

The 2018 ECI roundtable for Owner Operators and Investors in the European engineering and construction sector

The European Construction Institute
with McKinsey & Company and Shell

2nd October 2018

at Shell's Headquarters, The Hague, The Netherlands

This is a short report of a roundtable of owner operators in the engineering construction sector which was facilitated by ECI and McKinsey, and hosted at Shell's headquarters in The Hague.

1. Introduction

In 2015-16 the ECI held a series of consultative events culminating the publication of a report titled "Surviving and prospering after the *Perfect Storm*: Challenges in delivering capital projects". A copy of this report is attached¹.

The key issues identified affecting the use of capital were:

- Failings on mega projects
- Poor performance, productivity and HSE
- Inadequate innovation
- Insufficient integration, collaboration and early supply chain involvement.

2-3 years on we were interested to learn what has changed, and what different approaches might be needed to make a difference for owners and operators.

We are grateful to those who participated in the roundtable including from Shell, Total, ThyssenKrupp and EDF Energy, and look forward to working with them and other owners, clients and operators, investors and supply side to drive the agenda identified.

2. What has changed in recent years?

Capital efficiency and the need to work together better as a sector to address it remains the number one issue for clients.

2.1. The crisis led to incremental improvement but not transformational change

From an owner's perspective the shortage of capital linked to the fall in oil price led to incremental improvement, but not to the transformational change it has the potential to bring about.

"We have seen bits of incremental change locally but no transformational change or innovation"

"We focused on being more predictable, now need to be more competitive [on cost & value]"

"No structural change, just individual firms on particular projects"

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“There is a disruption coming from someone who has figured out how to do it radically differently”

2.2. Competition for capital has increased while project performance has not

The sector is competing for capital with other sectors, for example the renewables sector is becoming much more capital competitive. Project performance is not improving at the necessary rate to remain capital competitive. There has been good progress on predictability, however the next challenge is to be competitive as well as predictable.

“We are not competing well with other destinations for capital”

“Oil and gas has competition from renewables purely on cost, this is a new dimension of the challenge”

2.3. Industry-level standardisation could eliminate a lot of waste but remains elusive

Industry-level standardisation could eliminate a lot of costs, but remains elusive. Growth through acquisition is less risky than organic growth, and this holds back standardisation at an organisational level, never mind at an industry-level. Bespoke company standards are perceived to drive up costs; the supply chain would be more efficient if there was a standard client approach. Health & Safety is the only area where there is a cohesive approach, however this is not evident on quality and cost.

Furthermore, larger bespoke projects tend to absorb a considerable amount of effort. Project planning on a 10- year project needs to be more agile and the team need to have the ability to use contracts in the best way as the project evolves. It is very difficult to retain alignment on a mega-project, there are lots of opportunities for divergence. Smaller, repeatable projects open up opportunities for agile design, better use of digital technology and more scope for transferring learning.

“Try to get away from bespoke mega projects to smaller scale repeatable projects”

“If we all let go of our individual company standards it would help the supply chain a lot and it would help the operator to be dealing with the same kit”

“Try to get away from bespoke mega projects to smaller scale repeatable projects”

2.4. Banks assert more control and drive risk further down the supply chain, increasing cost

Banks are anxious about risk and seek to protect the return on their investment, but often the measures adopted are (sometimes counter-intuitively) misaligned to this objective and exacerbate the problems by placing more risk with parties less able to bear it or by erecting barriers to integration and collaboration. The implementation of more draconian restrictions on projects appears to show a regression on the part of investors.

Large, capital intensive projects tie-up capital, so owners and investors need to look at more flexible models that can help diversity risk.

“How do you distribute and share risk”

“The scale of the up-side means it is worth taking some risk through innovation. The implementation of more draconian restrictions on projects, appears to show a regression on the part of investors.

“We need a collaborative partnership with investors, owners, operators and supply side - we have common cause”

2.5. Many companies still fail to capture lessons learned and transfer knowledge to new projects

There is a real need to transfer lessons and knowledge across projects, and standardisation and repeatable processes can help achieve this. There are pockets of good practice, but each project is

treated as R&D without transferring that investment in knowledge into other projects. The lack of learning culture across the whole industry was perceived to hold back progress on standardisation.

“We haven’t learned and we haven’t transferred learning”

“We need to convert lessons that were learned the hard way so we don’t repeat mistakes”

3. What can improve performance?

The discussion identified a number of familiar themes for improvement, which require articulation of a clear road map to go from today to a different way of working:

3.1. More collaborative contracting/alliances

- Align everyone's commercials with the success of the project
- Make it worthwhile for owners to invest in building capabilities in the supply chain
- Make it worthwhile for the supply chain to rethink the fundamental approach to project delivery
- Empower the people delivering the project across the supply chain.

3.2. Harnessing the full power of innovation and digital technology to enable structural transformation of how projects are delivered

- Improve or transform processes first, then enable them with appropriate digital technology
- Transform in an agile way (develop and fail fast)
- Consider ring-fenced new business units to pilot new disruptive approaches
- Leverage the digital transformation to attract new talent.

3.3. Sector-level standardisation of processes and requirements

- Allow re-use of design elements and equipment versus bespoke solutions
- Better capture learning curve benefits.

4. The potential role of ECI

The discussion identified an important agenda for ECI:

- 1) Facilitate and moderate a safe place for owners, investors & supply side to come together (offline, away from commercial environment) to collaborate for change
- 2) Articulate a clear road map to go from today to a different way of working
- 3) Build the evidence base and “use cases” for better and new ways of working (and for the impact of new technology)
- 4) Support research led by CII on transformational models
- 5) Act as an independent mediator across all relevant stakeholders
 - a) Articulate shared vision and roadmap for how owners want the sector to develop (and get more owners on board beyond the participants in this roundtable)
 - b) Consult with key sector players, starting with **investors** then **EPCs** and supply side
 - c) Launch surveys (and conduct select interviews) with these stakeholder groups to find out what is preventing the industry from applying known and proven technology and improvements to change the current (failing) way of working?

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