

In business

The duke of hazard

How much was your last insurance premium? Too much, probably. Construction is a risky business but, if that risk is managed, it needn't push up your costs, says American expert Michael Mainelli. He tells [Victoria Madine](#) how we could learn from other high-risk industries

SOME FREE ADVICE FROM MICHAEL MAINELLI, co-chair of the Design Build Foundation's risk management working group: if you are going to one of his meetings, get there early if you want a seat. These days, contractors can't learn enough about risk management, and it's not hard to work out why. Mainelli's team has calculated that insurance and other risk costs bleed construction of about £1bn every year.

Minimising the chances of things going wrong and controlling the financial impact if they do – risk management, in other words – can bring these costs down. In one sense, project managers do this on a daily basis: if there are gale force winds on site, anyone can see that the best thing to do is to stop work until they die down. But a recent survey of DBF's 83 members suggests that contractors generally have a poor understanding of the wider issues, and benefits, of good risk management.

Other industries have a lot to teach the construction sector, says American-born Mainelli. He should know: he's worked with high-risk industries like medical research and shipping as director of risk management consultancy Z/Yen and he's chairman of building contractor CityAxis.

So what's the bottom line?

It is difficult to arrive at a definitive risk cost to the construction industry. Risk cost includes insurance costs, but there is much more besides: the cost of processing claims for construction firms can be significant, whether or not the claims are paid. For example, expert opinion and work disruption all cost the client money. We figure that insurance premiums together with all these ancillary costs could amount to some 3% of contract value.

What surprised you most about the findings of DBF's survey?

The survey revealed that there is a very weak correlation between corporate and project risk. This means that a project manager in construction won't necessarily think much about risk management because he or she knows the company's headquarters deals with stuff like that. It is usually a company's head office that takes out professional indemnity cover, which means that the cost of the cover comes out of a central budget – not a specific project's. Members appear to view insurances and risk as an annual exercise rather than something that can be actively managed. In other industries, such as banking, corporate risk is more likely to be attributed to individual projects.

So what would be a good model for construction companies to look at?

British Aerospace is very good at relating risk management to specific projects and also to individuals.

The first lesson construction could learn from BAe is that it doesn't just look at input costs for a project. It considers process costs, too.

The second interesting thing is the way in which BAe tries to reduce the number of claims made to its insurance companies. Each project leader has an insurance charge, which is calculated according to risks associated with that project, and everyone's internal insurance premium is published. This motivates the individuals concerned with that project to actively manage the risk involved. Also, the fact that internal units at BAe can make claims against a centrally operated insurance fund means problems can be dealt with rapidly.

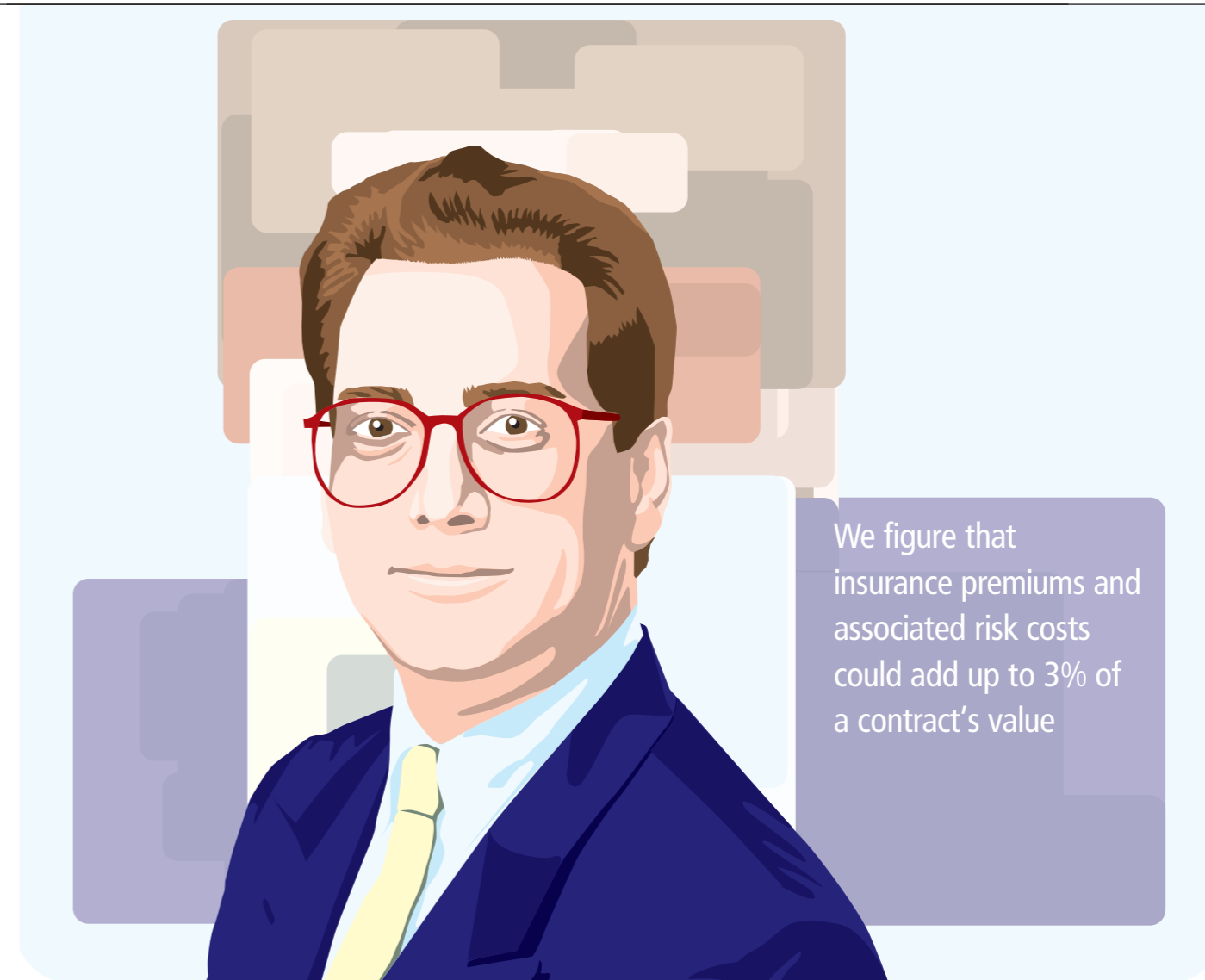
So how does this kind of in-house 'insurance company' work?

Well, for example, it would not make sense for a very large company to insure its computers at a corporate level – it has many thousands of PCs so there's no chance they will all get stolen at once. But if a particular team loses its computers, the effects on a project can be significant. So the manager could claim on the corporation's internally operated insurance system for the lost computers, the benefits being that the claim is settled very quickly and the company is controlling some of its risk without the involvement of expensive insurance companies. Large construction contractors could bring more risk management in-house in a similar way.

You have worked in other high-risk industries such as shipping ...

Yes, and the construction industry could learn a great deal from them. In shipping, firms that belong to mutual insurance companies must report near-misses and issues affecting business – for example, it might be that a particular kind of paint is of poor quality, or the chemicals used to clean tankers are causing fume problems. A mutual dealing with professional indemnity would alert its members to these problems.

Other mutuals insure companies against business interruption, like the international group the Strike Club. For example, if there was a strike by dockworkers in Algeria, which meant a ship couldn't unload there, this would be brought to the club's attention. It shares information about possible hazards that might affect its members' business and produces daily, weekly and monthly reports. The data collected is not attributed to the firms that provided it, so



We figure that insurance premiums and associated risk costs could add up to 3% of a contract's value

companies do not have to worry about commercial sensitivities. This approach has helped shipping maintain an excellent safety record.

So how would construction benefit from sharing risk management information?

Information about risk is getting lost. Normally you'd wait weeks before contacting your insurers to make a claim – in fact, you avoid making a claim if you can, to avoid your premium going up. Also, a lot of claims are settled out of court.

If construction had a way of reporting near misses, or problems that have not given rise to an insurance claim but have brought to light a high-risk activity or product, you could begin actively to manage risk rather than just claiming insurance payouts. This also means reporting things that might help reduce risks. For example, through analysis of near misses, a contractor recently discovered that wearing gloves on site reduced the number of hand injuries.

How interested are DBF members in improving their risk management?

Well, members proved reluctant to participate in meetings on the subject have to turn people away because we haven't got enough room for everyone to sit down. Most members seem to be at an early stage of understanding their risk.

Do you think construction and insurance understand each other?

Our work suggests that construction firms don't have a co-ordinated way of communicating with the insurance industry. Insurers don't fully understand changes in companies' risk profiles, like the increasing involvement of contractors with PFI contracts; and changes in the insurance industry, such as the aftermath of 11 September, are not understood by construction. Too many construction firms look at insurance in a flurry of renewals once a year.

So what is the DBF planning to do to improve risk management?

We are continually exploring how mutual risk management might reduce risk costs. Housing associations have successfully run a mutual insurance club since 1990. It has encouraged a tremendous amount of risk management work ranging from specialist design audits, to site inspections and benchmarking on quality.

We don't think the industry as a whole is ready yet for a collaborative insurance club. But we are in talks with Egan's strategic forum about the possibility of setting one up in the future.

In the shorter term, we want to increase dialogue with the insurance industry, improve risk information standards and study the feasibility of creating an incident and claims reporting system.

Other industries, such as shipping, have been working hard at risk management for the last 150 years with a lot of success. Now construction needs to wake up.