

### **Cost reduction and employee expenses**

Construction companies are continually under pressure to be cost effective, perhaps unsurprisingly as margins have been under pressure for many years, with net margins ranging between 1% and 3%. The recent downturn in the world economy has, in many instances, exaggerated this pressure hitting all aspects of construction hard – in particular private building and house-building. Some companies are weathering the storm better than others through strong order books of work, broad construction capabilities and fiscal stimuli bringing forward government capital spending.

### **The downturn could be prolonged**

However, construction is one industry that could have a prolonged recession. This is because existing construction commitments will be completed over the next 12-18 months, and with limited new builds outside of government programmes, backlogs of orders will start to look bleak.

Once the global economy starts to grow again, there will also undoubtedly be severe cutbacks in government spending in parts of Europe, as countries seek to balance their books and spend less to offset the large borrowing of prior years.

Integration into service operations has provided a cushion for many construction companies which were able to take advantage of PFI and build-operate arrangements, among other long-term service agreements. However, these are usually renewed over a period of between three and 30 years. Shorter-term arrangements will suffer as customers look to reduce their own cost bases, and more competition is possible as companies seek to use their existing workforces while diversifying into less volatile revenue streams.

As the market power moves from supplier to buyer, construction contractors will be under significant pressure to adopt higher risk contracting strategies, such as lump sum turnkey (as seen in petrochemical construction in the early 1990s when oil prices were low).

Therefore, you could argue that there has never been a better time to start a sustainable cost reduction programme to gain competitive advantage. However, cost reduction is not only about battening down the hatches, slashing overhead and operational budgets, and making the remaining staff work harder.

The key to real cost reduction is taking a balanced portfolio of cost out of the business, and using a structured and sustainable method for reducing the overall business cost model.

### **Operational efficiency**

Longer-term cost reduction requires a fundamental change in the way that operational processes are executed, so that the underlying cost base is sustainably streamlined.

Changes in operational efficiency take longer to implement than tactical improvements because they require more detailed analysis of how a particular process is performed before improvements are made, and because existing commitments may need to lapse before new improved methods can be used.

The level of operational efficiency required in construction is heavily dependent on the contractual relationship with the end customer. Key factors in terms of costs are safety, timings and quality. Understanding processes and addressing operational efficiencies behind these key elements can generate required improvements, ultimately reducing associated costs and creating competitive advantage.

Other areas companies should focus on include back office processing, corporate support services, and operation and maintenance services, where highly repetitive processes can be analysed and streamlined to bring down costs.

### **Strategic redefinition**

Using this approach, the fundamental way that a business operates is challenged and addressed from the top down in order to lower long-term costs. New ways of working are developed which make the best use of technology, organisation design, strategic partnering and global resource pools.

One example of strategic redefinition is a new trend for developing detailed design centres of excellence. High-level concepts are prepared by a company and then sent to design centres in countries such as India. The result is that the cost of detailed design is significantly lowered.

**A structured approach**

Delivering a large-scale cost reduction programme requires an organisation to put in place the correct structure for delivery and provide support from an engaged leadership team. Further embedding a culture of continuous improvement and low costs requires active change management to nurture and grow the organisation long-term, while at the same time addressing short-term organisational concerns about job security.

The construction industry is facing its toughest environment for a long time. Pressures to reduce costs are now greater than ever and will remain long after the recession headlines have disappeared. Therefore, companies must resist the temptation to wield the axe now only to erode their ability to deliver on cost, quality and timing in the future. Step back, take a structured look at how you do business and deliver cost reduction in a balanced and sustainable way. Lay the foundations to deal with the pressured times ahead.