

Commercial breakdown

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Nick Curran looks at the Commercial management of construction guidance note to highlight how the practice draws on core quantity surveying skills

The [Commercial management of construction](#) guidance note, published in March 2016, has been written specifically for commercial managers working for contracting organisations, outlining their involvement in the key stages of a project or contract. Many of the disciplines are also relevant to those representing a client in private practice or employed directly by a client.

The note defines the role of a commercial manager, their overarching duties and their responsibilities, which involve bringing together and managing several key activities traditionally carried out by quantity surveyors. Tracking the commercial manager's input through a project's life – from estimates and budgets to forecasts, value engineering, procurement, valuing of work, cost management, reconciliation and analysis, cash flow and commercial decisions, as shown in Figure 1 – the note covers the traditional responsibilities of the role across all sectors. Depending on the sector and the scale of the project, however, the commercial manager's emphasis and focus may vary.

The guidance note is not intended to be a quantity surveying handbook because many of the core skills are covered in other RICS guidance. However, where there was no relevant guidance at the time the note was being prepared, more detail is included.

In the introduction to the guidance note, the role of a commercial manager is defined as someone who:

'monitors, or controls internal processes such as production, and manages external relationships with customers, clients and trading partners. At the same time, the commercial manager monitors financial performance, both forecast and achieved, and manages any risks there may be to achieving forecasts, whether these are known from the outset or introduced through changing circumstances.'

To elaborate on this, one of the commercial manager's main responsibilities is to ensure that the final outturn result of the project – considering, for instance, not only the cost but the revenue and margin – is as close to the initial estimates as possible by developing a budget and tracking any changes and their impacts as they become apparent. This enables a clear line of sight between the first record of estimates and the final cost at project closure, analysing all estimates, budget, procurement, cost, value and cash flow data against common heading levels, using the project structure described below.

By using such heading levels, the process becomes clearer and anomalies are more easily identified, thereby enabling commercial decisions to be made based on timely, accurate information and improving the certainty of forecasts.

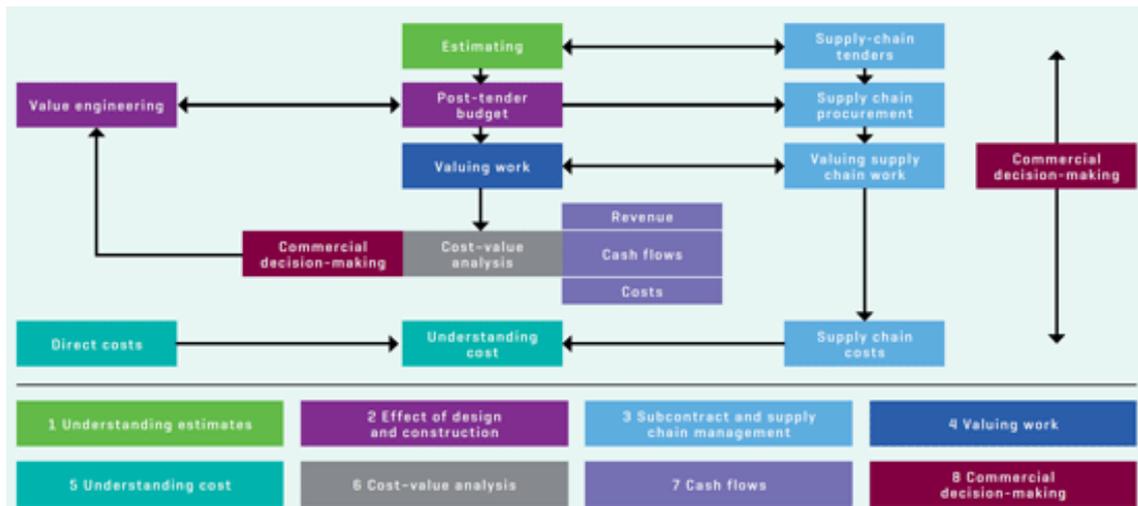


Figure 1: Flow of processes and associated data from an estimate through to cost/value analysis and commercial decision-making

A key theme in the guidance note is the need for definition and adoption of common analysis levels as early as possible to structure the project. These levels must be both readily recognisable as a logical breakdown of the project, and easily adopted by planners as well as by the delivery team to record costs further down the line. For this reason, the project and work breakdown structures are the ideal place to start.

These common analysis levels are usually set by taking the lowest common denominator of the estimate, the project plan and the optimum level for recording costs. Adopting these through all stages and tasks simplifies forecasting and analysis of estimates, preparation of budgets, commitments, valuation of works, costs, change management, cashflow and contingency plans.

If we do not group the levels at which these tasks are analysed into common levels then comparison is either not possible or will take up vital time, not to mention exacerbating the risk of error from repeat analysis.

Effective commercial management, and more specifically forecasting and decision-making based on perceived risks and opportunities, relies on harnessing data from the central processes of estimating, procurement, cost recording and earned value.

The commercial processes can be discussed as 8 distinct operations that not only align with the key competencies in the APC process but also relate to the role and overall composition of commercial management:

1. estimate and budget
2. value engineering
3. supply chain
4. valuation
5. cost management
6. cost and value reconciliations
7. maintaining cash flow

8. commercial decisions.

Estimate and budget

Commercial managers should be able to use the details of the estimate readily when developing and maintaining the construction budget. The budget should then be used to develop and subsequently maintain a forecast of outturn cost and value.

The guidance note covers the production of an estimate and how that develops into forecast cost, revenue and margin; the types of estimate at different stages in a project life cycle are defined in the [New Rules of Measurement](#) .

If the common analysis is used for the estimate and resource coding allowances, then the estimate detail can be used for the budget and forecast as well, so that it can then be adopted consistently in the later stages of the project, thereby enabling ready comparison.

Even at the initial stage, it is important to have designed and adopted a common analysis using the project and work breakdown structure; this is particularly important in providing analysis and ongoing comparison for the stakeholders if a cost plan has been used.

The guidance note continues with an outline of how an estimate is developed in terms of bill items and rate build-ups. It explains the importance of a standard method of measurement and why a detailed estimate can be difficult to produce without a detailed design; in some circumstances it may not even be possible to produce a detailed estimate before work has commenced.

Value engineering

The commercial implications here should either result in auditable amendments to the estimate and the budget or they should be recorded against the same headings as the common levels.

The key principles of value engineering are discussed, together with some key examples from different construction sectors. The impact of value engineering on the budget must be remembered, as should the way in which commercial risks or opportunities fall on different parties, depending on the procurement process that has been chosen.

How early or late in the design process any changes are implemented, and the risks and opportunities they present, are completely the responsibility of the client: for example, under a traditional remeasurable arrangement for procuring and administering works, the risks and opportunities of changes are assumed by the client. Under other arrangements, however, these risks may fall on the contracting organisation or, in some circumstances, even on the consultants.

Supply chain

Budget allowances must be visible when engaging with the supply chain, in order to inform negotiations and also to enable updates to the forecast as commitments are made.

Engagement with the supply chain to procure and manage packages of work is a key commercial management task. The chain includes all suppliers and consultants as well as subcontractors; depending on the risk and complexity, the commercial manager may get involved with all 3 on these packages, or may leave to other members of the team.

The guidance note explains how the procurement process defines the scope of packages and the use of a supply chain database to establish suitable vendors, followed by issuing enquiries, evaluation of quotations, negotiations, and then the formal engagement.

As each package progresses through its own life cycle, it is then commercially managed in its own right.

Valuation

The interim valuation and assessment of work in progress is dealt with in the guidance note. The measurement and evaluation of construction works is a core quantity surveying skill covered in some depth; however, it is the alignment of the estimate and budget with the common levels that is vital, so that the resulting earned value can be readily compared with the costs.

To support the cost and value reconciliation and ongoing forecasts, the commercial management process must let valuations or other earned value calculations use the estimate and budget allowances in calculating the earned value at a level comparable with the way that the actual, accrued and committed costs should be reported.

Cost management

Budget allowances must be visible when engaging with the supply chain, in order to inform negotiations and enable updates to the forecast

The levels at which costs are recorded must align with the common levels against which the estimate, budget and forecast are analysed, to allow a ready reconciliation of costs.

The sections of the note relating to management of costs initially discuss the different types incurred in construction, compared with the key cost headings of labour, plant, materials, subcontracting and others, along with an outline of the processes that are generally required in the business context. A contracting organisation requires costs to be monitored and allocated consistently in a way aligned with the common levels discussed above. It is essential that a contracting organisation has effective processes for recording costs on projects against the common levels.

Cost and value reconciliations

All commercial management processes should lead to reconciliation of costs and values. As defined above, the estimate, budget, forecast, earned value and cost recording should all be analysed against common levels, allowing reconciliations and revised forecasts.

The reconciliation of cost and value collates the assessment of work in progress with the cost management analysis. The initial stages of cost and value reconciliation are more effective and efficient if the earned value and costs are aligned with the common levels, thereby allowing the commercial manager to identify variances more quickly and concentrate efforts on explaining and mitigating them.

It is also important that the forecasts are in an identical format so that they can be updated at the same time and tracked; many contracting organisations' cost and value reconciliations are integral to their forecasts.

Maintaining cash flow

It is advisable for the cash flow forecast to be generated from the data underpinning the overall project forecast. In addition, an updated forecast should result in an updated cash flow.

Cash flow is a critical part of commercial management: unless cash is available to make purchases and pay labour and staff then projects cannot be completed. The note does not go into the cash flow process in great depth because there is another specific guidance note on this subject. However, it does offer a practical explanation of why cash flow is important and what to consider when developing a forecast for it.

Commercial decisions

The ability to make commercial decisions based on up-to-date evidence is crucial to the commercial success or failure of a construction project or contract. Change management and risk and opportunity registers should be aligned with the same common levels as the estimate, budget, forecast, earned value and costs to enable relevant adjustments to be made to the forecast.

Commercial decisions can be made in response to events that have already happened. They are also made in relation to risks and opportunities that have been identified as potentially foreseeable events.

It is essential that decisions made at all stages of a project or contract are recorded and their impact tracked through the life of that project or contract. Contracting organisations that manage their commercial decisions in a risk and opportunity register are the most successful at tracking their decisions.

Management of risk and opportunity registers is a key commercial process that should be given appropriate time and attention by the project or contract team and not only by the commercial staff. If risks and opportunities are identified at an early stage, commercial decisions can be made to mitigate the former or maximise the latter, should an identified event come about.

Lessons to learn

What should be clear from the above is that commercial management involves taking an holistic view of a project budget and forecast cost and value, together with the undertaking and management of traditional quantity surveying activities? the detailed processes that underpin commercial management and on which commercial management in construction relies.

Offering assurance that the activities have been carried out to a specific standard and with due diligence is vital. But providing outputs in terms of commercial and financial figures that are used to update the current and forecast positions of a construction project is essential as well.

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Further information

- See the full guidance note on isurv: [Commercial management of construction, 1st edition](#)
- Related competencies include [Commercial management of construction](#) , [Communication and negotiation](#) , [Contract practice](#) , [Data management](#) , [Design economics and cost planning](#) , [Procurement and tendering](#) , [Quantification and costing of construction works](#) , [Risk management](#)
- This feature is taken from the RICS *Construction journal* (February/March 2017)