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## REVIEW OF SUBCONTRACTING PRACTICE IN THE CONSTRUCTION INDUSTRY

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### ABSTRACT

Great numbers of traders from different specialization makes construction industry complicated and unique industry. The construction process is a function of many variables and is exceptionally complex both in conception and implementation. In a construction project of appreciable size, it is probable that much of the actual work will be sub-contracted. The situation is no longer obtainable for a contractor (builder) to simply carry out all the works for the client. This is as a result of the need to involve other specialists in some elements of the work. Success of a construction project is essential depending on the ability of the general contractor to select the appropriate subcontractor during bidding process, and the sufficient management of subcontractor during construction. Main contractors use subcontracting as a means of surviving the volatility of the construction business cycle such as transferring financial risks and burdens and offloading direct employment responsibility. The construction industry is one of the main sectors of the economy. The contracting companies carry out important construction projects in cooperation with subcontractors. The majority of works in construction projects (such as roofing, electrical, plumbing, painting, carpentry, and ironmongery works) are implemented by subcontractors through the main contractors. The paper is a summary of literature review done on the definitions, relationship between the client, contractor (builder) and the subcontractor, formation of building contracts.

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**Keywords:** Construction Project, Contractor, Contract, Client.

### INTRODUCTION

A construction project is awarded to a general contractor or prime contractor or principal contractor or main contractor, which resorts their work out to specialize outside firm to carry out specific project activities. General contractors are responsible for managing the project such as contract administration with clients, project financing, material and equipment procuring, and monitoring the project progress (Benjaoran 2009). According to Albino & Garavelli (1998), the general contractor's performance is strongly dependant on subcontractors. This statement is reinforced by Mbachu (2008), which stated that the ability of the general contractor and consultant to deliver the project within time, quality and cost depends largely on the performance of subcontractors.

A subcontractor is an individual or in many cases a business firm that signs a contract to perform part or all of the obligations of another's contract.

A subcontractor is a person who is hired by a general contractor (or prime contractor, or main contractor) to perform a specific task as part of the overall project and is normally paid for services provided to the project by the originating general contractor. While the most common concept of a subcontractor is in building works and civil engineering, the range of opportunities for subcontractor is much wider and it is possible that the greatest number now operate in the information technology and information sectors of business.

The incentive to hire subcontractors is either to reduce costs or to mitigate project risks. In this way the general contractor receives the same or better service than the general contractor could have provided by itself, at lower overall risk. Many subcontractors do work for the same companies rather than different ones. This allows subcontractors to further specialize their skills.

In the United Kingdom economy, the need to respond to a rapidly changing environment and service in diverse infrastructure has encouraged flexibility and diversity in its subcontractor community with the majority of subcontractors now providing specialised skills to a wide range of companies. Subcontracting is used much more extensively on housing and building construction projects than in engineering and industrial projects (Clough and Sears, 1994).

#### **WHAT IS A CONTRACT?**

A contract can simply be defined as an agreement between two or more parties which is intended to be legally binding. It apportions responsibility and apportions risk between the parties (Advanced English Dictionary). In general a contract is a written or spoken agreement especially one enforceable by law.

#### **FORMATION OF A BUILDING CONTRACT**

Offer and acceptance are elements required for the formation of a legally binding contract: the expression of an offer to contract on certain terms by one person (the "offeror") to another person (the "offeree"), and an indication by the offeree of its acceptance of those terms. The other elements traditionally required for a legally binding contract are (i) consideration and (ii) an intention to create legal relations. (Treitel, 2004).

Offer and acceptance analysis is a traditional approach in contract law. The offer and acceptance formula developed in the 19th century identifies a moment of formation when the parties are of one mind. This classical approach to contract formation has been weakened by developments in the law of Estoppel, misleading conduct, misrepresentation and unjust enrichment.

Treitel (2004), defines an offer as "an expression of willingness to contract on certain terms, made with the intention that it shall become binding as soon as it is accepted by the person to whom it is addressed", the "offeree". An offer is a statement of the terms on which the offeror is willing to be bound. It is the present contractual intent to be bound by a contract with definite and certain terms communicated to the offeree.

The expression of an offer may take different forms, such as a letter, newspaper advertisement, fax, email and even conduct, as long as it communicates the basis on which the offeror is prepared to contract.

### **CONSTRUCTION CONTRACT**

Western Australia Construction Contracts Act 2004 defines a construction contract as: a contract or other agreement, whether in writing or not, under which a person (the contractor) has one or more of these obligations:

- (a) To carry out construction work
- (b) To supply to the site where construction work is being carried out any goods that are related to construction work
- (c) To provide, on or off the site where construction work is being carried out, professional services that are related to the construction work
- (d) To provide, on the site where construction work is being carried out, on-site services that are related to the construction work.

### **THE CLIENT**

This is the person(s) who want(s) a building or buildings, who commission(s) the project and is responsible for paying for it. The primary obligation upon the client is to give the contractor the sum of money which forms the consideration for the contract. Hughes (1978 cited in Onwusonye 1982). Other duties, rights and obligations of the client are protected and administered by the commissioned professionals.

### **CONTRACTOR (BUILDER)**

According to Onwusonye (1982), the contractor derives its definition according to classification. By the nature of their business and the type of service they offer.

1. **A General Contractor:** This is he who with his own employees normally does construction works in several skills or trades.
2. **A Specialist Contractor:** This is he who normally restricts the work of his own employees to one type of skill or trade, or to a group of closely related skills or trades. Furthermore, the role associated with a contractor is a function of a given but specific contract and this is classified thus:
  - **A Main Contractor:** This is the man who is responsible to the client for the execution of the whole project contract, whether or not he performs any of the project operations with his own employees.
  - **A Sub-Contractor:** This is the man who is responsible for only part of a project and whose direct responsibility is to the main contractor and not the client.

However, the basic obligation of the contractor, according to Murdoch and Hughes (1992) cited in Onwusonye (1982), is to carry out and complete the contract works. In addition to this, Onwusonye (1982) posit that the contractor's duties also include:

- a. Reporting to the architect /quantity surveyor or where applicable, project manager of any discrepancy in or divergences between contract documents for necessary actions.
- b. Comply with and give all notices required by any Act of Parliament, any instrument, rule or order made under any Act of Parliament or any regulation or bye law of any local authority or of any statutory undertaker which has any jurisdiction with regard to the works or with whose systems the same are or will be connected.

### **SUB-CONTRACTOR**

The College of Estate Management (1985) generally defined sub-contractors as individuals or firms who enter into a legal contract with the main contractor to complete an agreed part of the contract.

Furthermore this definition is divided thus:

- a. **Domestic Sub-contractor:** This is referred to as the main contractor's own sub-contractors.
- b. **Nominated Sub-contractor:** Which arises where the design team/client requires control in the selection of a specialist.
- c. **Labour Only Sub-contractor:** This exists where the main contractor employs people on a labour only cost, supplying the materials and plant.
- d. **Listed Sub-contractors:** This goes to exhibit a compromise requiring a limited control of the selection including naming a number of firms (1-3) in the tender documents for a particular section of work. The eventual contract arrangement is that they become domestic subcontractors.
- e. **Designated or Named:** This is similar to listed subcontractor and only varies from the fact that only one name is given in the tender documents.

Debrah and Ofori (1997) defined a subcontractor as one who performs a particular trade under the supervision of a main contractor. It also includes one who provides labour to execute the construction work. This is termed a labour-only subcontractor. It is impossible to generalize subcontracting because the range of organizations embraced under the umbrella of subcontracting is so diverse (Peck, 1985). The definition of a subcontractor is by virtue of specialization among the various trades, not wholly because of the financial and technical constraints (Lim, 2003).

In the view of the United Kingdom, a subcontractor is an individual or in many cases a business that signs a contract to perform part or all of the obligations of another's contract. A subcontractor is a person who is hired by a general contractor (or prime

contractor, or main contractor) to perform a specific task as part of the overall project and is normally paid for services provided to the project by the originating general contractor.

### **NEED FOR SUB CONTRACTORS**

Ofori and Loh (2000) suggested that subcontractors are needed due to the following reasons:

- Different projects have different features and requirements and as a result, it would be uneconomical for the main contractor to keep all the required specialized skilled workers and equipment; and
- There is a lack of continuity in work due to fluctuating demands in the construction market. In response to the uncertainty of workload, main contractors do not want to employ workers directly in order to reduce overheads.

If the main contractor is established, he may retain a group of general workers, unskilled or semi-skilled, to assist the subcontractors as well as to carry out the minor operations on site. The main contractor would normally also provide the necessary tools, plant and any temporary supports for the subcontracted works.

According to Druker and White (1995), main contractors use subcontractors for two main reasons. These are:

- (1) Down-loading financial risks and
- (2) Off-loading direct employment responsibility.

Moreover, subcontractors play a very important role in a construction project as they make up for the lack of manpower, technical know-how, etc. of the main contractor (Pietroforte and Costantino 2001). They carry out most, if not all, of the works on site. Subcontracting does have its strengths and weaknesses. From the risk management point of view, subcontracting allows the main contractor to transfer some of the risks and financial burdens of a large project onto other numerous subcontractors' organizations (Pietroforte and Costantino 2001). On the other hand, the main contractor relinquishes some degree of control over the work by subcontracting. If high waste generation occurs and other difficulties arise, the main contractor's task of responding and making corrections to the deviations will be more complicated and sometimes almost impossible, because of the lack of direct control due to the multi-level subcontracting which is often involved. Nonetheless, the main contractor will need to do a cost and benefit analysis to weigh the advantages and disadvantages of subcontracting as he decides which portions of the work to turn over to the subcontractors.

The incentive to hire subcontractors is either to reduce costs or to mitigate project risks. In this way the general contractor receives the same or better service than the general contractor could have provided by itself, at lower overall risk. Many subcontractors do work for the same companies rather than different ones. This allows subcontractors to further specialize their skills.

In the United Kingdom economy, the need to respond to a rapidly changing environment and service a diverse infrastructure has encouraged flexibility and diversity in its subcontractor community with the majority of subcontractors now providing specialised skills to a wide range of companies.

#### **TYPES OF SUBCONTRACTOR**

In United Kingdom building industry contract law, particularly when using JCT standard form contracts, three subcontractor types are identified:

**Domestic Sub-contractor:** A subcontractor who contracts with the main contractor to supply or fix any materials or goods or execute work forming part of the main contract. Essentially this contractor is employed by the main contractor.

**Nominated Sub-contractor:** Certain contracts permit the architect or supervising officer to reserve the right of the final selection and approval of subcontractors. The main contractor is permitted to make a profit from the use of nominated subcontractors on site, but must provide "attendance" (usually the provision of water, power, restrooms, and other services to enable the nominated subcontractor to do his job). In effect the appointment of nominated subcontractors establishes a direct contractual relationship between the client and the subcontractor.

**Named Sub-contractors:** Effectively the same as a domestic subcontractor refers to a subcontractor who partner with the main contractor; to supply or fix any material, goods or execute work that form part of the main contract. Essentially this contractor is employed by the main contractor.

#### **THE RELATIONSHIPS BETWEEN THE SUBCONTRACTORS AND THE MAIN CONTRACTORS**

There exists a mutual relationship between the subcontractors and the main contractors. The quality of work the subcontractors deliver affects the performance of the main contractors. Normally, the working relationship between the main contractor and the subcontractors extends beyond one project. It is due to mutual trust and past working experiences between both parties that the cooperation continues (Lim, 2003).

In Japan, the relationship between the subcontractor and the main contractor is unique (Bennett et al., 1987). The main contractor depends on the subcontractors to execute his work. The main contractor is obligated to improve the capabilities of his subcontractors by extending benefits such as financial assistance, provision of training, technical and management guidance, and guarantee of the subcontractors' profit level. Firstly, it is not common for a subcontractor to remain exclusively at the service of one main contractor. Secondly, the main contractors in Singapore tend to address their own interests first (Debrah and Ofori, 1997).

Since it is of the lowest priority, the main contractor neglects the welfare of the subcontractors; it affects their performance, which, in turn, affects the industry (Debrah and Ofori, 1997). The main contractor-subcontractor relationship has been a focus of interest in the literature Kale and Arditi (2001), yet its impact on waste generation remains a virtually unexplored area in the construction management literature.

In the production aspect of the construction process in Singapore, the main contractor is usually regarded as the principal player. He has very few direct employees on a project, beyond the managers and engineers deployed for project coordination and quality control. This is because he relies on a pool of subcontractors, each offering a specialized trade. The subcontractors are responsible for the supply of labour and capital to execute the work. Therefore, the performance of subcontractors is as important as those of other participants in the construction process (Lim, 2003).

Partnering relationship between general contractor and subcontractors were proposed to create a win-win situation (Kumaraswamy and Mathews, 2000). According to Lee *et al* (2009), this long-term relationship must be established to avoid adversarial relationship between general contractor and subcontractor.

#### **SUBCONTRACTORS SELECTION PROCESS**

One of the most important phases in the construction industry is the bidding process. During the bidding process, selecting the most appropriate subcontractors for the relevant sub-works is highly critical for the overall project performance. In order to select the most appropriate subcontractors for the project and prepare the most realistic and accurate bid proposal, main contractors have to know all financial, technical and general information about their subcontractors. Within this context, main contractors should consider several factors in the selection process. These factors may include the quality of production, efficiency, employment of qualified members, reputation of the company, accessibility to the company, completion of the work on time etc. (Arslan *et al*, 2008).

Sub-contracting has extensively been used in the construction industry. It allows main contractors to employ a minimum workforce in construction projects and promotes specialization. Many main contractors only act as construction management agents in construction projects and sub-contract a large volume of their work to subcontractors (Shash, 1998).

The success level of construction projects may depend on the philosophy of selecting "the right person for the right job". Clearly, the correct choice of subcontractors increases the overall success of a construction project. However, the importance of subcontractor selection is mostly underestimated and neglected in construction (Kumaraswamy and Matthews, 2000).

#### **ADVANTAGES AND DISADVANTAGES OF SUBCONTRACTING**

According to the Construction Industry Development Board (CIDB 2013), subcontracting is an industry norm that benefits both the main contractors and the subcontractors. Some of the benefits to the main contractors are:

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- Reduced liability for labour retention as well as reduced overheads, especially during periods of low construction activity;
- Risk sharing arrangements with subcontractors for their specific work packages;
- Higher quality and productivity from a core of people engaged in specialist work packages; and
- Better cost control through fixed-price subcontracting.

The main contractor does however also experience some negative impacts that can arise mainly due to poor quality work from subcontractors which place added responsibility upon the main contractor to implement better supervision protocols. Where main contractors do not have sufficient construction supervision and management skills in place, concerns about the quality of work may have a negative impact on project performance and on payment schedules.

Compliance issues can also negatively impact on the main contractor, especially with health and safety where the main contractor is legally responsible and many end up having to carry the compliance costs of subcontractors who have neither the technical expertise nor the resource to invest in these legislative requirements. Some main contractors reported that their sites have been shut down because of poor compliance by the subcontractors – a situation that negatively impacts on time schedules and the overall profitability of a project.

Subcontracting has also been described as an unsatisfactory practice with subcontractors reporting poor treatment and delayed payment by the main contractors as the main points of contention. Delayed payments were mentioned as the most significant shortcoming in the subcontracting relationship, especially where the main contractor uses the „ pay when paid in terms of contracting.

As the specialist and trade contractors operate fully autonomous companies providing their own equipment and materials, delayed payments are especially growth limiting. The subcontractors mentioned that where there are payment disputes between the main contractor and the client, the subcontractor has to carry the burden of an unusually lengthy payment cycle, a process tantamount to pre-financing the main contractor.

Subcontractors also cited the loss of control over the construction works programme or management in order to fit into the main contractors' site programme as a further disadvantage. This often impacts negatively on productivity and profits because of time delays.

The benefits of subcontracting to the subcontractor are dependent on whether the subcontractor is a specialist, trade or labour-only subcontractor. Specialist and trade subcontractors are generally able to innovate and improve their productivity in their area of specialization. They can improve their productivity and increase their clientele



by servicing multiple clients with distinction. Training and employee development is also possible for both specialist and trade subcontractors who undertake related work for multiple clients.

The major benefit for labour-only subcontractors is that they carry minimal overheads for the work they produce. As indicated earlier, labour only subcontractor mostly carry out labour intensive work packages such as the wet trades in building and kerb laying in civil construction. They also tend to be subjected to more favourable contracting conditions with many contractors indicating that they pay labour-only subcontractors as employees to reduce the financial burden on the subcontractor.

Subcontractors working in specialized fields (such as electrical and geotechnical work) accept that because of the nature of the construction industry there will always be subcontractors on major projects, but state that the advantages of working in a specialist, niche market such as reduced competition and higher profit margin outweigh the disadvantages of working as a subcontractor.

## **CONCLUSION**

Subcontracting has become a great subject to all the practitioners in construction industry due to the common practice of subletting construction works into smaller packages in construction industry. Effective subcontractor selection and monitoring which can minimize the problem would determine the success of construction companies. Problems of subcontractors, if ignored, can cause an immense impact to the construction project, and can extend into the operation of the general contractor's organization. Therefore, attention shall be given to the issues of subcontractor, which is the main participant in almost all the construction projects.

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