SUBCONTRACTING GROWTH
2019
Subcontractors are often overlooked. As in our previous reports, this research reveals the challenges and opportunities that businesses in the construction sector face today, from operational issues to macro-economic factors.

Linked with fears around labour shortages and rising costs, it’s unsurprising that Brexit is the primary threat to the sector, with a quarter of respondents (25%) citing it as their main challenge. Yet subcontractors are also facing commercial pressure from decreasing work volumes (13%). As pipelines are squeezed, this has driven them to prioritise higher value contracts, increasing to an average contract value of £175,951 this year, compared to £130,968 in 2018.

Nationally, the sector has been under pressure from softer economic growth projections and subdued demand for new commercial projects. This has been reflected in the construction Purchasing Managers’ Index (PMI) data, which saw the sector contract in February and March this year. Despite these challenges, the sector is still performing well. Our research found that it is business as usual for more than one in ten (13%) subcontractors, whilst other subcontractors consider their biggest opportunity to be new, larger or better contracts (9%). However, the fact remains, the sector is experiencing a period of relative inertia.

Whilst a cautious attitude is driving much of this behaviour, there are signs subcontractors are taking unnecessary risks. For example, one in four said that they do not always thoroughly check their contracts, and nearly half (48%) find them difficult to understand. Despite this, a majority (59%) do not seek professional support in relation to checking contracts. Our research also provides further evidence of this power disparity. Over half (55%) said that they have to accept contracts as they are, otherwise, they would lose business. Two thirds (66%) said they do not always receive the full amount billed. This suggests subcontractors do not always have the professional help or internal support they need to do business with contractors on equal terms.

Addressing this problem requires a change in the sector. Whilst it is perhaps understandable that primary contractors are looking to protect themselves, particularly in light of recent high-profile collapses, they need to realise that subcontractors and their supply chains are crucial to the long-term success of the industry. Backing from the Government and changes to legislation would also support this shift, such as enforcing a mandatory Prompt Payment Code.

Main contractors need to put an end to the large versus small culture. Recognising the value of subcontractors is one way of doing this but paying fairly and on time would help level the playing field for smaller subcontractors. Failure to recognise their skills and contribution to the construction industry can only cause problems for a sector that needs to work together to achieve growth and prosperity.

**KEY FINDINGS: 2019**

- **£175K**
  - Average value of contracts
- **17%**
  - Personal savings as a source of funding
- **£10K+**
  - Average amount written off in bad debt
- **48%**
  - Find contracts difficult to understand

**A FAIRER SECTOR IS THE KEY TO GROWTH**

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This year’s research revealed that subcontractors have less work in the pipeline in comparison to the same period last year. Firms have reported an average of 19 weeks work in the pipeline, compared to 27 weeks in 2018. However, the average value of a new contract is higher in 2019, with subcontractors reporting an average contract value of £175,951 compared to £130,968 in 2018. This suggests business owners are making a conscious effort to prioritise larger contracts to compensate for less available work.

HOW IS THE SECTOR FUNDED?

We’ve been funding SMEs in the construction sector for over 10 years and, in that time, we’ve seen the funding landscape change significantly. Historically, it has been difficult for SMEs to source funding as upfront labour and material costs often need to be paid before a job is completed. This requires traditional lenders to take on a lot of risk. At the same time, subcontractors may also have day-to-day business costs to meet during the delivery of a project.

Pressures like this can mean that many traditional lenders find it difficult to fund the sector adequately. Our research shows that these challenges may be impacting the funding options available to subcontractors.

Bank overdrafts remain the key source of funding for one in three (33%), followed by nearly one in five (17%) who are reliant on personal savings or loans from friends and family, which has almost doubled since last year (9%). This is particularly concerning when a similar number of subcontractors are using credit cards or traditional bank loans (16%) to fund their business.

All of the above forms of funding are unsecured, which means they are only supported by the borrower’s creditworthiness. Funding in this manner may provide some stability for growth but is often inflexible and can leave subcontractors with insufficient cashflow to meet the needs of running their businesses.

In fact, nearly half (48%) of the subcontractors we spoke to are writing off an average of £10,641 in bad debt from unpaid work. Undoubtedly, this is leaving many with a funding shortfall at a time when they need to be investing in themselves or funding larger contract work. In such instances, bad debt protection allows a business to pass on the risk of non-paying customers. This gives business owners the peace of mind that they will not be left out of pocket for the work they complete.

Overcoming these challenges requires firms to take advantage of the funding options available to them. Some subcontractors may be missing out completely, as nearly half (47%) aren’t using any form of funding at all.

Funding shouldn’t be a solely defensive or protective measure. Business owners can, and should, use their funding to unlock new sources of growth. This could take the form of hiring additional employees with new skills, purchasing specialist equipment or branching into a new sector.

Whatever the future holds, ambitious subcontractors should look to use different forms of funding to help them reach new goals and achieve bigger and better things for their business.
A SECTOR UNDER THREAT

A quarter (25%) of subcontractors see Brexit as the biggest threat to their business with larger businesses the most likely to cite this as their biggest threat. This is likely driven by the exposure that bigger businesses have from negative economic headwinds linked to Brexit, such as those that rely on trade or employ labour sourced from overseas.

The weaker pound is another factor adversely affecting businesses across the board. It has increased the cost of importing raw materials, and so it is no surprise to see that more than one in ten (12%) subcontractors, with a turnover of £5m plus, are the most affected by this as they tend to purchase more materials.

The research revealed other threats, including fears linked to a lack in demand / decrease in work (13%), the UK economy (8%) and skills shortages (8%).

PREPARING FOR BREXIT

Even though the largest threat identified by subcontractors is Brexit, few have acted to mitigate this threat. The research found that two thirds (66%) have not done anything to prepare.

Of those that have prepared, the main actions they have taken are holding back from recruiting staff (17%) and building up company cash reserves (16%). A small number (9%) have also taken on contracts they would not normally have accepted and have done so because of a decrease in demand for their services.
PAYMENT PRACTICES

This year’s research reveals that average payment terms are 30 days, however subcontractors are waiting an average of 42 days to receive payment from their main contractors once they have issued an invoice. However, nearly a third (29%) of subcontractors are still waiting over 55 days to receive payment.

RECEIVING THE FULL AMOUNT?

The research also reveals that around two thirds (66%) of subcontractors do not always receive the full amount they billed. The most cited reasons for not receiving the full amount are:

- Disagreement/disputes over the contract or invoice (11%)
- Queries relating to the quality of work (11%)
- General disagreements (10%)

BAD DEBT

Nearly half (48%) said they have written off an average of £10,641 in bad debt / unpaid work in the last 12 months, although this has improved from £16,148 in 2018. This may be due in part to subcontractors being more cautious and taking steps to protect themselves following the collapse of leading contractors. Additionally, they are taking on fewer contracts than in previous years, which reduces their exposure to risk.
One in five (20%) do not always thoroughly check the contracts they're signing, a slight increase since 2018 (17%).

Nearly half (48%) find contracts difficult to understand. The net proportion of those finding contracts difficult to understand has increased from 44 per cent in 2018 and 38 per cent in 2016.

Nearly three in five (59%) do not seek professional support in checking contracts, a similar proportion to 2018 (61%).
“There is a sense of fear and trepidation in the construction sector at the moment, caused in large part by Brexit. No one wants to be mid-project when Brexit day finally arrives, and this has resulted in subcontractors electing to take on shorter term contracts in order to reduce risk – BFS’ findings reflect this trend, revealing that pipelines have shrunk by 30 per cent this year.

It is not just subcontractors who are worried. Contractors are trying to insulate themselves from the effects of economic uncertainty by introducing extended payment terms and more aggressive sub-contracts. The big issue here is that whilst contractors are indeed protected, we have encountered numerous examples where the contract terms suggested would have caused subcontractors to go out of business. Payment terms need to be fair for all parties and the risk can’t just be pushed down onto the smallest members of the supply chain – who are vital in driving the country’s economic growth.

It’s great that finance providers, such as BFS, offer training to their clients, have a telephone helpline in place and offer discounted legal support. Subcontractors need to be made aware that whilst it may seem as if they have no power in negotiations, there is professional support available to them. Simply crossing their fingers and hoping for the best shouldn’t be the default option.”

The research found that subcontractors still feel powerless when it comes to negotiating the terms of their contracts. Over half (55%) said they have to accept contract terms or they risk losing business, a very similar position when compared to 2018 (56%). Meanwhile, smaller subcontractors are the ones that are most likely to accept contracts because they risk missing out on business. Three fifths (60%) of businesses with a turnover below £500k said they would accept contracts, compared to over two fifths (44%) with a turnover of £5m+. 
CREATING A FAIRER SECTOR

The research shows that there is overwhelming support for regulatory intervention in the sector, with 89 per cent of subcontractors indicating they would like to see the Government provide more support to the construction industry.

The chief concern is a desire to redress the power balance between main contractors and subcontractors on payments. Almost three quarters of subcontractors (74%) support the introduction of compulsory adherence to the Prompt Payment Code.

The sector is also calling for more business opportunities from public sector contracts, with over three fifths (62%) of subcontractors wanting to see the opportunities from large contracts distributed more widely. This could be achieved by opening up the public sector procurement process to smaller firms.

The third most important policy priority is the abolition of cash retentions in construction contracts, which was supported by three fifths (60%) of subcontractors. Finally, over half (53%) support mandatory Project Bank Accounts (PBAs) for payments on Government and public sector contracts.

EUROPEAN CONCERNS

When it comes to trading, over half (55%) of subcontractors are calling on the Government to avoid tariffs on goods to the EU, which is a concern closely linked to the cost of materials.

A similar number (54%) of firms want the Government to secure trade deals with new markets which businesses can then access themselves. This will offer British companies the chance to diversify their offering across multiple markets and open up new avenues for growth.

89% of subcontractors would like to see more support from the Government

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METHODOLOGY

Fieldwork was conducted between 4th April and 1st May 2019 by an external research agency, Critical Research.

250 telephone interviews were carried out among 250 subcontractors. The average turnover of these businesses was £16m.
ABOUT BIBBY FINANCIAL SERVICES

Bibby Financial Services is a leading independent financial services partner to more than 7,000 UK SMEs. Formed in 1982, we are a member of UK Finance, supporting the growth of businesses in over 300 industry sectors.

Our total funding capability exceeds £1bn and through our network of 19 regional offices we handle annual client turnover of £6bn.

Our portfolio includes invoice discounting, factoring, export finance, asset based finance, lease finance, foreign exchange services, and specialist funding for the construction and recruitment sectors.

In 2011, 2012, 2014, 2015, 2016, 2017, 2018 and 2019 the company was awarded a place in The Sunday Times 100 Best Companies to Work For, ranking 42nd in the most recent poll.

To find out more about Bibby Financial Services, visit: www.bibbyfinancialservices.com

ABOUT THE VINDEN PARTNERSHIP

The Vinden Partnership (Vinden) is a multi-disciplinary firm of management consultants. It has a 24 year track record of providing innovative services to the construction, engineering, banking, asset based lending and insurance sectors.

The team is made up of chartered quantity / building surveyors, adjudicators, arbitrators, barristers, forensic planners, engineers and architects, many of whom are dual qualified and from an industry background with 24+ years’ experience.

The Vinden Partnership provides services through its regional offices and network of client relationships throughout the UK and beyond.

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