

Payment Scenario in the Malaysian Construction Industry Prior to CIPAA

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Abstract

This report is literature reviews undertaken to re-establish the state of payment problems in the Malaysian construction industry. The findings from this study will be used as a guide for further survey to measure the situation of the payment problems before the enactment of Construction Industry Payment and Adjudication Act (CIPAA). There are journals selected to be included in this study. The purposes of the journal were to discover the financial issues of late and non-payment problem related to the causes of delay in construction projects. Most of the research in the journals was carried out by adopting a combination of document analysis, law cases and review of act and statue. The possible solution to overcome the issue to the late and non-payment in construction projects were also highlighted in the journals. Based on the discussion, this research gives a general view and provides a comprehensive result of the "Payment Scenario in the Malaysia Construction Industry Prior to CIPAA". The result in this paper covered the factors contributed to the late and non-payment problem in construction industry, impact of late and non-payment and also the possible solution towards late and non-payment problem in construction industry.

Keywords: payment, contracts, legislation, delay, adjudication

1. Introduction

Payment problems are old age issues that permeate the Malaysian construction industry. So often, contractors and parties in the construction industry complain either not getting paid or payments have been unduly delayed by the employer. The issues of late and non-payment are paramount to the construction industry as compared to other industries. This is due to the following facts; unlike many other industries, the duration of construction projects are relatively long, the size of each construction project is relatively large and each progress;

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payment sum involved are often relatively large, payment terms are usually on credit rather than payment on delivery, services are rendered before progress payment is made, and products become fixtures disabling removal.

A failure of the contractor in getting regular and timely payment could result in project delay, reduced profitability and in the extreme case the company may go into liquidation. It will also have a knock-on effect on the entire construction value chain because when clients do not pay the main contractors on time, the sub-contractors, suppliers, hirers and everyone in the construction value chain will suffer.

In addressing the issues on payment in the construction industry, the government has introduced the Construction Industry Payment and Adjudication Act (CIPAA). CIPAA is expected to come into operations in early 2013. The act applies to all construction contracts made in writing and that which relates to construction work carried out wholly or partly within the territory of Malaysia. Under CIPAA, a statutory right has been created for unpaid parties to demand for payment for work done.

In preparing to measure the success of CIPAA, a detailed and more accurate study needs to be undertaken in re-establishing the state of payment problems in the Malaysian construction industry. The findings from this study will be used to measure the success of CIPAA in addressing the payment problems before and after its enactment.

1.1 Introduction on CIPAA

The Construction Industry Payment and Adjudication Act 2012 (CIPAA) was recently gazetted. CIPAA is a speedy dispute resolution mechanism. The process is quick and relatively cheap, particularly in comparison to litigation and to those arbitrations that have somewhat unfortunately, for whatever reason, been allowed to become more time consuming and costly than they should have been.

The construction industry, in particular, the Construction Industry Development Board (CIDB) and Master Builders Association Malaysia (MBAM) and other related promoters have been instrumental in getting the government to enact this piece of legislation since 2003 to address the cash flow problems plagued by the industry. The primary objective of the Act is to address cash flow problems in the construction industry. It removes the pervasive and prevalent practice of conditional payment (pay when paid pay if paid) and reduces payment default by establishing a cheaper and speedier system of dispute resolution in the form of adjudication. The Act also provides for the recovery of payment upon the conclusion of the adjudication process in addition to a host of other remedies such as a right to reduce the rate of work progress or to suspend work or even to secure direct payment from the principal.

It offers a relatively simpler, cheaper and faster process compared to arbitration and/or court proceedings by virtue of express provisions prescribed by the proposed Act itself. The adjudicator's decision is regarded as void and that they cannot recover their payment if they fails to make a decision within forty five (45) working days from the completion of the reference by the parties who fail with the decision. The decision is temporarily binding in that

it can still be subjected to an arbitration or litigation in court i.e. if either or both the parties so desire. In the interim, the parties need to still comply with the adjudicator's decision and pay the disputed amount unless the decision is stayed (by application made to High Court). CIPAA applies to every "construction contract" (as defined by the Act) relating to construction work carried out wholly or partly in Malaysia. It therefore affects both local and international contracts that fall within the ambit of the Act.

CIPAA identifies the particular construction contracts which are included within its scope. Generally, these encompass construction work contracts and consultancy services contracts. More importantly, CIPAA only applies to contracts which are made "in writing". The Act applies equally to the Government of Malaysia as well as the Private Sector. CIPAA is wide ranging and covers inter alia, the building industry, the oil and gas industry, the petrochemical industry, telecommunication, utilities, infrastructure, supply contracts and consultancy contracts.

Findings of this study may assist the government and relevant parties in addressing problems associated to late and non-payment in an effective and timely manner to create a win-win situation for all parties in the Malaysian construction industry. It is hoped that the government and relevant parties will adopt and implement the necessary plan of action in order to minimise disputes on payment in any construction project, so as to create a friendly and enjoyable working environment for all parties and to improve the payment flows in the Malaysian construction industry. The result of this research may be of significance to the introduction of a legislation known as the Construction Payments or Security of Building Payment Act, which already enacted in many advanced countries.

2. Identification of Late and Non-Payment Problem

A delayed payment by a party who is involved in the process of payment claim may have an influence on the supply chain of payment in whole. According to the Construction Industry Working Group on Payment (2007), problems in payment at the higher end of the hierarchy will lead to a serious knock-on cash flow problem down the chain of contracts.

The previous research done by Hasmori et al. (2012) stated that client's employees are wrongfully holding the payment and most of the time they do this to obtain some kind of "gift" from contractors once they pay out the payment. According to Ye and Abdul Rahman (2010), identified clients deliberate delay for their own financial advantages, delay in releasing of the retention monies to contractor and wilful withholding of the payment for personal reasons are the cause of the paymaster's withholding of payment.

Based on result analysis by Ye and Abdul Rahman (2010), contractors in Malaysia perceived that delay for few day less than 5 working days is acceptable and accepted late payment from the clients as they are always at the mercy of the clients. This could be due to the inherent culture of late payment in the Malaysian construction industry that the contractors perceived late payment for a few days were acceptable.

According to Ye and Abdul Rahman (2010), delay in certification by parties involve in the project might also cause of late payment issues. The parties involve may delay in approving the application for payment claim due to certain reasons which may arise because of his own or other parties involve.

The journal/ paper/ report that included in the report of Payment Scenario in the Malaysia Construction Industry: A Literature Reviews and a Report of Industry Responses 2012 are as follows, Table 1:

Table 1: Factors contributed to late or non-payment in construction

Factor	Description	Author
Paymaster's Poor Financial Management	<ol style="list-style-type: none"> 1. Cash flow problems because of deficiencies in client's management capacity 2. Client's ineffective utilization of funds 3. Scarcity of capital to finance the project for instance, client's need money to roll 4. Poor cash flow because of lake of proper process implementation 5. Financial failure due to bankruptcy or winding up paymaster other business activities 6. Overlook the ripple effect of economic downturn on cash flow 7. Client's poor financial and business management 	Abdul-Rahman et al. (2011); Hasmori et al. (2012)
Paymaster's Withholding of Payment	<ol style="list-style-type: none"> 1. Withhold of payment by client 	Hasmori et al. (2012)
Conflict among the Parties Involve	<ol style="list-style-type: none"> 1. Contractor's misinterpretation of client's requirement of variation order 2. Heavy work load of consultant to do evaluation for variation order 3. Argument of the amount to be paid 4. Non-payment for certified sums 	Abdul-Rahman et al. (2009)
The Use of Pay When Paid Clause In Sub-Contractor	<ol style="list-style-type: none"> 1. The sub-contractor will only be paid after the main contractor himself has received payment from the employer 	Ab. Halim et al. (2010)
Local Culture / Attitude	<ol style="list-style-type: none"> 1. Delay for few days less than 5 working days is acceptable and accepted late payment from the clients as they are always at the mercy of the clients. 	Hasmori et al. (2012); Abdul-Rahman et al. (2006)
Short of current year's project	<ol style="list-style-type: none"> 1. Over deduction of the sum payment 2. Bank line of credit constantly borrowed to the limit 	Hasmori et al. (2012); Supardi, A. et al. (2011); Ab. Halim et al. (2010)
Delay in certification	<ol style="list-style-type: none"> 1. Delay in valuation and certification of interim payment by consultant 2. Involvement of too many parties in the process of honouring certificates 3. Issuance of payment certificate by party not in construction contract 	Supardi, A. et al. (2011)
Disagree on the valuation of work done	<ol style="list-style-type: none"> 1. Inaccuracy of valuation for work done 2. Unpaid of work done due failed on defect work 3. Decreased in productivity 4. Unclear instruction and miscommunication due to language barriers 5. Verbal instruction given is not confirmed in writing 6. Work carry out by contractor does not comply to the specification 	IMohamad et al. (2012)

Contractual Provisions	<ol style="list-style-type: none"> 1. Contract agreements do not bring any justice to both main contractors and sub-contractors 2. Disrespectful from parties involve regarding to the contractual provisions effectiveness 	Ab. Halim et al. (2010)
Technical Problems	<ol style="list-style-type: none"> 1. Delay in processing for approval 2. Delay in receiving progress payment from client 3. Absence of a comprehensive business plan 4. Wrongly calculated claims 5. Without using the right procedures 6. Claims without adequate supporting documents 7. Errors in submitting claims 8. Failure to identify technical problem and remedial action to be taken 9. Insufficient information and poor documentation on work progress 10. Inexperience of site supervisor and contractor's representative 11. Unclear material description and details in specification and drawing 12. Actual quantities does not match as stipulated in Bill Quantities (BQ) 13. Incomplete claim document 	Ab. Halim et al. (2010); Abdul - Rahman et al. (2009)

3. Impact of Late and Non-Payment

Haseeb et al (2011) identify the four major factors which caused the delay in construction and these are client problem, service provider problem, sources problem and universal problem. Based on the survey results, client factor is identified as a major factor causing the delay in construction with the inability to make payment due to economic background and lack of financial arrangement for the project (Haseeb et al., 2011). In addition, the breakdowns of equipment and labour disputes caused the delay in completion of the project.

Delays in construction projects lead to serious consequences that may retard the development of the construction industry and influence the overall economic condition of a country (Abdul-Rahman et al., 2009). According to Abdul-Rahman et al. (2009), delay in the completion of construction projects could be the greatest cause for extra cost and loss in financial return or other benefits from project. Thus, delay is costly for both owner and contractor. To the owner, a delay means loss of potential revenue, whereas to the contractor, a delay means increased costs in overhead.

Payment has been an issue of major concern in the construction industry and majority of contractors reported that they have went through late payment situation in government funded projects whilst more of them affirmed the same situation in private funded projects as told by Hasmori et al (2012).The late payment issues in the construction industry is a global phenomenon and in Malaysia the impact of this problem had cause a massive destruction to the country's economic and this have tarnish the good image of the construction industry. The impact of late and non-payment are described in Table 2.

Table 2: Impact of Late and Non - Payment

Impact	Description	Author
Creates negative chain effect on other parties	The construction payment blues have domino effects. A delayed payment by one party may affect the whole supply chain of payment of a construction project. For instance, if an employer delays in making payment to the contractor this in turn will result in contractor's delay in making payment to the sub-contractors and suppliers.	Mohamad et al. (2012)
Results in delay in completion projects	Late payment causes cash flow problems which in turn can affect the overall progress of works. Financial problem is confirmed by the top management as the main cause of delay in addition to manpower shortage.	Abdul-Rahman et al. (2009) Haseeb et al. (2011)
Leads to bankruptcy or liquidation	Late payment may affect the financial status of the contractor. It will influence a company's cash position.	Ab. Halim et al. (2010)
Project delay	A failure of the Contractor getting regular and timely payment could result in project delay, reduced profitability and in the extreme case, the company may go into liquidation	Judi and Rashid (2010)
Affect the contractors reputation	Frequent late payments could result in loss of reputation, trade credit constraints, and reduced credit ratings	Hasmori et al. (2012)
Profitability of the project	The profit margin is small and this situation can led a player to go on bankruptcy and there goes another project on abandoned list	Hasmori et al. (2012)

4. Potential Solution of Late and Non – Payment Issues

Regarding cash flow management, Abdul-Rahman et al (2011) suggested that the clients to be trained on cash flow management and financial management whereas the contractors should accessing risk management in managing material, transportation, labour and maintenance. Apply payment bond with bank and client is also the suggestion that should be taken in account.

Contractor need to be smart in accepting the contract and to choose a good paymaster (Abdul-Rahman et al., 2011). Before any payment is being certified, it is a contractual responsibility of the committee to also monitor whether the claim is made in accordance to the terms, product delivery and other criteria prescribed. In fact, 98 percent of such processing can be completed within 10 days. If the payment is late, the finance officer must inform the reason for the delay in writing (Hasmori et al., 2012).

Legislation should be amended to give a clear message to constructors and clients as to clarify the payment matters and refund procedures said by Abdul-Rahman et al. (2011). Termination at common law can only take place where one party commits a breach of contract, and that breach amounts to a repudiatory breach. A party is said to have repudiated a contract if he expressed by his words or conduct that he does not intend to be bound by the contract or to perform his obligations. Normally, refusal by the Employer to pay sums due is clearly a default and Contractor can take action based on such reason. But, failure to pay one installment out of many is not ordinarily sufficient to amount repudiation.

Hasmori et al. (2012) said that the remedies to overcome the late and non-payment is by adopting a new way of payment method among developers or clients whom wrongfully

withholding the payment. Penalties shall also be given personally to the employees if they are found wrongfully withholding the payment. Table 3 show the potential solutions of late and non-payment issues in construction industry.

Table 3: Potential solutions of late or non-payment issues

Solution	Description	Author
Financial Management	<ol style="list-style-type: none"> 1. To conduct training on cash flow management and financial management 2. Accessing risk management in managing material, transportation, labour, and maintenance. 3. To apply payment bond with bank and client. 	Abdul-Rahman et al. (2011)
Contractual Matters	<ol style="list-style-type: none"> 1. To be smart in accepting the contract and to choose a good paymaster. 2. Determining the contract with the Employer 3. The development of principles of modern construction contracts 4. There should be a specific clauses in the contract related to managing construction failure. 	Abdul-Rahman et al. (2011); Hasmori et al. (2012)
Legislation	<ol style="list-style-type: none"> 1. Legislation should be amended to give a clear message to constructors and clients as to clarify the payment matters and refund procedures. 2. A right to a speedy dispute resolution mechanism 3. A right to suspend work 4. A right to regular periodic payment. 5. Applying charges to overdue payments. 6. A right to a defined time frame for payment 7. Collection period (CP) in 48 days. 8. A specific agencies or bodies must be existed for the party involved to set guideline in resolving that matters. 	Abdul-Rahman et al., (2011); Judi and Rashid (2010)
New way of payment method	<ol style="list-style-type: none"> 1. Adopting a new way of payment method among developers or clients whom wrongfully withholding the payment. 	Hasmori et al., (2012)
Local Attitude	<ol style="list-style-type: none"> 1. Fundamental change in the mind-set towards timely payment and statutory enactment to deal with payment in construction industry 	Hasmori et al. (2012)
Technical Issue	<ol style="list-style-type: none"> 1. The detail and proper procedures of claim issuance to resolve matters arising 2. The relevant provisions of construction failure should be stated in separate clause due to its scope of event. 	Mohamad et al. (2012)
Financial institution	<ol style="list-style-type: none"> 1. Reduced interest rates/bank fees for businesses with robust cash flow management 2. Extension of credit facilities on a temporary basis 3. Seasonal repayment/ payment based on money flowing into the business 4. Repayment holidays 5. Slow or delayed start to repayment terms 6. Access to free/ heavily subsidised cash flow software 	

Figure 1 illustrates the framework of the study which includes the factor, impact and solution of late and non-payment in construction industry.

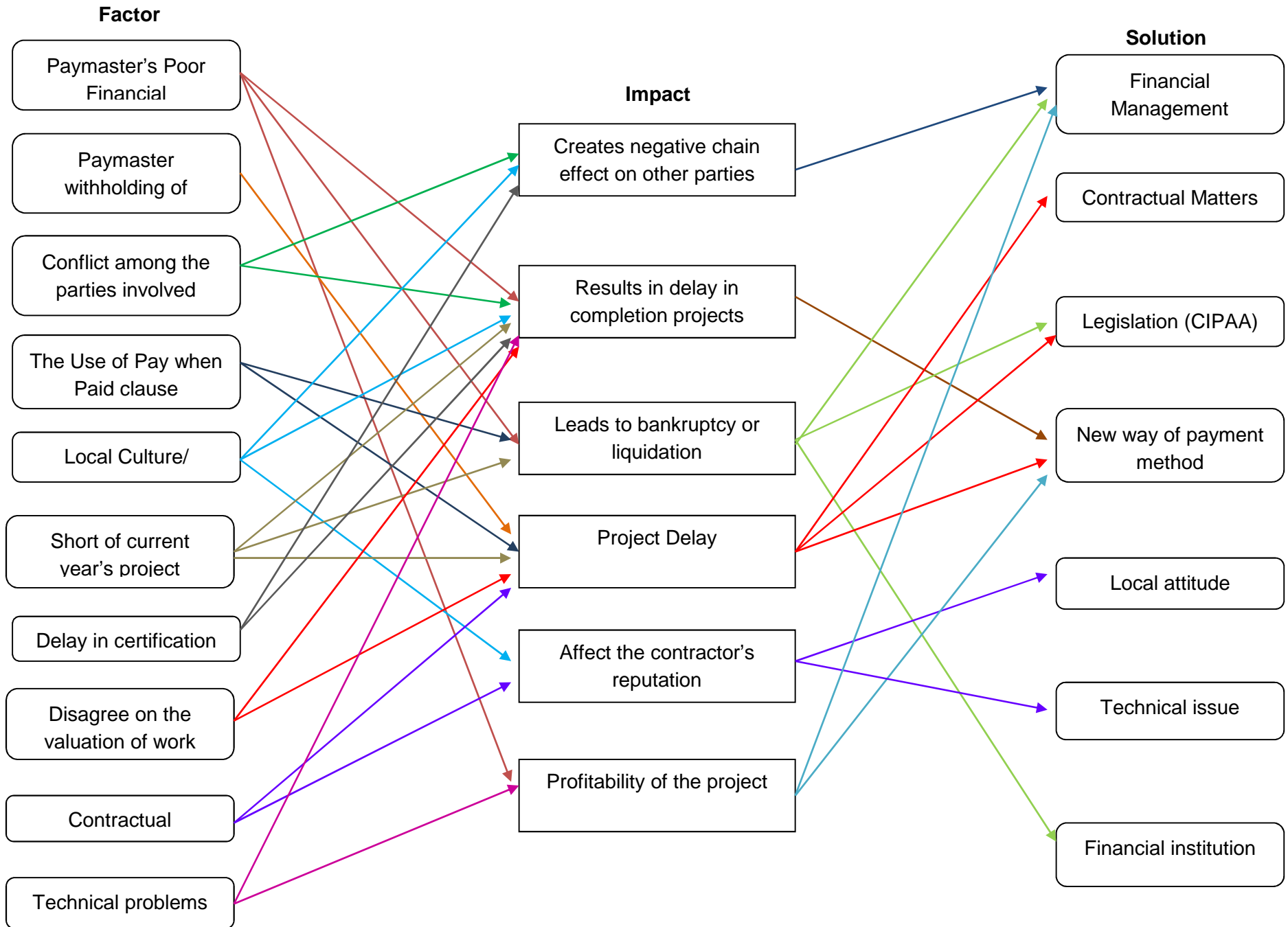


Figure 1: Framework of the study

5. Conclusion

The literature described above show that there are ten (10) factors that may contributed to the late and non-payment in Malaysian construction industry. The most significant factors that may contribute to the late and non-payment are short of current year's project and technical problem. The problem caused late and non-payment in current year's project include over deduction of the sum payment and bank line of credit constantly borrowed to the limit. The technical problem that may be the causes to the late and non-payment problem are mostly because of delay in processing for approval, delay in receiving progress payment from client, absence of a comprehensive business plan and wrongly calculated claims.

Based on the survey done by researcher mentioned above, the impact of those factors in late and non-payment problem are creates negative chain effect on other parties, results in delay in completion projects, leads to bankruptcy or liquidation, project delay, affect the contractors reputation and profitability of the project. The worst impact that may be happen when late and non-payment occur is the profit margin is small and this situation can led a player to go on bankruptcy and there goes another project on abandoned list.

The factors and impacts of the late and non-payment can be solved through financial management, contractual matters, legislation, new way of payment method, local attitude, technical issue and financial institution. Based on the survey done by the researcher, financial management is the best way to resolved late and non-payment issue.

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