

**PAYMENT WOES AMONG MALAYSIAN CONTRACTORS**

**MUHAMMAD EHSAN B. CHE MUNAAIM**

**UNIVERSITI TEKNOLOGI MALAYSIA**

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## ABSTRACT

Payment problems have prompted several developed countries to introduce construction-specific statutory security of payment acts typically known as construction contracts act to eliminate poor payment practices and smoothen the contractors' cash flow. Malaysia too cannot pretend not to have these problems despite adequate mechanisms provided in many standard forms of construction contract. This paper presents findings of a study conducted amongst Malaysian contractors with the aims to determine the seriousness of late and non-payment problems, to identify the main causes and effects of late and non-payment and to identify remedies for securing payment debt as already been embedded in the construction contracts acts in other developed countries. It can be concluded that many local contractors have experienced late and non-payment problems in the Malaysian construction industry and the situation is far worse when it comes to government clients. This problem actually involves enormous amounts of money and leads to other problems that could affect the performance and image of the construction industry. The study via theoretical investigation and research survey found that the late and non-payment problems are contributed by *inter alia*: local culture/attitude, disagreement on the valuation of work done and paymaster's poor financial management. The study shows that late and non-payment can create cash flow problems, stress and undue financial hardship on the contractors. Amongst the most appropriate remedies to overcome or mitigate the problem of late and non-payment faced by local contractors include: a right to a speedy dispute resolution mechanism e.g. adjudication, a right to suspend work and a right to regular periodic payment. It is perhaps timely for Malaysia to introduce its own statute on the Payment and Adjudication Act.

## ABSTRAK

Masalah pembayaran dikalangan kontraktor telah menyebabkan beberapa negara untuk memperkenalkan akta sekuriti pembayaran bagi industri binaan atau lebih dikenali sebagai akta kontrak binaan untuk menghapuskan praktis pembayaran yang lemah dan melicinkan aliran wang tunai bagi pihak kontraktor. Malaysia tidak boleh beranggapan tidak mempunyai masalah yang sama walaupun terdapat mekanisma yang mencukupi di dalam borang kontrak seragam. Kertas projek ini mempersembahkan hasil yang dijalankan di kalangan kontraktor-kontraktor di Malaysia bertujuan untuk menentukan betapa meruncingnya masalah pembayaran lambat dan masalah tidak dibayar, untuk mengenal pasti punca dan kesan masalah tersebut dan untuk mengenalpasti remedi-remedi untuk menjamin pembayaran yang boleh didapati di dalam akta kontrak binaan yang boleh didapati di negara-negara maju. Kesimpulannya kebanyakan kontraktor-kontraktor tempatan mengalami masalah kelewatan pembayaran dan tidak dibayar dan situasi ini adalah lebih serius apabila melibatkan klien-klien dari pihak kerajaan. Masalah ini sebenarnya melibatkan jumlah wang yang banyak dan membawa kepada masalah-masalah yang lain yang boleh menjejaskan pencapaian dan imej industri binaan. Kajian ini melalui penyiasatan teoritikal dan kajiselidik mendapati masalah kelewatan pembayaran dan tidak dibayar adalah diantaranya disebabkan oleh budaya/sikap tempatan, ketidakpuashati di dalam penilaian kerja yang dilakukan dan pengurusan kewangan yang lemah oleh majikan. Kajian ini menunjukkan masalah pembayaran boleh menyebabkan masalah aliran wang tunai, tekanan dan masalah kewangan kepada kontraktor. Diantara remedi yang boleh digunapakai untuk mengatasi masalah pembayaran ini ialah adjudikasi, hak untuk menangguhkan kerja dan hak untuk pembayaran secara berkala. Mungkin sudah tiba masanya untuk Malaysia untuk memperkenalkan statutnya sendiri berkaitan akta adjudikasi dan pembayarannya.

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## CHAPTER 1

### INTRODUCTION

#### 1.1 Introduction

The practice of efficient and timely payment in construction projects is a major factor leading to a project's success. The importance of payment is further amplified by the fact that the construction industry relatively involves long durations to complete, large amounts of money to spend and the widely use of credit payment term rather than payment on delivery in purchasing of materials (Ameer Ali, 2005b). It is generally accepted that late and/or non-payment will cause severe cash flow problems especially to contractors, and this would have a devastating knock-on effect down the contractual payment chain. The importance of cash flow was also recognized by late Lord Denning in *Dawnays Ltd. v. FG Minter*<sup>1</sup> who regarded cash flow as the "lifeblood of the enterprise". Late and non-payment issues or rather contractors' payment woes are considered to affect many players in the local construction industry, whether in government or private funded projects.

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<sup>1</sup> 1971 1WLR 1205.

Due to these problems, some countries like United Kingdom, Singapore, New Zealand and some states in Australia have legislated their construction specific statutory payment security regimes that purposely enact provisions to address issues on prompt payment in the construction industry, and to eliminate as much as possible poor payment practices and smoothen the contractor's cash flow. Malaysia too cannot pretend not to have this problem. A study conducted by the Master Builder Association of Malaysia (MBAM) shows an unsurprising discovery of the subsistence of the late-payment culture in the Malaysian Construction Industry. As such, there is an urgency for us to find alternative remedies which could effectively put an end to the cash flow problem in our industry. It is important to note that some of the remedies have been incorporated in many Construction Contracts Acts across the globe. Basically, a typical construction contract Act contains two sections. The first section deals with adjudication provisions and the second section governs the payment mechanism. Once the Act is in place, it will provide mandatory requirements for construction contracts to include adjudication and payment provisions failing which a default Scheme will be incorporated and acts as implied terms of the contract. Currently, Malaysia is in the midst of drafting its very own Adjudication and Payment Act, which is targeted to be in force in 2007. Extensive efforts are being conducted by the Construction Industry Development Board (CIDB) to promote the use of the Act in the future should the Act receive its Royal Assent. If the bill becomes an act, all the standard forms of contracts available in Malaysia have to be amended to reflect the new parameters introduced by the Act.

## **1.2 Problem Statement**

Although there are adequate mechanisms provided in many standard forms of construction contracts, yet there remains a chronic problem of late and non-payment issues in the Malaysia construction industry (Ameer Ali, 2005b). It is anticipated that

the protections against the employer's failure to pay, suspension of works, determination and claim on interest are considered as the major problems associated with late and non-payment issues in Malaysia. The main issues that require particular attention are as follows:

1. Why do Malaysian contractors still experiencing late or/and non-payment situation despite adequate mechanisms provided by many standard forms of contracts?
2. How to overcome this problem and to smoothen contractors' cash flow, which will ultimately improve the quality of end products.

### **1.3 Aim and Objectives of Research**

This aim of this study is to address the problems of late and non-payment by way of providing evidence about the seriousness of late and non-payment issues in the Malaysian construction industry.

The above aim is supported by the following objectives:

- i. To determine the seriousness of late and non-payment problems among Malaysian contractors and sub-contractors;
- ii. To study the causes of late and non-payment in the local scene;
- iii. To analyse the effects of delayed and non-payment to the payees down the contractual payment chain and to the society in general; and
- iv. To identify and establish contractual and/or statutory remedies to resolve or mitigate contractors' payment woes.

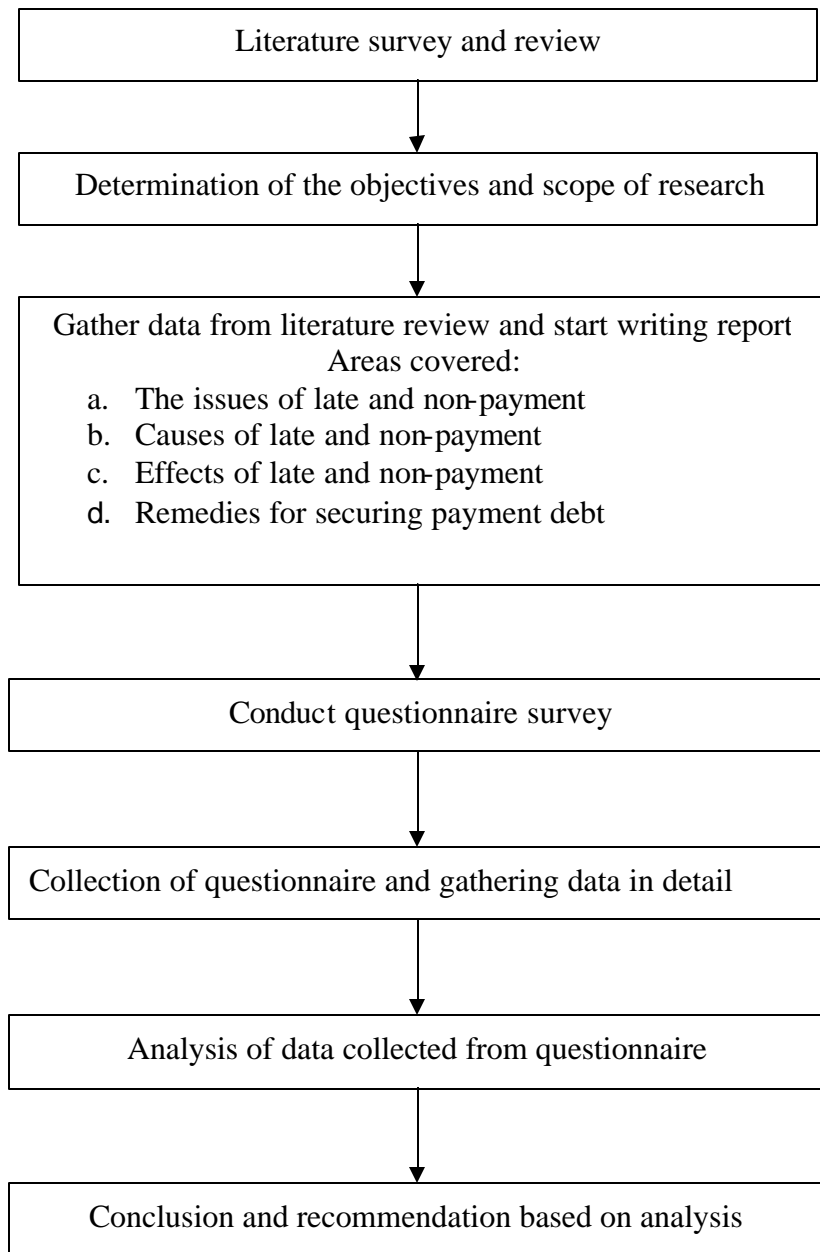
## **1.4 Significance of Research**

Findings of this study may assist the government and relevant parties in addressing problems associated to late and non-payment in an effective and timely manner to create a win-win situation for all parties in the Malaysian construction industry. It is hoped that the government and relevant parties will adopt and implement the necessary plan of action in order to minimise disputes on payment in any construction project, so as to create a friendly and enjoyable working environment for all parties and to improve the payment flows in the Malaysian construction industry. The result of this research may be of significance to the introduction of a legislation known as the Construction Payments or Security of Building Payment Act, which already enacted in many advanced countries.

## **1.5 Research Methodology**

A framework of the methodology has been designed to show the distinct stages and the sequence in which they occur. The framework is represented diagrammatically in Figure 1.1.





**Figure 1.1: Framework of Research Methodology**

The research for this dissertation was conducted using the following approaches:

a) Literature Review

This includes the latest secondary data and information collected from different sources which can be used for the survey being conducted. The sources include books, journals, magazines, dissertations, conference papers, periodicals and information from the internet. These materials were used for background reading to obtain full understanding and information needed for discussion and analysis in the research. References were obtained from the libraries in University of Technology of Malaysia, Kuala Lumpur and University of Malaya

Research papers and journals provided invaluable information regarding the causes, effects and probable solutions related to the issues of late and non-payment in the global construction industries.

b) Questionnaire Survey

Due to the restrictive nature of the study, the principal information was obtained solely from a questionnaire survey. The questionnaire survey was conducted to collect primary data from contractors in Malaysia for research purposes. Details and analysis of the survey are presented in Chapter 6. A sample copy of the questionnaire is included in Appendix 'A'.

## **1.6 Limitation**

The questionnaire survey undertaken is confined to studying the responses to and opinion of contractors in Malaysia about the seriousness of the issue of late and non-payment and the contributing factors for its existence. The contractors' favourable remedies in securing payment debt from their respective clients were also recorded in this survey.

It is anticipated that the small sample selected in the questionnaire survey and the poor response may limit the reliability of the findings. Notwithstanding this, the findings can still be used and further research should be able to verify the matter.

## **1.7 Structure of Dissertation**

The dissertation is structured into seven chapters.

### **a. Chapter 1 - Introduction**

The introductory chapter provides an overview of the context in which the research was conducted.

b. Chapter 2 – The Issues of Late and Non-Payment

This chapter deals with the problem of late and non-payment experienced by other developed countries and Malaysia in particular.

c. Chapter 3 – Potential Causes and Effects of Payment Problems

In this chapter the potential causes of such problem are discussed and scrutinized. Thereafter, the effects of untimely payment and non-payment to the payees down the contractual payment chain and to the society in general are identified and established.

d. Chapter 4 – Alternative Remedies for Securing Payment Debt

This chapter discusses the remedies available in securing payment debt that are being practiced in developed countries. The suitability of each remedy in Malaysia scenario is also examined.

e. Chapter 5 – Data Collection

This chapter presents the data collected from the questionnaire survey. The findings reveal the response from Malaysian contractors pertaining the issue of delayed and non-payment.

g. Chapter 6 – Data Analysis

This chapter analyses the data collected in Chapter 5 together with the discussion of results.

f. Chapter 7 – Findings and Conclusions

This chapter draws together all the research results to present the overall findings and conclusions.

**1.8 Concluding Remark**

This dissertation aims to study the payment problems experienced by many contractors and sub-contractors in Malaysia by providing statistical and tangible data of the seriousness of the problems which have persisted for ages but not fully addressed and attended to. The foundation of this dissertation is clearly stated in this chapter in order to give a clear view before proceeding further to the following chapters. The next chapter deals with the issues of late and not-payment faced by other developed countries and Malaysia.

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