Resolving agency issues in client–contractor relationships

A CASE-STUDY INVESTIGATION AND RESOLUTION FRAMEWORK

KEYWORDS

- Relational risks
- Agency theory
- Adverse selection
- Moral hazard
- Contractual completedness

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Abstract

This study investigates how relational risk is managed in projects delivered by external contractors for clients. Agency theory informs the authors' analysis of four case studies, two from the construction sector and two from the clinical research sector. Qualitative data was collected and analysed to evaluate the effectiveness of formal and informal mechanisms used to manage the client–contractor relationship in each case. Agency-related issues with implications for success or failure were identified and investigated. Based on the findings, the authors developed a framework proposing five mechanisms that are effective in resolving agency issues and conducive to project success.

Methodology

The authors gathered qualitative data on four projects: an airport terminal construction project (Case A), a reservoir construction project (Case B); a clinical trial for a treatment for lung cancer (Case C); and a clinical trial for a treatment for haemophilia (Case D). The data was gathered both at the framing stage of each project and towards the end of the project. Data consisted of transcripts of semi-structured interviews, internal project control documents, and project performance data.

The researchers conducted a thematic analysis, quantifying interviewees' use of certain terms indicative of six agency-related variables: goal conflict, opportunistic behaviour, information asymmetry, trust, performance verification (by the client), and concealment of negative outcomes (by the contractor). They gave each project a score against these criteria, leading to conclusions about success or failure. The findings enabled the authors to develop a framework for managing agency-related issues.

Agency issues in the four cases

Case A was deemed successful on the basis of a mutual understanding of goals, sharing of information, and checks to verify contractor performance. The client organisation educated its team about the required competencies and engaged effectively with the contractor. This training and communication led to clarity about roles, responsibilities and shared goals. An incentivising contract encouraged the contractor to perform well, and where difficulties arose the client demonstrated flexibility, adapting the contract to maintain deliverable goals.

Case B failed because although there was a shared understanding of goals there was also a lack of consensus about project processes and key performance indicators. Poor internal communication was evident at the client organisation, where the contracts team chose the lowest-priced tender without inviting the project team to evaluate the risks of non-delivery. An atmosphere of mistrust then prevailed, compounded by staff turnover, and there was a perception by the contractor of being micro-managed, while the client felt important information was being withheld.

Case C succeeded because of the trust underpinning the client–contractor relationship. This was ascribed in particular to effective email communication between the project managers on both sides. Although they had not worked together before, they demonstrated the ability to 'communicate with each other in the right way and about the right things'.

Case D was the least successful of the four. In this clinical trial project there was significant goal conflict, as well as differing perceptions about the relative values of activities within the project. The contractor was focused on activities relating to the trials themselves, while the client's main concern was the final report. There was disagreement about the role and responsibilities of the client project manager. The contract was not fit for purpose and lacked financial incentives for the deliverables. Owing to the different focus and expectations of both parties, demands were placed on the contractor that had not been budgeted for, and ineffective internal communication within the contractor organisation led to the executive director being excluded from some email correspondence, probably to hide extra work being done outside the budget. Changes in project manager on both sides compounded the deterioration of trust in what became a vicious spiral.

Key features of successful and unsuccessful projects

The core feature of the successful projects turned out to be a relationship of trust between client and contractor, promoted by contractual completeness and effective communication. Skilful project management by individuals who were strong communicators was a key success factor.

The unsuccessful projects demonstrated low or neutral scores in relation to trust but scored highly on variables with a negative impact on outcomes, namely: goal conflict, opportunistic behaviour, information asymmetry ('adverse selection'), performance monitoring by the client (sometimes interpreted by contractors as micro-management, eg. in Case B), and concealment of negative outcomes by the contractor ('moral hazard').

The CURED framework

The authors present a framework for managing agency issues, based on the five effective mechanisms identified in their study. These are as follows.

- **Contract** – contractual completeness promotes shared goals and expectations, reducing the likelihood of opportunistic behaviour, excessive performance monitoring, or concealment of negative outcomes.

- **Understanding** – effective communication both between and within the client and contractor organisations promotes a shared understanding about goals and risks, and reduces information asymmetry.

- **Resources** – getting the right staff in place, and retaining them, is crucial to resolving or avoiding agency-related issues and promoting trust.

- **Education** – robust training programmes in project management competencies within the client organisation, combined with activities to communicate expectations to the contractor minimise agency issues and are conducive to project success.

- **Delegation** – the ability of a client to 'let go' means that a contractor feels empowered, leading to a flexible, trusting and productive relationship.

Summary

Underpinned by a review of relevant literature and based on qualitative data relating to four cases in the construction and clinical trials sectors, the authors identified six agency issues that can, and do, lead to the success or failure of projects. The CURED framework they put forward specifies five mechanisms that are effective in mitigating these issues, leading to mutual trust and ultimately project success.

Additional Information

Since we undertook our study there has been further published research indicating that management of relational risk plays an important role in project success. For example, a large-scale quantitative survey of software development projects found 'relational governance' – characterised by information sharing, flexibility and solidarity between the parties and roughly equating to our notion of approaches to managing relational risk – enhances the performance of such projects (Ul Haq et al., 2019). This study specifically highlights the role played by relational governance in moderating the potentially negative effect of opportunistic behaviours between the parties.

Having developed the CURED framework, we are now in the process of developing tools that build on the framework to help project managers effectively manage relational risk. If you would like further details please contact Professor David Bryde at **D.J.Bryde@ljmu.ac.uk.**

Reference: Ul Haq, S; Gu, D; Laing, C and Abdulla, I (2019). Project governance mechanisms and the performance of software development projects: moderating role of requirements risk. *International Journal of Project Management,* 37(4), 533-48.