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Preparing for the  
Next Surge  
*How GCC Contractors  
Need to Adjust Their  
Operating Models*



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## EXECUTIVE SUMMARY

*During the past decade, the structure of the contracting industry in the Gulf Cooperation Council (GCC)<sup>1</sup> region has changed dramatically, with marked shifts in the type, complexity, and size of contracting projects. Customers are launching projects of a larger scale and budget, have become more sophisticated, and are setting ever-higher standards for quality, timeliness, and overall performance. In addition, cross-border and cross-sector competition has increased significantly. Financing requirements, furthermore, are higher and more rigorous, while the complexity of projects is placing new demands on supply chains, equipment needs, and human capital capabilities.*

*Although overall growth in the contracting industry has allowed market participants to continue to succeed in this changing environment, they must start adapting their overall strategies and operating models to the demands of the new environment, or risk losing out to others. Contracting companies must pursue strategic imperatives with the potential to affect every aspect of operations, including supply chain management, human capital development, systems integration and investment, and other critical functions. In addition, contractors will need to assess where they want to compete. Firms going through that process successfully will emerge with a stronger position from which to build their market share and profitability.*

## KEY HIGHLIGHTS

- Cyclical changes in demand have been overshadowed by broader and more structural shifts in the contracting marketplace. The pressures on contractors are not temporary and will force contractors to make systemic changes to their operating model.
- GCC contracting firms face the risk of being overtaken if they do not address four major areas of potential weakness: fragmented operating models, underused technology systems and processes, underdeveloped human capital strategies, and insufficient attention to the broader array of priorities beyond costs and deadlines.
- Firms need to take five major steps to address these gaps: refocusing corporate strategy around both regions and sectors; setting goals for performance rather than rigidly following processes; defining and communicating priorities clearly; deploying technology selectively to meet priority goals; and integrating and elevating the skills and experiences of both incumbent and recently hired employees.

# FUNDAMENTAL CHANGES TO INDUSTRY STRUCTURE

Today, the contracting industry in the GCC region is consumed with the demands of delivering government-sponsored infrastructure and other large-scale projects. Considering the industry's overall upward swing—reflected in its 35+ percent compound annual growth—during the past decade, it appears that the industry is in a position of continued growth, despite a recent short-term slowdown and decreasing activities in selected cities.

The industry is undergoing a significant structural transformation, attributable in part to the business cycle. The growth spurt driven by megaprojects across the GCC region is forcing the industry to rapidly develop specialized expertise and to expand operations throughout the region. At the same time, the residential and commercial megaprojects that defined the industry's growth spurt earlier in the decade have been replaced in many cases by government-sponsored infrastructure projects—mostly in Saudi Arabia, the UAE, and Qatar (see *Exhibit 1*). This change in the mix of projects has presented the first of many shifts in the industry.

Yet the structural changes facing the industry are driven by factors far broader than project mix and

shift in geographical concentration of projects. They emanate from five critical areas: project size and budget, customer expectations and sophistication, competition, suppliers and the supply chain, and investors and financing (see *Exhibit 2*).

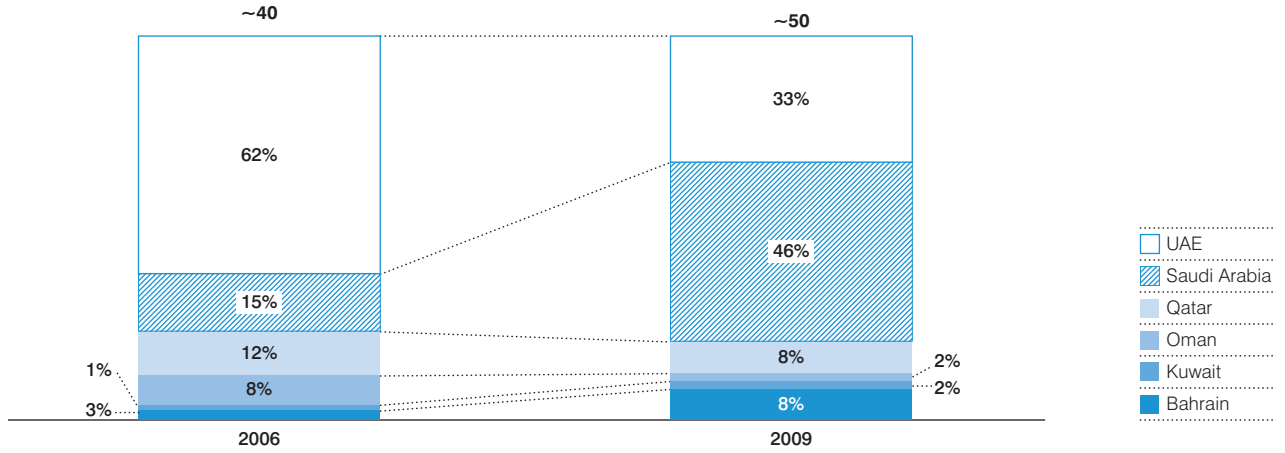
## Project Size and Budget

In the past decade, the industry's watchwords have changed from small, simple, and single to colossal, complex, and coordinated. Rather than the typical small to medium-sized projects of up to US\$100 million, contractors are looking at multibillion-dollar projects, often involving complex civil works, electromechanical systems, and other vital infrastructure. Certain megaprojects, such as Burj Khalifa and the Palm Island, require unprecedented architectural and civil engineering feats. Perhaps most emblematic of this trend, Saudi Arabia's Kingdom Holding Company has announced plans for a mile-high tower in Jeddah, a \$10 billion project that will test the boundaries of civil engineering and building materials science.

As a result, contractors now carry portfolios of projects far larger than they did just 10 years ago. For example, in 2005, one of the largest GCC contracting companies managed a project portfolio of approximately \$1.8 billion; by the end of the decade, the same company's portfolio was about \$5.2 billion. Finally, project complexity requires contractors to be far more reliant on an array of highly specialized subcontractors, which they often need to manage under challenging deadlines and high expectations for quality.

**Exhibit 1**  
*The Upcoming Wave of Infrastructure Projects Is Financed Through Governments' Fiscal Stimulus Packages*

**PERCENTAGE OF GCC NEW CONSTRUCTION CONTRACTS, BY COUNTRY  
 (US\$ IN BILLIONS)**



Note: Numbers have been rounded.  
 Source: MEED

**Exhibit 2**  
*The Structural Changes Facing the Contracting Industry Are Evident in Five Critical Areas*

CRITICAL AREA	OLD PARADIGM	NEW PARADIGM
<b>PROJECT SIZE AND BUDGET</b>	<ul style="list-style-type: none"> <li>- Simple projects</li> <li>- Small to medium-sized projects of up to US\$100 million</li> <li>- Single contractor</li> </ul>	<ul style="list-style-type: none"> <li>- Complex projects requiring civil works, advanced systems, and other vital support</li> <li>- Megaprojects, often exceeding US\$1 billion</li> <li>- Multiple and specialized contractors</li> </ul>
<b>CUSTOMER EXPECTATIONS AND SOPHISTICATION</b>	<ul style="list-style-type: none"> <li>- Limited client knowledge of contracting; focus is mainly on time and price</li> <li>- Limited client oversight</li> <li>- Design-bid-build projects</li> </ul>	<ul style="list-style-type: none"> <li>- Increased client sophistication and focus on additional parameters, such as quality and sustainability</li> <li>- Close client supervision</li> <li>- Design-build / EPC / BOT projects</li> </ul>
<b>COMPETITION</b>	<ul style="list-style-type: none"> <li>- Localized players</li> <li>- Sourcing through privileged networks</li> <li>- Clear boundaries between large and mega players</li> </ul>	<ul style="list-style-type: none"> <li>- More regional and international players</li> <li>- Competitive and rigorous tendering</li> <li>- Blurred distinction between large and mega players</li> </ul>
<b>SUPPLIERS AND THE SUPPLY CHAIN</b>	<ul style="list-style-type: none"> <li>- Cost plus contracts structure in relatively stable material cost environment</li> <li>- Simple resource requirements (e.g., equipment, labor, material) and regulations</li> </ul>	<ul style="list-style-type: none"> <li>- Lump sum and re-measured contracts in more volatile raw material markets</li> <li>- Specialized and complex resource requirements and increased regulatory / design constraints</li> </ul>
<b>INVESTORS AND FINANCING</b>	<ul style="list-style-type: none"> <li>- Limited financing needs mainly fulfilled through internal cash flows</li> <li>- Lending based on brand name and reputation (i.e., name lending)</li> </ul>	<ul style="list-style-type: none"> <li>- Larger and more complex financing needs involving several banks</li> <li>- Lending based on cash-flow covenants leading to increased financial transparency</li> </ul>

Source: Booz & Company

## Customer Expectations and Sophistication

As customers' stakes have grown and capital has become more scarce, customers are taking a more active interest in their projects and contractors' activities. Whereas they once focused mainly on time and budget, they are now more deeply involved in every stage of the delivery process, taking an interest in materials sourcing, quality, environmental impact, and other key metrics. They have also moved away from a model in which they relied entirely on their contractors to conduct the different planning and implementation processes, applying limited oversight and quality control via individuals or ad hoc committees. Today, they are increasingly using consultants and internal program management offices to monitor and regularly report on the quality and performance of contractors' work. Furthermore, customers have greater insight into contractors' operations and value drivers, giving them the leverage to demand more competitive terms regarding pricing, deadlines, quality, and other key variables.

## Competition

Growth in the region is shifting into new geographies and sectors, with a pronounced impact on three key dimensions of operations. First, international players have entered the region, and regional players have expanded beyond their previous

national markets. For example, in 2006, most of Arabtec Holding's projects were in the UAE. Now, it operates in Qatar, Pakistan, Saudi Arabia, Russia, Jordan, and Syria, among other markets. This new region-wide competition requires companies to evaluate where they have the capabilities and scale to compete, and to focus on growth opportunities in markets where such capabilities and scale are present, or can be built. In turn, companies should not stay in markets where they lack such capabilities and scale, even if they retain a connection to that market through past work.

Second, competition is now heightened in specialty sectors of the industry. Because of a slowdown in certain types of real estate projects, contractors now focus on other areas, such as infrastructure. This strategy allows contractors to diversify their portfolios, moving away from civil construction for real estate projects and into other sectors that remain strong, despite the cyclical slowdown. However, this shift means that contractors chasing new business in strong sectors are infringing on one another's territory in ways that they hadn't done previously.

Third, contractors can rely less and less on the tight-knit networks that allowed them to serve, often without competition, as the preferred suppliers of services. With these networks

in place and business often assured, contractors had to focus on scaling up capacity to meet demand—and did not focus enough attention on their pricing, margins, or long-term operating efficiency. Now, these national and relationship-driven networks are slowly yielding to a far more competitive system dominated by price competition, strict prequalification criteria, bid reviews, and rigorous tendering processes.

These shifts in the competitive landscape have blurred the boundaries between large companies and mega companies, and have driven many small and medium-sized companies to reevaluate their position in the market to continue to grow. Companies, especially in the latter group, will need to either grow through mergers or differentiate themselves through specialization.

## Suppliers and the Supply Chain

As customers exert greater control over project management, they are pushing contractors to assume greater levels of risk—for example, moving from cost-plus to fixed-price contracts and thus making contractors absorb increases in the costs of raw materials. This change is further exacerbated by growing volatility in the environment for raw materials. Contractors therefore have to more closely manage those costs and develop strategies to minimize the possibility of cost

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overruns. In addition, the increasing complexity of GCC projects means that materials themselves are more complex. Regulatory standards for construction, some of which stem from environmental policies, have pushed contractors to develop efficient ways to source special materials and supplies, such as specialized insulation materials. This trend affects equipment needs as well: The complexity of projects has placed a new burden on contractors to source advanced and specialized equipment for projects—equipment that may sit idle and depreciate when the market slumps. These trends in sourcing both materials and equipment have challenged contractors to focus on improving their financial risk management through hedging as well as their supply chain strategies.

These supply and equipment issues also apply to human capital. Because of projects' growing complexity, those employees who can handle specialized tasks are in demand. Contracting companies that deploy just-in-time labor models are discovering that it is harder to find the more specialized and advanced skills required by today's projects. At the same time, employees on projects need to have a broader range of skills than they once did. Therefore, companies need to develop strategies to source and develop their human capital, and manage that capital for maximum benefit across their portfolio.

#### **Investors and Financing**

Previously, contractors could obtain working capital for projects either through internal cash flows or through

bank loans secured on the basis of their brand name and reputation. The recent financial crisis and increased size and scale of projects now preclude contracting companies from using only cash flow for projects; indeed, some projects require preapproved financing as part of the bid. Therefore, companies are seeking larger and more complex financing structures involving several banks. Following the credit crunch, name lending has largely disappeared, and financing is becoming an issue for many contracting firms. Most important, the new financing environment has increased the demand for financial transparency and strong cash management systems. Although some firms find these demands challenging, the end result is likely to be an industry featuring stronger overall financial discipline.

*Contracting companies that deploy just-in-time labor models are discovering that it is harder to find more specialized and advanced skills.*

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## GCC CONTRACTORS ARE HAMPERED BY INTERNAL WEAKNESSES

Despite the significant changes in the contracting industry, few contracting companies have evolved their operating model to accommodate this change and position themselves for future growth. Many have outgrown their organizations and are not taking full advantage of their scale; many have invested in the right systems but fallen short of their goal of fully implementing them. And in their relentless focus on meeting customer demands for greater cost control and on-time delivery, they have not yet expanded their attention to other critical issues such as construction quality and contractual relationships.

Indeed, these companies are executing projects using the same project structures and procedures used a decade

ago, with little attention paid to the new demands of the marketplace. As a result, even successful companies have developed internal weaknesses in their operating models. In order to properly prepare themselves for the next inevitable surge in demand, contracting companies must address this problem with a systematic review and reevaluation of their organization, systems, talent, and priorities.

### **Fragmented Operating Models**

During the rapid growth of the industry, most companies focused on delivering individual projects successfully, rather than building well-integrated organizations to become more competitive in the long run. The result is an industry whose organizations are marked by often fragmented operating models in which key pieces of the business do not communicate, share information, or coordinate. Often the only linkages that tie a company together are a few support functions and common shareholders. The fragmented nature of operating models becomes clear only when a problem emerges. Frequently, that happens the first time two important but separate functions—such as tendering and purchasing—communicate with each other over a project in a meaningful

way. In such a case, what it takes to do a job and do it efficiently is not known to the tendering function; the result is either unexpected costs or unrealized efficiencies.

Lacking a corporate center to provide strategic guidelines, general oversight, and risk management, key functions have been managed informally or scattered across the organization: These include functions such as HSE (health, safety, and environment), human capital development, business development, and finance. A survey of 10 of the region's largest firms showed that only two had a risk management department and that corporate finance strategies were, to a large extent, missing. Moreover, although the majority of the selected sample had dedicated corporate-level staff for HSE, our experience indicates that HSE strategies are not uniformly implemented across corporate and project organizations, increasing the potential for public scandals and damage to companies' reputation. The lack of coordination and communication hurts operations as well. When large contracting companies fail to take advantage of their scale to share best practices and manage resources, equipment, labor,

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and engineers across their business units, the units themselves become possessive of resources, creating further inefficiencies. And because each business unit evaluates and manages risk on its own, the company does not have good risk controls that take into account its entire portfolio.

The problem of fragmented operating models has multiplied as companies expand their personnel into new sectors and geographies. Many business units in different geographies have limited say over strategic decisions, leading to delays in operations and decisions not in line with market realities. And yet, most operational responsibilities are fully delegated to business units, depriving central managers of the ability to oversee operations to ensure consistent delivery of quality and make use of best practices and lessons learned. For example, project managers in many contracting companies are not allowed to purchase raw materials during price spikes, which can jeopardize projects' timely delivery. Because those supply chain decisions are made by central managers, the focus remains on achieving predetermined cost targets, not on hitting project deadlines, which are often far

more critical to the project's long-term success.

Fundamentally, the presence of highly independent units means companies fail to set organizational priorities such as regional and sector growth targets. They also fail to manage business operations efficiently and exchange vital information between units. Such companies forgo the benefits that should come with synergies: economies of scale and knowledge sharing.

#### **Underused Systems and Information Technology**

Although most large contracting companies have invested in necessary information or enterprise resource planning systems and attained external certifications, such as ISO 9001 quality management system certification, they have often failed to integrate these systems and processes into day-to-day operations. Indeed, companies are often ill prepared to use these advanced IT systems—because most staffers are transient, recruited for one project and then let go. There is no institutional knowledge of the systems. On rush projects, in particular, newly hired staffers are thrust into projects with little to no training on the company's systems.

In other cases, people are unwilling to give up their old and comfortable ways of accomplishing tasks. This is especially true at the project level and in organizations with lax environments and limited enforcement. For instance, some zones and sites still use Excel-based shadow schedules despite the fact that the project has installed scheduling and planning software such as Primavera—which, in any case, is not updated regularly.

These patterns represent not merely a lost opportunity, but an invitation to diminished work quality and lost profitability. When companies do not use their system investments effectively, they lose control over key processes and therefore over their finished product. The cost to companies comes in the form of inefficiencies in virtually every aspect of operations, stemming from the need to redo work that was not done correctly the first time.

#### **Underdeveloped Human Capital Strategies**

In their growth spurt over the past decade, contracting companies did not give sufficient attention to talent development. Many hired professional engineers and labor in a rush without a long-term development

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plan, with limited integration effort, and in many cases without appropriate due diligence. The endemic problem is exacerbated by the fact that the estimation departments of contracting organizations often neglect to budget for training in their pricing of projects. In fact, this is symptomatic of the organizations' shortsightedness in considering staff—especially project staff—temporary instead of focusing on the long-term value to clients of a stable workforce. This has left contracting companies lacking employees with the capabilities required for sustainable growth, such as quality management, health and safety, and finance and human capital management. In addition, the employees who have been hired often come from a diverse mix of cultures and nationali-

ties, bringing with them their own way of work and values, and making it more difficult for the company to create a coherent culture. Without a concerted effort to unify human capital strategies, it will become even more difficult to coordinate strategy and decision making.

This is all part of a broader challenge of managing talent. With rapid growth, employees thrust into greater management responsibilities either were unprepared for the scale of changes or had limited experience, or both. Compounding the problem has been the trend of handing ever more responsibilities to employees within the company who already cope with many tasks. This in turn has led to the consolidation of decision-making

power among a small circle of people, some of whom do not have the experience or qualifications required to handle all their responsibilities. As a result, managers fall short in their ability to handle challenges unique to their companies, such as far-flung supply chains and complex financing.

Companies have not anticipated this problem. Indeed, they have worsened it by continuing to rely on temporary and transient staff. This deprives firms the institutional knowledge gained from each project and creates a need for still more staff training, which most companies don't do properly as it is. As a result, the quality of services offered by the company decreases, because most of the work ends up being performed by untrained staff.

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## CRITICAL IMPERATIVES

In order to make the necessary adjustments to their operating model without losing momentum in their current operations, companies must approach change in a synchronized manner. They can take five clear steps toward creating a more sustainable operating structure.

**Revise corporate strategy.** The proliferation of business lines, new markets, and types of operations has created a web of sometimes conflicting priorities, with few efficiencies of scale and a diminished capacity to take the lead in certain segments. Therefore, companies must focus on those sectors, activities, and geographies where they enjoy competitive advantages and deep expertise in meeting customer demands. As part of this process, companies need to analyze where they enjoy geographical and sector strength, where those strengths complement each other, and where there is room to grow further. This process of discovering capabilities, and selecting and rejecting strategic focus areas, will affect virtually every action that follows,

from use of capital to talent retention and acquisition. It is the basis for a corporation's ability to have the right to win consistently.

After this first step, companies need to determine how they want to play in each target market. Do they want to be full-service contracting firms or focus more on specific business lines? This process is essential; it will determine how much they invest in those core activities that provide their greatest market differentiation, and whether they need to build an internal team for most tasks or can instead use a network of subcontractors. And finally, companies must evaluate whether their strategic focus will require involvement in adjacent services, such as equipment leasing or labor camp management, to match their existing strengths. Companies may find that many of these adjacent services appear to be attractive initially, but are ultimately not worth the investment of time and capital compared with investments in core capabilities.

Following this process, any nonessential or uncompetitive operations should be divested, spun off, or outsourced. Companies could consider outsourcing non-core services, such as project site management and catering for workers. Adopting an "asset-light strategy" would allow contracting

companies to be nimbler and help them to ride out industry cycles.

**Focus on results, not just processes.** Many GCC companies have a tendency to put in place processes related to various corporate activities—for instance, through the use of manuals or industry standards—and follow those processes by rote, without sufficient attention to whether or not they are delivering the desired results. In procurement, for example, contracting companies might have an automatic process for seeking three bids for their tenders—but often give too little attention to the truly critical elements of the bid process, such as evaluating vendors' delivery delays, capacity, backlog, expertise, and track record. As a result, companies end up with underperforming vendors—even though they have followed their vendor-selection process to the letter.

Another case in point is ISO certification, the nameplate for quality certification. Many contractors have gone through the laborious process of getting certified, developed comprehensive manuals, and set up yearly management improvement reviews, but still face significant shortfalls in achieving the desired level of customer satisfaction.

To succeed in changing the culture of a company and the behavior of

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employees in deploying standardized systems and processes, companies and employees need to focus not simply on what they are doing but on what they are accomplishing. Those charged with implementing new systems, processes, and standards will need to understand how their effort will contribute broadly to the company's progress, and how they will be held accountable for the results they achieve by deploying those systems. This accountability will have to be present for everyone, from senior executives to site supervisors and foremen, each of whom will need to be held to a performance target.

***Prioritize and proactively manage the change.*** Contracting companies in the GCC region may seek to launch a myriad of initiatives to improve their operating model, ranging from organizational restructuring to implementing a new project quality plan template. But one of the most significant mistakes that managers can make when retooling an organization is trying to tackle too many things at once. In doing so, they may introduce change either improperly or too superficially, and run the risk of confusing employees regarding company priorities

or having them lose interest in the process. To counter this, managers need to prioritize areas to change, and focus first on those most important to improving the operating model, on the basis of two elements: How essential are they for the development and sustainability of the company's core capabilities, and what is the degree of risk presented if they are not implemented? For many contracting companies, a focus on quality might be a main priority and a major risk area if not implemented correctly. Cash flow management might not be a top priority for some contracting companies, but for those pursuing larger projects, poor cash flow management could become a significant risk.

Once priorities are set, contracting companies need to ensure there is a central body at the highest level of the organization ready to manage or coordinate the execution of these initiatives. This is true even if change items appear to be independent of one another, since coordination is critical to the success of any strategic priority. For example, a change in the procurement process will affect the ability of project managers on job sites to meet deadlines.

***Use technology—but use it wisely.*** Technology is critical to supporting these priority efforts, yet businesses must be selective in deploying it. Companies need to determine what is vital to their success—and technology investment will need to be prioritized accordingly. For example, an enterprise resource planning system can automate key decisions and processes, so it should be designed and implemented only after a company has first developed its strategies and policies for such decisions and processes. The system is an enabler of strategy, not a substitute for it. Contracting companies need to use technologies that help them deploy productive assets (e.g., cranes) and people (e.g., project managers, engineers, and laborers) as effectively as possible. Other technologies, such as those that keep track of historical tenders and performance and bills of quantities for reference, or computer-based tendering processes that accelerate bid production, also can be essential for the efficiency of contracting firms. In every case, companies first need to decide what they want to accomplish, then get the system to fit their goals. If they buy the system first, and establish

***Technology is critical to supporting these priority efforts, yet businesses must be selective in deploying it.***

priorities and processes later, they may have wasted their initial investment because the systems will end up being retrofitted.

***Build and invest in all generations of talent.*** In keeping with the industry's overall growth, GCC companies have hired a lot of new employees, and they possess innovative perspectives, new technical skills, and an entrepreneurial approach to doing business. This generation of new workers must be integrated fully into the firm, without causing a loss in the contribution of incumbent employees, who have established a strong record of leadership throughout the industry. The older generation embodies the values of the company and defines its purpose, and often has critical proven business acumen, contacts, historical perspective, and knowledge of customers and prospects. These employees know the ins and outs of the operations, the details of the company, and the best ways to navigate both booming and declining markets. Most important, they have gained the trust of their shareholders over a long period.

Companies take a significant risk when they add new workers with-

out integrating the contributions of the older generation; the incumbent employees might choose to keep their knowledge and expertise to themselves and maintain tight control over power and decision making. This can compound the human capital problem by frustrating the ideas and ambitions of the new generation and by creating bottlenecks for operations. And if the older generation's knowledge and perspective are not sufficiently captured and shared, when they leave the firm, they take their experience along with them. The result is a knowledge vacuum that causes delays and misuse of resources. Indeed, succession planning and institutionalization of corporate know-how are essential solutions to the same problem.

This is a cultural challenge for many firms. There is frequent conflict between the new and old generations in terms of how to solve problems and make decisions. Often, the old generation believes that systems should not be improved unless operations come to a halt, whereas the new generation trusts that there is continuously room for change and improvement. Therefore, in order to achieve long-term success, it is pivotal for com-

panies to integrate the two groups. First, companies need to routinely tap and capture the perspectives of their valuable incumbent employees, and have them impart their experience to new employees regularly. Second, companies need to create forums for open interaction and collaboration between the old and the new generations of workers. And third, companies need to set expectations for the older generation to be more open to the contributions and ideas of the new generation, regardless of their rank and years of experience.

And no matter which generation is involved, contracting companies need to invest in developing their talents and skill sets. For project site personnel, companies should gradually develop a culture of certification starting with project managers, engineers, foremen, equipment operators, and some set of laborers. Most important, companies should focus on developing their engineers across various disciplines in order to see them eventually become project managers. This can be accomplished through the creation of disciplined rotation programs for new engineers.

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## A STRATEGY FOR LONG-TERM GROWTH

The GCC contracting industry, although buoyed through the economic crisis by a significant influx of government megaprojects, nevertheless faces several challenges stemming from strategic and operational weaknesses. These weaknesses crept unnoticed into the firms during a period of rapid growth, but they represent a long-term risk to their ability to prosper further. To identify and address these weaknesses, companies will need to conduct a comprehensive review of their strategic focus, identify where they can dom-

inate the market for their products and services, develop performance-based processes, focus on priority projects first, deploy technology selectively, and fully train and integrate new and more senior workers. The end result will be far more streamlined operations, more competitive positions in key markets, and a stronger foundation on which to build. Those that adjust their organizations to close any existing gaps will be well rewarded as the overall market strengthens around them and they emerge as market leaders.

## Endnotes

<sup>1</sup> The GCC consists of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

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