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Engineering and Construction industry summary

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Recent events have clearly demonstrated the extent to which the world is interconnected. The crisis which began in the US banking system has spread through the global economy as a whole – and no region has emerged unscathed. This historic moment provides an unprecedented opportunity for companies, governments and individuals to think more deeply about the sophisticated eco-systems of which we are all a part.

The current crisis has highlighted the need for new institutions, new mechanisms, new strategies and – most critically, perhaps – a different mindset among those leading the world's most important institutions and companies. Every CEO will have to make tough decisions about what actions are required to ensure his or her company's short-term survival. Yet none can afford to ignore the need to build a business that is agile enough to respond to new situations as they emerge, durable enough to grow over the long term and responsive to the requirements of all its stakeholders.

Redefining success, the PricewaterhouseCoopers 12th Annual Global CEO Survey, explores how CEOs are reconsidering the fundamentals of business in response to extreme operating conditions and assuming responsibility for issues that were once considered outside the scope of industry. We interviewed 1,124 CEOs around the world between September 10 and December 2, 2008. Our findings show that they are collaborating more extensively to balance the interests of increasingly influential stakeholders. They are also seeking new kinds of information to help them anticipate changes in critical business drivers.

Here, we look specifically at what the 80 CEOs in the engineering and construction (E&C) industry think, and how they are dealing with a combination of challenges such as mankind has never seen before.

The business environment

Last year, CEOs in the E&C industry were quite optimistic; 56% were very confident about increasing their companies' revenues over the next 12 months. This year, the mood is much bleaker, with only 18% of respondents very confident about the prospects for the next 12 months. Moreover, most E&C CEOs are not expecting a rapid economic recovery; only 24% are very confident that they will be able to boost their turnover during the next three years, and only 15% are very confident about the outlook for the industry as a whole over the same period.

The sharp drop in confidence stems largely from concerns over the impact of the global financial crisis. Nearly two-fifths of E&C CEOs (39%) are extremely concerned that the disruption of the capital markets could threaten their companies' growth. More than three-quarters of E&C CEOs also anticipate that the difficulties the global banking system is currently experiencing will increase the cost of credit and restrict access to finance, while about two-thirds think that they may be forced to delay their investment plans and curb their growth expectations.

The marketplace is certainly challenging. E&C companies in the US have been particularly hard hit; the slump in the housing market has been compounded by a widespread recession that is slowing down other kinds of construction activity as well. But the rest of the world has not escaped unscathed. Land prices continue to fall, and some companies operating in residential markets (e.g., the US, British, Spanish and Irish residential markets) may well fail, although the situation is somewhat easier for companies that are

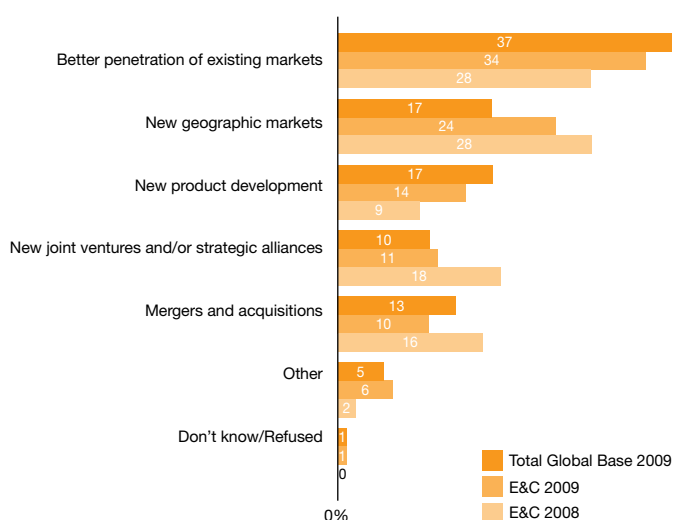
more reliant on infrastructure and public-sector projects because they are cushioned by longer-term order books.

Given these challenges, E&C CEOs are understandably concerned about the threat of low-cost competition; indeed, they are more anxious than the total survey population on this score (53% versus 48%). Their concern reflects the fact that some E&C companies have been pricing work more aggressively, assuming that materials prices will fall. But the end result could be cut-throat competition in some segments, as many CEOs focus on short-term wins, possibly at the cost of long-term profitability.

So how can E&C companies navigate through such choppy waters? Some contractors may establish public-sector framework agreements to secure a steady stream of projects and reduce their risks. Many companies will also return to the fundamentals. We spoke with Chip Hornsby, the CEO of building products maker Wolseley, a company which has grown aggressively in recent years. Now divisions with a significant exposure to troubled customers, such as the US house builders, are facing very difficult times. Wolseley's approach: stick with the basics, such as outstanding customer service and strong discipline regarding working capital and expenses, and build market share in order to capitalise on the upswing when it happens. 'We have put much more focus on managing the expense base as well as working capital...I think it will position us to be that much stronger, more viable and increase value that much more for our shareholders, as we move through this cycle,' he explains.

Focusing on opportunities to get stronger is even more critical when overall growth slows down. We looked at where E&C CEOs see the greatest potential and noted some shifts from previous surveys. Last year, geographic expansion and better penetration of existing markets shared the top spot, with 28% of respondents citing each factor as the main route to growth over the next 12 months. This year, E&C CEOs are retrenching; 34% are concentrating on their existing markets, and only 24% are looking farther afield (see figure 1).

Figure 1
Engineering and construction CEOs concentrate on existing markets to grow



Q: Which of these potential opportunities for business growth do you see as the main opportunity to grow your business in the next 12 months?
Base: Global: 1,124; 2009: 80; 2008: 68

Source: PricewaterhouseCoopers 12th Annual Global CEO Survey 2009

Note: Data for 2009 are based on interviews conducted in the last quarter of 2008
Data for 2008 are based on interviews conducted in the last quarter of 2007

But though the emphasis on geographic expansion may have waned, the CEOs of E&C companies operating in mature markets where the construction sector is severely depressed would do well to keep looking overseas – even if they no longer think that mergers and acquisitions (M&A) are the best way of heading abroad. Last year, 46% of E&C CEOs said that they were planning a cross-border M&A over the next 12 months. This year, the number plunged to 21%. Even more tellingly, perhaps, only 10% of respondents now see deals as the best way of growing their businesses over the next 12 months, compared with 16% last year.

It seems unlikely that many large, highly leveraged deals will take place in the current economic environment. However,

a significant number of E&C CEOs are looking to other types of transactions to fill the gap; 50% expect cross-border joint ventures and strategic alliances to play a greater role in the growth of their companies over the next three years.

Balancing short- and long-term concerns

Addressing global risks

Some E&C CEOs may want to consider looking to international markets with growth potential, such as the Middle East, India and Turkey, to supplement unfilled order books and ensure the longevity of their companies. Developing a strong client base in these territories could help them both to reduce the impact of the downturn in other markets and to start building a long-term project stream.

However, one thing of which to be wary, wherever they operate, is the increasing likelihood of contract disputes, as the sector becomes more financially constrained. Contract disputes can inflict considerable damage on a company's brand, by tarnishing its reputation with potential partners and customers alike. Any CEO with an eye on the long term should therefore try to minimise the danger of getting embroiled in a dispute, by assessing the supply chain risks very carefully and choosing subcontractors who can fulfil their obligations.

Virtual project management, which facilitates transparent collaboration between contractors and subcontractors, can also help, by exposing delays and cost overruns when they occur – thus enabling project managers to react more swiftly. Many E&C CEOs already recognise the benefits of collaborating in this fashion; 45% believe that the ability to form successful business partnerships is important to their companies' success, while 29% view such arrangements as critical.

Climate change creates opportunities for the sector

Like their peers in other industry sectors, E&C CEOs are well aware of the commercial implications of climate change. They, too, want clear and consistent government policies, clear communications and a new global climate agreement to succeed the Kyoto Protocol. Moreover, excellent opportunities exist for those companies that can develop a proactive strategy to capitalise on the opportunities climate change creates. E&C CEOs are increasingly recognising this; 29% believe that threats to the general population and to property due to climate change will have a positive impact on their businesses, compared with just 13% of the total survey sample.

The built environment is a significant contributor to global emissions, so retrofitting existing structures and building new structures more sustainably can play a key role in improving the overall carbon balance. Indeed, some governments are actually mandating progress in this area. Moreover, although many companies may currently find it difficult to afford capital improvements, the crisis in the global financial markets provides a stark illustration of what can happen when systemic risks are ignored.

Collaborating with government to achieve regulatory stability

For companies in the E&C sector, government is not only a regulator; in many cases, it is also their biggest customer. Major infrastructure projects account for a substantial part of the order books of many contractors. Cement manufacturers and other building products suppliers also rely on new roads, railways, highways and bridges to drive demand. And, in recent years, the sector has become an increasingly active partner with government in infrastructure development, with the rise in the number of Public Private Partnerships (PPP).

In the short term, financing for PPP may be almost as hard to come by as financing for other sorts of contracts. In the medium to long term, however, PPP models are likely to become even more important. As the debt markets recover, government-backed infrastructure projects may prove a more attractive lending proposition than other private-sector projects.

Nevertheless, government and industry still have much to learn about working together. All too often, the bidding process focuses on technical considerations, without adequate consideration of the financial and commercial risks. Many governments also see contractors as service providers, rather than as partners with whom they should be teaming up to develop the most appropriate infrastructure solutions. This may explain why 34% of E&C CEOs do not think that governments seek private-sector input into the design of policies and regulations. Similarly, public-sector projects often attract strict scrutiny, which may account for the fact that 60% of E&C CEOs do not think that the regulatory burden has decreased.

Cultivating key skills

The E&C sector has always experienced significant seasonal and project-related headcount variations, and the 29% of E&C CEOs who anticipate cutting the number of people they employ this year corresponds closely with the level in our overall survey sample (26%). However, advances in building technology, such as increased prefabrication and off-site production, are reducing the number of on-site workers the industry needs. They may also have implications for the sort of skills it requires.

One skill that will remain vital, though, is the ability to maintain strong customer relationships; indeed, this becomes even more important in periods of economic turbulence. A robust strategy for recruiting, retaining and developing the right talent is a prerequisite for delivering top-quality service, as Hornsby points out. 'We have a pretty simple philosophy. Take care of your people and they will take care of your customers. All we have to sell is customer service,' he observes.

Looking forward

Over the long term, CEOs need to ensure that they are addressing not only short-term risks, but also global, long-term systemic risks such as climate change and the impact of demographic shifts on the talent pool. Focusing on sustainability issues in general will be fundamental to retaining competitiveness.

PricewaterhouseCoopers Global E&C Leader Jonathan Hook explains that 'as pressure increases to reduce carbon emissions, the construction industry will be able to play a major role in making the built environment more sustainable. Our survey shows that 69% of E&C CEOs already describe the strength of their corporate social responsibility programmes as critical or important to maintaining long-term growth; we believe that this emphasis is fundamental for every CEO looking to build a durable business.'

For further information, please contact:

Jonathan Hook

Global Engineering & Construction Leader

PricewaterhouseCoopers (UK)

+44 (20) 7804 4753

jonathan.hook@uk.pwc.com

Full findings of the PricewaterhouseCoopers 12th Annual Global CEO Survey are available at www.pwc.com/ceosurvey

For additional information regarding PricewaterhouseCoopers' engineering & construction sector practice, please visit www.pwc.com/engineering&construction