Marsh

Marsh Specialty

Contractor risk review 2021

Top 10 risks analysed

November 2021

> **The shadow cast by the COVID-19 pandemic, is a much longer one than was presumed at the start of 2020, impacting risks in the construction industry in a range of ways.**

Contents

Introduction

Welcome to Marsh Specialty's *Contractor Risk Review 2021* (CRR), analysing the risks most commonly identified by the UK's largest contractors.

In our last annual review in September 2020, we highlighted how the construction industry was facing some of its biggest challenges in living memory, with risks and opportunities for contractors across a wide range of business segments. We updated the development of some of these areas in our Interim Contractor Risk Review, released in May this year, which specifically looked at how Brexit, potential mergers and acquisitions activity, and increasing levels of cyberattack are affecting the perceived and actual risk profile of the construction industry.

As well as the obvious constraints on the future movement of labour that the UK's withdrawal from the EU instigated, our study of Brexit's effect on the industry also highlighted the developing risks of material price increases and delays in the supply chain. The causes of these are deeply intertwined with the general impact of, and recovery from, COVID-19 and we have considered this topic in more detail below. Begun to be felt in the early part of 2021, when they were exacerbated by the week-long closure of the Suez Canal, increases and delays have become far more sustained than originally envisaged.

Many of the trends cited in our previous annual review as giving rise to construction industry risks, continue to develop. Increased digitisation, along with innovations, such as 3D printing, advances in unmanned aircraft systems, and offsite manufacturing, are continuing to reduce the time taken to construct infrastructure and buildings. These factors also have a direct impact on labour requirements — which may go some way to addressing chronic skills shortages within the industry, over the long term. Likewise, the UK government's plans to loosen planning on the one hand and tighten building regulations on the other, have the potential to offer both opportunity and challenge to the construction industry. With the UK's commitment to become net-zero carbon by 2050, and the shift in the business environment in the post-COVID world, environmental, social, and governance (ESG) issues have started featuring in mainstream corporate agendas, and we have included some detailed discussion of this topic as well.

The impact of COVID-19

There is no doubt that the COVID-19 pandemic, which continues to wreak havoc on the health, wellbeing, and economies of the entire world, will be seen as a seminal event in history. Research suggests that the impact of the pandemic on construction industries globally resulted in a 2.4% contraction in real output value in 2020.[1]

It is estimated that total construction output in the UK fell by a record 40.1% in April 2020 following the first national lockdown — this was the largest month-on-month fall recorded since records began.[2] However, it would be fair to say that the industry, as a whole, has recovered relatively swiftly. Despite construction output in June 2021 still being 0.3% (£39 million) below the February 2020 pre- COVID-19 level, the annual rate of construction output price growth was 3.4% in June 2021, the strongest annual rate of construction output price growth since August 2019.[3]

Yet, these headline figures mask the reality of the huge amount of additional work construction companies had to undertake by reopening sites throughout much of 2020 and into 2021, while COVID-19 infection rates were high. Companies were confronted with having to adhere to government regulations to resume normal working operations. As a result of these regulations, they had to undertake risk assessments, review on-site operations, and implement newly-mandated social distancing measures that limited the number of people allowed onsite. All of this has increased cost and had a knock-on effect on productivity and project lead times.

The realities of living with the virus have also placed a significant strain on contractor human resources departments[4], which have had to ensure new sanitary equipment and procedures are in place to protect employees, and that support is available to help them manage the stresses of COVID-19 fears and lockdowns. Many companies have reacted by turning to telemedicine for speedy diagnoses and online check-ups.

As referenced above, the resumption of construction works, post lockdown, has seen a boom of pent-up demand in the industry, which has been mostly responsible for a sustained general increase in materials prices that began to be felt back in the second half of 2020. As an example, by May 2021, the cost of timber prices in the UK was up by 80% since November 2020.[5] The week-long closure of the Suez Canal added to the pressure of new labour and goods movement regulations, while stockpiling following Brexit has greatly exacerbated this trend in the UK, although globally, other factors are at play.

These include greater demand for raw materials for manufacturing and construction to sustain the strong recovery in China; the huge increase in internet purchasing feeding demand for packaging; and a global shortage of shipping containers leading to higher freight costs and further constraints in the supply chain. The supply chain has also been pressured in the UK by the lengthy closure of builders' supply merchants, forcing firms to secure alternative suppliers or suspend operations in the face of materials shortages — again pushing

2.4% global construction in real output value in 2020[1]

40.1% fall in UK construction output in April 2020[2]

80% increase in UK timber prices since November 2020[5]

25.7% contractors surveyed state that work has returned to normal (Global Data 2021)

48.6% of contractors continue to face obstacles in their attempts to resume normal operations

1 GlobalData Analyst Briefing Wednesday 9th June 2021 (data paid subscription access only)

2 https://www.ons.gov.uk/businessindustryandtrade/constructionindustry/bulletins/constructionoutputingreatbritain/april2020

3 https://www.ons.gov.uk/businessindustryandtrade/constructionindustry/bulletins/constructionoutputingreatbritain/

4 https://www.mmc.com/insights/publications/2021/april-/pandemic-induced-hr-challenges.html

5 https://www.theguardian.com/business/2021/may/15/building-crisis-looms-as-dwindling-supplies-bring-sites-grinding-to-a-halthtmljune2021newordersandconstructionoutputpriceindicesapriltojune2021

up costs.

So, where does this leave the contractor sector as we approach the end of 2021? Research undertaken by GlobalData on a global basis suggests that the extent to which COVID-19 challenges currently affect construction companies is mixed. Of those surveyed, 25.7% stated that work had now returned to normal, while 48.6% reported that they continue to face obstacles in their attempts to resume normal operations. However, surprisingly, a significant proportion of those surveyed, some 25.7%, reported no disruption due to the COVID-19 pandemic whatsoever.

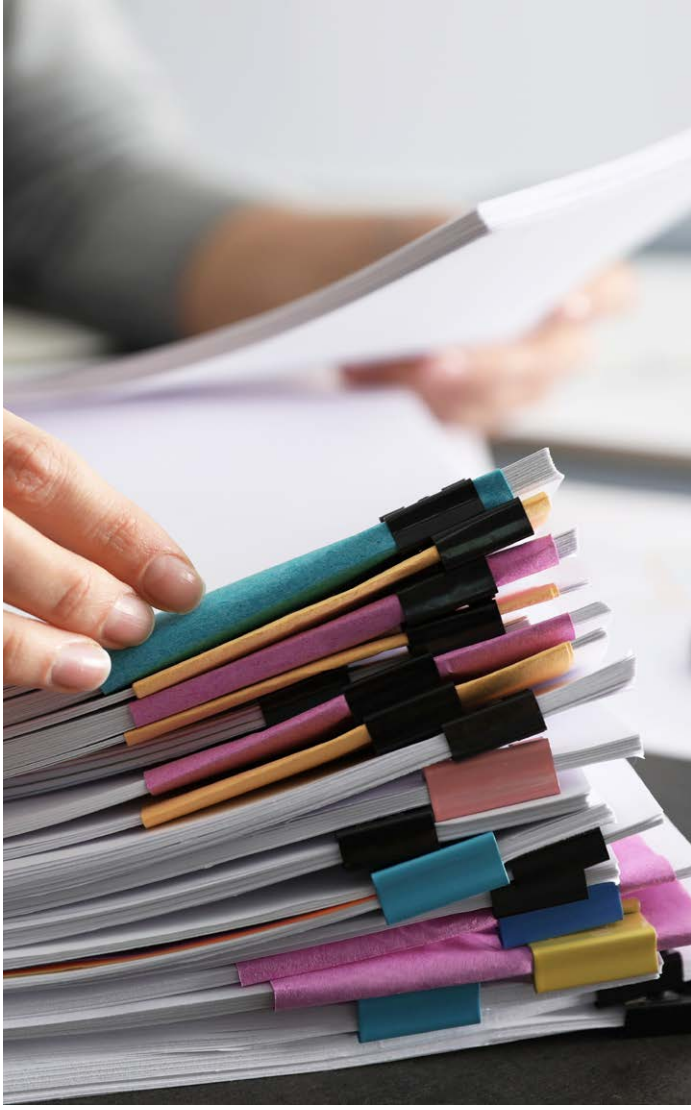
While the industry moves towards recovery, firms will need to be proactive in reviewing the robustness of core suppliers, developing innovative procurement approaches to ensure potential long-term risks are managed in a transparent and efficient way. That includes reviewing contract clauses to help mitigate short-term risk, and moving away from traditional global supply chains, in order to be able to evaluate local partnership opportunities.

ESG in construction

Environmental, social, and governance (ESG) requirements in business, driven by increasing governmental regulation, greater consumer awareness, and broad stakeholder demand for action on such issues, is having a huge impact on the construction industry. Further, financial institutions are beginning to reference corporate ESG metrics and strategies to inform investment decisions and insurers are starting to scrutinise such data before committing to cover certain risks and projects.

In recent times, broadly, areas such as sustainability, health, and wellbeing have been treated as separate entities, without interlinkage to each other, or to business growth. However, from 2021, a minimum of 10% weightage is allotted to ESG objectives in each UK government procurement tender. The Procurement Policy Note (PPN) 06/20 further states that: "...bidders who are unable to demonstrate or verify ESG elements would be at a disadvantage while competing for public contracts."[6]

Contractors now need to establish comprehensive ESG strategies — that include factors such as sustainability, social value, health and wellbeing, and human resource development — under the same umbrella. It is clear that contractors that cannot demonstrate a robust ESG strategy to combat such risks, may be putting the sustainability and resilience of their business at risk.



Globally, construction uses 32% of the world's natural resources[7], so the industry certainly has a responsibility to reduce its carbon footprint. The challenge for construction will be to minimise resource usage through innovation, sustainability, and "best-in-class" quality, while also reducing waste generation by greater recycling and reuse of materials. Successful achievement of these goals also has the potential, of course, to create greater competitive advantage and stronger economic growth.

A good example of a contractor making progress in this area is the Mace Group, which reduced its carbon emissions in 2020 by 50%. Among other measures, the organisation diverted 200 tonnes of waste timber to alternative uses and convinced many of its largest suppliers to switch from single-use plastic packaging to paper-based alternatives.

The adoption of more rigorous ESG strategies by contractors will also have a significant effect on supply chains, with product manufacturers and suppliers who can effectively demonstrate their own adherence to ESG objectives favoured over those who cannot provide or validate the environmental impact of their products.

6 https://www.mayerbrown.com/en/perspectives-events/publications/2020/10/esg-in-uk-public-procurement-taking-social-value-seriously
7 https://www.ciob.org/sustainability-environment

For instance, in collaboration with Innovate UK, Leeds Beckett University, the University of Hertfordshire, White Frog Publishing, and Balfour Beatty have created a carbon calculation tool for the construction and infrastructure industry — offering a consistent, practical solution for the measurement of embodied carbon.

The AutoBIM Carbon Calculator automatically links building information modelling (BIM) data to embodied carbon data from the Inventory of Carbon and Energy (ICE) database, an online source which provides energy and embodied carbon information for construction materials. The platform also allows users to enter information from environmental product declarations sheets. During the design phase of a project, this innovative platform allows teams to compare products and materials, provide alternative solutions, and ultimately help those involved make informed, low carbon decisions.

More than just aimed at tackling environmental risk, however, ESG policies will directly affect the sourcing of materials and products and will help maintain ethical labour standards. Contractors will need to ensure their executive team and relevant stakeholders are fully aware of the environmental and social impacts of their business, and the mechanisms they have in place to monitor them. Specifically, the health, safety, wellbeing, staff development and training, and legacy planning of the workforce will also need to be monitored more effectively, as will the effect of any construction activity on local communities.

Clearly, ESG concerns will have an increasing influence on the construction sector in the future. Therefore, demonstrable awareness of and action on ESG performance will be vital in ensuring the construction industry continues to operate a robust business model.

Methodology

This report explores how the UK's top main contractors quantify and manage their business risks. We focused on the UK's largest contractors, by revenue, which are involved in civil engineering and/or construction works, and have publicly available information.

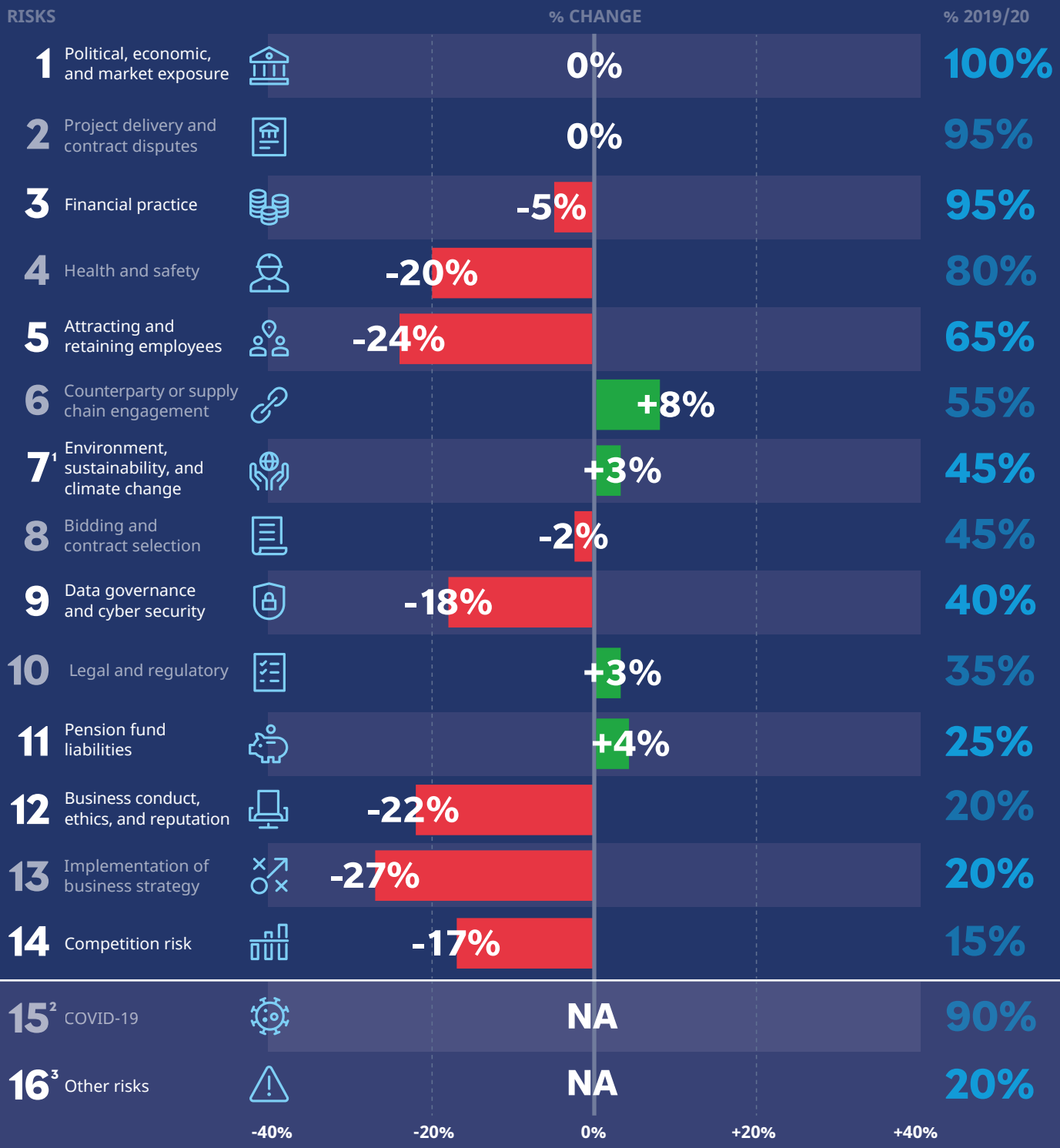
The company reporting periods analysed for this document were 2018–19 and 2019–20. Our experts analysed the companies' 2019 annual reports to measure the frequency with which they cited different risks. We scrutinised the weight given to each hazard by company risk specialists, then pinpointed the measures companies took to reduce their exposure.

We then analysed the same companies' 2020 reports to compare the year-over-year change in construction risk perception, and researched how companies' mitigation strategies evolved between the two years.

The following risks are ordered according to how commonly they were cited by contractors in 2020. Where the frequency was the same for two or more risks, they are ordered by "risk development", that is, by how much more often the risk was cited in 2020 compared with 2019.

CONTRACTORS' TOP RISKS BY FREQUENCY

This chart is based on analysis of the frequency that risks appear in the risk management sections of company reports and accounts. It is in no way intended to be an analysis of the severity or importance of individual risks to any company in the data research group.



1 Due to the similarities between the environment, sustainability, and climate change categories, we have decided to combine them in the chart. However, environment and sustainability remains a separate section within the commentary, as it ranked within the top 10 risks in its own right, while climate change ranked outside the top 10.

2 As COVID-19 was not mentioned as a risk in our previous review, and appears in the 2019-20 report and accounts within and also outside of risk management sections, we have entered the frequency separately here for illustrative purposes.

3 Other risks include those that companies consider to be important but not important enough to be reported under the principal risks section.

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Executive summary

Political and economic risks were cited by all contractors surveyed. Project delivery, contract dispute, and financial risks were cited by all but one of the contractors reviewed.

Political and economic risk arises out of changes in the political and economic climate in the UK, and globally, along with changes in competitors' behaviour. The continuing effect of Brexit and the COVID-19 pandemic, with their impact on material prices and supply chain constrictions, makes it no surprise that this risk continued to feature so highly, staying in the number one spot in our Contractors' Top Risk by Frequency table.

Rising two places from fourth place last year, is **project delivery and contract disputes** risk (cited by 95% of contractors), which consists of the failure to manage the delivery of projects to required specifications within the planned timeframe and budget. Its high ranking lies against a backdrop of continued suppression of project margins due largely to COVID-19 disruption and the ongoing shortage of skilled construction workers.

With its 95% frequency, falling 5% year-on-year, **financial** risk (poor financial discipline that restricts a company's ability to achieve market growth or take investment decisions) remained in the third spot in our risk table. The pandemic impacted contractors' revenue generation and ability to meet their financial obligations, although our research indicates that cash balances improved substantially in 2020.

Perhaps the biggest surprise in our rankings is the two-place fall of **health and safety** risk (joint second place last year) with a year-over-year decrease of 20% — with 16 companies reporting this as a risk, compared to 19 previously. The risk relates to the physical dangers inherent in onsite construction work, and the likelihood of contracting industrial diseases. While physical and mental wellbeing of employees remained a top priority for contractors, a decline in site accidents and injuries, due to a combination of COVID-19-related operational factors, was apparent. In addition, new operating regimes, technologies, and wellbeing services have become fully integrated and established, which may have contributed to reducing some of the concern regarding this risk.

In fifth place, with a survey frequency of 65% (down 24% on last year), **employee retention and development** risk again reflected the continuing skills shortage affecting the construction industry, with Brexit-driven labour shortages and large numbers of skilled workers approaching retirement, as key factors.

Counterparty and supply chain engagement risk, which emerges from the potential failure of a supplier or subcontractor to deliver their scope of work, moved up three places, with 11 companies reporting this as a risk this year, as opposed to nine in the last edition — an increase of 8%. The UK construction industry has faced sustained supply chain disruption since the beginning of the pandemic, pushing up the cost of construction materials. Brexit factors have also had an effect on the pool of skilled labour available in the logistics and transportation sectors.

The combined **environment, sustainability, and climate change** category moved up to number seven in the rankings, increasing 3% in year-over-year frequency. These risks are now being given much more attention at a governmental level and by society at large. The all-pervasiveness of the risk has led to a number of contractors commenting on it within their executive summaries, or in separate stand-alone sections, as opposed to within the specific risk sections of their report and accounts. Similarly, a couple of contractors have referred to this risk within their wider health and safety strategies. With this in mind, this risk will almost certainly be even higher up the scale, in terms of severity, for individual contractors.

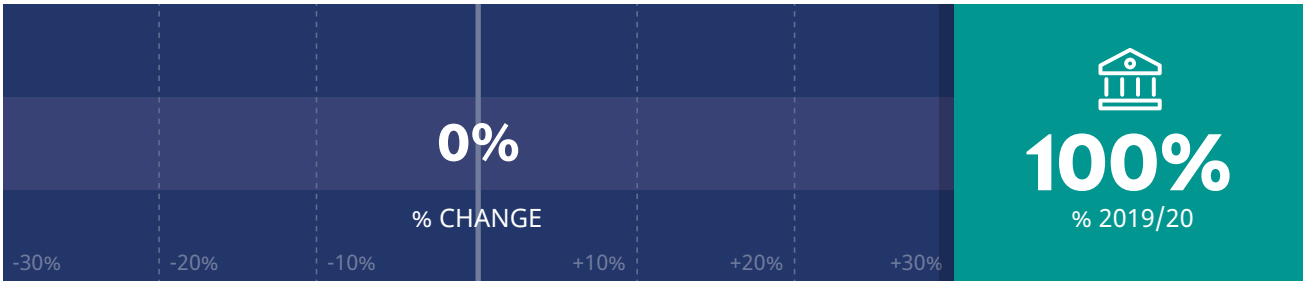
Bidding and contract selection risk, remained at number eight, covering risks arising out of a company failing to identify and undertake work within its core competencies. During the research period, contractors have undoubtedly been exposed to the risk of challenging markets and some reductions and constraints on workload, due to the COVID-19 pandemic.

Data governance and cyber security risk placed ninth — a drop of three places on the previous edition with a reduction in frequency of 18%. It continues to be a surprise that this well-publicised risk does not feature higher up the rankings. In fact, COVID-19 seems to have exacerbated cyber threats as the digital economy becomes ever more dominant, albeit that substantial investments are being made in security infrastructure by contractors.

A new entrant into the top 10 is **legal and regulatory** risk, rising in both percentage terms (up 3%) and ranking (up three places). With a new set of regulations on movement of people and goods post-Brexit and the UK government establishing a target of net-zero carbon emissions by 2050, there are a number of legislative and regulatory changes proposed.

Top 10 risks

Political and economic risk



Political and economic risk includes any unexpected change in factors, such as supply chain disruption, fiscal policies, exchange rates, and civil or political unrest that might impact a business. Throughout 2020, the impact of the COVID-19 pandemic and uncertainties regarding Brexit have been the chief concerns of contractors.

Risk impact

Analysis of the annual construction work dataset published by the Office of National Statistics showed construction output in the UK in 2020 was down 14% on the previous year. This compared to an average growth rate of 3.2% over the past five years, and has been primarily attributed to strict restrictions set in place, as a result of the COVID-19 pandemic. Mirroring this slowdown in construction activity, 2020 revenues for the surveyed data set also plunged by around 10% year on year.

Contractors additionally faced uncertainty regarding the anticipated impact of a no-deal Brexit. A number of scenarios were evaluated to discern the extent of additional cost to business in the event of a hard Brexit.

Among the knock-on effects of the pandemic and Brexit uncertainties, contractors expected an increase in construction costs (due to material price escalation), a dip in investment and workflows from the public and private sector, increased competition, and supply chain failures.

Our analysis of ONS data showed that construction material price indices increased by an average of 2.4% year on year from 2016 to 2020. As of Q1 2021, the indices increased by 6.7%, compared to Q1 2019, and prices are expected to remain high throughout 2021 and into 2022. This inflation is likely to cause a dramatic increase in tender prices, as well as contract values, for projects under execution.

> **“ Our analysis of ONS data shows that construction material price indices increased by an average of 2.4% year on year from 2016 to 2020.**

Risk mitigation

UK contractors have broadly taken three actions to tackle these risks. These are:

- Strong order books have been built in markets and sectors with long-term growth potential.
- Business has been secured from public sector and regulated entities.
- Frameworks and repeat business from clients have been focused on.

To avoid over-dependence on specific sectors or clients, contractors are expanding into stable sectors while leveraging their core expertise to gain market share. Order books of our surveyed set grew by an average of around 14% on the previous year driven, in part, by public sector expenditure to boost economic recovery from the pandemic.

To cope with the continuing economic uncertainty, contractors are shifting towards long-term contracts, such as public sector frameworks, and securing a high proportion of the order book from public sector clients and regulated entities.

In our analysis, we observed that three of the top 10 contractors have expressly stated their aim of shifting from fixed-price to long-term contracts, such as cost reimbursement or framework agreements. Most of the surveyed dataset targeted a move towards long-term frameworks in a bid to achieve stability.

Also, seven of the top 10 contractors derived more than 80% of their business from the public sector and regulated entities through frameworks and repeat orders. In addition, contractors placed an emphasis on securing repeat business from their existing customer base.

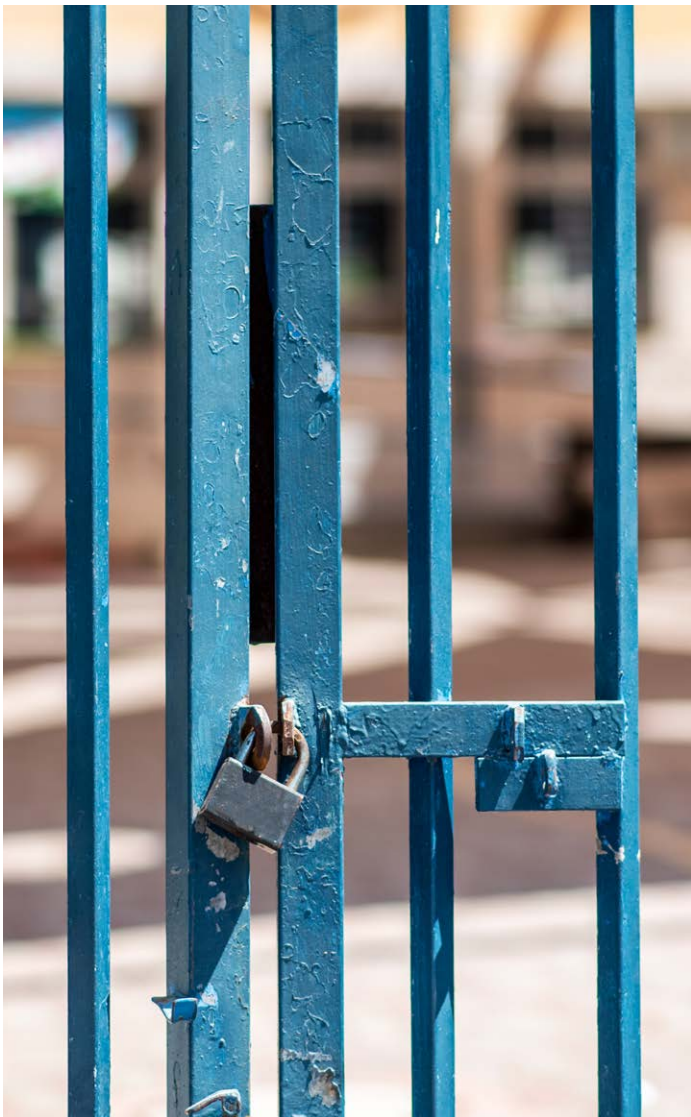
In response to the impact on business due to COVID-19, some contractors from our surveyed data set carried out group restructuring and management consolidation to manage the additional costs incurred.

Other mitigation measures included discipline in contract selection, monitoring counter-party stability and resilience, and setting up working groups to monitor lagging impacts of Brexit and other macroeconomic factors. To counter supply chain disruption, contractors are placing orders in advance to account for the higher lead times, stockpiling materials to manage inflationary effects, and exploring alternatives amongst UK-based suppliers.

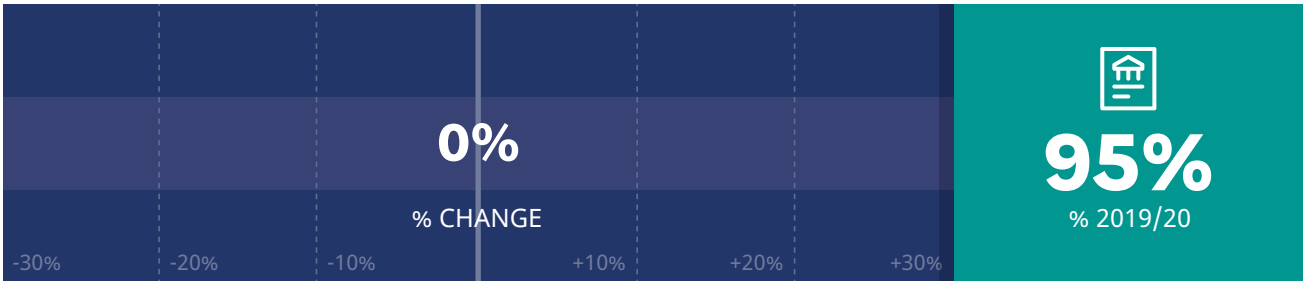
Risk development

Contractors reported a significant slowdown due to temporary project site closures in the first half of 2020, followed by a return to operations with strict Covid-19 protocols. Brexit transition remained a threat and its potential impact, from a labour and goods perspective, was monitored throughout the year.

Post the UK-EU Trade and Cooperation Agreement, effective from 1 January 2021, some contractors have stopped capturing Brexit as a standalone risk. Groups continued to evaluate the impact of Covid-19 and lagging effects of Brexit as potential risks.



Project delivery and contract disputes



Project execution is prone to lapses in delivery of work in accordance with the agreed time, cost, and quality. Such lapses can lead a contractor to suffer reputational damage, significant margin erosion on projects, and liquidated damages. In some cases, failure to deliver on time and quality can result in disputes, potential litigation, and a contractor being ineligible to bid on other projects. In 2020, margin erosion for contractors and project disputes could be mainly attributed to the impact of the COVID-19 pandemic.

Risk impact

A failure to manage execution of key deliverables, as per the contract agreement, can result in design issues, changes to the scope of work, poor construction quality, delays and their associated costs, and contractual disputes. They can also have an adverse impact on customer satisfaction.

A study conducted in 2020 on the impact of COVID-19, estimated that construction projects in the UK suffered productivity losses of nearly 35%. An in-depth analysis of 45 projects executed during the pandemic revealed that social distancing measures resulted in around 7% of the productivity losses. In addition, 1% was lost due to poor transmission of design information, as a result of remote working. Material scarcity and delayed deliveries accounted for another 7% of the attrition.

According to the Global Construction Disputes Report 2021, the average value of disputes in the UK reached US$38.6 million in 2020, an increase of 117% on the previous year. The average length of disputes remained at about 10 months, in line with the dispute lengths in 2019. The UK is considered to be a leader in resolving disputes in a timely manner.

The top cause of disputes in the UK was a failure to understand mutual contractual obligations. Force majeure events did not feature among the common causes of disputes in 2020. Legal uncertainties concerning the effects of COVID-19 could be behind force majeure claims remaining low last year.

The construction sector also suffered from bottlenecks in the supply chain, as a result of COVID-19 and Brexit. These can lead to delays to project schedules.

> **Comprehensive contract administration and commercial management practices are deployed to assess project monitoring and forecast outturn.**

Risk mitigation

Contractors have checks and balances in place for monitoring project health throughout the construction cycle. These controls can be broadly bucketed as below.

- Project controls and commercial reviews.
- Effective contract administration.
- Monitoring the supply chain.
- Value engineering.

There are project control dashboards, commercial metrics, as well as digital tools to track early warning signals around potential issues that could arise in a project. Teams are also provided an impetus to successfully deliver projects within a stipulated time and budget.

Comprehensive contract administration and commercial management practices are deployed to assess project monitoring and forecast outturn. Firms can carry out a robust review of the contract terms and specification at the tender stage to avoid taking on projects with onerous terms. Contractors have set processes for tracking contract variations and for documenting their impacts on the schedule, cost, and quality during the construction phase.

They are also focusing on building strategic supply chain capabilities in order to ensure quality and timely delivery of projects. There are systems in place for prequalification and competency assessment of supply chain partners, along with performance monitoring.

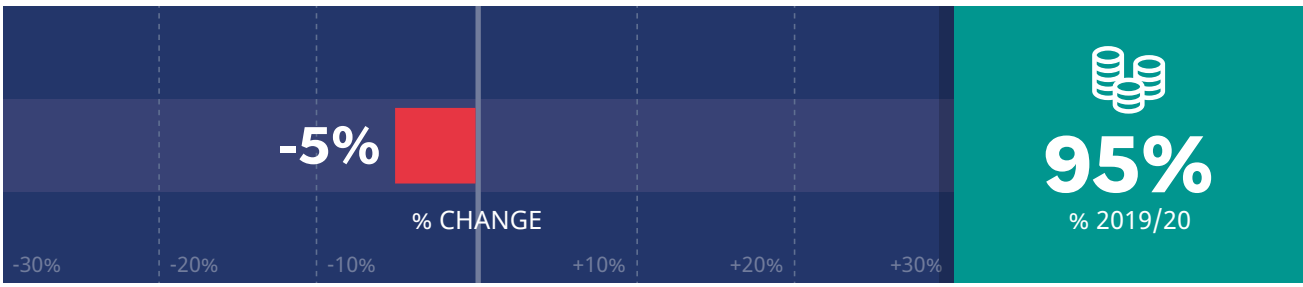
Contractors can also advocate value engineering solutions to achieve cost rationalisation, in order to improve project margins. Focus on implementation of modern methods of construction, off-site construction, and digital enhancement for better decision-making can help augment the bottom line.

Risk development

Project margins for contractors remained suppressed throughout 2020 due to the disruption caused by COVID-19. Social distancing restrictions, transition to remote working, and availability of materials were key issues leading to productivity losses in construction activities.

Uncertainty around the pandemic's status as a force majeure event hindered the performance of contractual obligations. Following the initial waves of the pandemic, removal and imposition of restrictions could turn the disruption due to COVID-19 into a foreseeable event. Contractors should have contingency plans in place to mitigate against any adverse impacts of such events.

Financial practice



Contractors are exposed to the risk of having ineffective financial controls in place, which can ultimately lead to an inability to secure funding and maintain a sufficient cash balance in the business. Companies are additionally subject to risks arising out of foreign currency exchanges, interest rate changes, commodity price fluctuations, credit exposures, and insufficient liquidity.

Risk impact

Poor financial management can lead to a failure in meeting debt service requirements and other obligations, resulting in a breach of financial covenants.

Contractors can also fail to maintain liquidity. This can hamper their day-to-day operations and have a cascading effect on value chains, resulting in markets losing confidence in these firms.

Financial mismanagement can impact a company's ability to raise funds and may mean it loses out on future business opportunities.

Procurement from foreign suppliers additionally subjects contractors to foreign exchange exposure when they make payments to overseas suppliers.

> **"Contractors face credit risk arising out of their counterparties' inability to meet contractual obligations.**

Contractors face credit risk arising out of their counterparties' inability to meet contractual obligations. The exposure could be through cash and cash deposits, derivative financial instruments, loans provided to joint ventures and associates, and credit exposures to customers, including account receivables and committed transactions.

Risk mitigation

Contractors' finance and treasury teams are actively engaged in prudent financial management. Key measures taken by contractors to manage financial health of their businesses, include:

- Establishment of strong lender relationships;
- Standardised processes for budgeting, forecasting, and cash management;
- Diligent working capital management;
- Restructuring of non-core assets.

In 2020, COVID-19 made it difficult for some contractors to satisfy financial covenant tests set out in their financing facility agreements. Consequently, many negotiated waivers and revised covenants with lenders. Contractors also have access to committed bank facilities, where lenders are able to facilitate liquidity for these companies.

Companies have established systems and processes around cash flow monitoring, budgeting, and forecasting to keep a tab on financial performance and future requirements.

Contractors are additionally involved in monitoring and management of working capital requirements with an emphasis on pending dues. Liquidity requirements can be managed by maintaining adequate cash balances. The cash and equivalents in the set surveyed for this report have increased by around 16% in 2020, compared to 2019, specifically due to improved cash inflow from operations. This indicates that contractors had a better grip on working capital management throughout 2020.

To reduce net debt or generate liquidity, contractors are generally open to considering a restructuring of their non-core assets and businesses. Contractors from the set surveyed have demonstrated a lower debt ratio that translates to low risk of default. Thirteen of the firms in our surveyed set have debt-to-equity ratios in the range of 0.55-0.95, indicating sufficient capabilities to meet their debt obligations.

To tackle risk arising out of foreign exchange exposure, contractors typically enter into forward foreign exchange contracts. Forward contracts — known as interest rate swap contracts — are also used to hedge exposure to fluctuating interest rates.

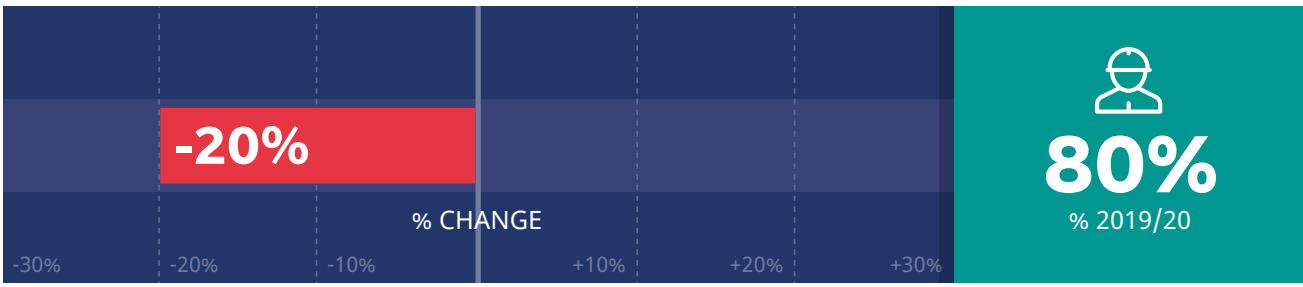
To mitigate credit risk attributable to the default of counterparties, contractors have often instituted policies and mechanisms to assess the creditworthiness of potential customers, before committing to any transactions.

To minimise risk from cash, deposits, and derivative financial instruments, contractors usually choose to onboard counterparties that have a high long-term credit rating, as assessed by independent rating agencies. Similarly, independent ratings are used for evaluating customer's credit quality to reduce exposure on accounts receivables.

Risk development

The COVID-19 pandemic impacted contractors' revenue generation and ability to meet their financial obligations to lenders. To avoid breach of any financial covenants, contractors negotiated waivers and agreed revised covenants with their creditors. Their cash balances improved substantially in 2020, indicating a better handling of working capital requirements. An analysis of our surveyed set shows that, on an average, contractors are capable of covering their liabilities. Also, they are open to strategies, such as disposal of non-core assets, in order to improve their net debts.

Health and safety



Health and safety is an intrinsic risk in a labour-intensive industry, such as construction. These risks primarily arise from working at height, trips, slips and falls from height, moving vehicles, plant and machinery operations, and operating other tools and equipment.

Musculoskeletal disorders, stress, depression, and anxiety are other manifestations of work-related ill health. In 2020, COVID-19 presented novel challenges, in terms of implementing the safety regulations introduced by the government. A focus on mental wellbeing is another priority measure for contractors, since a part of the workforce shifted to working from home due to the pandemic.

> **“ Thirteen of the top 20 contractors have reported an average fall of 21% in their health and safety indicators from 2019 to 2020.**

Risk impact

An inability to manage risks in an under-construction project could result in injuries, fatalities, and disabilities. Such occurrences could lead to fines, penalties, and even criminal prosecution. Damaged reputation and debarring from bidding for work on future projects, due to a dismal health and safety record, could be a consequence of these lapses.

The Health and Safety Executive (HSE) reported 39 fatal injuries to workers in 2020 against 42 in 2019. Over a five-year period from 2016-20, 47% of the fatalities were caused by a fall from height.

As far as prosecution was concerned, there were 143 prosecution cases for health and safety offences in the construction industry with total fines imposed amounting to £8.2 million in 2018-19. This was down from 157 prosecution cases in 2018-19, leading to £18.5 million in fines.

As far as our surveyed dataset is concerned, contractors have reported a significant improvement on their health and safety parameters, such as lost time incident rate (LTI) and accident incident rate (AIR) in 2020. Thirteen of the top 20 contractors have reported an average fall of 21% in their health and safety indicators from 2019 to 2020.

Risk mitigation

Contractors have established governance structures, such as comprehensive policy frameworks, site reviews, inspections, and safety monitoring systems, in accordance with the OHSAS 18001 and ISO 45001 standards. They are also extending their health and safety programmes to their supply chain partners.

In 2020, COVID-19 has had a major health impact on workers and contractors have accordingly adopted site operating procedures (SOPs) in line with government regulations.

Contractors have made consistent progress in terms of improving their health and safety performance over the past five years. This is largely due to a conscious effort towards making health and safety a systemic priority. The health and safety management efforts of these contractors can be broadly placed in three categories:

- Cultural shift to embed health and safety as a strategic priority.
- Collaboration with industry bodies and academia.
- Focus on employee wellbeing.

Ten of the top 20 contractors have multi-year health and safety programmes in place to drive their safety and wellbeing culture. The contractors are committed to improving safety culture through a combined top-down and a bottom-up approach. Management and board-level teams are tasked with health and safety reviews and monitoring of the key performance indicators. Simultaneously, there is a definite push around engaging staff in training and workshops.

Contractors collaborate with industry bodies, such as the Construction Leadership Council (CLC), National Federation of Builders (NFB), Confederation of British Industry (CBI), Civil Engineering Contractors Association (CECA), Construction Industry Training Board (CITB), and Build UK to implement standard health and safety guidelines.

There is a renewed focus on mental wellbeing of the workforce in the wake of COVID-19. Contractors had to adapt to working remotely, while maintaining quality. Dedicated COVID-19 employee resource centres were established to support mental health and wellbeing of employees. Additional support measures, such as wellbeing days off, volunteering days off, employee assistance programmes, and mental health first aid, were instituted to reinforce commitment to employee wellbeing.

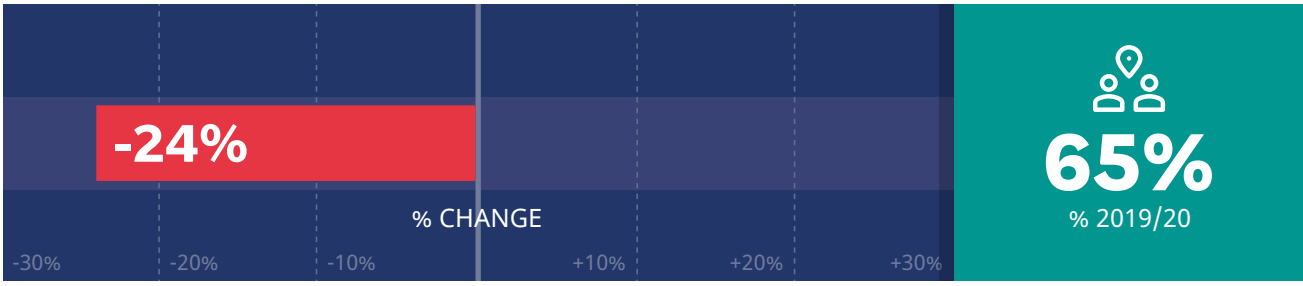
Risk development

Physical and mental wellbeing of employees remained a key area of focus for contractors in the light of COVID-19. There was a decline in accidents and injury incidents on sites, as a result of a combination of factors, namely: new COVID-19 safety operating procedures, a reduced workforce on project sites, and increased monitoring of safety procedures.

Contractors have continued to work on digital initiatives around site inspections, wearable technology, monitoring through predictive parameters, permit systems, and other wellbeing services. Some businesses have dedicated programmes in place to manage safe working practices for specific construction activities or different seasons.

The draft Building Safety Bill, published in July 2020, is currently under scrutiny in parliament. The construction industry is uncertain about the measures to be put in place under the new regime but they are expected to bring significant changes for building owners, and the finance and insurance industries.

Attracting and retaining employees



An inability to attract and retain skilled and competent staff can lead to a failure to deliver on project commitments, manage costs, achieve business growth, and meet company objectives. High staff turnover or low employee engagement can additionally result in lower competency levels, impacting a company's reputation in the market and its ability to achieve business growth.

Risk impact

Contractors are concerned with the possibility of a failure to recruit, develop, and retain skilled personnel. A constraint in the availability of talent usually presents a hurdle to a firm's growth strategy and may reduce the quality of construction and other services. This could result in a negative impact on customer experience and a contractor's reputation in the market.

Subpar bidding and scheduling practices could lead to undue stress on staff to achieve completion, as well as profitability. Limited visibility of the long-term project pipeline and a lack of clear career progression opportunities could result in higher attrition rates within any given workforce.

As the volume of construction activity increases, the demand for skilled employees goes up. In these market conditions, companies can experience the poaching of key employees by their competitors.

A study suggested that in the UK construction industry, nearly 10% of the skilled workforce comes from the EU. This proportion rises to 33% in London. The new immigration system that came into operation as a result of Brexit requires employers to register as sponsors to be able to recruit from outside the UK. In order to be permitted to employ overseas nationals, the recruited individuals must meet job, salary, and language requirements.

This new development makes it imperative for contractors to have recruitment strategies, training and development procedures, and succession plans in place, in case key employees leave.

The UK construction industry has faced a major skills shortage recently. Research suggests that a substantial portion of the workforce are ageing employees, expected to retire over the next few years. This, coupled with the impact of COVID-19 and Brexit, raises questions around the training and adaptability of the workforce. Identifying skill gaps and training requirements, along with building an inclusive and engaging work culture, remains a major challenge for contractors.

> **Contractors have developed competency frameworks for core job families within their businesses, which helps in making recruitment decisions and assessing the skill requirements of their workforces.**

Risk mitigation

To ensure recruitment, retention, and development of the right employees for the right roles, contractors are taking measures that can be classified under three headings:

- Strategic workforce planning.
- Training and development.
- Employee engagement.

The human resource departments of our surveyed set have workforce planning processes in place in line with their business requirements. There is a focus on building good work cultures, as well as on offering competitive remuneration packages and wellbeing initiatives for employees. Winning work and project delivery are aligned with recruitment activities to ensure a company has sufficient bench strength for delivery on any given contract. Recruitment and retention rates are also reviewed regularly and succession plans developed for key roles.

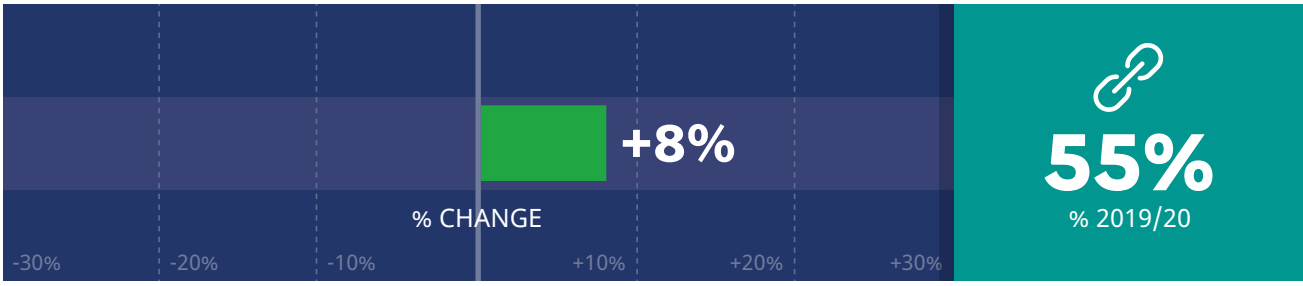
Contractors have developed competency frameworks for core job families within their businesses, which help in making recruitment decisions and assessing the skill requirements of their workforces. Annual performance reviews of employees are conducted to identify the need for key skills and expertise. Development plans are laid out accordingly and personal and professional development is facilitated through various internal resources. Major skill gaps and capability requirements are evaluated through needs assessments, thus informing investment decisions in workforce development. Leadership pipelines are developed through graduate, trainee, and apprenticeship programmes.

Employee engagement surveys are conducted regularly to gauge employee satisfaction and identify areas for improvement. To increase engagement, employees are given a clear view of the company's future pipeline and opportunities. Clear communication channels are established to celebrate individual and organisational success.

Risk development

The transition post-Brexit has led to new legislations making it tougher for labour movement from the EU. Adequate skilled workforce availability is expected to be a challenge in the short and medium term. Nearly 20% of the construction workforce is expected to retire over the next decade, which is going to maintain the skill shortage within the industry. The industry has not been able to build a positive public perception as a preferred destination for young talent. In addition, the COVID-19 pandemic accelerated the transition to a remote and digital mode of working, which has highlighted the challenge in transitioning the ageing workforce towards such work practices. The current situation indicates that attracting and retaining talent is likely to remain a major challenge for construction industry employers.

Counterparty and supply chain engagement



A supply chain default due to factors relating to performance, quality, environment, health and safety, and financial resilience poses a major risk for contractors. Failure to meet any of these stated obligations could result in project delays, business disruption, defects, disputes and litigation, fines and penalties, reputational damage, and debarring from bidding for future opportunities.

Risk impact

Contractors are primarily concerned with the performance and financial health of the supply chain. The inability of a supply chain to meet the required performance standards could lead to costly disputes, delays in project delivery, and loss of reputation for the contractor. Poor payment practices and weak relationships with supply chain partners can lead to a loss of confidence in the contractors from whom they obtain business.

The impact of COVID-19 restrictions, coupled with Brexit, has resulted in pressure on construction supply chains in the UK. Border delays on material coming in from the EU, import and custom arrangements, and levies on imported materials are expected to impact project timelines and costs.

> **“Since 2017, construction sector employment went down from 2.3 million workers to 2.1 million at the end of 2020. EU personnel in the UK construction sector has gone down by 42%.**

Construction activity is forecast to rise by 13.7% year on year in 2021, according to data published by the Construction Products Association. The shortage of skilled personnel and material scarcity, coupled with high prices, has raised doubts about the capacity of the supply chain to service the high construction demand. Since 2017, construction sector employment went down from 2.3 million workers to 2.1 million at the end of 2020. EU personnel in the UK construction sector has gone down by 42%.

Financial distress in the supply chain is another cause of concern for contractors. Since 2018, the UK construction and infrastructure sector has witnessed high levels of insolvency. Many participants are struggling with suppressed margins, increasing costs, Brexit uncertainty, and the financial impact of the pandemic.

Risk mitigation

Contractors can minimise the risk of default by:

- Building long-term relationships.
- Carefully selecting counterparties and continually monitoring supply chain performance.
- Ensuring fair payment terms and mechanisms to reduce the impact of insolvencies.

In addition, contractors can undertake measures to increase engagement with suppliers, in order to give them a view of future pipelines, and understand their operations and dependencies.

They can also put in place due diligence procedures for the selection of suppliers and subcontractors. An assessment of suppliers can be carried out by looking at their financial health, capabilities, and processes to ensure quality, safety standards, ethics, as well as policies regarding labour and modern slavery.

Contractors have shown a willingness to manage the long-standing problem of delayed payments in the UK construction industry. The government also has initiatives in place to protect the interests of suppliers. At the beginning of 2020, the Prompt Payment Code (PPC) was strengthened, with the required payment period to smaller suppliers being reduced by half — from 60 days to 30 days.

According to a report by BuildUK, 93.4% of supplier payments on average were made within 60 days by contractors in 2020. As for our surveyed set, 11 of the top 20 contractors were not able to make supplier payments within 30 days. This would be in violation of the overhauled prompt payment code. Contractors took 32.5 days on average to make supplier payments in 2020.

To tackle the danger of pandemic-related insolvencies, the government recently introduced reforms to the UK's Corporate Insolvency and Government Act 2020 (CIGA) in June last year. These amendments allow insolvent companies some space to reorganise their business affairs, and continue to service their supply contracts, wherever viable.

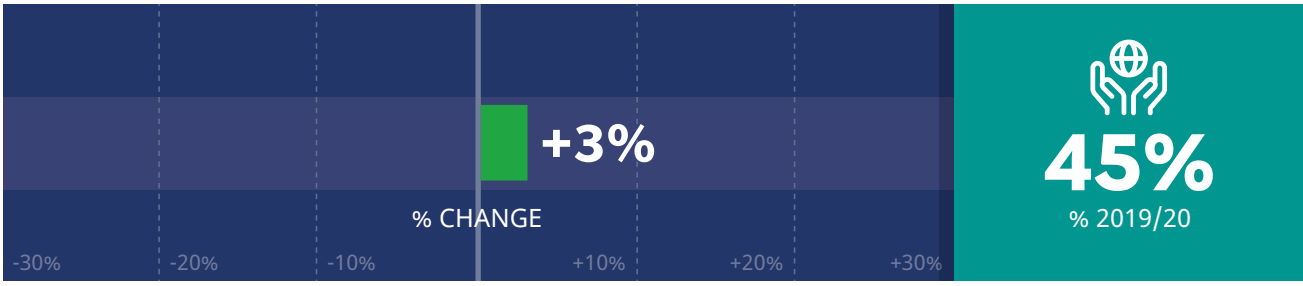
The UK government's relief measures through the furlough and business interruption loan schemes, as well as the protection afforded to companies against debt recovery tools and winding-up petitions, all helped to ward off a rise in insolvencies.

According to data published by the ONS, there was a 36% drop in insolvencies in the construction sector from 2019 to 2020, indicating the effectiveness of government assistance during the pandemic.

Risk development

The UK construction industry has faced sustained supply chain disruption since the beginning of the pandemic. Following the resumption of building activity, the demand for construction resources has outpaced supply. This has pushed up the price of some materials, such as timber and steel. The restricted supply of materials, logistical factors, and long lead times have all constrained construction. The supply of skilled personnel has also been impacted by Brexit. A combination of these factors has led to a rise in input costs, consequently pushing up tender prices and increasing cost burdens on the supply chain. The supply chain has also struggled with financial distress and insolvencies.

Environment and sustainability



The construction industry contributes to nearly 10% of the UK's carbon dioxide emissions. This number goes up to 45% when the entire built environment sector is considered. Failure of the building sector to manage the environmental impact of their activities could lead to pollution, biodiversity loss, and delayed project schedules, due to the time and cost incurred in investigation and remediation activities. Any of these outcomes could also result in potential liabilities, fines, and reputational damage.

Risk impact

According to a study conducted by the Institution of Civil Engineers, the consumption-based carbon footprint in the country's infrastructure sector dropped by 23% between 2010 and 2018. But it still accounts for 54% of the UK's consumption-based carbon footprint. Of this 54%, 13% accounts for capital and operational carbon, while the remaining 41% can be contributed to the end users of infrastructure facilities.

The UK government's sixth carbon budget, published in April 2021, set a target of a 78% reduction in emissions, compared to 1990 levels. In 2020, the UK government introduced measures aimed at reducing carbon emissions. These included the Green Homes Grant, which provided homeowners with £5,000 to implement energy efficiency measures, such as retrofitting. For low-income individuals, the amount provided was £10,000. Regarding public buildings, funding of £1 billion has been announced, which will be distributed through the Public Sector Decarbonisation Scheme.

Contractors are focused on decreasing their operational carbon footprints. Although, efforts are now concentrated on reducing the lifecycle carbon footprints of certain activities, such as the production of concrete and steel, and other carbon-intensive materials. It is essential to integrate the zero carbon aims in the initial design and procurement phases of projects. The Construction Playbook, published in December 2020, states that the solutions proposed by potential suppliers should be accompanied by a whole-life carbon assessment and embed a whole-life carbon approach in identification and selection of solutions.

The impact of climate change is now visible in frequent environmental changes and occurrences of increasingly extreme climatic conditions. The UK Green Building Council (UKGBC) reports that many areas are at risk of flooding and overheating, which specifically affects the housing sector. Sustainable drainage systems and flood risk alleviation need to be prioritised.

A failure on the part of contractors to manage their environmental outcomes could subject them to investigations by environmental agencies, in addition to prosecution and legal proceedings by third parties demanding compensation. Firms could also be forced to pay for the costs of remediation of these consequences.

Risk mitigation

Industry bodies, such as the Construction Leadership Council (CLC), have developed a Performance Framework to measure the effort and progress of businesses to reduce embedded carbon in the built environment. The key commitments of the framework are:

- Elimination of 78% of diesel machinery across construction sites by 2035.
- Retrofitting 27 million homes by 2040 for low-carbon energy usage.
- Reducing energy consumption in production of construction materials and products.

Contractors have started recognising the risk that climate change poses to the construction industry and, accordingly, have begun taking steps to measure and manage their carbon footprints. Steps taken by contractors in our survey to promote sustainability include capturing carbon data and focusing on targeted emissions reduction.

Contractors are taking measures to reduce their Scope 1 and Scope 2 emissions — direct and indirect emissions respectively — as defined by the Greenhouse Gases (GHG) Protocol standards. Firms are working on capturing granular data around their carbon footprint and then setting targeted reduction goals for these elements. A carbon footprint is generally quantified by capturing data in line with the GHG Protocol standards. Companies have mostly adopted the Streamlined Energy and Carbon Reporting (SECR) standards for measuring their energy usage and carbon emissions, and are continuously evaluating methodologies and developing tools to measure carbon outputs.

As a primary measure, contractors are shifting towards procuring their electricity from renewable sources. Since vehicle and equipment fleets account for a substantial portion of direct carbon emissions, firms are targeting transition to emission-free hydrogen and electric vehicle fleets. From 2019 to 2020, carbon emissions reduced on average by around 14%. Ten of the top 20 contractors have reported a significant reduction in carbon emissions in 2020, as compared to their baseline years. Also, nine of the top 20 contractors have set targets to become net-zero carbon emitters by 2035. Contractors are implementing zero carbon solutions in their own buildings to reduce emissions and improve energy efficiency.

Installation of LED lighting, energy efficient heating, ventilation, and air-conditioning systems are some of the steps taken to reduce energy consumption. Offsite construction methods offer another avenue for reducing operational carbon.

Risk development

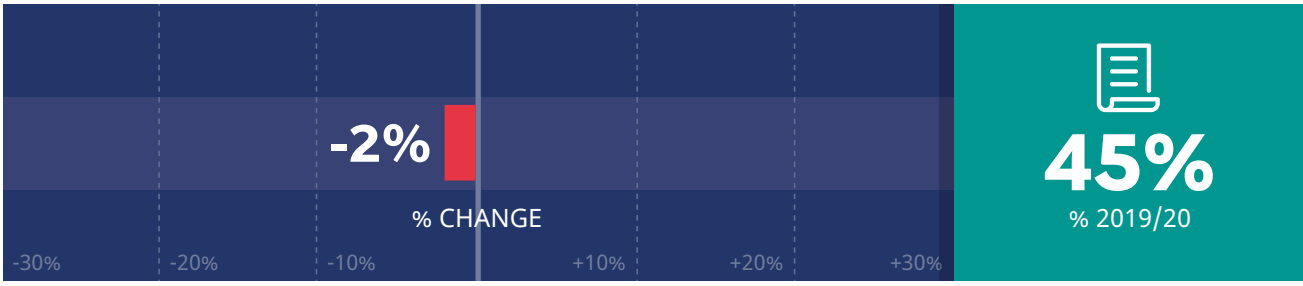
The UK government is taking steps to decarbonise the country's infrastructure through legislation, and other measures, in order to meet a target of net-zero carbon emissions by 2050. Many contractors are focusing on reducing operational carbon, although there is also a shift to cut the whole-life carbon of infrastructure assets. The Construction Playbook, published by the UK government, is trying to embed the whole-life carbon approach in public procurement. On the construction industry front, contractors are proactively becoming part of industry-led efforts to accelerate decarbonisation through programmes such as the World Green Building Council's Net Zero Carbon Buildings Commitment, CO2structZero, the Institution of Civil Engineering's #shapezero campaign, and UK Contractors Declare — a global movement to raise awareness of the climate and biodiversity emergency.

Contractors have proactively signed up for net-zero carbon initiatives established by various industry bodies, such as the World Green Building Council and the Construction Leadership Council. To maintain standardisation in approach, firms aim to get certified under standards, including:

- PAS2080 Carbon Management; ISO 50001, the Energy Management System standard for plant and machinery;
- ISO 14064-1:2006 for GHG, Carbon Trust Standard's recognition for measurement and reduction of emissions.

Firms employ external agencies for verifying their carbon footprint and implement strategies to manage and reduce impacts. Certification programmes, such as Toitū Envirocare's Carbon Reduce and Carbonzero, act as indicators of a firm's commitment to positive environmental change.

Bidding and contract selection



Contractors are at risk of failing to price a contract correctly, with fair terms and bidding for contracts that are not in line with their capabilities. Failure to correctly define the scope of a contract could lead to losses, reductions in margins, reputational damage, and also place strains on supply chains, and relationships with clients.

The uncertainties arising out of COVID-19 and Brexit could put pressure on contractors to secure business without appropriate consideration to pricing and risk profiles. This could impact future profitability and reputation.

Importance of competitive advantage

Contractors are subject to a number of risks when in the process of winning business. These arise out of external market conditions and the ability of contractors to choose projects at the right price, in line with their capabilities. Businesses are facing challenging market conditions due to the pandemic, and as a result, contractors expect a possible reduction in workload. Consequently, they run a risk of bidding for contracts — in an attempt to secure work — that may not be in alignment with their capabilities and risk appetite.

> **“ Damage to reputation in the market and relationships with the clients and suppliers is another outcome of inadequate controls on contract selection.**

Additionally, poor tendering processes can lead to inaccurate costing, ineffective scheduling, and an inadequate understanding of project risks during the bidding stage. Contractors are advised to avoid signing or bidding for contracts with onerous terms, or those which are outside their areas of expertise and established markets, as they could lose their competitive advantage.

A reduction in competitive edge could ultimately lead to a loss of market share for these firms and an erosion of margins, as well as contract and commercial disputes. Damage to reputation in the market and relationships with clients and suppliers is another outcome of inadequate controls on contract selection.

> **Maintaining customer relationships and focusing on the management of key accounts has been one of the strategies of UK contractors to ensure business wins.**

Risk mitigation

Contractors generally use three key measures to mitigate bidding and contract selection risk. These are:

- Comprehensive tender review processes.
- Focus on client relationships.
- Leverage of competitive advantage.

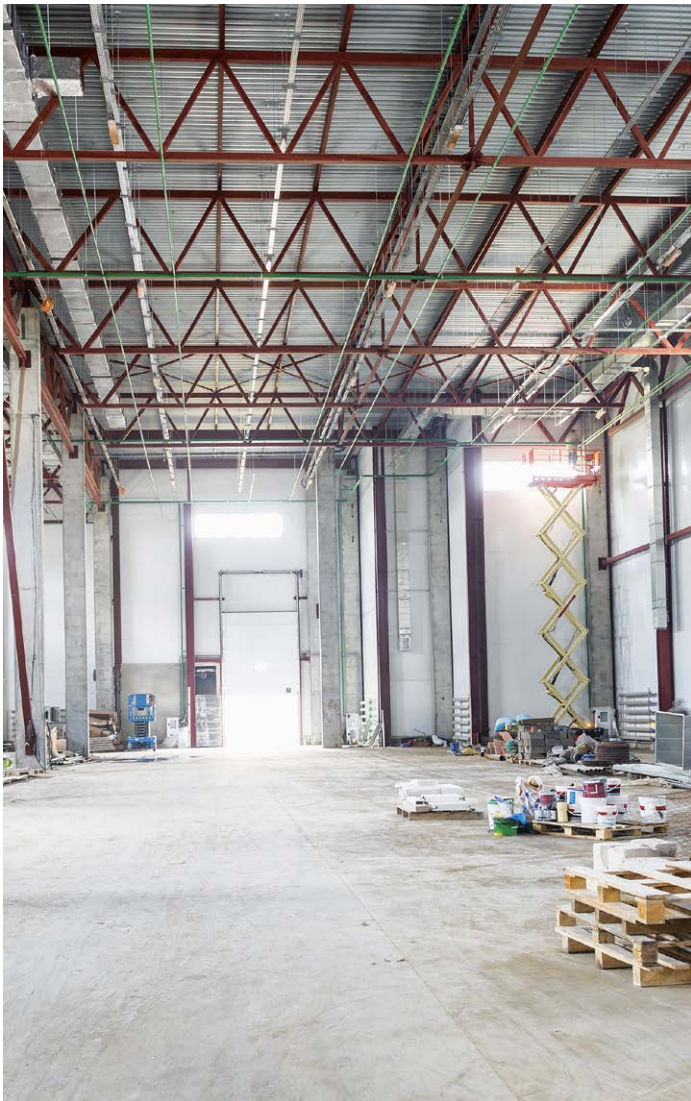
Contractors approach project selection through a number of protocols designed for reviewing tender opportunities based on defined financial, technical, and operational parameters. These opportunities are evaluated by investment panels before capital decisions are made. Contractors also follow approaches, such as two-stage or negotiated procurement, to achieve onboarding of counterparties in the early stages of a project, as well as to evaluate financial offers and contract terms. These methods help to manage the project risk and to ensure that the bidding teams have experienced personnel, equipped with the right skills to deliver project wins in line with their growth strategy.

Maintaining customer relationships and focusing on the management of key accounts has been one of the strategies of UK contractors to ensure business wins. To reduce risk on contracts, firms are aiming for repeat business with major clients, in the form of frameworks and partnership agreements. Senior leadership teams across these contractors participate in government and industry forums to maintain working relationships with the government and regulators. Another aspect of successful client relationship management is the offering of value addition to clients through innovative solutions and digital and advisory services.

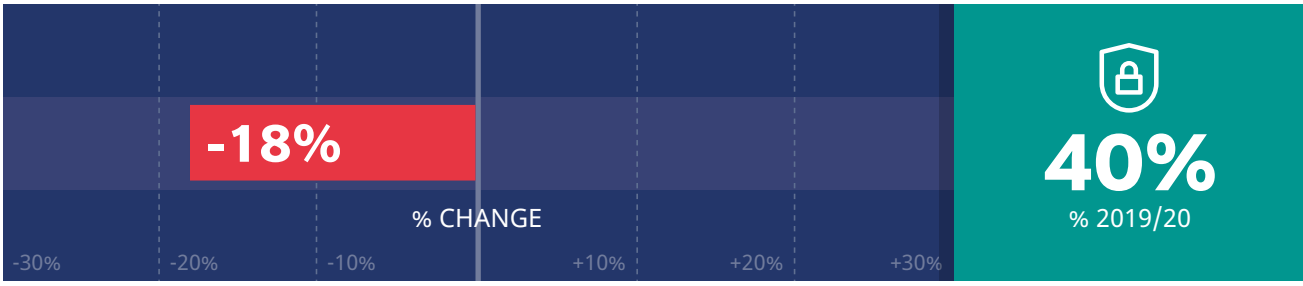
Firms continually assess the sectors in which they operate and try to bid for business in these areas. Focusing on the sectors where they have competitive advantage allows contractors to attain accuracy in costing of projects, compared to entry into new markets.

Risk development

Contractors were exposed to the risk of challenging markets and a possible reduction in workload due to the COVID-19 pandemic. Consequently, they ran the risk of taking up business, without due consideration to risk profiles and contract pricing. However, there are standard practices in place around due diligence regarding counterparties, as well as strong internal processes. A long-term resilience strategy for contractors could be to focus on opportunities aligned to their core expertise. This would allow them to leverage their competitive advantages and build solid client relationships for a consistent stream of business.



Data governance and cyber security



The construction industry has been traditionally a slow mover in implementing technology within its business operations and as a result, is particularly vulnerable to the threat of cyberattacks. Any failure to protect company and employee data, in addition to any other confidential information, could lead to a breach of a system's security. A significant data breach may be in violation of the General Data Protection Regulation (GDPR).

This could cause business disruption, reputational damage, fines and prosecutions, legal proceedings, investigations and associated costs, loss of intellectual property, and debarment from entering into contracts.

Risk impact

The construction sector is poised to gain competitive advantage, cost reduction, facilitate data driven decision-making, and increase agility through adopting technology solutions. Contractors are targeting efficiency gains through the use of cloud-based applications, 3D and 5D Building Information Modelling (BIM), Industrial Control Systems (ICS), drones, robotics, Internet of Things (IoT) systems, and mobile devices. This adoption of technology, with a number of different players involved in a project, creates weak links in the security chain. Cyber incidents are on the rise within the UK construction industry. Over the past 18 months, hackers have targeted four major contractors from our surveyed set.

Contractors are implementing digital transformation programmes across different functions, such as procurement and performance monitoring, as well as their supply chains. This opportunity necessitates the need for cyber security. The COVID-19 pandemic has accelerated the scaling of IT systems for contractors, which in turn has amplified their cyber risks.

With an increased use of personal devices and remote working during the pandemic, contractors are facing more exposure to phishing and ransomware attacks. Nearly half of the UK's working population worked remotely, as of April 2020. Many employees use remote infrastructure, such as VPNs and Remote Desktop Protocol (RDP), to access corporate resources. In some instances, vulnerabilities or breach of passwords in these systems were exploited during the pandemic. According to a report by ESET, RDP attacks increased by around 768%, between Q1 and Q4 in 2020. This rise was mainly attributed to the shift to remote working.

Cybercrimes can cause disruption in day-to-day business functions. Contractors, for example, can suffer the theft of sensitive project data, such as BIM designs, bid data, technical, and budgetary information. Ransomware attacks can cause project delays and productivity losses leading to financial and reputational damages. Exchange of data and documents between joint venture partners also puts each party at risk of cyberattacks.

Risk mitigation

To ensure security of data and network systems, contractors have taken a number of actions, including:

- Investment in strong security systems, processes, and controls
- Monitoring and systems review of internal and external threats.

Contractors have robust standardised systems, procedures, and policies in place to monitor performance of their IT systems and identify and mitigate external threats. Firms continue to invest in upgrading their IT infrastructure, software, and cyber threat assessment capabilities. They also endeavour to develop and enhance data protection procedures, as per market regulations.

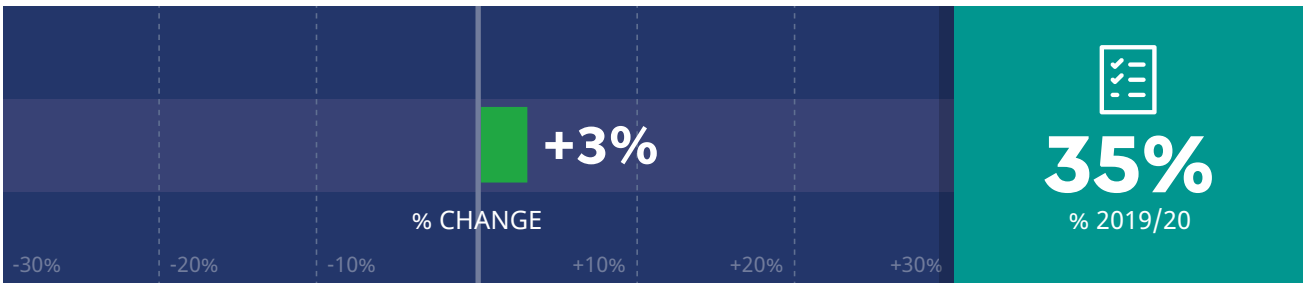
> **“ Employees are given training around data protection and information security to increase awareness.**

Security protocols embedded in contractors’ current IT systems are periodically reviewed and stress-tested by cyber security experts. Independent internal, as well as external, audits are regularly carried out to monitor controls and procedures. Data governance and information security systems are certified and accredited by industry bodies. Firms have certification from the UK government’s Cyber Essentials Plus scheme and ISO 27001:2013, which is the international standard for information security management. Employees are given training around data protection and information security to increase awareness.

Risk development

The Cyber Security Breaches Survey 2021 identified cyber security as a serious threat to businesses in the UK, including within the building sector. Nearly 40% of the businesses surveyed reported cyber security breaches or attacks in the past year. The incidence of cyberattacks is higher in medium and large businesses. COVID-19 appears to have exacerbated cyber threats, as businesses struggled to administer cyber security measures during the pandemic. In 2020, one in five firms ended up with a financial or data loss or a loss of other assets in the event of a cyberattack. Among the breaches and attacks identified, phishing remains the most common threat vector. The estimated average cost of a data breach for medium and large businesses is £13,400. The recent increase in cyber threat levels, particularly due to a shift towards remote working during COVID-19, has led to substantial investments being made in security infrastructure by contractors.

Legal and regulatory



The failure of contractors to comply with relevant laws and regulations could result in legal proceedings, investigations, disputes, losses, fines and penalties, and damage to reputation. Any of these events could impact the valuation of a business and reduce shareholder confidence.

Throughout 2020, construction projects were subject to stringent regulations, due to the COVID-19 pandemic. In some cases, contractors suffered a loss of productivity, as a result of compliance to these regulations.

Risk impact

The UK construction industry saw a number of new measures and proposed regulations in 2020. With the end of the Brexit transition period effective from 1 January, 2021, new regulations were introduced around the movement of construction goods in the UK market. Under the Construction Products (Amendment etc.) (EU Exit) Regulations 2020, CE (Conformité Européenne)-marked products from the EU will not be recognised within the UK from 1 January, 2022. Products already present in the UK before 31 December, 2020, remain valid. From January 2022, a UK-recognised body will act as the approver for construction products and a new legislation will be brought into effect for these changes. As a result, organisations could incur additional cost of compliance during this transition.

The Building Safety Bill and Fire Safety Bill, introduced in the aftermath of the Grenfell tragedy, are moving forward through parliament. The Fire Safety Bill aims to address concerns around fire safety in buildings and clearly demarcate accountability for managing fire risk.

The Building Safety Bill has a much wider ambit of improving the current building safety regime, defining roles and responsibilities of the construction value chain in terms of safety, and addresses fire safety concerns.

The Building Safety Bill proposes maintaining a real-time digital document of updated building data and the introduction of a building safety regulator to ensure adherence to regulatory requirements and a stringent regime during a project lifecycle. The regime is particularly directed at safety concerns in high-risk buildings with a height of 18 metres above ground level. Any non-compliance with statutory obligations will lead to issuance of compliance and stop notices, followed by prosecution.

A number of consultations were carried out throughout 2020 around topics such as tackling modern slavery in supply chains, embedding social value in public procurement, developing sustainable supply chains, transforming the UK's infrastructure to net-zero emissions, ensuring timely payments to small businesses, green and affordable housing, and planning reforms.

Any ignorance of the evolving regulatory landscape, compliance concerning health, safety, and the environment, accounting and taxation, human resources, and anti-bribery and modern slavery laws could lead to losses in business, a damaged reputation, and penalties.

Risk mitigation

Contractors have a set of policies and procedures to track these legislative changes and ensure compliance. Firms ensure adherence to legal and regulatory compliances through the following:

- Ensuring policies, procedures, and risk management processes are in place.
- Engaging with government and external advisors.
- Carrying out regular updates and training of employees.

Contractors monitor and assess the impact of any new tax, legal, and regulatory developments in the regions where they operate. They implement codes of ethics and business conduct across group operations governing decision-making processes. Firms also try to ensure that their subsidiaries, group companies, joint venture partners, and employees, as well supply chain partners, are compliant with applicable laws and regulations.

> **“ Employees, as well as members of the supply chain, are given training and learning modules to keep them updated about relevant regulatory changes.**

Contractors regularly engage with government departments and agencies to assess their performance on the legal and regulatory front. Wherever necessary, they employ external advisors or consultants on the matters of policy and other compliances.

Employees, as well as members of the supply chain, are given training and learning modules to keep them updated about relevant regulatory changes. These updates cascade down to different functions within the businesses to ensure compliance.

Risk development

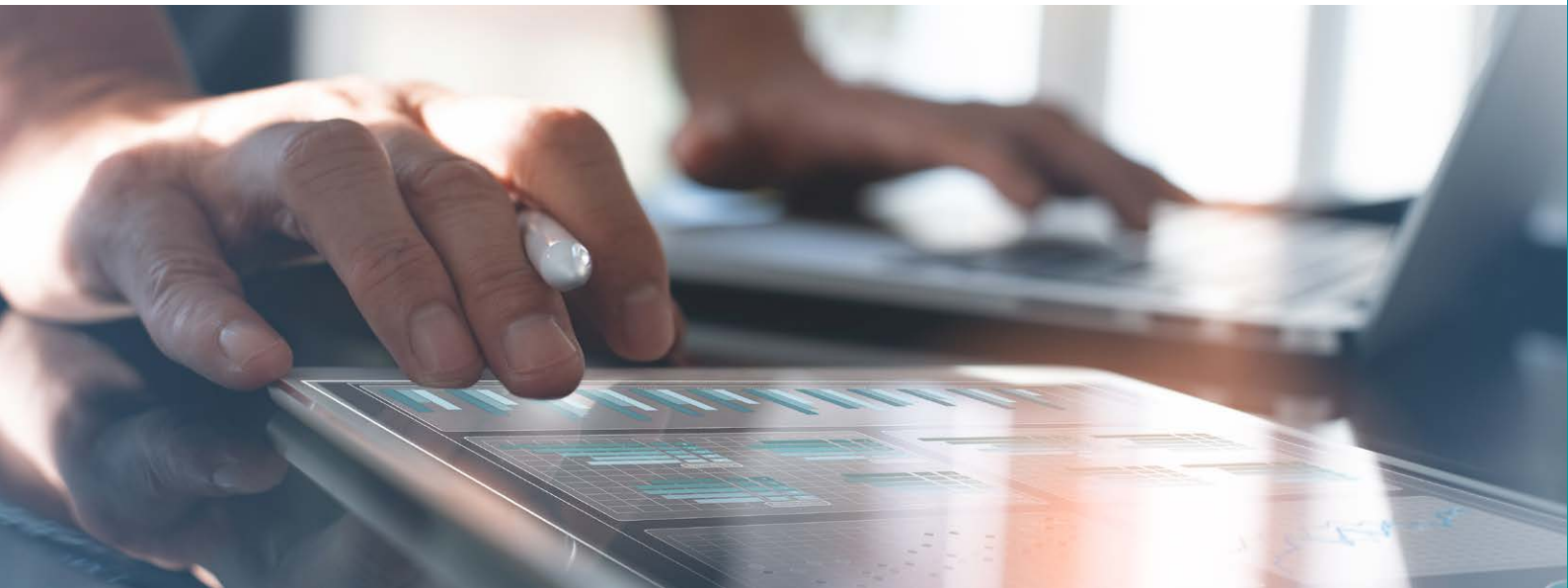
The UK government has set a target to reduce the country’s net emissions of greenhouse gases to zero by 2050. A number of legislative and regulatory changes have been proposed as a result of this commitment. The Construction Playbook, published in December 2020, sets out guidelines on commercial best practices and specific reforms in the construction industry. Its key elements include embedding in the sector a culture of safety and wellbeing, driving the net-zero carbon commitment, and promoting social values. Broadly, it outlines the government’s expectations around the way contracting authorities and supply chain participants engage with each other. The government has also published the Procurement Policy Notes (PPN) that make evaluation of social value delivered and carbon reduction plans of those in the supply chain central to the procurement of government contracts. Contractors should have plans in place to adapt to this gradual shift in the UK’s public sector procurement. In addition, the introduction of the Building Safety Bill and Fire Safety Bill is set to change the way safety is managed and administered throughout an asset’s lifecycle. The Construction Products (Amendment etc.) (EU Exit) Regulations 2020 brings in a new regime for movement of construction products in the UK market. Contractors need to build robust systems and processes to adapt to these upcoming changes in the construction industry.

4 Conclusion

The analysis of company reports and accounts, by its very nature, is always going to have an element of retrospectivity in its view of the construction industry. Therefore, while Brexit alarm, the aftermath of the Grenfell Tower tragedy, and the pandemic were the main factors underpinning contractor risk concerns in the Contractor Risk Review 2021, new risks from the period 2019 to 2020 are only just beginning to feed into the latest corporate risk analyses.

What is clear, however, is that the shadow cast by the COVID-19 pandemic, is a much longer one than was presumed at the start of 2020, impacting risks in the construction industry in a whole range of ways. It has been a prime factor in the rise in the cost of materials and supply chain disruption, and changes in the way that the industry monitors and supports the health and wellbeing of its workforce.

ESG factors are also impacting the construction sector and will do so long into the future, as the industry grapples with continuing to support growing economies with the infrastructure they need, while reducing waste and reliance on environmentally-damaging processes and materials, and improving the life experience, not just of their workforces, but of the communities they operate in.



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