

Guideline for establishing effective Subcontracting Relationships SINCE Tigray – Lot 5

1. Definition of subcontracting practice

The practice of “subcontracting” is a relationship between a contractor, namely an individual or a company, who complete work for another entity – namely a company – under a contractual agreement. In practical terms, a company hires out some of the work to another company/entity/individual.

The practice is common in construction industry: builders often subcontract plumbing, electrical work, painting and other tasks to other companies.

The reason behind the subcontracting practice is mainly that the provision of in-house service would not be cost-effective thus the company decides to assign another entity to do the task in exchange of money. Moreover, the service/good to provide is specialized work and the company does not have in-house the resources and skill to accomplish it because it represents a limited and specific part of the work.

The chief disadvantage of using contractors is diminished control over the function and less ability to predict its future costs.

2. Subcontracting Strategy as part of DEAL project

Studies conducted by several research institutes and ILO emphasize the importance of networking and regional clusters for industrial development. One of its main components is represented by the subcontracting relationship which is one important tool for cooperation between firms of different sizes. Within the project DEAL, the subcontracting relationship approach is one pillar of the strategy for development of industrial clusters that will lead to an improved productivity of the companies and to an increment of employment opportunities. Moreover, within the project 58 Business Partnerships have been created in two value chains - metal and construction- gathering group among 7 and 18 trained beneficiaries who received technical training in the previous months. As part of the project, the effort of the consortium is addressed to facilitate the relationship between

the newly established business groups (legally registered as Micro and Small Enterprises) and bigger companies with the aim to establish a cooperation framework within the umbrella of the subcontracting system.

The action to enhance the relations between SMEs and bigger companies will follow two directions:

1. Facilitation of the relationship, capacity building and awareness for SMEs and bigger companies

One of the key aspects that affect the results of a subcontracting relation is the common understanding about the work assigned to the SMEs and clear and realistic expectation about the outcome. In the long terms, the interdependence between the two parties brings added value and technology exchange but it is essential to create a clean and constructive environment and knowledge-sharing about the subcontracting as winning strategy for both the owner/manager of big companies and owner/manager of SMEs.

Effective communication and negotiation skills allow SMEs to interact with partners and stakeholder and enable them to exploit the market potential and promote technology transfer. In light of this, Micro and Small Enterprises shall be equipped with effective communication and negotiation skills to increase their chance to gain the market share.

2. Enhancing contracting relationship and comprehensive agreements

In the short term, the subcontracting relationship that the consortium will facilitate is a contract between parties for a single task. The contractor assigns a selected SMEs to perform a specific task within a define time bound as per the contract agreement that defines the relation between the parties, the responsibilities, the payment modalities and the time of delivery. In this case, the relation is transactional that means it ends when the activity is complete, and it represents the most flexible, least risky and easiest way to manage the relationship.



In the long run, the subcontracting relationship that will be established during the project implementation period might bring to long term arrangement between giant companies (i.g. Mesfin Industrial Engineering; Sur Construction Company) and selected SMEs. This arrangement would establish an agreement based on which the company outsource their labour-intensive tasks to SMEs in a continuous way.

