



Department
for Business
Innovation & Skills

CONSULTATIVE COMMITTEE ON CONSTRUCTION INDUSTRY STATISTICS

Minutes of the meeting held on Thursday 18th June 2015

Venue:

Conference Centre,
Department for Business, Innovation and Skills,
1 Victoria Street,
London.
SW1H 0ET

Attendees

Present

Frances Pottier (Chair)	Dept. for Business, Innovation & Skills
Liam Cavin	Dept. for Business, Innovation & Skills
Arran Cleminson (Minutes)	Dept. for Business, Innovation & Skills
Ole Black	Office for National Statistics
Kate Davies	Office for National Statistics
Pete Lee	Office for National Statistics
John Allcoat	Office for National Statistics
Alastair Gibb	Office for National Statistics
Noble Francis	Construction Products Association
Ian Pegg	Building Cost Information Service
Alex Murray	University College London
Neil Thompson	Balfour Beatty
Adam Valentine	Barbour ABI
Michael Dall	Barbour ABI
Kelly Forest	Core Five
Alberto de Biasio	University College London
Robert Yates	Federation of Master Builders
Ian Murdoch	National Specialist Contractors' Council
David Bishop	National Specialist Contractors' Council
Steven Gruneberg	University of Westminster
Giorgio Buttironi	National Federation of Builders
Brian Green	Brickconomics
James Hastings	Experian

Apologies

Jim Meikle	AECOM
John Appleton	HM Treasury
Siobhan Carey	Dept. for Business, Innovation & Skills
Neil Higgins	Dept. for Communities & Local Government

1. Preliminaries

Attendees introduced themselves. Minutes from the previous meeting were agreed, and progress on actions from the previous meeting discussed.

2. Construction Products Supply

Dr Noble Francis, Economics Director from the Construction Products Association, delivered a presentation on construction products supply.

Construction in the recession was discussed, noting key statistics of construction products. Construction output fell 17% (peak to trough) during the recession. Construction products capacity fell over 20%. Private housing starts fell 52% (peak to trough) and brick production fell 61% (peak to trough). Both housing-related falls were due to house builders and brick manufacturers focusing on short-term destocking rather than the medium-term. But this leads to a greater long-term impact on manufacturers.

Construction product manufacturing was discussed. Only approximately 40% of bricks are used in a new build. 40% of bricks are used in Repair, Maintenance & Improvement (RM&I), which fell 16%. There have been anecdotal stories of brick shortages over the past 12-18 months. As the derived-demand for bricks has risen, so has the price and a need for advance planning, as happened pre-recession. However, this is a natural consequence of a rise in demand rather than a shortage. There have been two mothballed operations which have reopened in the past year.

Key statistics were noted of changes in the last two years. Construction output rose 15% but is still 4% below the pre-recession peak (on the revised ONS data). Private housing starts rose 41%. Brick production rose 36% and brick imports rose 129%. This has led to issues on supply, with key questions being asked including 'Will there be further investments in brick capacity?', 'Who would invest?', 'How will sustained housing growth occur?' and 'With more broad-based growth going forward (not just housing but commercial and infrastructure), will other materials also have issues?'.

The feasibility of a key target from Construction 2025, the industrial strategy, was discussed. This is a 50% reduction in the trade gap between total exports and total imports for construction products and materials. It was noted that imports are expected to rise alongside construction output (18% in the next four years alone). The top five imported and exported products were discussed. It was noted that 3 of the top five imported products are also 3 of the top five exported products, suggesting that British exporters focus on the quality of products produced, due to competition with other countries for the manufacture of cheap products. In addition, it also highlights the impacts of international supply chains.

Noble Francis can be contacted at noble.francis@constructionproducts.org.uk.

A wider discussion followed this presentation:

Brian Green asked about the effect of timber on imports and exports, specifically on how the choices of materials used in the way buildings are constructed will affect import and export figures. Noble Francis stated that this is affected by policy decisions. Brian Green suggested that policy could be used to direct material choices, which Noble Francis agreed with although he questioned whether this was a sensible focus for policy.

James Hastings said that the materials shortage was somewhat overstated and a short-term effect. This is the same with the labour side of construction. Shortages may be easing because of a rise in wages in construction and an increase in employment of skilled people. The SME sector is always hardest hit in a recession. Noble responded stating that higher wages will attract skilled people but this is not necessarily the case for managers. In general, the construction sector uses imported labour to get by. James Hastings said that there is a global market for the skilled workforce. Noble said that skilled workers can go into a sector/industry/country where the business isn't as volatile. The problem is that the sector has had to deal with large falls in demand for skilled workers during the recession. James stated that there is evidence of skilled workers leaving during recessions. Noble responded by saying that this was made worse by public sector house building no longer being able to offset falls in construction in the private sector.

Ian Murdoch said, with regard to the output and import/export graphs, that one of the biggest contributors to falls in the 1990s may have been due to timber. He went on to say that the use of high-end products, such as air conditioning units, will grow.

Michael Dall asked if there are any comparative advantages that the UK possessed which could close the import & export gap. Noble praised the efficiency of the UK brick industry, but this is not viable as an export item. Manufacturers should focus on the light side, where they can add value. To take advantage of products to reduce the trade gap, you need investment but only if investors see the rate of return. Manufacturers don't like volatile markets, which is what our market is like.

Manufacturers don't like their sales to rise due to strong economic growth, then to make losses due to that growth disappearing. Manufacturers prefer sustained slow growth to rapid growth followed by rapid losses.

Brian Green noted that lack of brick layers was being touted as a tight constraint on growth. James Hastings advised that anecdotal evidence suggested that bricklayers were not as hard to source as has been suggested. In the future, changes to building methods may result in lower demand for these skills. Noble mentioned recent labour market publications suggesting that wages of construction workers were up 5.3% on a year ago, for construction generally. James Hastings pointed out that this followed 5 years of underperforming construction wage rises, and that recent rises may go some way to tempting workers back to the construction industry.

3. Trade credit in UK construction industry: contractor financial positioning and performance

Alex Murray delivered a presentation on trade credit in the UK construction industry, and the use of accounting data in assessing the economic characteristics of construction firms. This presentation is based on a 2013 study commissioned by the Department for Business, Innovation and Skills entitled 'Trade Credit in Construction'. It was authored by Graham Ive and Alex Murray, and was published alongside the Industrial Strategy: Construction 2025. It is an empirical study of the use of trade credit in industry, as well as providing insights into recent trends in profitability.

The term 'Trade Credit' was defined as supplier cash flow finance. Firms (contractors) often pay for goods/services sometime after the delivery of those services (and after the client has paid for sub-contracted work). Labour typically demands payment more promptly, but is wrapped up into sub-contracts. The strategic management of organisational cash flow was defined. Trade Credit is more relevant with the increasing use of outsourcing and sub-contracting. Companies risk insolvency in situations where turnover is falling, as the positive cash position unwinds while incurred liabilities are still due.

The framework consists of the Du Pont accounting identity. An equation for 'Return on Capital Employed' (ROCE) was presented (see below). This equation takes into account profit before interest & tax, turnover, total assets and capital employed.

$ROCE = (\text{profit margin}) \times (\text{asset-turnover ratio}) \times (\text{asset-capital ratio})$

$$ROCE = \frac{\pi}{K} = \frac{\pi}{T} \times \frac{T}{TA} \times \frac{TA}{K}$$

Where:

π = Profit Before Interest and Tax (PBIT)

T = Turnover of Sales

TA = Total Assets

K = Capital employed (=TA minus Current Liabilities)

Equation: Du Pont identity of ROCE determination. Source: Ive, G., Murray, A., 2013. Trade credit in the UK construction industry: An empirical analysis of construction contractor financial positioning and performance (Academic consultancy No. 118), BIS research papers, Department for Business, Innovation and Skills).

Financial Analysis Made Easy (FAME) was presented as the data source, and an explanation of the methodology, sampling and coverage of the study was provided. A detailed section covering the methods is available in the full report.

Findings of the report were presented. Key summaries of statistics included the net balance (inflows and outflows within the supply chain), operating ratios (for contractors versus a rest of the economy benchmark), firm financing (for contractors versus rest of the economy), the need for working capital, profitability, sources of finance and total assets.

A link to the full report can be found here:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/210964/bis-13-956-trade_credit-in-uk-construction-industry-analysis.pdf

Alex Murray can be contacted at alex.m.murray@ucl.ac.uk.

A wider discussion followed this presentation:

Brian Green asked how trade credit impacts the organisational behaviour of a contractor. He said that you are seeing different points from the whole of the industry. Alex responded that for Tier II and lower, there are strategic conditions used by companies. It should be in the contractor's strategic management process how to handle that, for example with regard to late payments. These strategies are used by companies to handle the possibilities of, for example, late payments and plan their trade credit. Main contractors often seek a percentage of their return from organisational cash flow.

Noble Francis noted that the nature of volatility in the sector dictates the business model, which leads to fragmentation and exacerbates downturns. Those lower in the supply chain don't necessarily have the ability to find funding, and can't always be selective in who they work for. Alex said that this was an unfortunate consequence of a volatile industry, with many contractors arriving at cash farming. Responding to Brian's request for older data, Alex advised that he can provide the list of providers of statistics used in this presentation including FAME, which provides data back 10 years.

Stephen Gruneberg spoke about the trade credit over liabilities ratio. This is a good industry-wide measure of risk. If you're getting trade credit when there is less work, then that is a useful unintended benefit of measuring risk in the industry. Alex said that this is a good generic measure but not useful in individual companies. Stephen said that it wasn't possible to look at the small and medium enterprises (SMEs), because there are lots of firms. He asked what Alex thinks is really going on with the SMEs. Alex responded by saying that it is hard to comment without the necessary data. The issue seen in Tiers I and II is potentially exacerbated further down the tiers. Alex discussed his sampling criteria. He said that relaxing the criteria he used to analyse FAME could enable further drilling down into the supply chain. He agreed with Stephen regarding the missing SMEs' data.

Ian Murdoch stated that there has been a Tier II survey over 21 years. He asked how long companies wait for payment. There have been interesting trends since 1994 regarding length of payment. Alex said that invoice rates are more competitive directly compared to dealing with a bank. Members of the NSCC should be aware of this.

Noble Francis discussed factoring. Noble Francis said that the cynical attitude of his members is: 'so what?'. Is the suggestion that business models should change? Alex pointed out that the recommendations in his report focus on providing financial stability for lower tiers in the supply chain and for materials suppliers.

ACTION - BIS to circulate the 'Trade Credit in Construction' report, with the minutes.

4. Update from the Office for National Statistics

Kate Davies presented an update from the ONS. She discussed the proposals put forward for the construction price and cost indices following the meeting on 8th May 2015. Much of the information is contained in the ONS release published on 12th June 2015 entitled 'Output in the Construction Industry April 2015 and New Orders Quarter 1 (Jan to Mar) 2015'. The link to this bulletin can be found here:

<http://www.ons.gov.uk/ons/rel/construction/output-in-the-construction-industry/april-2015/stb---output-in-the-construction-industry--april-2015.html>

Kate mentioned the consultation on how ONS can improve this interim solution in the short term to provide the users with better measures. A link to this consultation can be found on page three of the statistical bulletin on the link above.

Kate Davies can be contacted at kate.davies@ons.gsi.gov.uk.

A wider discussion followed this presentation:

Noble Francis spoke about the 'growth rates' table. He said that the most interesting statistic for CPA was the 2015 Q1, because of the change in sign for the year-on-year from previously published to interim solution. The revised figures seemed more sensible, and more in line with sales data for construction products. However, inflation in 2015Q1 conflicts with labour market data, with wages increasing much faster than reported inflation. Kate said that going forward, how construction output is released looks into what contributes to growth and could be improved. The aim is to break down cost indices by components.

Alberto de Biasio commented on the strengths and limitations of the interim solution. To assess the strengths, we need to know how Eurostat collects data. This should be examined and explained by ONS. Existing ONS data collection methods are fine, by contrast. On limitations with regard to PPIs, these work well when the market is growing, but not during a downturn. This is precisely when price and cost indices are needed the most. They don't account for other things such as transportation, regional differences and discounts. Alberto had prepared a chart using data from SPONS, which he would be happy to discuss further, and was preparing an article on this topic, in a personal capacity.

" Kate responded by saying that the solution proposed was an interim solution. Whilst recognising difficulties with it, it is not intended as a long term solution. The previous method of modelling deflators had to be replaced. There is a problem in terms of input costs and around PPIs. The methodology is the best that can be offered at the moment, which is why ONS are opening a consultation. Plans for a long term solution will be published by the end of the year. There is a need for another level of consultation on indices required, as discussed on 8th may. Noble Francis voiced support for the interim solution.

Ole Black suggested that this doesn't mean to say that the interim solution cannot be adjusted, and that some short term improvements were likely.

James Hastings said that there is some work funded by the Construction Industry Trading Board (CITB) which may be of benefit.

ACTION - BIS to circulate ONS consultation to CCCIS members

5. Development of Building Projects: The Inclusion of Property Developers into Construction Output

John Allcoat and Alastair Gibb delivered a presentation entitled 'Industry Review: SIC07-41.1: Development of Building Projects (aka Property Developers)'. They discussed the Gross Domestic Product (Output) (GDPO) improvement project, the Industry Review Programme, the definition of a property developer and current data sources.

The GDP(O) improvement project covers work on industry reviews and wider cross-cutting issues impacting short term GDP(O). Development of building projects (also known as property developers) is currently under an industry review. The industry review process is to evaluate concepts and methods against international guidelines. It quality assures current data & methods and investigates alternative sources & methods.

There was further discussion of the current BB14 methodology, and how the industry is measured. There was also further discussion as to how to display and communicate any changes to the ONS construction bulletin to users. The timetable for the Property Developers Industry Review was presented. The user engagement is due to be finished in summer 2015. Draft options to measure and disseminate the industry are due to be finished in autumn 2015. The recommendations are due to be consulted in winter 2015 and the final review is due to be published in March 2016. Users are invited to direct comments, suggestions and questions with any aspect of the review to John Allcoat and Alastair Gibb. It was also suggested that an update would be provided as to the work at a future CCCIS meeting.

John Allcoat and Alastair Gibb can be contacted at stoi.development@ons.gsi.gov.uk.

A wider discussion followed this presentation:

James Hastings asked exactly what the definition of a property developer is. John Allcoat said in response that they are looking at the definitions within SIC for guidance on this. They may have to consider this for future updates of the SIC.

Noble Francis asked for the exact definition of a property developer to be published. He asked if they were the same definitions as they were in 2002. Ole Black stated that the definition was unchanged in SIC07, and that we are dependent on how companies describe themselves and how the ONS interpret this. Stephen Gruneberg said that this is extremely important. Many firms in London together make London a global centre for construction and it's not measured. The problem is that lawyers do work for international construction and feel that they don't relate to construction. What the ONS are doing is starting to adapt to keep up with the changing activities which are taking place in the UK. Alastair Gibb said that they are trying to address this issue by doing this review.

Brian Green said that there are lots of joint ventures between, for example, charities and housing associations and then you have multiple companies doing one project. This is an issue for ONS. Alastair said that this consultation will help to try and resolve these issues

John Allcoat said that they are aware and careful of double counting. Stephen said that it is possible to have separate publications including and excluding duplications. Noble said that in retail sales it is quite important to have further discussion on duplicate counting.

6. Any Other Business

No other business was raised.

7. Date of Next meeting

The Chair of the meeting, Frances Pottier, said that the next meeting will be around October or November. BIS will be in touch with members closer to that time to agree an appropriate date.