

E&C firms need differentiation

Field becomes commodity business, experts say, by failing to keep pace

By failing to keep pace with the process industries, engineering and construction contractors have made their services a commodity business in need of new top talent.

At least that was the upshot of two talks at the recent 31st Engineering and Construction Contracting Conference in San Antonio, TX.

The annual gathering of the clan carried the theme "Creating Optimum Business Value Through Global Contracting Strategies."

Yet amid discussions of alliances, lump sum and reimbursable cost contracting (see pg 23), came two presentations that gave cause to pause and assess.

McKinsey & Co.'s Frankfurt-based Sönke Bästlein told a topical workshop that engineering and construction (E&C) firms have failed to adapt to changing demands of shareholders, customers, and top talent.

Keynoter Phil Carroll, Fluor Corp. chairman & CEO, drove home a similar message, saying the engineering and construction contracting field is becoming a commodity business, and its ability to attract the right young people is a key to its future.

Bästlein said that "talent, the future source of competitive advantage, is not sufficiently attracted to E&C firms due to 'old fashioned' structures."

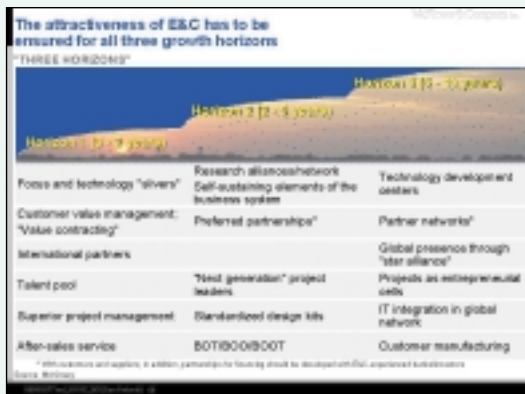
He noted what he called negative perceptions of the industry, regarding low profits, lack of growth, rigid structures and a seniority-driven leadership style.

On the positive side, the industry is perceived as having interesting projects with international scope, Bästlein said.

"The homemade portion of the unsatisfying situation results from a weakened value proposition," he said. "Regaining attractiveness requires overcoming ingrained paradigms and habits."

So what does the McKinsey crystal ball tell us about the future? Here's the prognosis:

- E&C companies have to reshape their business system



Source: McKinsey & Co.

and accept the rules of the capital market—first and foremost, profitable growth through distinction (i.e., success through technology leadership);



- To maximize capital productivity, E&C firms have to understand the customer's business case;

- Value contracting and value-based pricing will be key to future success.

Value contracting (i.e., value engineering, plus performance contracting) requires new approaches to projects. Value-based pricing leads to profitability increases based on win-win situations forming the basis for sustainable partnerships.

Customer value management requires a different mindset, which Bästlein highlights in his four "steps to excellence":

	FROM:	TO:
1. Identify value-driven segments	Treating all customers equally	Segment-specific value & define value proposition
2. Benchmark customer value	a. Focusing on technical features b. Benchmarking cost	a. Quantifying customer value b. Benchmarking customer value
3. Exploit existing price/volume potential	"Cost-plus" pricing	Value-based pricing
4. Renew market offering and business system	Engineering-driven R&D	Customer-value-driven R&D

Take a look at McKinsey's "Three Horizons" picture of the future (left). Will top talent be attracted by great opportunities in an exciting new environment? You'd think so.

The urgency of the need for change was captured in a comment by an E&C company representative, who said: "We expect markets to recover in 2003, but the question for us is whether we'll survive the next three to four years."

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