster pace is inevitable.

[5] See: http://www.bca.gov.sg/cpcf/cpcf.html and
http://www.corenet.gov.sg/einfo/Uploads/Circular/CBCA130313.pdf

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The necessary scale, competitive capability, capitalisation and prospective contribution to a modern construction industry operating in a global, industrialised and sophisticated market should become the medium term objective of the Committee's inquiry. The Australian economy cannot entertain or subscribe to the continuity or propping of businesses or workforces that at best represent the lowest common denominator. Their ongoing sheltering by powerful industry associations or unions must cease. Unsustainable market entry barriers must give way to capability and competitiveness.

An example of unsustainable barriers is the current attempts to defend an Australian steel industry which now represents only .5% of global steel consumption. Australian industry and unions dealt steel a fatal blow decades ago in this country. Most steel for construction now and in the future will be imported. Similarly, cement, glass and plasterboard are more likely to come from off-shore in the future as will building plant, fitments and almost anything that can be more innovatively manufactured elsewhere. Chinese quality issues are being overcome, and India is emerging with a construction mantra of "*German quality at Chinese prices*". In this context Australia will need to review the viability of its current approaches to industry standards, compliance and barriers.

So challenging are the multi-faceted forces now affecting Australia's ability to meet its built future it is surprising that not a single institution or public official seems able to present a considered picture on how construction may be undertaken in 10 years from now. These institutions and officials have the greatest sway over the industry's policies and priorities. Notwithstanding they have a duty of care to build future capability and to prepare tomorrow's constructors for the environment in which they will need to fit if they are to enjoy long term success. These considerations go to the heart of helping to mitigate the degree of future insolvency events. They would seem core to this enquiry.

Summary

With due respect to the Committee it is hard to see how it serves any purpose in attempting to tinker at the edges of Australian construction industry insolvency. The states and the proponents of the status quo have shown a durable capacity to defend most business as usual conduct in the past.

The Committee has the potential however to look at the bigger picture. It should take some time to appraise the prospects of Australian construction domestically and how it may fare in the context of rapid changes in modern methods of construction globally. The Singapore examples given are just a glimmer of how nations around the world are looking to transform their construction industries, to make them more competitive and to reverse the net inflows of construction imports into their economies. It's sufficient to say that Australia is a laggard in this context. A situation that can no longer be left to the vagaries of state and association sovereignty and often ineptitude.

The grim reality for Australian construction is that there is so little interest politically at the national level that any prospect of the leadership or investment needed to change its likely course is a forlorn hope. This was the reasoning when I surmised in a recent strategic presentation to the Australian Construction Industry Forum[6] that "*it did not matter what actions they elected to take or not take as an organisation the momentum of events elsewhere would play out here regardless".*

Perhaps the Committee's expanded findings on insolvency threats may challenge this conclusion.

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[6] See: https://www.acif.com.au/ for the Australian Construction Industry Forum's purpose and representation