

# Risk in Subcontracts Management

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**Abstract:** Instead of transferring, the contract risks to the contractors, in observe, the development company ultimately winds up presumptuous new responsibilities and risks that aren't forever evident. If some important measures are not taken by management team then hiring contractor for a particular project can increase risk of execution. This paper presents actions that management team should take to avoid risk in construction project that use the work of contractors.

**Keywords** — Contracts, planning subcontracts, risks, subcontracts,

## I. INTRODUCTION

Today, the most common way of executing construction work is directly hiring contractors for construction projects. But hiring a contractor without specific terms and conditions, rules will significantly increase the project execution risks. Management teams are not aware of the risks they are taking and it results in failure of project.

The paper presents some measures that should be carried out by the project management team to eliminate the risk while hiring contractors for project and increase performance of project by better contract administration. The lack of time forces the management team to make contracts with contractors without detailed planning, scope, and proper study of contractor's proposal which results in schedule delay, over budget of project, extra claimed.

This paper can help management team to take some steps in any type of construction project to minimize contract's risks to improve results in projects.

## II. CONTRACTORS – ONE OF THE MAIN SOURCES OF PROBLEMS ON CONSTRUCTION PROJECTS

Even though hiring contractors to execute construction projects of all kinds is a common practice, there are many problems for the contracting companies. However, the contracting companies are not always prepared to actively limit these risks. Not much attention is given towards preventing common problems, and project managers end up responding reactively, which can then cause significant financial losses for the contracting company.

The most frequent risks faced by the hiring company are: Fiscal and labor risks; Accidents on the job site; Delays in project execution and surpassing the project budget; Risk

of receiving a product of low quality/durability; and Risk of not receiving a warranty from the contractors. When contracting another company to execute part or all of a project, it's not possible to transfer 100% of the risk. The ultimate responsibility remains with the hiring company, and the same is true for promises made to the final client. It's rarely possible to transfer fines to the contractors, or transfer costs for extensive repairs and/or delays which might occur.

Without preventative action against risks, the planned profits from the contract can easily turn into huge losses to the hiring company. To guarantee the advantages of partnership with contractors, the hiring company must do the preparation for the entire contract process, paying special attention to the documentation done by the sub-contractor candidates and to creating a good risk response plan.

## III. HOW TO PREVENT RISKS

Two factors are fundamental in preventing the risks that arise when a contractor is hired: the contracting policies of the company and the attitude of the project manager. The contracting policies of the hiring company can cause many constraints in the project manager's work (e.g., many companies always hire the contractors that offer the lowest prices, without analyzing their structure or experience). Changing the company's policies is difficult, because it depends on the level of influence and autonomy of the project manager inside the organization, but a preventative attitude against risks during the contracting process is his/her obligation. The project manager plays a decisive role during the contracting and management of contractors, and therefore must always use the best practices that can help to reduce risks.

Based on the procurement management processes in *A Guide to the Project Management Body of Knowledge (PMBOK® Guide – Third Edition)* (Project Management

Institute [PMI], 2004), it is possible to suggest four steps that can help a project manager with the efficient management of contractors:

Contract planning, Contractor selection, Contract administration, and Corrective actions.

These four steps will be further elaborated in the following:

### **Contract Planning – Take the Time to do it Right**

One of the first problems faced by a project manager when hiring a contractor is also often one of the biggest obstacles throughout the whole project: lack of time! Many times the construction needs to start instantly after the signing of the contract, obliging the hiring company to select only those contractors that can start immediately. As many companies do not have an updated list of prequalified contractors, this lack of time in the initial preparation can cause failure in the contracting.

To start a contract off the right way, it's first necessary to reserve enough time to prepare the contracting process. It's necessary to define what exactly will be contracted and in which way, to decide how many contractors will be asked to give a quotation, and to prepare the detailed scope that will accompany each one of the contracts. It's also important to define in good time the selection criteria for the contractors (cost, structure, good references, documentation) and the requirements that will be demanded from each company.

This time, which is necessary at the beginning of the contracting process, is an investment of the hiring company for risk prevention. Many times, hiring the first contractor available to begin immediately seems to be the only way out for the project manager, but the results of this practice show that things do not work out that way. Contractors hired in this manner hardly ever meet the real needs of the company and, hiring a contractor in this way is no guarantee that your project will be delivered on time. Contract planning is essential to a successful partnership, and during the contracting process, the project manager must stick to the selection criteria established during planning.

### **Selecting Contractors – Use Your Planned Criteria**

Once the scope is defined and the selection criteria agreed, the moment of hiring the contractors comes. Beginning with the contractors' proposals, the project manager and his or her team must select the contractors based on the advantages and risks that each one can bring to the project. A necessary part in evaluating a contractor is to review:

The documentation of the company and employees, Good

references of past work,

Price, and Company structure

Hiring a contractor without their documentation (of the company and employees) in order can cause the failure of the project. Labor disputes and legal battles can cause serious losses to the hiring company. Should the contracted company be remiss in any of its requirements, it ultimately reflects back on the hiring company, so it's necessary to Take care, verify the contractors' documentation, and keep an updated registry throughout the whole project.

It's also important to check the references from previous work by the contractor: (1) to see if any of their previous work was similar in size, complexity and quality of finish to the current project; and (2) to certify that the relationship between the contractor and the contracting company was good and, in particular, find out if the contractor gave assistance and guarantees in cases of construction issues.

The contractor's price should not be treated as the only criteria for the contracting process. It is certain that the price is important and that a project manager will always be trying to get the best financial result for his or her company. Normally, the problem is that the price ends up being the ONLY criteria used in practice when hiring contractors. The hiring company believes that the savings from the lower price compensate for the risk taken—a decision that's often wrong. According to Choma (2005), hiring the cheaper contractor is rarely the low cost solution.

Together with the analysis of the price proposals, the contractors themselves must be evaluated. A contractor without an adequate structure may not have the proper conditions to execute the contract on time and with the expected quality. The hiring company must, therefore, give more weight to the contractors with the most adequate structure: sufficient and trained labor, appropriate equipment, and trained technical personnel. In the majority of situations, it's worthwhile to pay a bit more upfront in order to have a better contractor who's able to execute the contract as specified, without causing problems that can cause large losses during or after the project execution.

### **Contract Administration – REALLY be in Control**

Once there is a well-detailed contract with all the conditions agreed, the work starts up on the job site. From now on, the project manager has the responsibility of making the contractors fulfill everything that is in the contract, applying all of his or her efforts to manage the contract as best as possible. One of the few things that the project manager knows for sure is that things will change, and it might be necessary to change the contract during the execution of the project.

In order to control the contract (and the project), good planning is essential, and this will be discussed more specifically in the next topic. Assuming that adequate planning has been done, the project manager and his or her team work to follow the contractors' performance closely, comparing it to the contractual requirements. Different events can happen: project milestones are not met, triggering penalty clauses against the contractors; and design modifications or change requests from the final client can occur. These can cause alterations to the project scope, time, and cost. For that reason, the project management team must constantly be aware of all changes and keep the contract synchronized with the actual work been completed on the job site.

Another aspect needing attention throughout contract management is communication. The project team must have a communication plan and be using it all the time. The Official communication channels must be evident, as well as which individuals have responsibility within the different teams involved. The project manager must be constantly aware that information exchanged through official channels has the possibility to impact the contract, and therefore, must be closely tracked.

Beyond the attention given to the project time, cost, and quality, it's also necessary to follow the contractors' documentation throughout the execution to avoid surprises, such as future legal problems. This documentation has a huge impact on the project's success, and in some countries it must remain on file for up to 20 years.

To be in control of the contract means to closely follow the contractors' results, in order to note any deviation from the plan and to regularly perform trend analyses. To correct deviations, the project manager must decide which actions will bring the project back to what was planned.

### **Corrective Actions – Take Actions Based on Trustworthy Data**

How can one determine which actions are necessary to put the project back on track? Closely follow the results obtained from the contractors, comparing them to the contract and to the project schedule. Because of an insufficient planning capacity in the majority of contractors, the general contractor is obliged to keep close control of the contractors' work and try to anticipate any problems.

Following the productivity of the contractors' workers is not the responsibility of the general contractor's team, but we know that this is often necessary because few contractors have real control over the productivity of their workers. The biggest problem is that many general contractors do not prepare the planning structures necessary in order to closely follow the contractors' work. This practice can make the hiring company only notice a

problem when an important milestone is not achieved on time.

Based on the project plan and scope of the contract, the project manager needs to anticipate problems by meeting regularly with the contractor to decide together, if necessary, what corrective actions must be taken. The action plans that result from these meetings must be followed by the project management team to ensure their effectiveness. Contractors who repeatedly do not follow the stipulated plan must have their contracts reviewed and, depending on the evaluation, their contract could be rescinded.

### **Planning and Control – There is No EFFECTIVE Management without EFFECTIVE Control**

The contractors' work plan is the basis for contract control, that is, there is no effective control if there is no planning. After deciding on the final construction schedule, the main deadlines are put into the contractors' contract as constraints to guarantee that the most important stages of the project will be delivered on time to the general contractor. Performance and productivity goals are also Specified in order to facilitate the control of project execution.

Periodically, the project management team must update the project controls, calculate the actual performance index, and compare it to the project plan. The frequency of these updates will depend on the length and type of the project, but usually a weekly update is enough. With the deviations identified, the project manager must meet with the contractor and define the strategy for correcting the problems and bringing the project back in line with the plan.

To reduce the problems that can result from the contractors' lack of management expertise, the project team can help with problem identification (e.g., low productivity) and propose problem solutions in order to guarantee that the project will succeed in meeting the contractual requirements. This additional planning effort by the general contractor will be compensated for by the reduced risk to the construction project as a whole, and by ensuring better control of the contractors' actions.

It is also important to remember that the planning phase does not end when the construction starts; all control actions generate action plans that must be followed and carried through. If the risk impact is big, or if the risk exposure of the contract changes during the project execution, probably the project plan will need to be changed. The project management team must stay alert, keeping project information and the project plan "alive" all throughout execution, so it's available, and therefore,

useful for control actions.

What is, therefore, understood by effective control? Following the contractors' work closely, utilizing an up-to-date project plan, with detailed up-to-date performance information from the job site.

#### IV. CONCLUSION

For the process of hiring subcontractors not turn into a torturous experience for the general contractor, the project manager, together with his or her team, need to give them adequate time in order to complete the hiring process correctly. Not following some of the essential steps before hiring subcontractors, can significantly increase the risk exposure of the project. A result of poorly made subcontractor agreements is that some of the most damaging financial problems can appear long after the project has been delivered, via labor disputes, quality problems, etc. Adopting a mindset of prevention towards contractual risks is an obligation of the project manager; his or her company needs to give him or her the necessary support and avoid that subcontractors are selected, in the end, solely because they are the low cost provider.

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