

Relational Contracting

White Paper

Introduction

It is noted that a change in the successive theories of production has started to induce a gradual change in the existing contractual arrangements. Construction, which has long since been considered as a form of production is also under the influence of this phenomenon. The theory of production focuses more on contracting than how the different inputs to production are acquired or how production is initiated and the right product obtained. Based on this idea, researchers began to inquire if contracting as a realm is discrete enough or if there are underlying aspects which need a closer review to understand the relationships between project participants. This is how the concept of relational contracting arose and it was found that it is most coherent with the new production methods.

What is a relational contract?

The underlying philosophy

After extensive research, Macneil concluded that there are primarily two kinds of contracting engagements; 'transactional' which is product-oriented and 'relational' which is process-oriented. His contention was that the latter is more consistent with the flow and value generation production theories advanced by the Lean Construction community. This was substantiated by further discussion of two salient aspects of contracting- 'risk' and '(aversion to) collaboration'. Macneil outlines three fallacies related to risk which render conventional contracting insufficient when it comes to contracting organizations grappling with global competition and still trying to maintain profit margins and deploying cost-effective, time-saving and quality-improving methods. According to

Murdock & Hughes (1996) and Bevan (2005), in a construction project undertaking, the risk associated with execution and that which participants are subjected to are considered separately while process related risks are often overlooked. This becomes significant when communication systems for a project do not consider the interdependent relationships of the project participants and only serve to protect project interests and ignore the relational aspects or participant interests.

A relational contract provides the means for sustaining long-term and complex contracts with a high degree of flexibility in order to allow parties to express their detailed knowledge in specific situations and adapt to new environments (Macneil 1978, 1980; Joskow 1987, 1990; Leffler and Ruker 1991; Gundlach and Achrol 1993; Swierczek 1994; Cheung 2002). The performance standard is therefore governed by best effort or "good faith" requirements.

Why relational contracts in Construction?

The increasing realization that collaboration amongst all project participants is paramount in construction is resulting in a shift towards formal partnering to enhance project performance and relationship between parties (Cook and Hancher 1990). According to Hancher (1989) and Goddard (1997), the conventional design-build contracting delivery mode is insufficient to accomplish effective collaboration and respond to contingencies. Relational contracts have proven to be a successful medium to attain mutual benefit and develop long-term relationships and avoid adversarial tendencies (Rubin and Lawson 1988, Provost and Lipscomb 1989). Formal partnering and project alliancing are illustrative examples of relational contracts which are

already in use (Walker et al. 2002, Hauck et al. 2004, Wong and Cheung 2005).

Analysis of Relational Contracts

Researchers have approached relational contracting with two different outlooks, based on 'communitarian aspects' (Macneil, 1978) and 'economics' (Goetz and Scott, 1981) but the overall goal remains the same. The main idea is to enhance the project performance by maintaining long term relationship of parties, which acts as a buffer under the constraints of uncertainties, complexities, short lead time and unfavorable market competition.

Based on the communitarian aspect, the contribution of relational contract is to create value beyond the project not only for its participants; but also to the society through the development of sustainable communities. Here, prominence is laid on trust and partnership of project participants rather than the terms of the contract. This results in greater commercial value to individual participants and also effective team working through sharing of knowledge and benefits. It brings value to a project, when time, cost and quality objectives are achieved despite complex and challenging parameters. In her study, Barbara Colledge (2005), avers that the impact of relational contracting beyond the project is explored through four pillars of sustainable communities namely competitiveness, citizenship, connectivity, and creative citizens. The sense of community and commitment that develops during a project is extended to the community through corporate citizenship. Connectivity seeks culture change on a grand scale with emphasis laid on trust, less adversarial and more relational contracting, greater reciprocity and focus on the common purpose of client's needs. Creative citizens call for a radical change in the attitude of people and their development of skills. It encourages innovation, tolerance and entrepreneurship. Relational Contracting creates tangible and

intangible value to each of these four pillars with enhanced individual and organizational participation.

A relational contract is most recommended when the transaction is usually of a long duration, personal interaction is crucial, the future cooperation opportunity is large, there is a large degree of flexibility to cope with foreseeable matters, and it is anti-discreteness and anti-presentation (Macneil 1978, 1980; Joskow 1987, 1990; Leffler and Ruker 1991; Gundlach and Achrol 1993; Swierczek 1994; Cheung 2002).

The relational extent of a contract may be measured by factors such as cooperation, organizational culture, risk, trust, good faith, flexibility, use of alternative for dispute resolution and contract duration (Cheung 2002, Feinman 1992, Goddard 1997, Halsbury 1973, 2000, Haugland 2003, Macedo Junior 1997, Macneil 1974, 1975, 1978, 1987, 2001, Mcinnis 2003a,b, Williamson 1979, 1985).

'Cooperation' is a situation under which the contracting parties work toward the common goals and benefits of the project (Hartnett 1990)

'Organizational Culture' is the social energy which guides human behavior in an organization (Kilman et al. 1985). It provides implicit directions for the organization's members (Swierczek 1994).

'Risk' refers to a situation in which the assessment of the probability of a certain event is statistically measurable. It relies upon the availability of known events for this purpose (Ashworth 1999).

'Trust' is a complex construct with multiple bases, levels, and determinants (Hart 1988), and is often associated with situations involving personal conflict, uncertain outcomes, and problem solving (Whitney 1996). It is also a prediction and expectation of future events. Varying in intensity,

this is the confidence in and reliance upon the prediction (Rosenfeld et al. 1991).

'Good Faith' governs the contracting parties' behavior in terms of honesty (McCinnis 2003a, b).

'Flexibility' in a contractual performance is made explicitly or implicitly contingent upon external events affecting one of the parties, therefore making it a form of insurance and risk sharing. The riskier the environment, the higher the need for flexibility, the higher the likely incidence of contract nonperformance, and the higher the expectation to renegotiate (Bigsten et al. 1999)

Use of alternative dispute resolution- is an alternative to adjudicatory procedures. The ADR includes conciliation, mediation, adjudication, and the dispute resolution advisor system.

Contract duration- refers to the length of the contract period. Generally, the longer the contract period, the higher the chance that changes will occur and thus a greater reliance on the relationship is needed to maintain the contractual bond.

Structure of Relational Contracts/ How do we facilitate relational contracts?

A Relational contract is one agreement, signed by the owner, architect and the contractor; that is later "joined" by sub consultants and sub contractors. There are no "general conditions". Due to the significance of the relationship of parties, relational contract provides for the formation of an integrated project team which comprises of the core group, an integrated project delivery team and a senior management team. The core group is responsible for the overall management. The members of the IPD join the core group as needed based on the challenges and the phase of the project. The senior management team is to keep the groups focused on learning and innovation.

The relational agreement sets out the "business case" as basic design criteria for performing 'Target Value Design' (TVD). The core group is responsible for establishing communication protocols rather than simply stated what systems and tools will be employed. The group is also required to provide a validated budget as a basis for performing target value design and the plan for doing TVD. One innovation in the relational agreement is the requirement to plan and manage the project in clusters of specialists according to systems and phases of the project. There are new provisions in the construction phase: a 5S plan and a goal of zero RFIs. CII suggests that 10% of construction cost is "rework". Therefore, a "Built-in Quality Plan" seeks to directly attack the root causes of quality failures. To make sure the workers in the workplace understand the conditions of satisfaction for the work they will put in place standardized work is necessary along with QC feedback to the workers along with regular interaction with the design staff to understand their standards for accepting the work."

Application of Relational Contract

A good example of use of relational contracting is at the non-profit organization, Sutter Health, Sacramento, CA, where the project participants have contractually accomplished 'Target Value Design' and 'Built-in Quality'. The Lean Project Consulting, Inc. facilitated this endeavor by putting together five ideas and combining it with a new agreement form and relational contracting in order to achieve better project performance. 'Relationship of the parties' was the node for this venture and the five ideas were- to promote collaboration of the whole process from design through construction, to enhance the relatedness amongst all project participants, to view projects as a network of commitments, to optimize a project as whole and not in parts, to combine actions with learning. It is known that design and construction is not a product but a process-based and service-oriented industry which is

significantly affected by relational aspects of the parties involved in the life cycle of a project and the results are evident in the outcome. Therefore, a combination of relational contracting with integrated team effort will help us accomplish better project delivery and hence performance. (William Lichtig, McDonough Holland and Allen PC, 2005)

Limitations/ Continuing Concerns

In addition to all the progress that has occurred, further issues that are causes for concern and need attention are commitment of project participants, expanding the integrated project delivery team, risk management, standardization of direct cost definitions, sharing of gains.

Gaps/ Required Provisions

The further required provisions for the successful progress of relational contracts are developments of new financial provisions such as joint integrated project delivery team contingency, budget to cater to the re-design expenses; and development of new construction provisions such as 5S plan, zero RFIs, built-in quality, payments and problem resolution.

Conclusion

Relational contracting primarily fosters mutual trust and dependability among the stakeholders. The time, cost and quality issues are managed collectively and greater emphasis is laid on the process rather than just on the product.

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