Thinking about tomorrow: capital efficiency in the GCC

One billion Dollars. Seven billion Dollars. Ten billion, 30 billion, 100 billion, 130 billion Dollars! These numbers reflect neither the GDP of any particular country nor the market capitalization of any of the world’s largest corporations. They are simply examples of the value of a single capital project (1 to 7 billion dollars) and of total project portfolios (10 to 130 billion dollars) that have been committed to – in the past 12 months alone – by government, quasi-government and private sector entities in the Gulf Cooperation Council countries. They span industries from real estate to infrastructure to oil and gas.
But whilst spending on some capital projects within the GCC continues to shock, only two words can ensure its sustainability. Capital. Efficiency.

The entities commissioned to carry out the projects, whether government or private, are entrusted with absolute power not only to deliver these projects, but to deliver legacies as well to their respective commissioners.

But with absolute power comes absolute responsibility, and extracting maximum value from each project or portfolio not only improves a company’s Internal rate of return (IRR) or Return on investment (ROI) – it could also mean the difference between delivering 130 schools instead of 100, five bridges instead of three. It could mean installing rail networks that reach more communities, delivering critical lifesaving infrastructure sooner rather than later. The importance of these capital projects and portfolios cannot, and should not, be underestimated. Because of their wide-ranging influence, they should have the complete commitment of the project owners and governments – even consultants and contractors – to maximize their value and ensure their success.

What distinguishes the GCC region from other regions is the source of funds, which are predominantly government-related and driven from oil and gas-based economies. Many projects do not therefore take into consideration financing and interest when assessing how capital efficient they can be, which could drive better business practice and capital project delivery.

Many companies elsewhere in the world responsible for delivering capital projects continually consider shareholder value, driven by the need to be capital efficient because of the availability (or lack thereof) of project funding. The GCC is not different because of any reduced capital requirements for its projects, it is different primarily in that there is a perception that capital is readily accessible!

As world dependency on energy and resources continues to grow, what will drive capital efficiency in the Middle East for years to come is not likely to be anything borne out of necessity but by choice. What is clear is that the same capital efficient mentality employed elsewhere around the world, if applied to this region, could reap immense efficiencies and savings.

What all of the entities that are delivering capital projects in the region have in common – in addition to having captured the attention of global businesses with their jaw-dropping capital expenditure figures – is the need to deal with the challenges resultant from very compressed timetables. For some, it may be a limited-year concession agreement during which they need to begin oil refining operations, for others, it may be a rush to provide essential infrastructure for a vast population that has both social and political implications. Therein lies the critical paradigm – in their rush to deliver these large capital projects to achieve a wide range of critical objectives, are project overseers truly maximizing value or are they leaking away billions in cash that could be used for other projects?

With billions of dollars in the balance striving to achieve the optimum balance between cost, time and quality, project owners realize now is the critical time to shift towards achieving all three in the most efficient way possible.

To be or not to be (capital efficient)?

Rushing to deliver projects may eliminate the most cost-effective procurement strategy, whether it be to progress with project design to a more advanced level to allow for more accurate tendering, or to limit private sector involvement through longer-term focused tendering (such as Public Private Partnerships) which can add up to 12 months to the procurement process. Can
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We select the appropriate procurement strategy, balancing time and funding requirements and creating private sector opportunities that will diversify the economy? Or shall we simply progress with the front-end design, reducing overlap of design, construction and procurement activities, to focus more on driving expenditure into the region’s local economies? The question to answer is: do we have the ability and tools to identify, quantify and maintain value throughout delivery? Simple math would indicate that achieving even a few percentage points of efficiency will undoubtedly allow for billions of dollars in savings. The answer of course is yes, but some immediate measures will have to be considered and taken before we can fully take advantage of the concept of capital efficiency.

1. **Recognize the difference between strategic versus commercial projects**
   Many of the multi-billion dollar quasi-governmental businesses (government-related entities) that are established to operate in line with leading private sector corporations are also mandated with delivering projects that are primarily for economic diversification and development of the region’s national populations. Other entities are entrusted by their respective governments with delivering major civil and social infrastructure projects because of the importance placed on timing – they serve as a safe pair of hands. The measure of value – of what makes commercial sense versus what is a strategic, longer-term objective – is of a different nature. However, once the commercial and strategic imperatives are agreed upon, the capital project delivery objective remains the same: deliver the project requirements within an accurately estimated budget, in line with the agreed timing for projected operations.

2. **Defining value**
   What is value? Is it ‘delivering within budget’ – which could be achieved through measures as far-reaching as value engineering of the design or accepting reduced project quality during the course of delivery? Conversely, placing such emphasis on delivering under budget could create a culture that values predictability over true efficiency. Is value ‘delivering on time’ – where commercial operational revenues could vastly outweigh the additional cost of accelerating and delivering the project on time? Is it ‘delivering the industry’s leading technological solution’ – where cost could be viewed as no object? Or is it to ‘maximize local participation’ for the diversification and reinforcement of the local economy – accepting that this may cost more to the bottom line and result in delays to commercial operation? The answer, of course, is not simple at a project level. At a business-level, managing projects with different objectives and maximizing value requires a committed and experienced management team with the right information at their fingertips.

3. **Do we have the data to truly be efficient?**
   Many government and government-related entities have demonstrated that there is an essential need to improve discipline in terms of simple project and contract administration, which will subsequently allow for project data to be collected accurately, simply and consistently. One specific oil and gas project offered a significantly quicker return on its capital expenditure investment because it was delivered later than originally planned, inadvertently benefiting from greater commodity pricing at the time of commercial operation (in this instance, it was the cost of a barrel of oil). This is a simple example of an instance in which simply having access to commercial data and the tools to consider them when making decisions during project execution would significantly influence the project owner’s capital efficiency.
4. Effective and confident decision-making
The best data in the world will not be of any value if it is not comprehensive, nor analyzed in a consistent manner that allows executive management to make the best decision for the organization for the short- and long-term. The inherent linkages between projects within a portfolio, from timing and value of funding requirements to commitment of resources and management and operation of assets, must be recognized and considered to drive decisions at a project-level that are truly capital efficient at organization-level.

5. Commitment to overcoming technology challenges
Rigid Enterprise Resource Planning systems that have been developed over many years and designed with controls and software in mind to structure discipline, have now become the backbone of many organizations. This discipline can, at times, come at the expense of vision in an organization looking to create a dynamic project delivery system that can drive value in real time. This vision of capital project nirvana could be a project delivery process that relies on everything: from using estimating, cost, planning and contract data to virtually construct projects, to even utilizing qualitative and quantitative project site data via mobile technology to drive more accurate decision-making. The vision, leadership and investment required to truly capitalize on all facets of technology to achieve the capability to conduct such analyses are sizable from a management perspective – but easily justifiable when the cost savings alone are fully appreciated and understood.

6. Overcoming a business culture legacy
Real-time capital efficiency processes can help maximize every dollar, dirham or riyal, but will require a management team that thrives on being in a dynamic environment and that looks at the objectives of the overall business and each individual project in parallel and will be comfortable standing behind each decision, knowing it is in the best interests of the overall organization for the foreseeable future. It also requires having personnel with the experience and expertise to operate in an analytical and dynamic environment, supported by a top-down culture that is held accountable for the success of each decision in the long-term.

7. Creating and embedding ‘challenge’ to achieve value
Each capital project’s business case has, within it, assumptions that attempt to balance and address commercial and wider-ranging strategic objectives for the organization. These assumptions can be viewed as a ‘snapshot at a particular point in time’ and should be challenged and validated throughout the delivery of the project by the organization, not just at the outset. External factors, such as the commercial environment for the organization, scope changes, delivery challenges experienced, etc. all require a revisit and refinement of the business case. This can subsequently drive a different set of decision-making, to support a revised delivery plan, to achieve a revised definition of value for the project. Each time the anticipated ‘value’ of the project is revisited, the project’s risks (the downside impact on value) and opportunities (the upside impact on value) can be assessed and managed to achievement or resolution. This challenge creates a continual balance of risk and reward, which may drive, for example, a decision to revise the contracting strategy that was planned at the outset of the project. Therefore, value should not be viewed as a ‘frozen target,’ rather – through a focus on consistently driving capital efficiency – it can be a target that is continually revisited to ensure it is achieved.
8. Understand the capital efficiency implications on the entire life cycle
A lot of the discussion around capital efficiency is focused on the deployment of capital, but one has to recognize that the actual value of the initial capital deployed is not necessarily indicative of its importance to the overall project. For example, the earlier stages in the project (such as front-end design or scope definition) have a profound impact on the project definition and detailing of the scope that will drive the cost and schedule objectives, albeit with limited capital expenditure occurring at that point in time. Similarly, with respect to management and operations of the asset, not achieving quality objectives in the interest of reducing costs during project delivery may have a huge impact on operations and maintenance costs and ultimately the valuation of the asset.

Embracing capital efficiency
The values attributed to capital projects in the Middle East are nothing short of staggering and demonstrate how capital-intensive industries in the GCC are, and will remain, for quite some time. Throughout the GCC region, organizations have not been able to grow effectively and organically, due to the immense pressure to deliver increasingly large and growing capital programs. Technical, commercial, financial and corporate support functions operate in silos – not by design, but because historically they have operated in this manner and they are now attempting to instill controls across this silo structure to deal with the challenges of rapidly increasing growth.

While anyone in executive management will agree that capital efficiency analyses needs to occur at both the project and portfolio level (across projects), the actual planning and management of large capital projects is complex in itself, with many variables and uncertainties that need to be identified, assessed, analyzed, quantified and estimated. To truly be capital efficient requires a complete commitment by the organization to consistently collect and consider the right inputs – accurate data and metrics, appropriately from the right phase (e.g. planned costs during early design, forecast costs during execution, commercial and market data) to provide the right answers and to allow effective decision-making to be an output.

Time and again in the region, we have seen an erosion of capital project and shareholder value during the execution of these major projects. In its most simplistic form, focusing on capital efficiency and value can drive alignment across a myriad of departments and functions in organizations – when questioned as to why this is needed, the justification for change across these same departments and functions becomes easy once everyone recognizes the answer is ‘it will save us lots of money’. Effectively assessing capital value and planning capital effectively creates clarity across the organization and supports decision criteria for the long-term benefit of the organization. It will more than likely provide organizations with the best possible chances of achieving their future objectives: success.

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