Target Cost Contracting
Principles, Challenges & Benefits

Its all about mindset
Or is it?
AGENDA

- How did we all get here
- Principles
- Challenges
- Benefits
- Q&A
CORPORATELY

MTRC

- Merger
- Donald’s undertakings
- Latham, Tang, Egan & others
- VMV & cultural integration
- Re-branding of staff – change of mindset
- Growth of Project Division
- Corporate alignment with Contractors
**CORPORATELY**

**CONTRACTORS**

- Famine to Feast – selective interest
- Strategic Partners
- Growth of staff numbers
- Corporate alignment with MTRC
- Re-branding of staff – change of mindset
Drivers

- Revised forms of Contract
- Partnering to next level
- Intense procurement timetable
- Extremely competitive market
- Financial chaos & uncertainty
FURTHER DEMANDS

• Two Stage Target Cost contracting
• Heavily dependent on relationships
• Need to preserve company policies
• Jointly manage the contract
• Risk management skills required
• Open book environment
• JCMC
<table>
<thead>
<tr>
<th>Team building:</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Promote total team involvement</td>
</tr>
<tr>
<td>• Breakdown resistance to change</td>
</tr>
<tr>
<td>• Create shared project objectives</td>
</tr>
<tr>
<td>• Empower team members</td>
</tr>
<tr>
<td>• Anticipate and solve team problems</td>
</tr>
<tr>
<td>• Develop trust and commitment</td>
</tr>
<tr>
<td>• Promote creativity, innovation, and satisfaction</td>
</tr>
</tbody>
</table>
CONTRACTUAL FOUNDATIONS

The Contract
BINDING

The Charter

EMPLOYER

Compliance requirement

EMPLOYER’S OWN
Rules & procedures
Systems and Processes
Authoritative bodies
Shareholders

CONTRACTOR

Compliance requirement

CONTRACTOR’S OWN
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Stakeholders
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PERSONAL FOUNDATION

Mindset - a habitual or characteristic mental attitude formed by past events that determines how you will interpret and respond to situations in future.
TARGET COST PRINCIPLES

The Principles

Does the Contract change us?
### TARGET COST FORM

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risks clearly understood and responsibility known at award</td>
<td>Contractors must have high quality management to sustain such a business / contractual relationship</td>
</tr>
<tr>
<td>Joint management of works</td>
<td>More time consuming in procurement process</td>
</tr>
<tr>
<td>Incentivisation of both parties</td>
<td></td>
</tr>
<tr>
<td>Claims significantly reduced</td>
<td></td>
</tr>
<tr>
<td>Avoids confrontation on highly complex works</td>
<td></td>
</tr>
<tr>
<td>Greater confidence in Works methods and mitigation of programme risks</td>
<td></td>
</tr>
<tr>
<td>More predictable Outturn Cost established from process</td>
<td></td>
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</tbody>
</table>
# ACTIONS ON EMPLOYER FROM RISKS

<table>
<thead>
<tr>
<th>Matter arising from</th>
<th>Employer’s Risk</th>
<th>Shared Risk</th>
<th>Contractor’s Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Instructions / Variations, Delays</td>
<td>Instructions / Variations, Delays</td>
<td>Value Engineering, Interfaces, unknowns</td>
<td>Contractor assumed risks</td>
</tr>
<tr>
<td>Engineer to decide</td>
<td>Time only as costs are recoverable under open book</td>
<td>Issue only as time and cost are covered by process</td>
<td>Nothing</td>
</tr>
<tr>
<td>Affect on Price</td>
<td>Target will be Adjusted</td>
<td>Target not adjusted</td>
<td>Target not adjusted</td>
</tr>
<tr>
<td>Affect on Completion</td>
<td>Completion Obligations amended</td>
<td>Completion Obligations not amended</td>
<td>Completion Obligations not amended</td>
</tr>
<tr>
<td>Valuation</td>
<td>Contractor paid Actual Cost Plus mark up</td>
<td>Contractor paid Actual Costs with no mark up</td>
<td>Contractor paid allowance in Fixed Costs</td>
</tr>
</tbody>
</table>
DOES THE CONTRACT CHANGE US?

**The Contract**

- **BINDING**
  - And introduces
    - Refined roles at high level
    - Refined allocation of risks
    - Introduces a share arrangements
    - Requires open book accounting
    - Envisages joint management

**EMPLOYER**

- Compliance requirement

**EMPLOYER’S OWN**

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- Authoritative bodies
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**CONTRACTOR**

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**The Charter**

**Probably not**
THE TEAM’S STRUGGLE

Stage One Bid

- Intense period of bid preparation (5 >>>> 2)
- Determine commercial model
- Declare appetite for risk sharing
- Define partnering involvement
- Demonstrate ability to do the Works
- Decide strategic subbies & supplier

- This is my offer
- Objective to participate in Stage Two
- MTRC semi passive – Tenderer full on active
**THE INTERNAL CONFLICT**

- Tenderer tries to convince Client that he has the right team with necessary skills to deliver the contract.
- Tenderer tries to convince Client that his technical & commercial framework are optimised.

- All internal disciplines are **aligning**.
- How to deal with innovation: declare our hand or not?
- Tension is **created** both internally & externally.
- Focussed on getting through.
- Limited interaction with Employer.
- First pass on risk.
- Programme & methods determined.
- Management team assembled.

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**$$$$$$**
## Stage Two Bid

- More intense period of bid preparation (2 >>>> 1)
- Interaction with client
- Trust starts to develop
- Intervention from the client
- Understanding starts to develop
- Changes/VE/Risks/Innovation – all discussed
- Develop the JCMP
- Openness & sharing starts to develop

- This is our offer
- Objective - to be awarded the Contract
- MTRC and Tenderer full on active
OUR BEST SHOT

All internal disciplines are aligned

Incentive to save cost, innovate and focused on winning contract

Tension is created both internally & externally

Tenderer tries to convince Client that he has the right team with necessary skills to deliver the contract

Tenderer tries to convince Client that his technical & commercial tenders are optimised

Programme, cost & methods challenged

Management capability tested

Emphasis on risk

Openness and working with Employer
THE WAITING PERIOD

Stage Three

- The MTRC blackout – radio silence
- Two presentations to influence client
- The Q&A process (Tech & Fin & Comm)
- WE keep fully motivated
- The dreaded Letter of Clarification
- The silence, the news & the rumours (motivating & demotivating)

- MTRC Objective - to award to the Tenderer offering the lowest risk adjusted outturn cost
- MTRC and Tenderer full on active
WHAT IS THE JCMP?

An Agreement

• that is prepared, signed & agreed before award
• to establish joint objectives (The Mission)
• between the parties on how to approach & administer the Contract
• setting out the roles and responsibilities
• to ensures transparency, accountability & auditability
• to act as a bridging procedures between the parties
• to provides guidelines for successful delivery of the contract
• providing a framework for personal change
“The parties must “partner” and “collaborate” to achieve the successful ‘value for money’ outcome of this Contract. This Procedure is designed to encourage these behaviours and to create an environment:

- that is non-adversarial but professional;
- in which the parties will proactively manage issues arising, including interfaces with other parties;
- that encourages ownership and resolution of issues rather than blame; and
- will facilitate prompt, fair and reasonable solutions to problems and disagreements

to deliver the lowest outturn cost to the Corporation and a profitable outcome for the Contractor and other relevant parties.”
<table>
<thead>
<tr>
<th>Role and Responsibility</th>
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<tbody>
<tr>
<td>Execute duties fairly and reasonably</td>
</tr>
<tr>
<td>Monitor the Target Cost</td>
</tr>
<tr>
<td>Timely issue of Payment Certificate &amp; Final Certificate</td>
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<tr>
<td>Be involved in procurement process</td>
</tr>
<tr>
<td>Promptly respond to hold and trigger points</td>
</tr>
<tr>
<td>Manage the audit process</td>
</tr>
<tr>
<td>Participate in decision process</td>
</tr>
<tr>
<td>Support the Mission by actions and behaviours</td>
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</table>
ROLES AND RESPONSIBILITIES – THE CONTRACTOR

- Appoint a suitably qualified Project Director
- Manage the cost and accounting process
- Manage the procurement of sub-contracts and suppliers
- Manage his sub-contractors and suppliers
- Manage interfaces with Designated & Interfacing contractors
- Promptly respond to hold and trigger points
- Securely store records on or off site
- Action in a timely manner to instructions
- Support the mission
UNDERPINNING THE CONTRACT

The Contract
BINDING

Charter
Joint Commercial Management Procedure
Commitments
The Team

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Compliance requirement
Compliance requirement
THE COMMITMENTS

- The contract commits & binds the Corporations
- The charter commits & binds the spirit
- The JCMP commits & binds the individuals
- The committed processes bind the trust
- The individuals commit to & bind themselves but ....

Without the right mindset and a willingness from all individuals, teams and Corporations involved, then success will be harder to achieve.
TARGET COST CHALLENGES

The Challenges
TARGET COST CHALLENGES - INDIVIDUAL

- Understand that it is not a traditional lump sum arrangement and what this means
- The joint learning curve
- Behavioural changes
- Understand open book accounting & cost control
- Joint reporting and feedback
- Participate in joint procurement
- Cost Audits
- Early joint resolution – best for project
TARGET COST CHALLENGES – TEAM

- Joint reporting and feedback
- Participate in joint procurement
- Early joint resolution – best for project
- To function through a jointly agreed procedure
- Incentivised through the contract & JCMP
- Calculation of pain or gain is contractual
- Partnering the supply chain
<table>
<thead>
<tr>
<th>Target Cost Challenges – The Corporations</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Personalities &amp; relationships are key</td>
</tr>
<tr>
<td>• Committing to the “process”</td>
</tr>
<tr>
<td>• Empowering the team to manage</td>
</tr>
<tr>
<td>• Open book accounting on all costs</td>
</tr>
<tr>
<td>• Contractor is maintained cash neutral</td>
</tr>
<tr>
<td>• Vertical integration - pull opportunities up not push risk down</td>
</tr>
<tr>
<td>• One Team – One Approach – One Goal – Total alignment is key</td>
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TOUGHEST CHALLENGES – KEYS TO SUCCESS

- Personalities & relationships are key
- Joint management, shared objectives & best for project solutions
- Focus on saving cost rather than inflating the Target
- Vertical integration - pull opportunities up not push risk down
- One Team – One Approach – One Goal – Total alignment is key
TARGET COST BENEFITS

The Benefits
<table>
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<th>Tendering Benefits</th>
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<tr>
<td>• Personalities &amp; relationships are tested early on</td>
</tr>
<tr>
<td>• Develop a JCMP to suit the team</td>
</tr>
<tr>
<td>• Empowering the team to manage</td>
</tr>
<tr>
<td>• Early resolution of potential future problems</td>
</tr>
<tr>
<td>• Risk allocation reflects risk appetite</td>
</tr>
<tr>
<td>• Hit the ground running on award</td>
</tr>
<tr>
<td>• Client knows the delivery</td>
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<tr>
<td>• Tactical horizons exposed and removed</td>
</tr>
<tr>
<td>• Innovative thinking from the Team</td>
</tr>
<tr>
<td>• Pooled resource and knowledge</td>
</tr>
<tr>
<td>DELIVERY BENEFITS</td>
</tr>
<tr>
<td>-------------------</td>
</tr>
<tr>
<td>• Personalities &amp; relationships are continually tested</td>
</tr>
<tr>
<td>• JCMP a live document to suit the team</td>
</tr>
<tr>
<td>• Joint management by the team of key issues</td>
</tr>
<tr>
<td>• Early resolution of potential future problems</td>
</tr>
<tr>
<td>• Client can influence the delivery and outcome</td>
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<tr>
<td>• Tactical horizons aligned to “best for project”</td>
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<tr>
<td>• Innovative thinking from the Team</td>
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<tr>
<td>• Pooled resource and knowledge</td>
</tr>
<tr>
<td>• Continual concentration on cost certainty and saving money</td>
</tr>
<tr>
<td>• Share and share alike</td>
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</tbody>
</table>
We encounter a problem

- Parties become entrenched with own position
- Mindset alignment breaks because of personalities will not change
- Teamwork breaks because of mindset mis-alignment
- Relations fail because of teamwork issues
- JCMP calls for the issues to get elevated
- The Team can move on

Have we or the process failed???
Change of Mindset – can this 40 minute talk by Malcolm & Shaun change how you interpret and respond to situations in future?
If you have a willingness to change......

<table>
<thead>
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<tr>
<td>CONFLICT</td>
<td>INTO</td>
<td>COOPERATION</td>
</tr>
<tr>
<td>CORRESPONDENCE</td>
<td>INTO</td>
<td>COMMUNICATION</td>
</tr>
<tr>
<td>INDIVIDUAL</td>
<td>INTO</td>
<td>TEAM MEMBER</td>
</tr>
<tr>
<td>THEIR PROBLEMS</td>
<td>INTO</td>
<td>JOINT SOLUTIONS</td>
</tr>
<tr>
<td>SEGREGATION</td>
<td>INTO</td>
<td>INTEGRATION</td>
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</table>

..... then maybe the Target Cost model is for you
SUCCESS STORIES

- Contract requires 20,000 T steel
- Priced in tender at $xxx
- Prices fluctuations difficult to predict
- Avoid a joint loss (ie painshare)
- Proposal from Employer to advance cash
- Proposal from Contractor to procure all
SUCCESS STORIES

• Temporary Footbridge A3
  2 months late completing temporary footbridge

Joint initiative to discuss issue
Resolution with HKU found - no delay in the end
SUCCESS STORIES

• Realignment of 704 / 703 Interface
  – 4 month critical access delay
  – Off Site workshops held to brainstorm solutions
  – Joint workshop 704 & 703
  – Project needs considered: Solution found
MINDSET ALONE IS NOT ENOUGH

It must be coupled with a commitment and a willingness from all individuals, teams and Corporations at all levels.
THE FUTURE

There appears to be an improved willingness and commitment from the Industry to enhancing partnering .......

- WIL
- NEC
The Contract Compliance Requirement

The Charter

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INITIATIVE TRIALS
AT LAST THE FINAL SLIDE

Please be back in 15 minutes