

ARE RELATIONAL AND FORMAL CONTRACTS IMPLEMENTED AS SUBSTITUTES IN THE UK CONSTRUCTION INDUSTRY?

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Relational contracts have been claimed as substitutes to formal contracts in overcoming adversarial contractual relationships and mistrust in the UK construction industry. This research provides a rich insight into the dynamics of implementing relational contracts as substitutes to traditional contracting. It is argued that as a collaborative working practice is implemented, it often develops in a manner quite different from what was planned or conceptualized in the framework or proposal. Once in operation, innovative programs are frequently changed as practitioners learn what works and what does not, as they experiment, develop and change their priorities. Data was gathered from two case studies and interviews with senior industry figures, exploring their experiences of implementing relational contracts. Findings suggest that aspects of both systems of sanctioning, self-enforcing (relational contracting) and third-party enforcement (formal contracting) are operating in tandem.

Keywords: collaborative working practices, formal contracts, relational contracts, UK.

INTRODUCTION

Construction industry reports over the past six decades, have called for radical cultural changes to traditional ways of construction procurement in the UK (Murray and Langford 2003). Relational Contracting (RC) (Macneil and Campbell 2001), in the form of collaborative working practices (CWP) (i.e. variant forms of partnering, alliancing, supply chain management), have been proposed as substitutes to traditional or formal contracting in overcoming inadequate organizational systems, adversarial contractual relationships and mistrust in the UK construction industry (Latham 1994, Egan 1998).

RC models have gained extensive popularity in the UK construction industry and academia as several firms claim to have adopted RC principles of commitment, mutual trust and collaboration as policies (Fisher and Green 2001). Although there is broad agreement about the overall philosophy of RC, a number of issues have been raised with the approach, understanding, uptake and implementation of these CWP within and between different organizational settings; and extending it down the entire construction supply chain (Bresnen and Marshall 2000, Hughes and Maeda 2002). Fisher and Green argued that it was 'difficult at times to distinguish between partnering as a distinctive practice and partnering as managerial rhetoric' (2001: 58),

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whiles Hughes and Maeda (2002: 4) question how a spirit of mutual trust and co-operation can be contractually assured. Phua has described the implementation of RC models as being ‘patchy, with varying degrees of success and, in many instances, its adoption is more an exception than the norm’ (2006: 615). It is not clear whether construction clients and practitioners are implementing models of RC as substitutes to traditional contracting. It would be interesting to know whether CWP have been implemented as intended by the policy, how they actually work, and how well they are achieving the goals envisioned for them.

The paper is structured as follows. After a review of the literature on CWPs, from an institutional and enactment theory perspective, this paper attempts to show that as a CWP is implemented, it often develops in a manner quite different from what was planned or conceptualized in the framework or proposal. This will be done by presenting data gathered from two case studies and interviews with senior industry figures, exploring their experiences of implementing relational contracts. An attempt is also made to show that the use of formal contracting or relational contracting is not as powerful a cue as the human interpretation of another's actual and likely behaviour and the culture of their organization.

CHANGING THE CULTURE

The culture of conflict, apparent in the fragmentation and adversarial manner in which the industry has operated and continues to operate (Murray and Langford 2003) was aggravated by the late 1980s boom in economic activities and its sudden crash in early the 1990's. During the recession period of the early 1990's, construction procurement was dominated by a ‘low bid, claim high’ culture where practitioners sought to obtain work at all cost, with an aspiration that some profit could be recovered through claims and extras as the project progressed. Clearly, this practice created an increasingly adversarial and conflict-driven business environment. It is upon this background that the Latham (1994) and Egan (1998) Reports were commissioned. The reports increasingly exhort clients and practitioners to change their culture by adopting the partnering and supply chain management concepts. Here, the term, collaborative working practices (CWP) is used as an umbrella term for all forms of partnering, supply chain management and other collaborative working practices.

These CWPs can imply no more than an informal agreement between partners to do away with the adversarial aspects of their respective cultures and substitute an ethos of trust and cooperation. On the other hand, CWPs can imply a sophisticated contractually significant matrix regulating successive contracts over a long period. Within this context, is the important dichotomy between non-contractual agreements, which are not intended to be legally binding, and contractually binding agreements. While contracts can be devised so as to uphold a convergence of interest between the parties to the contract, there are difficulties in incorporating the ‘spirit of trust and cooperation’ as well as the good relationship aspects into a contractual framework (Hughes and Maeda 2002). Despite CWP's considerable popularity in the construction industry, there is still a gap existing between agreement and implementation.

COLLABORATIVE WORKING PRACTICE: AN INSTITUTIONAL PERSPECTIVE

From an institutional and enactment perspective (DiMaggio and Powell 1991, Arrighetti *et al.* 1997, Scott 2001), RC may need to be underpinned by other forms of institutional regulation that can contain the risk of misplaced trust as well as fostering trust (Arrighetti *et al.* 1997, Blois 1999). Based on Scott (2001), it is suggested that cooperation/collaboration is more easily achieved in social contexts where the system of sanctioning are mutually supportive and enjoy high levels of legitimacy. It is argued that the practice of collaboration is fundamentally shaped by the institutionalized rules and resources that originate in the organizational environments of collaborators. Thus, to fully understand the dynamics of collaboration, it is essential to examine those patterns of institutionalized activities, rules and resources. Also, contracts act as tools for structuring relationships as well as a sanctioning mechanism for breach of obligations. The legitimacy of the contract is only supported by sanctions that are imposed on the breaching party, and can be enforced by a legal system or non-legal enforcement mechanism i.e. third-party enforcement or self-enforcement. Sanctioning systems act as a situational cue that triggers an assessment of the type of decision that one is making (i.e. ethical or business), which in turn influences cooperation rates (Tenbrunsel and Messick 1999).

RELATIONAL CONTRACTING IN THE CONSTRUCTION INDUSTRY

RC theory, is a socio-legal philosophy of contracting (Macneil and Campbell 2001), where a need for enforcement of formal contract or agreement is of less importance than the need to maintain the relationship for future cooperation (Arrighetti *et al.* 1997). The success of the relationship is entirely dependent on mutual trust, commitment and *cooperation* in both performance and further planning. Within the construction management literature, it is not clear what RC really means in terms of the demands that it makes on all the parties involved and how the relationships formed fit into the complex project-based nature of construction activity.

Funnel (2000) pointed out, among the most common difficulties connected with performance indicators and performance monitoring is addressing process and institutional arrangements. Although there are several reasons why processes and institutional arrangements are relatively ignored, some of the most apparent reasons are reality; difficulty to identify, articulate, and measure; and attribution. The reality is that these processes and institutional arrangements are not immediately exciting. These processes and arrangements take time to become institutionalized and as such some aspects will at all time continue to be dynamic in nature.

Understanding the gap between implementation plans and actual procedures is made difficult as a result of 'formalization, organization culture and the broader social culture, including personal relationships' in varying degrees, may be exceptional to planned procedure. As some aspects of the processes and institutional arrangements are dynamic, requiring a regular review and modification in program theory assumptions and thus indicators of such processes and institutional characteristics are not easily quantified (Brinkerhoff 2002). Put together, these processes and institutional arrangements are difficult to identify, quantify and measure.

There is evidence that construction firms are increasingly found to be enthusiastic towards the benefits of partnering (Fisher and Green 2001), however the absence of its

widespread usage suggests that other relevant rationale may exist that account for the discrepancy between the supposed tangible benefits and its uptake. Previous researches on RC based CWPs have explored conceptual models of 'partnering', process models in providing guidance on best practices and how to implement the models and categorized the various stages in the development of the relationships (Crane *et al.* 1997, Cheng and Li 2001); and the facilitating structure for resource exchange and decision-making among the parties (Thompson and Sanders 1998, Cheng *et al.* 2001). While significant, these studies fail to reveal what was actually happening when CWP are being implemented.

RESEARCH DESIGN AND METHOD

In the light of the above discussion, there is a need to understand CWP in its own right by exploring a number of fundamental questions about the envisioned cultural change:

Is RC implemented as substitute to formal contracts in a CWP?

What are the mechanisms being employed to understand, interpret and enact RC principles in a CWP?

Assuming an interpretive perspective, an exploratory case study was conducted on two CWPs. A case study research approach was adopted as it was especially useful in investigating real life situations (Yin 1994); providing a richly detailed portrait of a particular social and economic phenomena in a real life context. In this research design, the assumptions were that management practices and structures provided clues to an organization's relationship preferences. This will expose what actually 'goes on' on daily bases as management have an impact on the process flow by implicit consequences of their decisions concerning the organization, availability of resources and specification of organizational roles and by impacts of their established policies and day-to-day flow of decisions. Also it was assumed that organizations give responsibility according to the value they place upon the function. The final assumption was that as senior managers are the 'brains' of the organizations, the comments and responses that they make are representative of the organization's chosen method of doing business. However, it also accepted that not all the managers within a given firm will mobilize the same message in every situation. Managers formulate, communicate, implement and change relational contracts; management becomes very important in relationships between firms as within. Management practice and structure can provide clues to whether a firm's culture will be more or less tolerant for power sharing and willingness to adapt (Sako 1992).

Rather than invite respondents to agree or disagree with a pre-formulated hypothesis or construct, open-ended questions were asked to obtain a more general, open-ended picture of a firm's practices, based on the subjective understanding of the respondents themselves. Using a semi-structured interview protocol, a series of interviews with fourteen participants about their experiences in implementing CWP strategies, representing clients, consultants, main contractors, subcontractors, and facilitators involved in a CWP. The interviews presented a first-hand insight into the implementation of RC, which was further corroborated by the collection and analysis of secondary documentation such as internal memos, proposals and framework agreements.

While much of previous research had taken the project as the unit of analysis, this study takes the organizations as the unit of analysis, focusing on the management practices and policy implementation. Drawing upon research undertaken by Crane *et*

al. (1997), the degree of implementation (firm's internal alignment: partner selection; alliance alignment; project alignment; work alignment) were evaluated. The two case studies were

Case study 1

A partnering agreement between a local authority, client A and a main contractor, B. Contractor B is a subsidiary of a national construction and civil engineering company. The original contract was tendered in the conventional fashion of price and quality with a sort of 'partnering' clause in there. Partnering was then encouraged at the managing director level. A partnering board was set up at director level where they sat down every other month and review the ongoing partnership.

Case study 2

A partnering framework agreement between a national university, C and an quantity surveying firm, D; an architectural firm, E; two main contracting firms F and G; and a structural engineering firm H. These firms have been working together on various capital projects ranging from £200,000 to £20 million for the past 6 years. As a public body it is a legal requirement for client C to carry out tenders exceeding £3.6 million. EC regulations allow for only four year terms, thus every four years, the client advertises frameworks in the OJEU and all the partners have to tender for the jobs as any other firm.

DATA ANALYSIS

Overall, the plan for analyzing the data collected was guided by the six generic steps of conducting qualitative analysis offered by Creswell (2003: 191-5) and the eight steps of systematic coding process by Tesch (1990: 142-5) for coding. In order to make the analysis procedure as transparent and intelligible as possible, the qualitative analysis tool, 'QSR Nvivo' (Jackson 2003) was used in re-organizing and reducing the data to themes and categories. It allowed for an effective handling of the large textual information produced.

CASE STUDIES – KEY FINDINGS

Given the exploratory nature of the research, and the fact that attempting to explore fully all aspects of implementing CWP is beyond the scope of this study, the main areas which were examined related to 1) the nature of the contract and relationship management; 2) the goals of the firm and the CWP; 3) administrative arrangements; 4) degree of implementation. Below is outlined and evaluated the areas addressed by the case studies and interviewees.

The nature of the contract and relationship management

To gain their understanding of the nature of the contractual relationship in the CWP, respondents were asked to indicate whether RC was a substitute or complementary to traditional contracting. The majority indicated RC as being complementary, emphasizing the importance of the formal contract. However, client C thought it was a substitute to traditional contracting, even though client C acknowledged that in addition to the framework agreement signed up to by all parties, standard forms of contract were also in use as a legal framework.

'The original contract was four years ago so it was tendered in the conventional fashion of price and quality with a sort of partnering clause in

there, 'you will work together in partnering; enjoy yourselves'. ... Initially partnering came out of the previous contract and it was pushed in at the managing director level and everybody was sceptical.' (Contractor B)

'We live in a commercial world, and there is a whole fraternity out there called lawyers who have to make their earnings. ... The contract is there for if things go wrong. Dispute resolution gives you a vehicle to hope you resolve most of those things without ever going to the law courts. You still have a contract. That is why I said it about attitudes, state of minds and approach.' (Contractor G)

In both case studies, the processes of initiating RC in the firms were very much market-led; a bolt-on business process. In case study 1, for instance, the CWP evolved out of a clause added to the original contract (above comment by contractor B). There were no extra non-contractual agreements signed. In case study 2, all participants had agreed to a set of non-legally binding framework agreements separate from the forms of contract used on each project. All the interviewees thought both formal and informal arrangements were used for coordinating and meeting objectives. The informal arrangements were developed as needed, from everyday processes of mutual adjustment, trial and error. In their experience, these informal mechanisms lay the foundations for the more formal processes of coordination. However, there was a lack of clear acknowledgment and nurturing of the informal mechanisms developed.

'To be fair it is due to relationships and type of persons as well. So personalities play a 'big-big' part in that at the lower level.' (Contractor B)

Goals of the firms and the CWP

In general, both clients viewed the CWP as a way of developing a long term relationship with practitioners, thus not having to go to the marketplace for every project and as a way of cutting down costs. The practitioners however viewed it as a way of generating potential future work. Paradoxically, Client C had a major capital project procured through the traditional method as a result of change in goals of the client firm, although the client C had adopted 'Partnering'. The result was that the firms had to develop in such a way to get their business to mirror the marketplace.

'I think the principle desires for any project are the three that we always mention, to provide a project on program, within budget and to a good quality.' (Client C)

'At the end of the day, will these things make good business sense? There is no point in doing all these. We are a company that make money, so if we did not think that working collaboratively with these other organizations was not going help our bottom line, reduce our risk, then we probably would not be so motivated to do it.' (Contractor G)

In both case studies, while practitioners became critical contributors to achieving the clients' goals and objectives, the clients saw this issue as complex, as the parties generally had different objectives. It was implied that clients and practitioners do not have the same objectives but compatible objectives. This is summarized in a comment by consultant E:

'There is something called the golden rule in business, and the golden rule is whoever has the gold writes the rules. So, depending on who is actually

spending the money, they are, have the power to decide how they want to procure anything. And if you're in industry and you want to serve the client bodies, then frankly, you get told how things are done. ... All we can do is tell what's successful and what isn't successful in the past.'

Administrative arrangements

Generally, the framework agreements did not affect the administrative arrangements of the individual firms. Each firm developed its own system to reflect the marketplace in which they operated. Adaptation in most cases came about without having to take strict procedures to change; it was more a process of developing an understanding.

Interviewees noted that the CWP was largely a loose coalition of firms that temporarily join forces to gain advantage through cooperation and that ultimate power resided with the client body. Within most of the firms studied, they do have routine management meetings of all the senior managers where all issues and problems relating to the firm are deliberated upon and decisions taken. No specific guidelines in relation to RC have been produced.

'Our procedures, which we call IBP ... that forms part of our induction with all our staff and ... what we are trying to get, the message to start off is, there are some hard targets in terms of what we are trying to achieve money-wise but these are the values.' (Contractor G)

In most of the firms, there had not been any significant change in the administrative arrangements to reflect the policies and structures of the CWP. In some cases, employees of the practitioner firms were not sure whether the project was a 'partnering' project or not as the daily routine had not changed.

'I have heard people say in the past, 'Are we partnering on this contract or not?' It is an attitude, it is a state of mind, and it's not something that you switch on and off.' (Contractor G)

Several of the interviewees noted that as a CWP is implemented, it often develops in a manner quite different from what was planned or conceptualized in the framework or proposal. In most of the firms, the five steps of partnership process (Crane *et al.* 1997) were not followed. In Client A's firm, for example, there were no 'partnering champions' who had an inherent belief in the principles of partnering and effective lead in its implementation. Between Client A and Contractor B, not all policies, guidelines, goals and objectives were aligned. Once in operation, the CWP is frequently changed as practitioners learn what works and what does not, as they experiment, develop and change their priorities. Beyond the guidelines, most of the interviewees targeted their comments on the lack of education and training effort. One interviewee commented

'People have changed, other people have come in. We have a new director at HRD, fantastic, great at his job but we are not aligned in where we were going in partnering' to support this view. (Contractor B).

'... because it's all very well to say, we want you to partner, but if you haven't been trained in partnering, you don't understand it, and there is a danger and a risk.' (Consultant E).

Although within the CWPs, committees or partnership boards had been formed, interviewees were of the view that these were merely developed as an advisory group.

'there is a Partnership Board that looks at team working and how things work well together, but I have to say that's at quite a high executive level, and whether that actually filters down to the men that do the work on the ground is debatable, really.' (Client A)

'There is nobody there, and they have this 'cumbersome' partnering board, which is just made up of the directors. And at my level as well, everybody will sit around and talk about it but actually nobody pushes it forward and gets on with it.' (Contractor B)

Recounting their experiences in the CWP, the interviewees noted that on most occasions there was no planning of a formal transition period for CWP. Furthermore, in terms of promoting CWP in the firms, this philosophy was not reflected enough in the company objectives, vision, and mission statement as most of the firms were engaged in both traditional and CWP based projects simultaneously. As such some of the employees were not aware of the change in company policy. However, in some offices visited, there were posters and slogans encouraging teamwork, open communication to encourage staff. In an extreme case, each letter in the name of one of the firms had been used as the first letter in a string of sentences portraying the firm as a relationship driven organization and how they wanted to work with people.

Throughout the study, all interviewees emphasized that a formal mechanism is used to identify and select potential CWP partners. Partners were selected using traditional methods of soliciting sealed bid tenders, in the conventional fashion of price and quality negotiations. In most cases, it is the client who brings all the other partners together. The presence of a long term contract that guaranteed a certain amount of business was frequently used to foster the relationships. Surprisingly, within the alignments, there were evidence of inconsistent operating goals, policies and procedures, and no shared vision and mission. Clearly most of the emphasis was internal rather than the CWP.

'On a day-to-day level, it is quite a contractual relationship. The client gives us an order, 'You will do that work and we want it done in such a time scale and at such a quality and fashion'. We have an input in there if we see a better way of doing something without being in a partnership, we would recommend it and change it but it is not. And that is where, I would say, it is five, six years down the line where it has really failed.'
(Contractor B)

This point is reinforced by an interviewee who stated that

"We are having to make up and negotiate the rules as we go along".
(Contractor B)

This shows the limitations of pure relational contracting in a wider context. The findings suggest that a 'collaborative relationship' has to be reflected in both contractual and management issues in order to manage risks and responsibilities. For example, clients and practitioners signing up to a framework agreement as a preferred partner and attending workshops to improve teamwork is not enough. All aspects of the contractual relation and management have to be managed collectively to fulfil the business case. In some cases, while the design and implementation of RC included highly specified governance mechanisms, it lacked a well-articulated approach. Process is being rationalized through a combination of existing structures. The setting

up of the CWP through contracting arrangements that specifies price based on the delivery of goods and services neither encompass nor promote trust.

CONCLUSIONS

Within the literature, much of the emphasis has been focused on the potential benefits and performance while ignoring process dimensions of RC as well as alignment mechanisms. While the practice and rhetoric of CWP is based on an assumption that CWP not only generates potential future economic benefits/outcomes, but overcomes adversarial relationships, enhance performance and less use of formal contracts, Clearly, the great potential of using RC to engage the construction industry clients and practitioners in overcoming the fragmentation and adversarial nature of contracting is not being fully realized in practice. Although numerous forms of RCs have been developed to address the problems discussed the experience, thus far, seems to have generated more frustration than results. There is still no proven road map for building successful partnerships, even after decades of experience. Consequently, it is very difficult for the people who participate in, or fund, partnerships to translate the appealing rhetoric and principles of RC into practice.

The results show that when a collaborative working practice is implemented, it often develops in a manner quite different from what was planned or conceptualized in the proposal. Once live, CWPs are frequently changed as practitioners learn what works and what does not; priorities develop and change both formally and informally. The results show that both formal and relational contracts are utilized as complements rather than as substitutes at various stages. Interestingly, the use of formal contracting or relational contracting is not as powerful a cue as the human interpretation of another's actual and likely behaviour and the culture of their organization. The findings depart from most current work that highlights relational contracts as substitutes for formal contracts. Instead of becoming cohesive, integrated teams, CWP are still loose coalitions of firms that temporarily join forces to gain advantage through cooperation. Clients and practitioners engaged in significant collaborative practices must be 'collective' owners of the project.

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