Causes of Insolvency and Unethical Practices of Contractors In Pakistan Construction Industry

Dr. Faisal Manzoor Arain
Academic Chair, Construction Project Management, Southern Alberta Institute of Technology (SAIT), Calgary, Canada.
Email: faisal.arain@sait.ca

ABSTRACT

A construction project traditionally involves two major professionals in the construction industry. These two professionals are the designer and the contractor. Within the industry, the contractors appear to be most at risk player. This study identifies the causes of insolvency in the construction industry and the unethical practices that may lead to such causes of insolvency in the industry. As contractors are the players who are most at risk, their inputs regarding the above issues were examined. To achieve the study objectives, a questionnaire survey was carried out to collect the relevant information. Questionnaires about issues relating to causes of insolvency and unethical practices were sent to 90 contractors. 30 questionnaires were eventually returned and ten face-to-face interviews were completed. After checking through the completed questionnaires, 30 questionnaires were found to be suitable for the data analysis. Eleven causes of insolvency were identified from the literature review in this study. These are diversification, absence of barriers, family firms, management buy-outs, cash flow problems, over-trading, poor financial control, knock-on effect, overwhelming contract claims, imprudent diversification and onerous conditions of contract. Five issues that significantly caused insolvency of contractors in the industry were identified and explained. These are absence of barriers, cash flow problems, poor financial control, knock-on effect and onerous conditions of contract. It appears that all these five causes, with the exception of absence of barriers, can be caused by unethical practices. The study suggests that the construction industry should pay heed to ethical behaviour and practices in order not to jeopardize the financial stability of contractors in the supply chain. Special attention should be paid to the five significant causes of insolvency highlighted in this study to render the construction industry less onerous for the contractors.

Keywords: Construction, Contractors, Insolvency, Unethical practices, Pakistan.

1. Introduction

Projects are complex because they involve many human and non-human factors and variables [1]. The project process can be influenced by changing variables and unpredictable factors that could derive from different sources. These sources include the performance of the parties, resources availability, environmental conditions, involvement of other parties and contractual relations [2]. As a consequence, the projects may face problems possibly causing delay in the project completion time. It is commonly accepted that the construction industry has for many
years been criticized for not developing consistent projects that are on time, within budget and with high quality standard [3]. Generally, failure to deliver successful projects has been considered in relation to schism between design and construction, lack of integration, lack of effective communication, uncertainty, changing environment, and increasing project complexity [4, 5].

Construction is a complex industry in which disputes are common, uncertainties and risks are inevitable, individual interests of parties are natural, delays are routine and cause huge loss of resources, and aggravations are an everyday occurrence [1]. Among the project players, construction contractor is the person who has to carefully look into all these matters and ensure that the project completes on time, within budget, and according to expected quality standards [6]. Most of the disputes, as numerous researchers have established, are due to lack of communication and coordination interface management in the design phase [7]. This deficiency leads to difficult access of working area and conflicts in the requirements of various subcontractors during construction, and a design that does not deliver an end product that satisfies the Client [8, 9].

The term “insolvency” means the financial failure of individuals and companies and their position before and after the start of a formal insolvency procedure [10]. There are two different categories of insolvencies, namely short term insolvency and long term insolvency. The former means that there is a cash flow crisis where not enough money is coming in to meet a company’s outgoings and the latter means that the company is able to pay its debts as they fall due but its balance sheet shows a deficiency of assets over liabilities [11].

Contractors in the building industry are known to have low profit margins, low fixed assets and low capital but high cash flow and high return on capital employed [12]. Financing of contractors is generated internally from positive cash flow and retained profits and externally from short term finance, which is usually an overdraft repayable on demand. The short term finance will be able to support items such as working capital, stock and work in progress. However, for growth, there is a need for long term external finance in the form of equity investments and long term loans.

The unique nature of the construction industry has caused a large number of insolvencies each year [6]. Due to high interest rates and a generally poor economic climate, significant financial pressures are imposed on many companies in the construction industry. Companies with high levels of borrowing and an insufficient capital base are therefore forced into liquidation. The construction industry always ranks high among the annual number of liquidation. There are two striking features of insolvency in the construction industry [13]. Firstly, a fifth of the bankrupts were builders. Secondly, the building trade is the only sector that has displayed obvious vulnerability towards insolvency.

Within the industry, the contractors appear to be most at risk player. A study by Burnett [14] suggests that apart from being one of the easiest industries to join, the construction industry is
also one of the easiest in which to fail. It can also be safely assumed that the highest proportion of failures is in small sub-contracting companies.

Besides coping with economic and financial pressures, the contractors must also tackle profit squeezing from main contractors who abuse their rights to set-off, give late and insufficient interim payments and the introduction of onerous clauses into the forms of sub-contract [15]. In addition, the sub-contractor is less able to manage his accounts accurately. Furthermore, if the main contractor becomes insolvent, the sub-contractor will become an unsecured creditor and hence may also become insolvent due to cash flow problems.

The objectives of this study are first to identify and examine the causes of insolvency in the construction industry and second to identify and examine unethical practices that may lead to causes of insolvency in the construction industry in Pakistan.

2. Causes of Insolvency

Eleven causes of insolvency in the construction industry were identified [16, 17, 18]. These are discussed below:

2.1 Diversification

Many contractors diversify in order to use the cash earned from contracting higher profits, create assets as security for loans and seek financial stability by venturing into businesses that are counter-cyclical to construction. Whether the move was into property or into sub-contracting and materials supply, failed acquisitions undermining the financial health of a group were common [1, 19].

2.2 Absence of Barriers to Entry

Due to the ease of entry into the construction industry, there is a proliferation of small firms with little management expertise in the industry. In addition, the general lack of financial barriers to entry has created an industry where market forces are most ruthless [1, 19]. There are just too many contractors in the industry. This leads to the tendering of projects by small contractors who are not capable of doing the job. They become insolvent when they cannot manage the job.

2.3 Family Firms

Given the absence of a need to raise equity funds from shareholders, there are many family firms of contractors in the industry. The predominance of family firms has also contributed to a significant level of financial failure in the industry. This is because ingrained attitudes lead to financial complacency and an inability to adapt to a changing construction market [19, 20].
2.4 Management Buy-Outs

Management buy-outs have been a common exit from receivership as these provide a more feasible solution than in other industries. However, there have been cases where a management buy-out was soon followed by receivership due in part to the high level of debt that is required to finance. It may be possible to plan the receivership by appointing receivers to the parent company, allowing the target company to continue trading while a buy-out is negotiated [5].

2.5 Cash Flow Problems

Nearly all companies that went into solvency do so because of cash flow problems. Cash flow is more of a problem in the construction industry than in any other industries due to the fact that when tied to a fixed price contract, normal market forces are immobilized [5, 14]. It has been shown that cash flow problems are largely responsible for the high level of insolvency in the construction industry [21].

Construction is a labor intensive industry. Whether the contractor has been paid or not, the wages of the worker must still be paid. Cash flow is the lifeblood of the industry. Too often, people concentrate on whether they are making a profit. However, if this profit is tied up in debtors or work in progress and there is not enough left over to pay the bills, then that profit is of little utility.

Contractors frequently experience sharp decline in demand leading to reduced turnover and loss of cash flow. In the economic recession of the 1990s, excessive competition has forced many contractors in the UK to tender at below cost. Tenders for long term contracts were based on prices for contractors and materials whose prices have rose thereafter. These shortfalls cannot be sustained by the unstable sources of finance used by the contractors. Cash reserves built up in previous years were lost and contractors have to turn to their bankers and shareholders for support [19].

The situation for contractors is very much similar to the main contractors. It can even be worse especially when onerous contract clauses such as “pay-when-paid” and the “right to set-off” are in operation.

2.6 Overtrading

Another avenue, which small companies, like the contractors, can run into serious cash flow problems is when the company is growing faster than the capital base it can support [5]. A sub-contractor may or may not be receiving the monthly interim payments from the main contractor. However, during the month, he still needs to pay for materials, hiring of plants and equipments, overheads, labor wages, as well as loan repayments and other debts. The funds need to be drawn from the capital base since most of the sub-contractor’s money will be tied up in stocks, trade debtors and work in progress [14].
There can be a situation where the company has expanded so quickly that it finds that all its cash are tied up in stocks, trade debtors and work in progress. As a result, the contractors will have no money left to pay for additional materials, labor wages, hiring of plants and equipment and to make loan repayments to the bank. Although the company’s assets may outweigh its liabilities, it is however unable to pay its debts and hence become insolvent [14, 20].

2.7 Poor Financial Control

Successful contractors do well in cash control and management. They employed highly sophisticated techniques of cash flow forecasting and monitoring. A well managed contractor maintains detailed financial, cost and management accounts which allocate cost in as much details as possible to specific contracts and to individual elements within them. Unfortunately, many contractors in the industry fall short of this practice [4].

Many contractors become insolvent due to the lack of proper accounts in their organizations. They fail to collect debts, especially retentions; thus allowing these to accumulate until their delays made them difficult to collect later. The adage of strategic cash flow is to “collect early and pay late”. However, late payment is a two-edged sword [4]. It is serious problem and a contributory factor to the large number of insolvencies in the construction industry [19].

2.8 The “Knock-On” Effect

The majority of contractors in the industry are small firms with just a few employees. Small firms often fail because of the financial failure of another company which is further up in the supply chain. A significant number of insolvencies occurred as a direct result of the insolvency of another party [20]. This is known as the “knock-on” effect. There are three aspects related to this effect.

First of all, the knock-on effect is felt up and down the supply chain. The insolvency of a contractor in the chain may bring down a series of contractors and suppliers. However, it may also cause the failure of an employer due to the contractor’s failure. Secondly, the effect can be felt across different companies in the same group. As for the third aspect, the effect can be experienced across industrial sectors to cause a major impact on the country’s economy. The construction industry is cyclical and experiences boom as well as bust periods. A sharp decline in the market will reduce the demand for construction work which will cause insolvency among the contractors. The decline will be felt by contractors, suppliers and manufacturers of plants and equipments. Hence, a slump in house-building will inevitably lead to a contraction in demand for home furnishings, household appliances and Do-It-Yourself (DIY) services [19].

2.9 Overwhelming Contract Claims

If a construction contract goes wrong, it will go badly wrong. An exceptional claim against the contractor under one contract can be enough to cause insolvency. One such example is liability for liquidated damages due to failure to complete works on time. The greatest danger is when
management is forced to concentrate on one problem contract and the effort to extricate the company forces it to draw resources from the rest of the company or group [2, 19].

2.10 Imprudent Diversification

Many contractors look to other sectors and businesses in search of higher profits. During the 1980s, many contractors were tempted into property development for this reason but have since withdrawn from the sector or worst of all, become insolvent [19]. Diversification can also be achieved by moving from one method of procurement to another. Insolvency could also result from an acquisition which turns out to be a financial liability. Substantial sums can be incurred in supporting a new subsidiary, even by means of orderly wind down of its activities, and in litigation to recover losses from the vendor. For some, the urge to build an empire in the industry is just too strong. Hence, much insolvency has resulted from corporate aggrandizement.

2.11 Onerous Conditions of Contract

When a sub-contractor submits a quotation for a contract to be “as per standard form of subcontract”, he will often receive an acceptance that is “subject to standard terms and conditions” of the main contract. Many a times, the sub-contractor does not want to be burdened with the conditions of the main contract. However, because he does not want to lose the job, the sub-contractor frequently has no choice but to accept [14]. Some examples of onerous conditions include use of “pay-when-paid” clauses; making contractors liable for their works until practical completion of main contract works; excessive retentions and discount percentages; and right to hold back money on one contract for unproven faults on other sub-contracts.

3. Unethical Practices

There has always been a general agreement that insolvency will result in a loss of time and cost [4, 22, 23, 24, 25]. However, this view does not appear to be universally accepted. One client asserted that he could actually make money out of a contractor’s insolvency during the course of the contract [26, 27]. This could come about in three ways. Firstly, since clients usually pay in monthly installments, there would frequently be some payments outstanding at the time of the contractor’s insolvency. Hence, a client who has doubts as to the contractor’s financial position may well have deliberately withheld payments. The outstanding amount, coupled with the value of work undertaken since the last monthly valuation, means that the client is typically in possession of a six-week “buffer” [26].

Secondly, the client may be legally entitled to claim for its management time expended in dealing with the problems caused by the contractor’s insolvency and to set-off this amount against the funds held, before handing them over to the judicial manager. Many clients appear to have done so [26].

Thirdly, there are contractors who are keen to impress new clients and may often take on the completion of a contract at cheaper rates for works that have been stopped due to a contractor’s
insolvency. The procedure adopted by the receiver of an insolvent contracting company is that
the bids are invited from other contractors to buy the workload of the insolvent contractor. This
means that the successful bidders will have to pay the receiver for the right to take over the
insolvent contractor’s part-completed contract, either through a process of novation or by
entering into a separate contract for the outstanding items of works. Under a novation, the
successful bidder will take on the responsibility to the client for the work already carried out by
the insolvent contractor but if this is unacceptable, a separate contract will be used. However, in
either circumstance, the contract under which the new contractor buys the workload from the
receiver is entirely separate from the construction contracts between the new contractor and the
clients, who will not normally be aware of the price agreed [27].

Normally, the receiver will insist that all the unfinished contracts must be taken over. The
receiver will also attempt to tie each bidder to a “confidentiality agreement” which prevent them
from making a direct approach to the clients under the relevant contracts. In deciding on how
much to offer, the contractors will have to assess the value of the unfinished contracts to them.
This value usually consists partly of the money representing work already carried out which is
still held by the employer. There may also be resources on site which belonged to the insolvent
contractor and the receiver may be prepared to include them in at an advantageous price. The
new contractor will not take any responsibility for debts due to contractors or suppliers. These
parties will take their place as unsecured creditors of the failed contractor [26]. From the client’s
point of view, the advantage of the procedures described above is that it enables completion of
the contract works and in some occasions, it may be possible to secure completion at the same
price and at the original or a sensibly re-negotiated date [2, 27].

4. Research Methodology

The research instrument used in this study is a questionnaire. Section A of the questionnaire is
the demographic information section. Section B of the questionnaire consists of eleven causes of
insolvencies in the construction industry. The survey was carried out only on contractors in
Pakistan. Because the population of contractors in Pakistan is too large to be covered
completely, sampling has to be carried out first before the survey can be conducted. Before the
actual survey was carried out, the questionnaire was pre-tested with two contractors. The
selected respondents have industrial experience of more than five years. The purpose of the pre-
test was to obtain feedback on the questionnaire. Amendments like rewording, reconstruction of
the sentences and omission of repetitive questions were made to improve the questionnaire.

A total of 90 questionnaires were sent to contractors randomly chosen, together with a covering
letter explaining the purpose of the study and assuring them of anonymity. A self addressed,
postage paid envelop was supplied with each questionnaire. The questionnaires were mailed to
the president, vice-president, general manager or estimating manager of each company.
Recipients of the letters were asked to complete the questionnaire themselves or to pass it to
someone else in their company who are qualified to respond.
In addition to sending out the questionnaires, ten face-to-face interviews using the questionnaires were also used to ensure that all questions are answered and the respondents have a chance to clarify any doubts with the interviewer. 30 questionnaires were eventually returned and ten face-to-face interviews were completed. After checking through the completed questionnaires, 30 questionnaires were found to be suitable for the data analysis. This yielded a response rate of about 30%.

Descriptive statistics such as cross tabulation and mean ranking were used to describe and summarize the data. In addition, one-sample-test was employed to compare and find out the most significant issues that may cause insolvency in the construction industry.

5. Background of Respondents

32 contractors responded to the survey and 10 face-to-face interviews were completed. After checking through the completed questionnaires, 30 questionnaires were found to be suitable for data analysis. This yielded a response rate of about 33.33% as shown in Table 1.

Table 1 Survey response rates

<table>
<thead>
<tr>
<th>Respondents</th>
<th>Questionnaires sent</th>
<th>Responses received</th>
<th>Working experience</th>
<th>Valid responses</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contractors</td>
<td>90</td>
<td>32</td>
<td>1 – 4 yrs</td>
<td>3</td>
<td>10%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>5 – 10 yrs</td>
<td>12</td>
<td>40%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>11 – 15 yrs</td>
<td>11</td>
<td>36.66%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>15 yrs &lt;</td>
<td>4</td>
<td>13.33%</td>
</tr>
<tr>
<td>Total</td>
<td>90</td>
<td>32</td>
<td></td>
<td>30</td>
<td>100%</td>
</tr>
</tbody>
</table>

Of the 30 respondents, 21% were Grade 1 contractors and 79% were Grade 2 contractors. Only 13.33% of the respondents were in the group of 1 to 4 years working experience. A majority of the respondents fall in the group of 5 to 10 years experience in the construction industry, which is about 40%. About 36.66% of the respondents were in the group of 11 to 15 years experience and 13.33% were with more than 15 years experience in the construction industry. Respondents who were in the group of more than 11 years of working experience in the construction industry were very likely to be better able to assess the causes of inconsistencies between the design and construction more realistically. As for those who were in the group of 1 to 10 years working experience, their assessment of the causes of inconsistencies was also a good representation.

As shown in Table 2, 60% of the respondents were project managers. 30% of the respondents were senior managers. 10% of the respondents were directors of their organizations. As a majority of the respondents were professionally positioned at management level or higher, a certain level of accuracy in the data collected was assured.
Table 2 Professional respondents’ statistics

<table>
<thead>
<tr>
<th>Respondents</th>
<th>Appointments</th>
<th>Responses received</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contractors</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Directors</td>
<td>3</td>
<td>10%</td>
<td></td>
</tr>
<tr>
<td>Senior Managers</td>
<td>9</td>
<td>30%</td>
<td></td>
</tr>
<tr>
<td>Project Managers</td>
<td>18</td>
<td>60%</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>30</td>
<td>100%</td>
<td></td>
</tr>
</tbody>
</table>

6. Analysis Of Issues Causes Insolvencies

The questionnaire listed eleven issues that may cause insolvencies in the construction industry. Each respondent was asked to rate each issue according to how frequently they thought the issue will occur in the construction industry. In addition, the respondents were also asked to rate whether unethical practices will lead to the occurrence of each issue.

For the causes of insolvency, a score of 1 means that the issue never happen and a score of 5 means that the issue happens very often. The mean scores of these eleven issues are shown in Table 3. Of the eleven issues surveyed the five most frequently occurring issues that may cause insolvency are: diversification, imprudent diversification, management buy-outs, family firms and overtrading. Both diversification and imprudent diversification have the highest mean of 3.63. This may be because many local construction companies appear to lack commitment in their core businesses. Many local companies have become insolvent because they do not focus on their core construction businesses. They tend to diversify into other construction-related works. Worst still, the moment they have made enough profits, they will diversify into an area of work which is not related to construction at all. Many local construction companies appear to be very profit-oriented in the short term. Management buy-outs rank in third place with a mean of 3.57. Many construction firms, especially the larger ones, have become insolvent after they acquired another company with financial difficulties. The associated debts were simply too much for them to bear.

Table 3 Frequency of causes of insolvency

<table>
<thead>
<tr>
<th>Causes of Insolvency</th>
<th>Mean</th>
<th>Variance</th>
<th>t-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Diversification</td>
<td>3.63</td>
<td>0.37</td>
<td>5.64</td>
</tr>
<tr>
<td>Absence of barriers</td>
<td>3.23</td>
<td>1.15</td>
<td>1.19</td>
</tr>
<tr>
<td>Family firms</td>
<td>3.53</td>
<td>0.60</td>
<td>3.76</td>
</tr>
</tbody>
</table>
Many construction companies are actually family firms that have been around for many years. Firms that are family-run seem to be more resistant to changes. This resistance may be a cause for insolvency.

The critical point for t-distribution, having a degree of freedom of 29 and level of confidence of 95 percent, is 1.699. Table 3 shows the t-value results that have been generated using the one-sample t-test. From Table 3, it can be noted that out of the eleven possible causes of insolvency in the construction industry, only five of them are significant. These are absence of barriers, cash flow problems, poor financial control, knock-on effect and onerous conditions of contract. All these five causes have t-values lower than the critical value of 1.699. These five significant causes of insolvency are discussed below.

### 6.1 Absence of Barriers

Absence of barriers to entry in the construction industry has always been an important issue because of the ease of entry into the industry by companies who are not even professionally trained to do construction related works. 22 respondents viewed the absence of barriers to entry as a characteristic that does occur frequently within the industry that may cause insolvencies. Only 27 percent of the respondents opined that it rarely occurs within the industry.

Unlike other economic sectors, the construction industry does not restrict players from entering the industry although the Pakistan Engineering Council (PEC) maintains a registry for contractors in Pakistan. This registry is only for companies to list themselves for them to know which category of public sector projects they are financially qualified to tender for.

During a boom period, many companies will be keen to have a slice of the pie in the construction industry. However, in an economic downturn, companies which are not financially strong and do not have enough technical expertise in this area of work risk ending up insolvent.
The survey suggests that the absence of barriers to entry is a significant cause of insolvency in the construction industry.

### 6.2 Cash Flow Problems and Poor Financial Control

The next two significant issues that may cause insolvency in the industry are cash flow problems and poor financial control. Cash flow problems have always been a critical issue in the construction industry. The results from the survey showed that many respondents felt that cash flow problems have a higher chance of causing insolvency than other issues listed in the questionnaire.

80 percent of the respondents agreed that the cash flow problem is indeed occurring and that it has caused insolvency in the construction industry. Similarly, 73 percent of the respondents have rated poor financial control within companies as a significant contributing factor that may cause insolvencies. Out of this 73 percent, 37 percent of them rated it as a factor that often leads to insolvencies, especially during an economic recession. The reason is that subcontractors are unable to get their money back from the main contractors. Consequently, this leads to cash flow problems which eventually cause the bankruptcy of small contractors.

### 6.3 Knock-On Effect

The next contributing factor that may cause insolvency of contractors is the knock-on effect. This is a factor that is felt especially by contractors along the supply chain of contracts.

The downfall of a main contractor leads to the subsequent downfalls of other contractors. This is because the survival of contractors is usually dependent on the main contractors. The main contractor will usually tender out parts of the main contract to various contractors. Most contractors are paid on credit basis. Therefore, if the main contractor becomes bankrupt, the contractors, being unsecured creditors, will not be able to get their money back for any work done earlier. Hence, they may end up insolvent as well. 80 percent of the respondents felt that the knock-on effect is indeed one of the significant contributing factors affecting insolvency in the construction industry.

### 6.4 Onerous Conditions of Contract

The last contributing factor rated by the respondents for causing insolvency is onerous conditions of contract. 77 percent of the respondents linked onerous conditions of contract to insolvency. This is because the contractors will receive an acceptance of his offer to work as a sub-contractor for the main contractor “subject to standard terms and conditions of the main contractors”.

Although the sub-contractor does not want to be burdened with such onerous conditions, he frequently has no choice but to accept them. Otherwise, he risks losing the job by objecting to
them. Subject to such onerous conditions, many contractors were unable to survive and eventually become insolvent.

Some onerous conditions of contracts include “pay-when-paid” clauses, the contractors being liable for their works until practical completion of the main contract works, excessive retentions and discount percentages and last, but not least, the main contractor’s right to hold back money on one contract for yet to be proven faults on other contractors.

The “pay-when-paid” clause is one of the most onerous conditions of contract. It transfers the risk of a client not paying the main contractor to the sub-contractor. It provides some form of protection for the main contractor should the client becomes insolvent but at the expense of the contractors.

7. Unethical Practices And Insolvencies

Besides asking the respondents to rate their opinion on which issues they think would mostly cause insolvency, they were also asked to rate whether unethical practices will lead to the occurrence of these issues. The results from the survey are shown in Table 4 where it can be noted that out of the 30 respondents, 21 of them who think that absence of barriers to entry into the industry has caused insolvency in the industry have also felt that unethical practices do not lead to the occurrence of this issue.

Table 4 Cross-tabulation of causes of insolvency and unethical practices

<table>
<thead>
<tr>
<th>Causes of Insolvency and Unethical practices</th>
<th>Unethical Practices</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Yes</td>
</tr>
<tr>
<td>Absence of barriers</td>
<td>9</td>
</tr>
<tr>
<td>Cash Flow problems</td>
<td>25</td>
</tr>
<tr>
<td>Poor financial control</td>
<td>20</td>
</tr>
<tr>
<td>Knock-on effect</td>
<td>27</td>
</tr>
<tr>
<td>Onerous conditions of contract</td>
<td>21</td>
</tr>
</tbody>
</table>

From Table 4, 25 of the 30 respondents felt that the issue of cash flow problems may be due to unethical practices within the construction industry. This is because cash flow problems have
always been a critical factor that affects insolvency in the industry. Furthermore, cash flow problems within companies often occurred due to unethical practices such as failure to get back the debts owed etc.

From Table 4, 20 out of the 30 respondents felt that unethical practices have caused poor financial control resulting in insolvency. Like cash flow problems, poor financial control is often due to unethical practices as well. Some examples of these include the deliberate delay of payment by the main contractor even though the sub-contractor has finished the work and submitted the claim.

The frequency of unethical practices leading to the knock-on effect is high. In Table 4, 27 respondents, or about 90 percent, hold this view. This is because knock-on effect is a factor that occurs when one’s action will affect another party. Hence, main contractors who are unethical in their daily scope of work will affect the survival of the contractors who are at the bottom of the supply chain. One example is payment delays by the developer to the main contractor who will then not be able to pay the contractors.

As shown in Table 2, 21 respondents felt that unethical practices do lead to onerous conditions of contract. This is because the respondents, who are contractors, felt that they were bound by onerous conditions of contract such as “pay-when-paid” clauses, making them liable for their works until practical completion of the main contract, excessive retentions when they accept the offer from the main contractor, etc.

The mean rankings of the six unethical practices for the five significant causes of insolvencies are shown in Table 5. For quantifying unethical practices, a score of 1 means “most likely” and 6 means “most unlikely” were used.

From Table 5, it can be noted that for “absence of barriers” to entry, the respondents felt that it is likely to be caused by an unethical practice that fail to reconcile with the sub-contractor’s concerns (mean score of 2.81). As for “cash flow problems”, the respondents felt that these are likely to be caused by the unethical practice of the main contractor deliberately delaying payments (mean score of 1.93).

As for “poor financial control”, the respondents may feel that it is likely to be due to the misrepresentation of financial status by the main contractors (mean score of 2.17). This suggests that the main contractor may have created an impression for the contractors in making them think that they are financially stable when in actual fact, they are not.
Table 5 Mean scores relating to issues of unethical practices

<table>
<thead>
<tr>
<th>Causes of Insolvency and Unethical practices</th>
<th>Absence of barriers (Mean Rank 1)</th>
<th>Cash flow problems (Mean Rank2)</th>
<th>Poor financial control (Mean Rank3)</th>
<th>Knock-on effects (Mean Rank4)</th>
<th>Onerous conditions of contract (Mean Rank 5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Delaying of payments</td>
<td>4.19</td>
<td>1.93</td>
<td>2.71</td>
<td>1.67</td>
<td>3.24</td>
</tr>
<tr>
<td>Mishandling of sensitive information</td>
<td>2.94</td>
<td>4.41</td>
<td>4.13</td>
<td>4.59</td>
<td>3.38</td>
</tr>
<tr>
<td>Improper estimating practices</td>
<td>3.00</td>
<td>4.10</td>
<td>4.17</td>
<td>3.56</td>
<td>4.10</td>
</tr>
<tr>
<td>Abuse of resources</td>
<td>4.13</td>
<td>4.03</td>
<td>3.83</td>
<td>3.70</td>
<td>3.38</td>
</tr>
<tr>
<td>Failure to reconcile with subcontractor’s concerns</td>
<td>2.81</td>
<td>4.34</td>
<td>4.00</td>
<td>3.67</td>
<td>3.05</td>
</tr>
<tr>
<td>Misrepresentation of financial status</td>
<td>3.94</td>
<td>2.17</td>
<td>2.17</td>
<td>3.81</td>
<td>3.86</td>
</tr>
</tbody>
</table>

The respondents may feel that “delaying of payment” is likely to have resulted in the “knock-on-effect” which in turn, caused insolvency in the construction industry. As shown in Table 5, this has a mean score of 1.67. Every player in the construction industry is somewhat connected contractually. Hence, if one of the players, especially the main contractor, deliberately delays payment to the contractors, this may result in the contractors running into cash flow problems and becoming insolvent. Last but not least, the respondents suggest that the failure of the main contractor to reconcile with sub-contractor’s concerns has resulted in the occurrence of “onerous conditions of contracts” with a mean score of 3.05 in Table 5. This appears to be the case because most main contractors are profit-oriented to the detriment of others.

8. Conclusion

Out of the eleven possible causes of insolvency in the industry, five were identified as most significant causes by the respondents. These are the absence of barriers to entry, cash flow
problems, poor financial control, knock-on effect and onerous conditions of contract. All these five significant causes have a response rate of more than 70 percent.

In addition, the respondents also perceived that all these five significant issues that will cause insolvency may occur because of unethical practices. According to the respondents, unethical practices such as deliberately delaying payments, misrepresentation of financial status, etc. are likely to lead to the occurrence of insolvencies among contractors.

On another note, 70 percent of the respondents have also rated the overall behavior in the construction industry as unethical and that this seems to be a major problem in the industry. In addition, more than 70 percent of the respondents have rated main contractors as unethical. Hence, it appears that some causes of insolvency arose because of unethical practices.

The research revealed that unethical practices are major cause of insolvency of contractors in Pakistan construction industry. It is therefore important for the construction industry as well as main contractors to pay heed to ethical behavior and practices in order not to jeopardize the financial stability of contractors in the supply chain. Special attention should be paid to the five significant causes of insolvency highlighted in this study to render the construction industry less onerous for the contractors. Further, it is also strongly suggested that proper code of ethics and professional conduct be developed. This would assist in addressing the undesirable state of the construction industry in Pakistan.

Finally, as this study only surveyed contractors, future works can be extended to survey the consultants on the ethical behavior and practices of the client.

**REFERENCES**


