Ineffective Risk Management and the collapse of ISG[1]

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Introduction

As reported in the press, on 20 September 2024 the UK's sixth largest contractor[3], ISG, including its subsidiary ISG Construction Limited, went into administration. At the time of collapse, ISG was involved in 69 central government projects totalling more than £1 billion[4] including 22 projects for the Ministry of Justice (MoJ)[5]. Ernst and Young were appointed as joint administrators by the High Court of Justice in England and Wales[6] under the Insolvency Act 1986. The firm was owned by the private U.S. equity firm Cathexis Holdings LP, which had been attempting to sell off ISG in recent months. Its collapse is the largest failure in the building sector since the liquidation of Carilion in 2018-previously described in the PM World Journal commentary "Ineffective risk management and the collapse of Carillion", published in December 2018.

The timing of news of the collapse is particularly significant given that ISG was part of the Ministry of Justice's five-year £2.5bn constructor services framework[7]. The framework encompasses new build, alterations, refurbishment and maintenance requirements across the entire MoJ UK estate. ISG was holding contracts with a combined value of £1.65billion. They included an upgrade contract for the change of category of the Victorian-era His Majesty's Prisons (HMP) Liverpool valued at £56m, upgrading HMP Birmingham under a £61million contract and an extension and refurbishment of HMP Guys Marsh in Dorset, valued at £79millon. The collapse has come at a very unfortunate time for the UK government. The news of the demise of ISG follows hard on the heels of reports by mainstream news channels of an overcrowding crisis within the national prison system, the shortage of prison spaces exacerbated by prosecutions following national riots and the controversial early release of prisoners.

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[3] Construction News (2024) "Exclusive: ISG collapse risks £1.84bn of government contracts
20 Sep 2024 By Charlotte Banks

[4] Independent (2024) "Construction firm ISG in administration in UK with around 2,400 redundancies", Anna Wise. 21.09.2024

[5] The Standard (2024) "Construction firm ISG in administration in UK with around 2,400 redundancies" 21.09.2024

[6] Ernst and Young (2024) "ISG Administrations" https://www.ey.com/en_uk/administrations/isg-administrations#:~:text=On%2020%20September%202024%20the%20Companies%20entered%20administration,and%20Dan%20Edkins%20were%20appointed%20as%20Joint%20Administrators.

[7] Construction News (2024) "ISG wins £135m prison jobs", 07 Mar 2024 By Ben Vogel

ISG

ISG described itself as “a dynamic global construction services company”. Within its Annual Report of 2022 ISG announced “Our vision is to become the world’s most dynamic construction services company, delivering places that help people and businesses thrive”. In November 2022 at the Building Awards it was named as Major Contractor of the Year (over £500m). Their construction business operated internationally delivering what it called “hyperscale, technically complex and highly engineered construction projects” including “hospitals and scientific labs, datacentres, advanced technology facilities, film studios, pharmaceutical manufacturing plants, and logistics and distribution hubs”.

Following securing new contracts from the MoJ in March 2023, ISG issued a press release in which Alister McNeil, (ISG Sector Director for Justice) said “The MoJ continues to be one of our most innovative and progressive customers across a range of measures - from procurement approaches, modern methods of construction (MMC) adoption and as an environmental, social and governance (ESG) trailblazer” [8]. The release emphasised the reliance the MoJ was placing on ISG.

Subsequent to the announcement of the collapse of the company in the media, the Chief Executive, Zoe Price, explained to staff that the current situation had arisen due to legacy issues relating to large loss-making contracts secured between 2018 and 2020[9] primarily in the Residential, Logistics and Distribution sectors as well as some Data Centre projects. In an email sent to its 2,400 staff on 19th September confirming the administration, Price advised that offices would be closed, sites would not open and that all subcontractors would be stood down.

Lessons learned

In the earlier mentioned PM World Journal paper describing the collapse of Carillion, the examination of company insolvencies provides valuable insights into failed corporate processes. These lessons are important not only for investors and company executives but also for construction directors and managers, commercial managers, project managers, risk managers and advisers. At the heart of the insolvency there was an acute inability within ISG to comprehend and manage risk and the UK government to read the signs of company instability. As with Carillion, ISG ran into difficulty on multiple contracts.

[8] ISG (2023) “ISG secures new framework and major project win with Ministry of Justice. ISG continues to build on its near two-decade relationship with the Ministry of Justice (MoJ) – with two landmark wins”. 15 March 2023. https://www.isgltd.com/uk/en/news/isg-secures-new-framework-and-major-project-win-with-ministry-of-justice#:~:text=ISG%20continues%20to%20build%20on%20its%20near%20two-decade,a%20%C2%A361%20million%20upgrade%20scheme%20at%20HMP%20Birmingham.

[9] BBC News (2024) “Construction giant collapse sees 2,200 jobs cut” . Maisie Lillywhite and Lora Jones. 20 September 2024

Given the short space of time since the collapse, details of the reasons behind the company failure are not yet in the public domain. Like Carillion, despite the early warning signs that the company was running into significant difficulties, the company either had a poor perception of the risk it was facing, consciously ignored it or was unable to substantially mitigate it.
The chief executive of Build UK, Suzannah Nichol, told the BBC's Today programme that "Whilst there have been changes since Carillion six years ago, there clearly has not been enough change"[10]. She added "We know construction runs on very thin margins. You only need one project to go wrong and get delayed and you start to have cashflow issues," What exacerbated the problem was that "ISG had two major contracts which they started, mobilised [for] and then were stopped by the client and that happens time and time again in construction." More telling was the comments by Liam Byrne, chair of the Business Committee, who said of the collapse of ISG "It's why we've got to transform the quality of UK accounting so it once again provides the early warning system that investors, workers and suppliers deserve." ISG predominantly operated in low-margin industries within highly competitive markets with inherent risks.

Following the collapse, Josh Griffiths, ISG's former managing quantity surveyor, said "What has to change [is] the broken economic model that encourages low margin and high risk work, and a perception that this is acceptable because someone will sign a contract. This [change] starts from clients, professional teams and legal advisors promoting a fair and equitable contracting profile. [A] 2% [margin] is not sustainable; [a] 1% contingency is not sustainable, zero weeks programme time risk allowance is not sustainable [and] heavily amended forms of contract are not sustainable. No other industry would launch a development for the same financial risk and reward[11].

Timeline of unfolding events

As described by the online Building magazine[12] and captured in **Table 1** below in the space of 10 months, ISG went from dismissing speculation about its financial difficulties to administration.

Timeline of demise of ISG UK	
October 2023	Rumours sweep the construction industry that ISG is facing serious financial problems
13 November 2023	An ISG spokesperson says: "Some six to eight weeks ago, we were alerted to unsubstantiated, wholly inaccurate and false claims that were circulating about our business. As you would expect, we actively reached out to our stakeholders with facts and truth."

[10] BBC News (2024) "ISG collapse 'devastating' for construction industry". 23 September 2024.
[11] Building (2024) "Industry's 'broken economic model' under scrutiny in wake of ISG collapse" By Dave Rogers23 September 2024
[12] Building (2024) "Timeline: How ISG went from 'wholly inaccurate' claims about its financial health to 'ISG has filed for administration' " By Dave Rogers 20 September 2024

9 February 2024	Chief executive Matt Blowers leaves and is replaced by Chief Operating Officer Zoe Price. The firm also announces that Chief Financial Officer Karen Booth will leave at the end of the following month. A similar pattern to Carillion.
July 2024	Rumours were circulating that ISG needed a significant cash injection at the beginning of that month to keep going. It is understood the amount of money the firm needed pumping into it was close to £250million[13].
5 July 2024	ISG chairman Matt Roche tells staff a deal to sell the business will happen "in the coming days". He tells staff and suppliers: "We are pleased to announce that [ISG's private equity owner] Cathexis is very near to closing the sale of ISG and that all regulatory approvals have been received. "The buyer has confirmed that the sale will include a significant investment, which will recapitalise the business and support the return to normal trading." Later that month, in another email, Roche says of the planned sale: "Nothing has changed. We are going through the process. I fully expect the deal to complete."
August/September 2024	Towards the end of the August, optimistic rumours circulate that a deal will be struck with a buyer in the first week of September. By the end of the second week, rumours begin that the deal with the South African buyer is hanging by a thread.
18 September:	ISG staff told their upcoming salaries will be paid as usual. This is set for 23 September.
19 September	In an email sent by Zoe Price to employees she said plans to sell the business to a would-be buyer, (believed to be a South African businessman who made his fortune from healthcare and vitamin products), had failed after being unable to satisfy the funding needed to recapitalise the business[14]. At 10.30pm Chief executive Zoe Price emails staff to tell them "that ISG has filed for administration here in the UK".

Approach to managing risk

The approach adopted to the management of risk is described in ISG's Annual Report dated 2022. **Box1** includes an extract of the Annual Report under the main heading of 'Governance and risk management'. There is clear recognition that the management of risk was critical to the longevity of the business.

[13] Building Design (2024) "Major contractor set to file for administration, chief executive confirms" By Dave Rogers, 20 September 2024
[14] Building Design (2024) "Major contractor set to file for administration, chief executive confirms" By Dave Rogers, 20 September 2024

Box1
Managing our risks The ability to identify, evaluate, monitor and, where appropriate, implement action to mitigate risks and exploit opportunities within the Group is fundamental to ISG's continued success. A key objective of the Board and its senior management team is to safeguard and increase the value of the Group and its assets. It is the responsibility of the Board to set appetite levels for risk management, to be adopted within each area of the business, and to ensure that effective and relevant frameworks and internal controls are in place. The potential impacts of the Group's material risks and relevant responses are regularly monitored at a central level by the Board, and monitored at a local business unit level by business unit senior management. Source: ISG Annual Report 2022

Within the same annual report there was a declaration that the Board was responsible for capital risk management including the overall Group strategy, the acquisition and divestment policy, approval of major capital expenditure projects and consideration of significant financing matters. Specifically the Board was responsible for managing its capital (cash, borrowings and reserves) to ensure that entities in the Group will be able to continue as a going concern while maximising the return to stakeholders as well as sustaining the longevity of the business.

The report included what might be termed 'boilerplate language', in other words standardised text that is used repeatedly in successive annual reports without making major or even any changes to the original, such as "the Board has also considered downside scenarios including revenue decline and [an] increase in cost base". In addition the text stated that while "the cash flow of these scenarios will be different to the current forecast, mitigating actions have also been reviewed". An assertion was made that "these mitigating steps include cash management within management's control to improve working capital, reduction, or deferral strategies for operating and capital expenditure". The report stated these factors considered "the Board believes that the Group is well placed to manage the current business risks". Clearly in hindsight the Board was unable to manage the risks.

Principal Risks

Box2 below includes a comparison of the principal risk identified by Carillion and ISG. The ISG Principal Risks are drawn from the ISG Annual Report 2022 . It states "A summary of the Principal Risks and uncertainties, that have been identified by the Group that could impact on its performance, is shown in the table on the following pages, together with details of the mitigation actions that are being taken. These identified risks and uncertainties are specific to the Group and exclude overarching risk that will impact most businesses e.g. macro-economic, political, financial market and climate change risks".

The key Principle Risks of interest for both companies are winning work and contract management. Their ability to secure contracts within their risk appetite with adequate margins and subsequently manage them effectively were key.

Box2	
Carillion	**ISG**
Work-winning	Supply chain, procurement and labour practices
Contract management	**Project delivery and quality of service / product**
Pension liabilities	*Not addressed*
Brexit	*Not addressed*
People	Recruitment, development and retention of employees
New markets and services	Overreliance on key customers
Ethics and compliance	Legal, regulatory and reporting compliance
Systems and cyber security	Data protection and information security breaches
Health and safety	Health, safety and well-being of stakeholders
Human Rights	*Not addressed*
	Pollution control and environmental management
	Climate

The second ISG Principal risk "Project delivery and quality of service / product" is described in **Box3**. The threat appears to be adequately defined and the mitigation actions are appropriate for the threat. The salient point however is how successful were the mitigation actions that were implemented.

Box3	
Project delivery and quality of service / product	**Mitigation**
The ability of the Group to continue winning contracts at appropriate profit margins and with acceptable terms and conditions, in markets that are competitive. Failure to manage or deliver a key project in accordance with the agreed contract, to an appropriate standard and within the timescales agreed. This may lead to disputes and have an adverse impact on both the profitability of the Group and its reputation.	The Group has a controlled approach to contract bidding and selection (within clearly defined delegated authority levels and agreed sector focus). This ensures that work undertaken matches the capability and resources available, that contractual terms are acceptable, and that clear responsibility for scrutiny and approval is given to the appropriate level of management. Contracts that are in progress are controlled and managed through the Group's operating structure. Regular and detailed reviews take place within each business unit and centrally to monitor forecast revenues, costs to complete the project, cashflows, health and safety, and other non-financial metrics. Appropriate Group risk registers are maintained and reviewed frequently. Enhanced management and supervision are implemented when necessary for projects that are deemed to be higher risk.

Overstretching of the Group's supply chain as both markets and sectors grow, which could lead to subcontractor failure.	Regular reviews are also undertaken of each business unit's results, together with monthly / quarterly operational and budgeting / forecasting reviews. During 2022 we continued to develop ISG's Advanced Audit and Assurance (AAA) process in relation to site-related activities; designed to measure project delivery and quality of service / product

A number of loss-making projects would infer that these mitigation actions had been particularly difficult to implement. The 'Outlook' statement included in **Box4,** again drawn from the Annual Report, stating 'we build resilience into our business model' was clearly difficult to realise.

Box4
Outlook We have outlined above the principal risks and uncertainties facing our business, and what we are currently doing or planning to do to mitigate these. We build resilience in our business model by ensuring that our business decisions are made from a position of sound knowledge and trusted advice. We maintain involvement in key industry steering groups across our geographies, and collaborate with our customers and supply chain partners to identify and address future risks and opportunities Source: ISG Annual Report 2022

Loss making contracts

The demise of ISG was attributed to loss making contracts. Some contracts may be loss-making from the outset or become loss-making during their life cycle. There may be various drivers for a loss-making contract, including external factors or a company's own actions (see **Figure 1** below). External factors are referred to here as events beyond the control of a contractor whereas internal factors can be influenced or controlled by a contractor. The factors described in the figure are intended to be representative rather than exhaustive.

Perhaps the most difficult external factors to manage during the project life cycle, (if they are not expressly covered in the contract), are the actions of the owner (employer). This could entail owner delays, excessive owner changes, defective or late owner equipment, late supply of owner materials and or excessive oversite and inspections. Other well recognised external factors are inflation, material shortages, changes in material prices, increases in subcontractor prices or climatic conditions outside of the norm. The ability to recover costs associated with events outside of the control of the contractor will be influenced by the maintenance of adequate records, such as project schedules and updates, inspection and test reports, photo and video records, daily reports and production logs, cost records and correspondence.

Key internal factors include unanticipated mobilisation, acceleration or storage costs, inadequate supervision of sub-contractors or poor sequencing of sub-contractors in terms of mobilisation and conditions of commencement. A major internal factor may be the need to carry out rework to rectify defects.

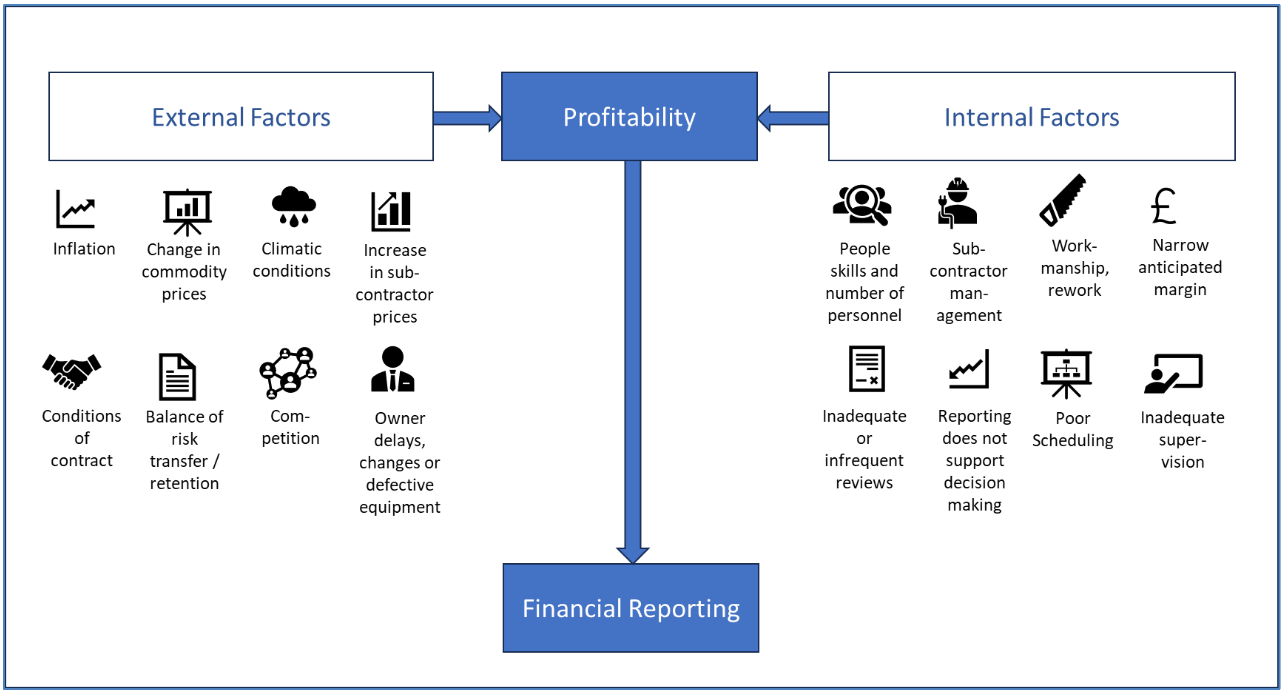

Figure 1: Internal and external factors affecting profitability

Transfer of knowledge

The demise of ISG was attributed to loss making contracts. What is unclear is whether there was a transfer of knowledge across the different businesses in terms of bidding, acceptable margins, transfer and retention of risk, contract conditions and management of contracts.

Internal Auditors

Following authorisation of the 2021 financial statements, BDO LLP resigned as auditors and, pursuant to section 489 (3) (c) of the Companies Act 2006, on 9th September 2022 the directors appointed MHA MacIntyre Hudson as the Group's auditor. It is unclear why BDO LLP resigned. The role of internal audit is to provide independent assurance that an organisation's risk management, governance and internal control processes are operating effectively. Contained within the ISG Annual Report under the heading 'Independent auditor's report to the members of ISG Limited' was the following statement:

> *Because of the inherent limitations of an audit, there is a risk that we will not detect all irregularities, including those leading to a material misstatement in the financial statements or non-compliance with regulation. This risk increases the more that compliance with a law or regulation is removed from the events and transactions reflected in the financial statements, as we will be less likely to become aware of instances of non-compliance. The risk is also greater regarding irregularities occurring due to fraud rather than error, as fraud involves intentional concealment, forgery, collusion, omission or misrepresentation*.

It is difficult to comprehend how this statement will have given comfort to the directors of ISG, investors or stakeholders that the audit will have been comprehensive -providing the safeguards that they would have been looking for.

UK government behaviours

Government monopoly: A significant factor in the demise of Carillion was that the Government's position in some public sector markets was (and remains) monopolistic. As a consequence the government has very considerable power as the only buyer in these markets to stipulate the risk to be absorbed by bidders, to set prices and standards of quality. It could be argued the same situation existed for ISG.

Government transfer of risk: Again, prior to the demise of Carillion, the Government it is claimed deliberately promoted an aggressive approach to risk transfer to the private sector - often even attempting to transfer risks that the government itself had completely failed to analyse or to understand. It is not clear if there has been any change in Government practices in relation to risk transfer.

Summary

The collapse of ISG has resulted in the loss of jobs, termination of pensions, non-payment of suppliers and contractors and the suspension of a significant number of Government and private sector contracts. It has left the Government in particular with the need to restart a number of pressing projects, such as those being undertaken by the MoJ to address over-crowding in the nation's prison service.

What has been highlighted is that ISG worked in highly competitive markets where margins are notoriously low. In addition, although it has not been confirmed, the Government has perpetuated its aggressive approach to risk transfer to the private sector. The combination of low margins, challenging projects, heavily amended contracts, extremely low contingency sums and risk transfer by the Government has made business longevity difficult. Loss-making projects undermined the financial performance of the company.

While the role of risk management is to provide information to support effective decision making, the prerogative of executives is to choose the most appropriate information to base their judgements upon. While the principal risks and their attendant mitigation actions appear appropriate, it is not always clear what information executives receive, what they act on and what they ignore. It is hoped they will make unbiased decisions, preserve diversity of thought and independent thinking, clarify assumptions and make decisions which will preserve the longevity of the company.

About the Author

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Dr Robert J. Chapman, PhD, MSc., FAPM, CFIRM, FCIHT, FICM is the Managing Director of Dr Chapman and Associates Ltd. He is an international risk management specialist. He has provided risk management services in the UK, the Republic of Ireland, Holland, UAE, South Africa, Malaysia and Qatar on multi-billion programmes and projects across 14 different industries. He is author of the texts: 'The SME business guide to fraud risk management' published by Routledge, 'Simple tools and techniques for enterprise risk management' 2nd edition, published by John Wiley and Sons Limited, 'The Rules of Project Risk Management, implementation guidelines for major projects' 2nd edition published by Routledge Publishing and 'Retaining design team members, a risk management approach' published by RIBA Enterprises. He holds a PhD in risk management from Reading University and has been elected a fellow of the IRM, CIHT, APM and ICM and is a former member of the RIBA. In 2007 Andrew Bragg (APM Chief Executive at the time) formally confirmed he has exceptional risk management skills. Robert has passed the M_o_R, APM Level 1 and PMI risk examinations. He has been shortlisted for national risk management awards in 2014 and 2024. In addition, he has provided project and risk management training in Scotland, England, Singapore and Malaysia. Robert has been an external PhD examiner.

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