

PERCEPTIONS OF SMEs ON THE USE OF FRAMEWORK AGREEMENTS IN THE UK CONSTRUCTION INDUSTRY

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Following the Latham and Egan reports, Framework Agreements (FAs) came into the limelight in the UK construction industry as a means of reversing the adversarial nature of construction procurement. While the use of FAs has since been growing rapidly in the industry, it is generally believed that they favour larger firms over SMEs. The aim of this study therefore was to investigate the views of SMEs on the use of FAs and to identify and evaluate the barriers to the participation of SMEs in FAs in the UK construction industry. Data obtained from 56 SMEs in a questionnaire survey in Northwest England were analysed using percentage scores, relative important indices and Pearson's Chi-square significance test with the aid of the SPSS software. The findings showed that most SMEs regarded FAs as a "closed system" barring new entrants into the market. The results also showed that the most and least significant barriers to SMEs' participation in FAs were excessive product/service aggregation and the inability of SMEs to understand tender information in FAs respectively. These findings indicate that SMEs which constitute about 90% of the construction industry still consider themselves as disadvantaged by the use FAs due mainly to their limited resources in relation to larger firms.

Keywords: framework agreements, procurement, SMEs, United Kingdom

INTRODUCTION

The UK construction industry has experienced strategic changes as a result of the Latham (1994) and Egan (1998) reports. These reports made far-reaching recommendations to promote innovation in construction procurement. According to Oyegoke *et al.* (2009), the recommendations of these reports for an integrated team building approach to procurement have contributed to the increasing use partnering in procurement in the UK construction industry. The need for such integration has been a key issue in the construction industry since the 1980s (Faisal *et al.*, 2006). According to Khalfan and McDermott (2006), the government-sponsored Latham (1994) and Egan (1998) reports have provided the impetus for change and innovation to improve the delivery and procurement of construction projects. The Egan Report stated categorically that it did not wish the industry to look at what it already did and improve on it but to start doing things entirely differently (Egan, 1998). This in effect required the industry to change the way it delivered projects. One aspect of this change would be for client and contractor organisations to work together as a unified team, instead of being a disparate collection of separate organisations (Briscoe and Dainty, 2005).

The use of partnering in construction procurement has been on the rise in recent times. This is because partnering and other forms of collaboration have been seen as a means to reduce the fragmentation and lack of integration which have been blamed for poor project performance in the construction industry over the years (Bresnen and Marshall, 2000). Smyth (1999) identifies framework agreements (FAs) as one of the main types of partnering. According to Arnek (2004), the use of FAs has been on the increase in public sector procurement in the EU as a means to lower purchase prices by reducing transaction costs.

Opinions differ on the ability of SMEs to compete for and secure FAs. Smith and Hobbs (2001) have reported that FAs and other partnering arrangements generally do not favour SMEs. This view is supported by Bakker and Walker (2008) whose study on collaborative procurement in local government in the UK showed that FAs tend to exclude SMEs. However, Arnek (2004) believes that the FAs do not necessarily constitute barriers to SMEs' participation, as many SMEs have successfully competed for FAs. The aim of this study was to highlight the current level of participation of SMEs in FAs in the UK construction industry and to identify and assess barriers to their participation.

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THE CONCEPT AND ORIGIN OF FRAMEWORK AGREEMENTS

Article 32 of the EU Public Sector Procurement Directive (Directive 2004/18/EC, 31 March 04) includes a provision for framework agreements. The Directive defines a framework agreement as

“an agreement with suppliers, the purpose of which is to establish the terms governing contracts to be awarded during a given period, in particular with regard to price and quantity”.

According to Wright Hassall LLP (2011), the corresponding UK Regulations which implement Directive 2004/18/EC came into force on 31 January 2006. The UK regulations are:

- Public Contracts Regulations SI 2006 No 5
- Utilities Contracts Regulations SI 2006 No 6
- Regulatory Impact Assessment – Public Contracts Regulations 2006
- Regulatory Impact Assessment – Utilities Contracts Regulations 2006

Prior to Directive 2004/18/EC, the EU enacted a number of Directives in the early 1990s to further enhance and define public services, supplies, works and utilities. Among these directives were:

- Directive 92/50/EEC. Co-ordination of Procedures for the Award of Public Services Contracts (OJEU, 1992);
- Directive 93/36/EEC. Co-ordinating Procedures for the Award of Public Supply Contracts (OJEU, 1993a);
- Directive 93/37/EEC. Co-ordination of Procedures for the Award of Public Works Contracts (OJEU, 1993b); and,
- Directive 93/38/EEC. Co-ordinating the Procurement Procedures of Entities Operating in the Water, Energy, Transport and Telecommunications Sectors (better known as the ‘Utilities’ Directive) (OJEU, 1993c).

Directive 93/38/EEC was of significant importance. It was the only Directive out of the four mentioned above to contain provisions for framework agreements. Article 1 (5) of this Directive defined framework agreements as ‘an agreement between one of the contracting entities and one or more suppliers, contractors or service providers the purpose of which is to establish the terms, in particular with regard to the prices and, where appropriate, the quality envisaged, governing the contracts to be awarded during a given period’. Articles 5 (1) to 5(4) of the Directive laid down the procedures to guide contracting entities in construing a framework agreement as a contract under the terms of the Directive. Article 5 (4) stated that contracting entities must not use framework agreements ‘in order to hinder, limit or distort competition’.

A framework agreement does not necessarily constitute a contract. It is merely an agreement of the terms and conditions to apply in any contract to be placed under the agreement. Specific purchases (call-offs) are made under the terms set out in the agreement (Constructing Excellence, 2005). Arnek (2004) also makes a distinction between a framework agreement (FA) and a framework contract (FC). FCs involve agreements between service providers and service purchasers which oblige the purchasers to source from the suppliers concerned. Both the price and product/service specifications are always fixed. On the other hand, FAs do not oblige the purchaser to source from the supplier and the purchaser can conclude agreements with several suppliers as shown in Figure 1.

In contrast with Arnek’s (2004) distinction, Oyegoke *et al.* (2009) also classify FAs into binding and non-binding. They call the binding “Framework Agreement” and the non-binding “Framework Arrangement”. The framework arrangement is used where the parties do not wish to enter into a legally binding agreement but wish to create a collaborative working environment.

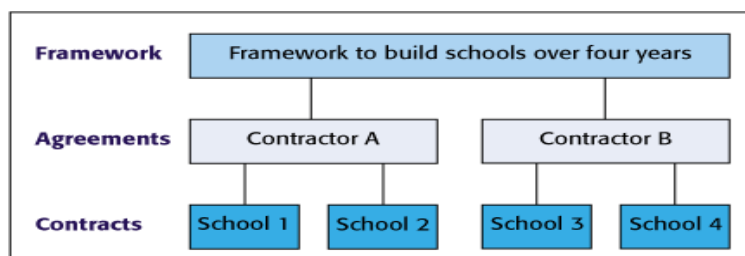


Figure 1: The framework, the agreement and the contract (Adapted from Constructing Excellence, 2005)

The FA changes the way services and products are procured from one-off contracts to a stream of similar contracts. According to Khalfan and McDermott (2007a), this has moved the client-contractor relationship from short term to long term with a continuous flow of similar projects. It has also changed the traditional project-based organisational structure of project teams to a set of long-term partnering relationships in an integrated supply chain.

THE PREVALENCE AND BENEFITS OF FRAMEWORK AGREEMENTS

Although framework agreements were in existence pre-Latham and Egan, they were infrequently used. The reasons for this include the ‘uncertainty over the permitted types of framework agreements’ (Arrowsmith, 2005, p.670). Framework agreements came into the limelight post-Latham and Egan as a means of reversing the traditionally adversarial nature of construction procurement, and as a means of moving away from acceptance of lowest price tenders to ones which afford better value for money. In fact, the Local Government Task Force Report (cited in Oyegoke *et al.*, 2009) recognises construction frameworks as an implementation of the partnering principles advocated by the Latham (1994) and Egan (1998) reports.

According to Oyegoke *et al.* (2009), partnering, including framework agreements and other forms of social integrative devices, is a temporary arrangement which is generally dictated by market forces. In this regard, it is their view that a framework agreement is one of the responses to market demands for an integrated supply chain. It is therefore not surprising that the use of FAs in public sector procurement of goods and services in the EU seems to be increasing. This, according to Amek (2004), is driven by the need to reduce transaction costs and lower purchase prices to achieve cuts in public spending. In the UK, for example, FAs have been used by many local government authorities and government departments (Khalfan and McDermott, 2007b; Glover, 2008; Oyegoke *et al.*, 2009). Available data provided by Gruneberg and Hughes (2004) shows that FAs accounted for 2% of all projects in 2001. This increasing popularity of FAs is reinforced by the fact that both the Joint Contracts Tribunal (JCT) and the New Engineering Contracts (NEC) forms of contract have recently issued standard form framework agreements as supplements (Glover, 2008).

The benefits of using FAs in construction procurement can be considered in terms of general benefits, benefits to the client and benefits to the contractor. The general benefits, according to Arnek (2004), Bresnen and Marshall (2002), Khalfan *et al.* (2006) and Goodier *et al.* (2006), include:

- Less waste and duplication
- Reduced transaction costs
- Savings on tendering costs
- Building of trusting, long term relationships
- Bringing of all “project knowledge” together at the inception of a project.

Khalfan *et al.* (2006) have identified the following among the benefits to the client:

- Improved design and delivery
- Greater cost certainty and better whole life costing
- Improved project quality

The benefits to the contractor include:

- The security of long term work programmes (Abbot *et al.*, 2006; Bresnen and Marshall, 2002)
- Improved cost recovery and relatively secure margins (Bresnen and Marshall, 2002; Khalfan and McDermott, 2006)

Framework agreements are not without their disadvantages. Among those identified by Arnek (2004) are:

- The large contract sizes often involved in FAs favour large suppliers over small, new ones
- There is normally no guarantee that the supplier with the most advantageous bid will be able to sell the most, and this may discourage companies from tendering
- In multiple FAs where purchase volumes are not defined at the time when the agreements are signed with the suppliers, suppliers may refrain from submitting tenders

SMEs AND FRAMEWORK AGREEMENTS IN THE CONSTRUCTION INDUSTRY

Micro, Small and Medium enterprises (SMEs) are generally defined by their number of employees (headcount) and their turnover or balance sheet total. The EU defines a micro enterprise with a headcount of less than 10 and a turnover or balance sheet total of not more than €2m, a small enterprise with a headcount of less than 50 and a turnover or balance sheet total of not more than €10m, and medium enterprise with a headcount of less than 250 and a turnover of not more than €50 million or a balance sheet total of not more than €43 million (European Commission, 2003). SMEs are of particular importance to the economy as they represent around

99.79% of all European enterprises (Burgi, 2007), providing in the region of 65 million jobs. In construction, SMEs account for 90% of the industry (Erridge, 1998).

O'Brien (1993) has stated that SMEs' share of public procurement contracts is not commensurate with their share of the economy. This may be due to the observations that:

- several factors concerning size, resources and ownership limit them in aspiring to radical product or process innovations (Ahedo, 2010), and
- they do not have enough absorptive capacity to apply new techniques or technology, or the necessary human resources to innovate (Olazaran et al., 2008 cited in Ahedo, 2010).

Instead of innovating, SMEs engage in other forms of creative and improving activities such as imitation, copying, small-scale experimentation, strategic relations with clients, etc., many of which may be regarded as a learning process towards innovation (Ahedo, 2010).

POTENTIAL BARRIERS TO THE PARTICIPATION OF SMES IN FRAMEWORK AGREEMENTS

It has been observed by Erridge (1998) that even though SMEs represent around 90% of the construction industry, they have only 15% share of the public procurement market. O'Brien (1993), Erridge (1998), Arnek (2004), Dutra *et al.* (2006) and Williams (2008) have identified and explained the effects of several key obstacles to SME participation in framework agreements. Among the obstacles are:

- the relatively large sizes of most FA contracts which are beyond the capacity of most SMEs,
- the time available in which to properly prepare bids,
- the inability of SMEs to obtain adequate information,
- the cost of preparing bids,
- financial problems, including delays in payment, and
- FAs over 4 years favour large well established firms over SMEs

Against these odds, it seems the best chance that SMEs have to increase their participation in FAs will be as sub-contractors to the large, established contractors.

RESEARCH METHODOLOGY AND DATA ANALYSIS

A total of 75 questionnaires were sent out via e-mail and another 17 hand-delivered to construction and consulting firms in Northwest England in February 2011. Sixty-five (65) questionnaires were returned, 48 via e-mail and 17 returned by hand. Nine (9) out of the 65 firms which responded were found not to belong to the SME category which the study covered. Thus responses from 56 SMEs, representing a response rate of 60.9%, were used for the analysis. This is a very good response rate, as according to Elhag and Boussabaine (1999) and Idrus and Newman (2002), a response rate of 30% is good enough in construction research. Over 73% of the respondents had more than 10 years working experience in the construction industry. Also, over 73% were aware of UK legislation on public procurement while over 41% were aware of the appropriate article on FAs in the EU Directives and 75% had experience working on projects involving FAs. This, overall, indicates that their responses could be relied upon.

The data were analysed with the Statistical Package for Social Sciences (SPSS) software using percentage scores, relative importance index (RII) and Pearson's Chi-square test of significance methods. The relative importance index is given by the formula:

$$RII = \frac{1}{5n} \left[\sum_{i=1}^{i=5} W_i x f_i \right], \dots\dots\dots Eqn. 1,$$

where W_i is weight given to i^{th} rating; $i= 1, 2, 3, 4$ or 5 , $f_i =$ response frequency of the i^{th} rating; and $n =$ total number of responses.

Table 1 shows that the sizes of the firms were fairly evenly distributed between micro (28.6%), small (26.8%) and medium (44.6%) enterprises.

Table 1: The distribution of the firms by size

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Micro	16	28.6	28.6	28.6
	Small	15	26.8	26.8	55.4
	Medium	25	44.6	44.6	100.0
Total		56	100.0	100.0	

The businesses of the firms were also almost equally distributed between contracting (51.8%) and consulting (48.2%) as shown in Table 2.

Table 2: The distribution of the firms by type of business

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Contractor	29	51.8	51.8	51.8
	Consultant	27	48.2	48.2	100.0
Total		56	100.0	100.0	

PERCEPTIONS OF THE USE OF FRAMEWORK AGREEMENTS.

The respondents were asked to express their views on some positive and negative attributes of FAs on a scale ranging from “Strongly agree” to “Strongly disagree”. Their ratings of the attributes were ranked using the Relative Importance Index (RII) given in Eqn. 1. The results are shown in Table 3. The rankings in Table 3 indicate that the most important positive attribute (advantage) is that FAs result in deeper, long-term relationship between the contracting parties which obviously benefits both parties. The most negative attribute is that FAs are viewed as barring new entrants into the construction market.

A comparison of the results in Table 3 between construction and consultancy firms using a Chi-Square test of significance gave Pearson Chi-Square significance values of less than 0.10 for only 3 of the 9 factors. For the other 6 factors the values ranged from 0.125 to 0.895. This means that, at the 10% level of significance, there was no significant difference between the opinions of contractors and the consultants on a majority (67%) of the factors.

Table 3: Ranking of some attributes of framework agreements

ATTRIBUTES OF FAS	FREQUENCY OF RESPONSE					RII	Rank
	5	4	3	2	1		
Framework agreements.....							
do not promote competitive bidding	3	30	8	10	5	0.657	7
Result in deeper, long-term relationships between the client and contractor	9	35	7	4	1	0.768	2
result in fewer losses to the contractor	6	15	18	16	1	0.632	9
provide cost savings through supply chain relationships	5	21	19	11	0	0.671	5
provide clear and committed commercial structures	2	32	15	7	0	0.704	4
carry less risk than other procurement methods	6	19	12	17	2	0.636	8
deliver continuous improvement agenda	3	19	27	6	1	0.661	6
present barriers to new market entrants as they are 'closed systems'	16	29	8	2	1	0.804	1
lead to contractors building in a 'risk' premium for the uncertainty where anticipated levels of work are uncertain	7	27	13	8	1	0.711	3

1-Strongly disagree 2-Disagree 3-Neither agree nor disagree 4-Agree 5-Strongly agree

Table 4 shows the respondents ranking of 8 factors considered as barriers to the participation of SMEs in FAs. The most significant barrier is the fact that “Projects using FAs are often too large for SMEs to tender for”, while the least is that “SMEs rarely understand what information is required in tenders involving FAs”. A comparison of the results in Table 4 between construction and consultancy firms using a Chi-square test of significance gave Pearson Chi-Square significance values of more than 0.10 for all the 8 barriers. This shows there was no significant difference between contractors and consultants in their ranking of all the barriers.

Table 4: Ranking of some barriers to the participation of SMEs in Framework Agreements

BARRIER TO SMEs	FREQUENCY OF RESPONSE					RII	RANK
	5	4	3	2	1		
Projects using FAs are often too large for SMEs to tender for	16	27	7	5	1	0.786	1
Adequate/relevant information on FAs is not always readily available to SMEs	7	27	14	8	0	0.718	5
Time given for tender submission is insufficient for SMEs to properly and thoroughly prepare a bid	7	23	12	13	1	0.679	6
The cost of preparing bids is too high for SMEs to carry	15	25	7	7	2	0.757	3
SMEs often fail to obtain the necessary Quality Assurance & Standards required for jobs using FAs	14	26	7	7	2	0.754	4
The cost incurred by UK SMEs in achieving credibility for FAs in other EU countries is too high	15	19	21	1	0	0.771	2
SMEs rarely understand what information is required in tenders involving FAs	7	17	13	16	3	0.632	8
Other financial issues, such as delays in payment and late payment by clients prevent SMEs from bidding for such jobs	7	19	15	12	3	0.654	7

1-Strongly disagree 2-Disagree 3-Neither agree nor disagree 4-Agree 5-Strongly agree

CONCLUSION

The study examined the views of SMEs on the use of FAs in the UK construction industry. The findings showed that there was agreement between the contractors and consultants on the perceived advantages and disadvantages of FAs as well as the barriers to SMEs’ participation in FAs. Most of the firms surveyed regarded FAs as a “closed system” barring small, new entrants into the market. The results also showed that the most significant barrier to SMEs’ participation in FAs was excessive product/service aggregation while the inability of SMEs to understand tender information in FAs was the least. These findings indicate that SMEs which constitute about 90% of the construction industry in the EU still consider themselves as disadvantaged by the use FAs due mainly to their limited resources in relation to larger firms.

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