



Cynulliad Cenedlaethol Cymru
Pwyllgor yr Economi, Seilwaith a Sgiliau

National Assembly for Wales
Economy, Infrastructure and Skills
Committee

Caffael cyhoeddus yn yr economi sylfaenol
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Ymateb gan SEC Group Cymru

Procurement in the foundational economy

Evidence from SEC Group Wales

**THE WELSH ASSEMBLY
ECONOMY, INFRASTRUCTURE AND SKILLS COMMITTEE**

**Inquiry – Public Procurement in the Foundational Economy
Submission from SEC Group Wales/Cymru**

The Specialist Engineering Contractors’ (SEC) Group Wales/Cymru

SEC Group Wales/Cymru represents the specialist engineering sector which contributes the largest element (by value) to Welsh construction. The sector primarily comprises small businesses. The following trade associations are represented under the SEC Group Wales/Cymru umbrella:

- British Constructional Steelwork Association (BCSA)
- Building Engineering Services Association (BESA)
- ECA - Electrotechnical and engineering services trade body
- Lift and Escalator Industry Association (LEIA)
- Scaffolding Association

According to the ONS construction statistics (2018) 99% of the contractors in Wales are SMEs and 96% of them employ less than 13 people.

1.	<i>What is the current position regarding the proportion of public contracts in Wales that go to Welsh suppliers?</i>
1.1	<p>Two preliminary points need to be made:</p> <p>a) there is a dearth of data in Wales on public sector procurement:</p> <ul style="list-style-type: none"> • how many contracts are concluded by each public body, what are their respective values and what are the services/products being procured? • to what extent are contracts being sub-let to supply chains? • what proportion of SMEs are successful in obtaining public sector contracts? <p>It is extremely difficult to inform and shape procurement policy unless data (such as the data that would be obtained by answering the above questions) is readily available. However, this is not just an issue in Wales; it is relevant to most other countries. In the EU Slovakia seems to lead the way in that it maintains a contract register. This provides a high level of transparency since information about all the contracts concluded by public sector bodies is available to be accessed by the public.</p> <p>b) There is a tendency for public bodies in Wales to rely on some of the large UK main contractors to deliver infrastructure works albeit the bulk of the physical works are outsourced to their supply chains (which may not all be Welsh-based firms). The consequences of solely relying on these large outsourcers were highlighted following the collapse of Carillion in January 2018.</p>
1.2	<p>We are grateful to Tussell (www.tussell.com is a data provider on UK government contracts and spend) for providing us with the statistics to help us answer this question. Since January 2015 there have been 121 construction contracts awarded by public contracting authorities based in Wales, with a total aggregate value of £1.94bn. Of these, 54 contract awards worth a total of £332m have been awarded to companies</p>

	<p>with a registered address in Wales. That's equivalent to 44.6% of the total volume, and 17.1% of the total value. Over that period the proportion of contracts by value being awarded to Welsh companies has improved from 5.6% in 2015 to 20.6% so far in 2019. Welsh contracting authorities have also created 128 construction frameworks since 2015. Of the 785 suppliers listed across these, 471 are companies registered in Wales. Whilst this is equivalent to 60% of total suppliers, it should be stated that this is not a guarantee of work. Moreover, while researching for available data, we looked into Office of National Statistics reports and the business growth of contractors in Wales is slower than the rest of the UK. While the increase in businesses since 2011 (to 2018) was +24% for Great Britain, for Wales that was only +16%. We need more data to be able to examine the relation of these two variables (contracts won and business growth).</p>
1.3	<p>Public bodies in Wales need to fundamentally re-appraise their procurement strategies when procuring infrastructure/construction works. It is suggested that the following four options now need active consideration:</p> <ul style="list-style-type: none"> a) separate and direct engagement of some of the major supply chain inputs such as mechanical, electrical and plumbing works, steel construction, cladding, lifts and temporary works; b) the above can be facilitated by alliancing arrangements which enable the delivery team to be appointed from the outset (where this occurs there are insurers willing to insure the cost plan against overruns provided that the team has robustly managed the risks associated with the project).* c) wherever possible, the breaking up of large contracts into smaller packages to enable SMEs to bid for the work. d) as much as is possible procurement practices and procedures should be standardised across all public bodies in Wales including the 22 local authorities; SMEs incur significant costs in having to adapt to the different practices and procedures used by contracting authorities most of which do not add value to the process. <p>Given that these options enable greater SME participation in the delivery of infrastructure/construction this, therefore, provides more opportunities for participation by Welsh SMEs.</p> <p>*This is discussed further in the response to Question 4.</p>
2.	<i>To what extent could increasing 'local procurement' by the public sector create stronger local supply chains and build wealth in communities across Wales?</i>
2.1	<p>EU public procurement rules (encapsulated in the Public Contracts Regulations 2015) make it unlawful to specify that suppliers must come from a certain place or locality. But this does not apply where contracts are let under the EU thresholds. Even so, under EU procurement rules it is possible to specify certain qualitative requirements that, in effect, will favour local suppliers.</p>
2.2	<p>Under EU procurement rules public sector bodies can select those suppliers which have submitted the <i>most economically advantageous tender</i> (MEAT). This allows tenderers to be judged on qualitative criteria such as the provision of social value benefits, support for the environment or ability to provide innovative solutions. A combination of one or more of these criteria can be devised to encourage main contractors to use local firms as sub-contractors.</p>
2.3	<p>The difficulty is that selection tends to be based on lowest price. Since this often starts at the top it is driven down through the layers of sub-contracting. Carillion was able to "hoover" up countless public sector contracts by submitting the lowest price. In a <i>Communication</i> (Making Public Procurement Work in and for Europe) sent to all the EU institutions on 3 October 2017 the EU Commission stated that 55% of procurements relied on the lowest price as the only criterion for selection. MEAT was under-used. In the same <i>Communication</i> the Commission added that only 45% of the aggregate contract value of public contracts above the EU thresholds was won by SMEs.</p>
2.4	<p>The focus on lowest price ignores the value which local businesses add to public procurements and, moreover, the Welsh Government's aim of using public procurement to encourage Welsh SME participation as expressed in <i>Opening Doors</i>, the Charter for SME Friendly Procurement (published by Value Wales over 10 years ago).</p>

2.5	<p>The benefits of using local businesses include:</p> <ul style="list-style-type: none"> • their focus is primarily on service/product improvement and innovation (rather than on satisfying the needs of major shareholders or large external investors); • agility and responsiveness to client/customer need; • usually less adverse impact on the environment because less travel and transport is involved in delivering contracts; • overheads are usually less because there isn't the need to meet the cost of sophisticated and extended management and administrative support.
2.6	<p>Using local supply chains adds social value through firms' investment in jobs, training and technology, plant and equipment. This, in turn, provides greater opportunities for local suppliers and economy. Local firms will have a sound knowledge of their local market place and be able to source supplies from businesses which they know can provide quality products, machinery and equipment at reasonable prices. Winning public sector work also enables local firms to employ more people who are likely to spend locally.</p>
2.7	<p>The main area of uncertainty is the extent to which public sector procurers are able to favour firms that provide benefits to their local communities whilst remaining within the confines of the Public Contracts Regulations 2015 (even where the MEAT option is used). If the UK exited the EU without a deal and agreed to be bound by the rules of the World Trade Organisation (WTO) this uncertainty would remain. The Agreement on Government Procurement (which is administered and enforced by the WTO) includes requirements similar to those under EU tendering rules relating to matters such as transparency and non-discrimination.</p>
2.8	<p>Aside of the legal complications, it is possible that an overriding policy of preferring local firms would not deliver the expected outcomes (i.e. improving the prosperity of local communities) unless the policy is implemented in a very structured way. The better approach would be a targeted one that focuses on deprived communities (where the local economy is stagnant) and where there is an insistence that those firms benefiting from public sector contracts provide opportunities for local employment and apprenticeships and use local suppliers.</p>
2.9	<p>According to the ONS construction statistics (2018) 99% of the contractors in Wales are SMEs and 96% of them employer less than 13 people. We therefore suggest that greater effort should be made in removing the barriers that make it difficult for SMEs in Wales to engage with public sector procurement. Most of the barriers exist where SMEs are involved in delivering public sector construction (and related services such as maintenance) as sub-contractors. The major barrier is poor payment practices. The Welsh Government is seeking to address this by mandating project bank accounts (PBAs) for all projects over £2 million.</p>
2.10	<p>PBAs enable all project participants to be paid from the same "pot" at the same time. Highways England, for example, use PBAs for all their work with the result that all suppliers are paid within 18 days from the assessment or valuation dates under the main contract. We believe that PBAs should be used on all public sector construction contracts including projects procured using the <i>Mutual Investment Model</i> (MIM) (so far Welsh Government has been resistant to applying PBAs to MIM projects). Projected value of MIM projects is over £1½ billion. They currently include:</p> <ul style="list-style-type: none"> • NHS re-development of the Velindre Specialist Cancer Care Centre. • Upgrading of the A465 Head of the Valley road. • High value education projects delivered through the 21st Century Schools programme. <p>We cannot understand the Welsh Government's refusal to use PBAs on MIM projects.</p>
2.11	<p>Whilst on payment another matter relates to the practice of retentions whereby monies are withheld for some years ostensibly as security in case a firm fails to return to remedy non-compliant work. In practice these monies are used to bolster the cashflow of the party deducting them. They also have other uses such as funding investment on the overnight money markets and financing new projects. These monies belong to the firms from whom they are deducted but are often lost in the event of upstream insolvencies.</p>

	<p>Research carried out in 2017 for the UK Business Department indicated that SMEs in construction are losing almost £1 million worth of retentions per working day as a result of upstream insolvencies.</p> <p>We include a Briefing where we set out the priorities for improving SME access to Welsh Public Sector Construction Procurement Opportunities: http://secgroup.org.uk/wp-content/uploads/2019/08/SEC-Group-Wales-Briefing-The-5-Priorities-27-08-19-Final.pdf</p>
3.	<p><i>What is your view of the Welsh Government’s intended approach to increasing the amount of ‘local procurement’ undertaken by the public sector in Wales (including how ‘local procurement’ will be defined and monitored; how the principles of sustainable and ethical procurement are being applied; and how the statutory goals set by the Well-Being of Future Generations (Wales) Act are being met)?</i></p>
3.1	<p>We fully support the efforts of the Welsh Government to enhance the social value of procurement within the <i>Foundational Economy</i> and to support the 19 Public Service Boards in driving this within their respective localities. The largest category of spend – almost £2 billion – by the public sector in Wales is on construction, facilities management and utilities but feedback to us from SMEs engaged in providing engineering services to construction suggests that much work needs to be done to improve procurement so that they are more efficiently engaged in the process.</p>
3.2	<p>The procurement of construction and infrastructure is fundamentally different from that relating to goods and services. Given that construction/infrastructure is the basis of the foundational economy and the level of spend involved, we suggest that there should be a more specialised focus on this sector. A helpful model is the Building and Construction Authority in Singapore which is a government agency that, for over 20 years, has promoted and supported best practice in construction procurement. For example, it has recently been working with SMEs to help them form consortia in order to bid for public works contracts. <i>Constructing Excellence Wales</i> was partially funded by Welsh Government to promote best practice but this funding ceased in 2018.</p>
3.3	<p>Unless there is established an authority to drive change in construction procurement (similar to that in Singapore) we are pessimistic that the necessary social, economic and environmental benefits will be obtained. Construction delivery in Wales – like the rest of the UK – is riddled with process inefficiencies. Procurement of construction/infrastructure is outdated since it relies on the traditional approach of sequential and hierarchical appointments with designers and other consultants being appointed at the outset and those, mainly SMEs delivering the bulk of the value, being appointed last (usually after their prices have been driven down by their main contractors). One of the key areas of waste is the divide between design and construction with firms in construction supply chains having to incur considerable costs in adjusting or changing designs so that they can be implemented. Such firms are rarely involved at the outset to inform the design process (where, incidentally, most construction risks can be more efficiently managed).</p>
3.4	<p>An authority to drive change in construction procurement with the aim of delivering improved social value, better outcomes for the environment and savings for the Welsh taxpayer, should be a statutory body so that it will have the necessary impact. It should be adequately resourced by those with knowledge and experience of construction procurement. Its remit should include:</p> <ul style="list-style-type: none"> • the development and enforcement of a code of ethical behaviours for procurers and their supply chains (complementing the <i>Code of Practice, Ethical Employment in Supply Chains</i> published by Welsh Government over 2 years ago); • challenging public bodies to break up large contracts into smaller lots where this is feasible; • an insistence that public bodies contract directly with key supply chain inputs such as mechanical, electrical design and installation, steel fabrication and cladding, lift installation and maintenance, and temporary works such as scaffolding; • effecting radical changes in procurement such as <i>alliancing</i> (see response to next question); • requiring public bodies to use standard pre-qualification processes throughout the supply chain and to insist on the use of standard contracts for all contractors including sub-contractors;

	<ul style="list-style-type: none"> requiring public bodies to use firms that have demonstrated their technical competence through accreditation by an recognised scheme (such as the arms-length schemes developed by many of the reputable trade bodies). <p>With regard to the last bullet, many reputable small firms in Wales fall victim to the lowest price syndrome which favours those businesses which have made little investment in training, providing apprenticeships in their localities or in employing local people under fair employment contracts.</p>
3.5	The key to effecting change is being able to wield a “stick” as well as a “carrot”. In implementing the Groceries Supply Code of Practice the Groceries Code Adjudicator (a statutory office) has been having a significant impact on the behaviours of the top 10 supermarkets towards their suppliers. The Adjudicator has the power to fine these supermarkets up to 1% of their turnover for non-compliance with the Code. We believe that this provides an appropriate model for improving procurement and contractual behaviours in construction. Procurers and suppliers involved with construction procurement (and, indeed, with other procurements) should be on notice that poor and unfair practices, as defined within a Code, will have consequences (such as being barred from bidding for public procurements).
3.6	A power to impose penalties for non-compliance with such code could rest with the statutory authority we have already proposed or possibly, be given to the Future Generations Commissioner. For this purpose the Well-being of Future Generations (Wales) Act will require amendment. At this juncture it is opportune to respond to the sub-question relating to this Act. Whilst we have very much welcomed the Act as an innovative measure to improve the prospects for future generations in Wales we are concerned about the justiciability of the Act. This was brought into question by the court in the recent case of R(B) v Neath Port Talbot CBC . The judge was of the view that the Act does “ <i>no more than prescribe a high-level target duty which is deliberately vague, general and aspirational and which applies to a class rather than individuals</i> ”. In light of this case we suggest that the operation of the Act is reviewed to ensure that it can be effectively enforced.
4.	<i>In what ways can local spend, and collaborative procurement amongst SMEs, be increased and sustained while working within the EU procurement framework, whatever arrangements may be in place following Brexit?</i>
4.1	We recommend that public sector procurers now trial <i>alliancing</i> . This enables SMEs, both consulting and contracting firms, to come together at the outset of a project to work with the public sector client to devise a cost plan that reflects the most efficient and cost-effective way of delivering the brief for the project.
4.2	The firms work closely together as if they were one organisation rather than working in silos and delivering the project in a disjointed and fragmented way. The firms are appointed on the basis of the skills they possess to meet the client’s success criteria and their ability to collaborate with each other. To ensure the necessary degree of collaboration a no-blame culture is applied so that each firm agrees not to instigate claims against each other. Team members are paid on a target cost basis plus overheads and an agreed margin (subject to a pain/gain share mechanism).
4.3	Insurers such as Sun Alliance and Zurich are now prepared to underwrite the cost plan agreed as part of an alliancing arrangement. This means that the insurer will meet any cost overrun subject to an excess which is paid by the delivery team in pre-agreed proportions (any excess is part of the pain-gain share mechanism that is agreed within the alliancing contract). The major caveat is that risks must be robustly managed by the team. Before incepting the policy, the insurer will have been given the “green light” by a team of technical and financial experts who will have verified that the risks have been duly addressed. This represents a major win-win for the public sector since cost savings of up to 20% of project costs are achievable (through removing process inefficiencies) and for the firms involved there is a guarantee of payment with margins protected (unless reduced by the operation of the pain/gain share management).
5.	<i>Can you give examples of similar public procurement initiatives elsewhere in the UK and EU?</i>
	<i>Insurance-Backed Alliancing</i> , as it is now called, has been piloted on a £12 million extension to Dudley College in the West Midlands. The College achieved savings totalling 6½% and an Energy Performance Certificate A. The majority of the firms involved in the project were locally-based SMEs. The College was

	delighted with the build quality and has offered another project to pilot this scheme. Another project, a £15 million refurbishment of the Silk Mill Museum in Derby is now underway. If the Committee requires more information on <i>Insurance-Backed Alliancing</i> we would be happy to provide this.
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