

# Collaborative contracting: Making it happen

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Full implementation of integrated project delivery (IPD) or other forms of alliance contracting isn't for everyone. But everyone can and should implement collaborative contracting practices today to improve project outcomes.

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**A**lliance contracting, also called integrated project delivery (IPD) in the United States—in which owners, contractors, and engineers are integrated into a single contract—has been heralded as the cure for what ails contracting. Indeed, many large firms in other industries, such as retail, healthcare, and financial services, have had great success with IPD.

But for many major construction projects around the world, full-blown IPD implementation may not be feasible. When a major-project owner is bound by public procurement rules, for example, it is nearly impossible to award contracts to any party but the lowest bidder. In many other cases, corporate governance functions and the banks that finance projects restrict owners' ability to completely rewire contractual frameworks and limit their options for recourse when a contractor performs poorly.

Fortunately, this is not an all-or-nothing type of dilemma. There are many collaborative practices—some borrowed from the IPD playbook, others created as innovations in traditional contracting—that construction project owners and contractors can implement today to better align the objectives of all parties and boost productivity.

Collaborative contracting, like IPD, treats projects as mutual enterprises. But in the collaborative approach, parties work within the boundaries of traditional contracts—and their agreements rest on a fundamental belief that both owners and contractors want the best possible outcome and that each party brings unique strengths and capabilities to the table. Only if participants hold these beliefs—and implement a number of simple but important collaborative practices—can collaborative contracting lead to better project outcomes.

Each stage of a project life cycle presents multiple opportunities for collaborative practices, and in many cases these practices will have a meaningful impact on delivery times and costs and improve project performance on other metrics, such as safety and quality. To achieve these benefits, owners must be open to incorporate contractor input early in the process, select the right contractors, clearly articulate the potential incentives, and then work collaboratively with those contractors to develop, apply, and standardize best practices.

## Where collaborative contracting falls on the IPD continuum

For the vast majority of construction project owners and contractors today, the default mode of interaction is adversarial. Both parties fiercely guard their perceived commercial interests and protect against inequitably allocated risks. This misalignment results in cost inflation, project delays, and shortcomings in quality, safety, and performance.

In IPD-style contracting, the parties seek to better align incentives by replacing individual transactional contracts—such as those between owners and prime contractors, or between a prime contractor and its subcontractors—with a single agreement signed by all parties. Collaborative contracting is also geared toward building better relationships, but it lies within the fold of traditional contracting. It encourages more cooperative relationships along a project's contracting life cycle, which of course is a central tenet of IPD, by offering incentives for various cooperative practices and behaviors. And it achieves this collaboration without completely overhauling the way the contractual relationships work.

The incentives to collaborate are based on four key principles:

- Everyone involved in a project—from the owner to the primary contractor to the subcontractors—should work to articulate a common vision, which involves agreement on target cost and schedule and defining what constitutes success for the project and for the individual companies involved.
- Contractors must have the expertise to steer a project toward efficient delivery and positive outcomes; owners must use this expertise to help encourage specific behaviors that lead to better project outcomes. This takes the form of early contractor involvement in site selection, design constructability reviews, locking a scope at the appropriate time, and long-lead procurement support.
- Contractors must be allowed to earn a reasonable return on the work, and both risk and reward should be shared.
- Performance management and production planning must be done collaboratively and at a systemic level.

To some degree, market forces have made this type of collaborative approach a sheer necessity in contracting. For example, on the Gulf Coast of the United States, modularization and prefabrication have led to the replacement of on-site, “stick-built” LNG liquefaction plants with plants built from multiple mid- and small-scale process units. This shift has already begun to dilute some of the power of the large construction contractors by forcing them to collaborate with the process-module fabricators, which are fast becoming significant players in this new model.

As always, such major changes to convention pose formidable challenges. Participants that cling to the old ways of maximizing their own profit will exacerbate these challenges. When major-project owners seize the opportunity to bring diverse interests together under the umbrella of collaborative contracts, on the other hand, they can drastically boost their chances of success.

## Getting started

Common misconceptions notwithstanding, collaborative contracting is feasible in many different industries in both the private and public sectors. Based on our experience, we've identified a series of practices built on the four principles above that owners can initiate to spur a more collaborative approach.

- *Get contractor input early.* During the contracting-strategy phase of a project, when owners are deciding on scope and delivery models for each phase of the project—such as engineering, procurement, and construction (EPC) or engineering, procurement, and construction management (EPCm)—they would benefit from contractors' input on their capacity and appetite for financial risk. By soliciting contractor input early in the process, one large oil and gas company was able to design a smart contracting strategy for a technologically and geographically challenging project. It also reduced the duration of the tendering process and improved contract terms for both sides since the company already knew the capacity and risk appetites of its potential contractors.
- *Cocreate the scope and schedule.* Before releasing a request for proposal, contractors eager to help shape a project can work with owners to cocreate the scope and schedule. For example, when a European utility engaged in a structured process of consulting on the impact of schedule requirements on bid value with multiple contractors, it was able to reduce the cost of an EPC package for a gas-fired power plant by 27 percent compared with the first tender, run traditionally just a few years earlier.
- *Choose the right contractors.* When evaluating proposals, owners need to make sure that potential contractors have what it takes to get the job done well. A rigorous process begins with screening a full list of general contractors for basic attributes such as financial strength, compliance and safety, team experience, and performance history. Then owners can assess proposals for strengths and weaknesses among the people and processes, including a judgment on whether a given contractor is committed to a better contracting model and is open to sharing cost and other information. When contracting for a portfolio of plant projects executed over an extended period, owners should ensure that contractors prioritize long-term

relationships over short-term profits. For example, when a metals smelter in Europe needed to select three general contractors for a large project, the owner first conducted quick financial due diligence on all bidders to minimize the risk of selecting a weak contractor. The owner then designed a multifactor selection formula which rewarded contractors' experience on similar projects and their ability to assemble a strong team with experience working together.

- *Design win-win incentives.* During the tender process, owners should design—and discuss with potential contractors—a win-win incentive scheme that can be linked to and propel the value that's actually delivered. This scheme might align contractor incentives with key operational milestones, such as the production of the first salable product in the case of a manufacturing plant, or the first product “in tank” in the case of a refinery or chemical plant. The amount of the incentive should be commensurate with value added. For instance, a European utility building a conventional power plant found ways to offer its EPC contractor incentives for improved boiler efficiency, a key quality parameter that had enormous implications for the net present value of the project. The incentive resulted in the parties improving efficiency by nearly a percentage point, and the contractor received part of those savings.
- *Define processes that help capture value.* Unfortunately, even the best-designed incentives won't generate value by themselves. Throughout the project, owners must also create processes that encourage contractors to be aware of those incentives and take advantage of them. For example, owners can continuously find ways to encourage contractors to innovate and improve performance by implementing advanced production planning and lean processes. A North American utility-scale renewable energy developer used this approach to form an alliance of preferred contractors. These contractors shared ideas for shrinking costs, such as reducing manpower and improving designs, with the owner in return for a portion of any savings generated. Over the course of two years, the approach saved 3 to 5 percent per project.

In our experience, owners that follow these steps to creating more collaborative partnerships attract contractors that are better partners. Contractors that respond to concepts such as collaboration and win-win incentives are more likely to enter into partnerships with an open-minded approach. Of course, for collaborative contracting to work, contractors must be willing to provide clear visibility into project cost drivers, including subcontractor costs—not always a comfortable concept. Contractors must also agree to remain responsible for cost and productivity performance within its assigned scope. In return, owners must be willing to cover all of the contractor's reasonable costs if conditions outside the contractor's direct control affect project schedule and cost. When these conditions are met, we have seen significant and continuous improvement in project outcomes.

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Owners may fear that collaborative contracting will be difficult and time consuming. But done right, it should never be overwhelming. Reaching a collaborative contracting agreement shouldn't take more than 18 weeks from start to finish—it takes weeks, not months, for owners to identify key goals and months, not years, to reach them. And a pilot program can be rolled out relatively quickly. As with most business transformations, however, while all parties will enjoy some of the benefits of partnership right away, it could take several months to achieve the full benefit.

Across all sectors and asset classes worldwide, we have seen some project owners reap the full benefits of collaborative contracting. But to facilitate the effective delivery of large and complex projects, and to break the construction productivity curse, more owners must embrace true collaboration in contracting.

Moving from an adversarial approach to a collaborative model means taking into account the many construction value drivers beyond up-front bid price. It also requires both owners and contractors to believe that they can indeed share and apply best practices, continuously learn, correct errors, and better plan to reduce management complexity and cost. But in the end, our experience suggests owners must lead the charge toward collaborative contracting, and that they will find willing partners with their most motivated contractors.

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