

RELATIONAL CONTRACT IN CONSTRUCTION INDUSTRY IN MALAYSIA

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To my beloved father, mother, husband, siblings and friends

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ABSTRACT

For many years, the construction industry has relied on formal contracts to define and enforce the obligations and rights of contracting parties. Nonetheless, existing formal contracts are subject to some disadvantages hence an alternative is required to address the issue. The objectives of this study are to study the current practice of construction contract, to analyze problems associated with the application of traditional contract in Malaysia and to appraise the knowledge and the application of Relational Contract in Malaysia. The data used in this study was collected through literature study and questionnaire survey from Class A contractor in Johor Bahru. Data was analyzed using Statistical Package for Social Sciences Software (SPSS) and the results analyses were presented in frequency and average index value. The finding shows that traditional contract has been identified to be the most frequently used contract in Malaysia due to its familiarity to works with but there are problems associated to the traditional contract. Potential barriers such as lack of client knowledge also being identified in this study and lack of client knowledge is found to be the most critical reason in adopting relational contract. The traditional contract can be improved through the incorporation of Relational contract's elements such as clearly defined scope, integrated project team, alignment of goals and open honest communication. It can be concluded that relational contract is still new in Malaysia. Many of the practitioners in the industry are not aware of this approach. However, they agree that some of the elements in relational contract can be adopted in order to overcome the weaknesses in traditional contract.

ABSTRAK

Industri pembinaan di Malaysia buat sekian lama bergantung pada kontrak tradisional dalam menentukan tanggungjawab dan hak pihak –pihak yang berkontrak. Walau bagaimanapun terdapat beberapa kelemahan dalam kontrak sedia ada dan suatu pembaharuan diperlukan dalam menangani isu ini. Objektif yang digaris dalam kajian ini ialah mengkaji jenis kontrak yang digunakan dalam industri pembinaan dalam masa kini, menganalisa masalah yang berkaitan dengan penggunaan kontrak di Malaysia dan untuk mengkaji pengetahuan serta aplikasi Kontrak Perhubungan di Malaysia. Data dalam kajian ini diperolehi daripada kajian literatur dan melalui borang soal selidik. Borang soal selidik ini telah diedarkan kepada kontraktor kelas A di sekitar bandaraya Johor Bahru. Statistical Package for Social Sciences Software (SPSS) telah digunakan dalam menganalisa data-data tersebut. Hasil analisis telah dibuat dengan menggunakan dua kaedah iaitu data frekuensi dan nilai purata index. Analisis, kajian menunjukkan bahawa kontrak yang lazim digunakan dalam industri pembinaan adalah kontrak tradisional. Ini kerana kontrak tersebut mudah digunakan. Namun begitu, masih terdapat beberapa kelemahan yang perlu ditangani. Faktor yang menghalang kontrak perhubungan turut dikaji dan didapati faktor utama yang menghalang kontrak perhubungan ini ialah kerana kurangnya pengetahuan berkaitan kontrak tersebut. Elemen dalam kontrak perhubungan seperti penerangan skop yang jelas, integrasi dainatra pihak berkontrak, matlamat yang sama bagi setiap pihak dalam sesuatu projek serta mengamalkan komunikasi yang telus dilihat dapat menangani kelemahan dalam kontrak tradisional. Kesimpulannya, kontrak perhubungan ini masih baru di Malaysia dan kebanyakan pihak tidak mengetahui tentang penggunaannya. Walaubagaimanapun kebanyakannya bersetuju bahawa terdapat beberapa elemen didalam kontrak perhubungan yang sesuai digunakan dalam menangani kelemahan kontrak tradisional ini.

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CHAPTER I

INTRODUCTION

1.0 Background of the study

Construction projects are undertaken by many parties, all with their own goals and motivations which may not always be aligned. The alignment is normally pursued through a contract between parties which aim at achieving are commonly agreed goals. A contract is a voluntary agreement between two or more parties, and the purpose of a contract is to set out the rights, responsibilities, and liabilities of the parties. The contract allocates risk among the parties. Contracts may be formal and written, with fairly explicit described behaviors and understanding. Years of legal analysis and substantial experience have gone into drafting and fine-tuning the standard forms of contract that are commercially available. Nonetheless, they are not perfect for every project or every party. Different groups of contracting parties, and also people within the same group, interpret contract clauses in different ways.

For that reason, many contracts are custom made to suit individuals and projects. The contractual interrelationship between parties to a construction project will often determine what remedies are available as well as allocation of responsibility and liability. Furthermore, they are governed by contracts, which do not necessarily produce win-win outcomes. In Malaysia there are two type of contract that is commonly used which are traditional contract and design and build contract. In traditional contract method, contractor agrees to build the design that provided by the client. The contractor only has responsibility for construction and

not for design. Design and Build comes in various forms but is typified by the contractor taking both design and construction responsibility. In integrated D&B contracting the contractor develops the design and constructs the building based on a set of requirements provided by the employer.

However recently there is a new approach in contracting in Malaysia construction industry which is relationship contracting. Implementation of traditional contracting systems in construction industries frequently lead to confrontations and unresolved issues associated with different commercial alignment of individual parties. Hence, the modern type of contracting systems emerges, hoping to replace and sealed up the adversarial traditional style of management.

According to a publication by Alan McLennan Strategic Services, an alliance network company in Australia, relationship contracting is a term applied to contracting arrangement where management of relationship is given precedence over the dictate of a standard form of contract. It is a strategic alliance between organisations to achieve mutual benefits. Relationship contracting is based on trust, appropriate risk allocation, teamwork, sharing of profit or loss and most importantly the alignment of goals.

Basically, relationship contracting falls into two broad categories. They are either project based or long term strategic alliance. Project based contracts are commonly known as project-specific partnering and the arrangement will last until the end of the project. The arrangement is between the principal and a few contractors. The other form would be a long-term partnering or more likely to be termed as alliancing because it usually last for years between the principle and the main contractor.

1.1 Problem Statement

In traditional contracts, contractual and flexibilities that are required in ever changing construction scenarios are not supported in order to face uncertainty and complexity. These include split responsibility between construction and design. This can and unfortunately often does lead to disputes about whether defects are really design defects (for which the employer is responsible) or defects in materials and workmanship (for which the contractor is responsible). The other major disadvantage of this route is that the final design is often not fully developed before construction starts and this can create problems and price uncertainty. This can make general contracting unsuitable for public bodies with budgetary constraints.

The traditional form of contracts emphasizes the separation of roles in the parties involved and a rather unbalance allocation of risks. The standard form of contract encourages self-interest and protection of individual positions (McLennan). It handles the contracts in a mechanical ways, indicating the time span, obligations and other notices in writing. It ignores some of the crucial aspects dealing with behaviors and commitments such as trust, honesty, fair dealing, good faith and open communication. According to Scott (2001), the limitations of traditional contracting are:

- Misalignment between the owner and the individual contractors
- Misalignment between the individual contractors
- Lack of access to the contractors' skills and expertise at a time when they can best and most influence the eventual outcome

Traditional contracting tends to escalate the project time and targeted cost due to unforeseen circumstances such as dispute between client and contractors. Moreover, the contractors have no interest or intention to reduce the overall project cost and construction schedule. There is no incentive or benefit for them to gain.

On the other hand, relationship contracting offers an approach to encourage cost savings and reduction in construction time through systematic contracting procedures. At worst, it contains schedule overruns and cost. The relationship based contracts is designed to overcome the limitation of traditional contracting. It opens up the doorway to continuous improvement in performance, communication, trust, risk management and future collaboration. Relationship contracting is founded on the principle that there is a mutual benefit to the client and the contractor to deliver the project at the lowest cost – when cost increases both the contractor and the client are worse off (Sai On Cheung etc.). The core values of the relationship rely upon commitment, trust, respect, innovation, fairness and enthusiasm. What is actually meant by relational contract and how its application could help to ease current dilemma in construction contract. Do the contracting parties have substantial knowledge on relational contract and to what extent its application in Malaysia? A study should be carried out to investigate these statements.

1.2 Aims and Objective

The aim of the study is to investigate problem in pursuing traditional contracts with the view of introducing relational contract in construction practice. The aim is supported by the following objectives:

- (i) To study the current practice of construction contract.
- (ii) To analyze problems associated with the application of traditional contract in Malaysia
- (iii) To appraise the knowledge and the application of Relational Contract in Malaysia.
- (iv) To recommend an improvisation of traditional contract through relational contract's elements

1.3 Research Methodology

Research methodology starts with problem formulation which consists of identifying area of study and selection of topics. Relational Contract in Malaysia has been chosen as the area of this study. After identify the area of this study, aim and objectives of this study were set. Then, literature review work been carried out involving a through searching and investigating relational contract related issues through different primary and secondary sources such as textbooks, articles, journals, papers and international conference paper. In additional, there also effort on searching and browsing through internet web pages, internet websites, online library, electronic database and online articles and journals to seek for supplementary information. The purpose of the literature review was to gather important information related to the topic and deepen the understanding of relational contract, the advantages and potential barrier in adopting it in the construction industry.

Based on the literature review work, a questionnaire was developed. There were five sections in the questionnaire contains of questions related on problems in traditional contract and relational issue. Each section in the questionnaire required respondent to answered questions that gives information required for the study. Then, the questionnaire has been distributed to Class A contractors in Johor Bahru area. Out of 44 questionnaires distributed, only 22 questionnaires returned. Returned questionnaire has been analysed by using software namely Statistical Package for Social Sciences Software (SPSS). In the analysis, two method has been used which is Frequency Analysis and Average Index Analysis. Based on the analysis, findings were obtained and a conclusion was derived based on the results. Findings and conclusion must be referred and answered the aim and objective that has been set before. Figure 1.1 shows the methodology flow chart of this study.

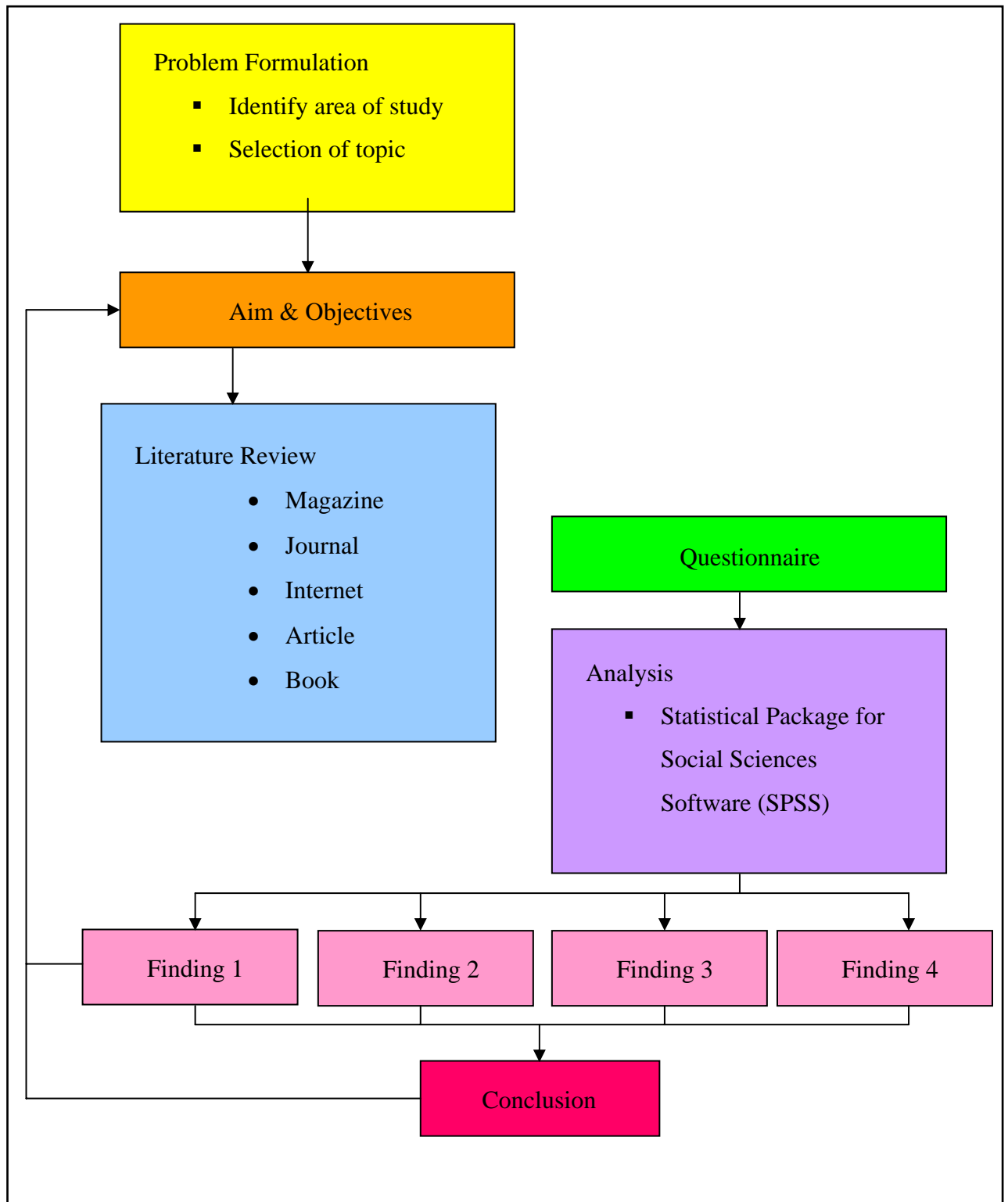


Figure 1.1: Methodology Flow Chart

1.4 Scope of Study

- (i) This research study on the current contract practice in Malaysia. It also will cover the problem occurs in traditional contracting practice.
- (ii) Further, it will cover on how the relational contract could overcome the weakness of current contract.
- (iii) The study is mainly to investigate the acceptability and knowledge of relational contract in Malaysia
- (iv) The questionnaire will be conducted in Johor Bahru.
- (v) Respondent of this study is from Class A Contractor.
- (vi) Analysis that is going to be used for this study is Statistical Package for Social Sciences Software (SPSS).

1.5 Importance of this study

The importance of this study is to know the current contract procurement that is regularly used in the industry. This information is important in order to see the pattern in contracting whether there is any development or new criteria stated by the client in choosing type of procurement. Furthermore, problem in current contract used is identified through this study and improvisation can be made by introducing the new philosophy in contracting. Relational Contract is introduced to the industry and their acceptance is studied.

1.6 Conclusion

This chapter has illustrated in details on fundamental of the study. In this chapter, background of the study was discussed in detailed. The natures of construction industry were illustrated. The following sub-section is on problem statement where problems in the traditional contract have been illustrated. Aim and objective were defined in this chapter. There four objective that has been outlined. Research methodology of this studies also being discussed. There also limitation in the study. Those limitations have been outlined in scope of study. Lastly is on the importance of the study.