Collaborative contracting: Moving from pilot to scale-up

Despite promising early successes, collaborative contracts remain a tough sell, especially in the context of a pandemic. Best practices can help project owners transition to greater collaboration.

Jim Banaszak
Partner, Chicago
McKinsey & Company

Jeff Billows
Expert, Dallas
McKinsey & Company

Rudi Blankestijn
VP, CP&I Major Projects, Houston
McKinsey & Company

Matthieu Dussud
Associate Partner, Toronto
McKinsey & Company

Rebecka Pritchard
Expert, Atlanta
McKinsey & Company

Over the past two decades, owners and contractors have experimented with elements of collaborative contracting to improve their relationships. However, collaboration has only been more generally accepted recently. The first adopters of true collaborative contracts—including companies in oil and gas, healthcare, water, and consumer-packaged goods—are already enjoying significant benefits.

In collaborative agreements and operating models—such as those found in integrated project delivery or project alliancing—key delivery partners work together during a defined preplanning period to develop the project scope, schedule, and budget; operate under a joint management structure; and form a single multiparty contract. The parties agree to waive their right to make claims against one another. And a governance board where all parties are represented makes every project-related decision, such as scope changes, and those decisions are binding—a stark contrast with traditional, adversarial contracting in which owners attempt to transfer as much risk as possible to the contracted parties.

This kind of collaboration and transparency presents many advantages, particularly in the context of the current COVID-19 pandemic. Indeed, collaborative contracting may actually help capital projects rebound from the crisis. For example, improved transparency on cost and schedule can help to determine the true impact of the pandemic, create opportunities to work together with key suppliers to address material shortages and delays in equipment delivery, and split the impact of lower productivity among parties. Seeing the benefits of more collaboration in solving the issues created by the pandemic will hopefully encourage industry stakeholders to take these lessons with them as they begin new projects in the post-COVID-19 era.

But project owners face challenges as they move toward more-collaborative contracts. Some public-sector owners are legally required to award their contracts to the lowest qualified bidder, while some projects that rely on financing require fixed-price agreements to increase outcome certainty. Other project stakeholders may be willing but stumble over unfamiliar elements of collaborative models—and some, rightly or wrongly, may anticipate difficulties in getting the best-suited partners onboard.

Our interview with one early adopter of collaborative agreements revealed that 30 percent of its contractors were unwilling to entertain the model when it was first suggested. Undeterred, the owner was able to find—and continues to work with—partners willing to work within the boundaries of collaborative structures.

Our analysis shows that to break old habits and increase adoption, project owners must first ensure that their organizations are ready for collaboration. Next, they must follow a set of best practices that includes selecting the right partners, investing early in building out a detailed project description, and aligning incentives for critical partners.

Implementing a collaborative contract

We studied eight collaborative contract pilots that collectively resulted in a 15 to 20 percent improvement in cost and schedule performance compared with traditional contracts (exhibit).

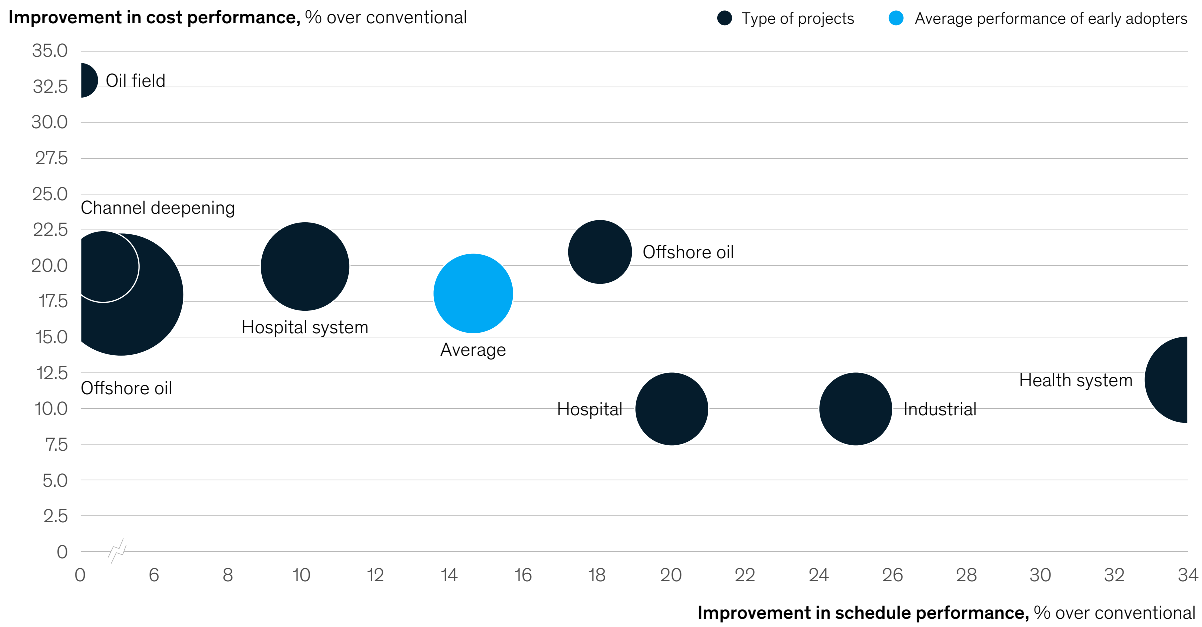
Select the right partners up front

It is critical for owners to ensure that potential partners have the right qualifications and expertise. This includes relevant experience, such as having designed similar facilities or local knowledge and presence; distinct capabilities so that no two partners overlap; and general financial health. A potential partner's project team and senior management must also be open to and supportive of collaborative agreements. Ultimately, whether the people are a good fit is what guarantees trust and a healthy collective decision-making process.

Invest in detailed project definition

When a cross-functional team of core project stakeholders works closely together to create a detailed project scope, execution plan, and cost estimate, they drastically increase the likelihood of a sound final investment decision. One project for a North American transit agency, for example, Exhibit

Early adopters of collaborative contracts are seeing improvements in performance.



involved a large and complex web of stakeholders. Initially, the agency used a traditional contract, intending to transfer risk to a developer. When potential developers evaluated this plan, however, none felt comfortable accepting this level of risk or even submitting an offer. The transit agency had no choice but to adopt a collaborative model in which each stakeholder—that is, the agency, developer, and designer—partnered to define the scope, craft design solutions, negotiate right-of-way approvals, and establish a target cost. The agency assumed the downside risk of delays that might extend past a certain point, but the developer, designer, and key subcontractors were given incentives to mitigate any potential overruns. Where a traditional risk-transfer model was unacceptable to the private sector, the agency made this project possible by adopting a collaborative model that more equitably distributed the risks.

Align incentives of all partners

Distractions and inefficiencies often occur when each project stakeholder works toward individual project goals. Setting up a common incentive pool that grows or shrinks based on overall project performance (along with all parties distributing pro rata compensation) is one approach to facilitate collaboration among project stakeholders.

Relentlessly invest in trust

Moving from an adversarial to a collaborative approach requires persistent investment in not only building and maintaining trust among delivery partners but also instilling collaborative behaviors, such as problem solving, knowledge sharing, curiosity, and creativity. To succeed, project owners should define their organizational aspirations and make those as important as a project's financial or schedule goals and enforce reliability and openness. Then they must measure their progress against their goals using performance indicators, such as scores on project team surveys or the number of cross-stakeholder problem-solving sessions.

Some collaboration is better than none

Where procurement constraints, strict lending requirements, government restrictions, or generally opposed mindsets and behaviors exist, owners can make progress on initiatives that would facilitate better collaboration, including shared digital information, tailored incentives, and an integrated design environment. Adding even one or two opportunities for collaboration is not only frequently possible but also beneficial.

An oil and gas company, for example, recently undertook a self-funded, midsize project for which it signed a long-term reimbursable agreement with an engineering, procurement, and construction (EPC) contractor. In this agreement, the company and the contractor collaborated on digital transformation and project-data transparency. In return, the EPC contractor was guaranteed a minimum of three projects over the next four years and earned incentives based on overall project outcomes, including cost and schedule.

Transitioning from a transactional approach to a collaborative model is no easy task. To start, owners (the driving force of a project) must understand their own readiness to implement a realistic level of collaboration. For example, to succeed in more collaborative arrangements, owners generally need sophisticated contracting as well as a ecosystems of reliable engineering and construction partners. They also need to allocate sufficient resources to develop a detailed project definition and properly align incentives, as well as work hard to promote collaborative mindsets and behaviors.

The time is now

In addition to these essential steps, no collaborative agreement can succeed without contractual enforcement. Other key factors involve rigorous project planning and performance management, including a centralized reporting and project-management function or "war room," and agile teams that are accountable for delivering impact. For those project owners who are able to make the transition, the potential value at stake is enormous. Industry participants are increasingly frustrated with the status quo. Contractors with weaker balance sheets due to the pandemic are becoming more risk averse. As the economy recovers from the current crisis and focuses on delivering government stimulus packages, it is even more critical to boost engineering and field productivity through increased collaboration.

The time is now to make collaborative contracts the norm, thereby reinventing the owner–contractor relationship—and the construction industry along with it.

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Jim Banaszak is a partner in McKinsey's Chicago office, **Jeff Billows** is an expert in the Dallas office, **Rudi Blankestijn** is a vice president of CP&I major projects in the Houston office, **Matthieu Dussud** is an associate partner in the Toronto office, and **Rebecka Pritchard** is an expert in the Atlanta office.

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