Navigating the storm
Charting a path to recovery?
Global Construction Survey 2009
Commercial and residential building work is inevitably suffering as funding dries up in the wake of the financial crisis. Yet the promised huge government stimulus packages have the potential at least to reinvigorate the infrastructure market. How much public money will be made available – and where it will find its way to – is a matter for much debate in the boardrooms of engineering and construction companies around the world.

It’s also easy to forget that just a year and a half ago, contractors were actually turning down work due to a lack of resources. Indeed, respondents to KPMG’s 2008 Global Construction Survey singled out a lack of skilled people as the biggest challenge facing the industry. The economic downturn has forced some construction companies to reduce staff numbers. Others however may prefer to hang onto their talent in the hope of an imminent turnaround in fortunes – remembering just how hard it was to build up their current roster.

The industry’s risk management practices have also come under the spotlight in recent years and many companies have invested heavily in improving their risk-related policies and controls (something also highlighted in our 2008 survey). In these turbulent market conditions, risk management may be more critical than ever to help ensure future success, yet at the same time there’s considerable pressure to cut back on such expenditures.

To find out how the sector is coping with these and other pressing issues, we sought the views of top management of more than 100 of the world’s leading engineering and construction companies in this, our fourth annual survey. Their responses – which have been augmented with specialist commentary by experienced advisors from KPMG member firms around the globe – offer a compelling insight into the industry at a unique moment.

I would like to thank all those who offered their valuable time to help complete the survey.

Geno Armstrong
International Sector Leader, Engineering & Construction
KPMG in the U.S.
L’Hemisferic, 3D cinema and science museum, in ciutat de las arts (city of arts), Valencia, Spain
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Executive summary

Escaping the worst?
Despite the deepest recession in 60 years, the construction industry is surprisingly positive about its future prospects, according to KPMG's 2009 global survey. Almost two thirds (64 percent) expect to either increase or at least maintain profit levels by mid-2010.

To date, the sector appears to have weathered the economic storm, with around half of respondents reporting order books and profit rates at similar or greater levels than 12 months ago. After a number of years of under-capacity, some balance seems to have been restored.

However, as longer-term projects wind down for some contractors, much may rest on the impact of the proposed government stimulus packages. Here, substantial uncertainty prevails, with only a small minority of respondents believing that these will bring significant opportunities.

Keeping a firm grip on talent
Workforce rationalization has been surprisingly limited, with most contractors choosing to retain their best people. In the face of funding constraints and project cancellations, more than a third of respondents have still managed to avoid any job cuts...and few have felt the need for salary reductions or freezes, or shorter working hours.

After years of struggling to attract good candidates, the industry is clearly loath to now let them go. This marks a change of direction from previous recessions, when many employers made deep workforce cuts, only to suffer again once the upturn arrived. However, there is still a question mark over how effectively the industry is nurturing future talent.

Risk management has arrived
The sector continues to embrace risk management, with almost three quarters of respondents devoting more time and resources to this critical activity. Having invested heavily in project risk management over several years, engineering and construction companies appear to be embedding such an approach, with greater due diligence on bid opportunities and more focus on cash flow, compliance and safety risks.

By placing a big emphasis upon bid evaluation risk, contractors have been able to reduce their exposure to cost volatility and avoid an increase in the proportion of high-risk contracts. Cash management – which received less attention during the boom – has become a bigger concern, with some companies linking cash flow performance with rewards.
Construction companies recognize the need to adopt sustainable policies and maintain strong health, safety and environmental programs. However, in this sector, being green – along with being safe – is rather seen as a minimum requirement to meet customer demands, and is more about efficiency than environmentalism. Respondents have invested in both sustainability and safety, yet some are still struggling to measure the return on this outlay.

The responses also demonstrate a great deal of concern about the impact of proposed changes to revenue recognition. The industry as a whole has been lobbying against such changes, fearing that they could create volatile earnings flows, as revenue would only be recognized once a project was completed. This may not only impact the views of analysts and investors; it could also make it hard to satisfy ongoing debt repayments. There’s far less worry about International Financial Reporting Standards (IFRS). Only a small minority feels that conversion to this new body of standards will have a negative impact upon their business – either now or in the future.
“Our margins have stayed steady as they’ve flowed from a previously secured order book.”

Respondent, Australia
A surprisingly positive outlook
Sales, profits and future prospects

As the world economy moves tentatively out of recession, many engineering and construction companies are unexpectedly upbeat about their future prospects. A majority of respondents expect profits to either rise or stay at current levels. There is more of a “wait-and-see” attitude towards the impact of proposed public sector stimulus packages, with concern in some regions over who will enjoy the benefit of such initiatives.

Given the intensity of the credit crisis, the construction industry has proved remarkably robust, according to our 2009 global survey. A majority of respondents report that backlog volumes and profits have either increased or remained the same over the past 12 months.

In the 2008 KPMG Global Construction Survey, companies spoke of having to turn work away due to a lack of capacity. Following several years of excess demand, the sector may have reached a temporary equilibrium. And, of course, the length of most construction projects means that many contractors may still be working off backlog contracts secured before the financial crisis.

64 percent expect profits to rise or stay level by mid 2010

Changes in backlog in the past 12 months

The story is similar when it comes to profits in the current backlog, with 44 percent claiming a decrease in projected earnings. Interestingly, contractors in Europe, Middle East and Africa appeared to have been hardest hit. The average length of project in this region is typically shorter, which means that more companies may be working on newer contracts at less favorable margins.

When compared to other regions, contractors in the Americas experienced a relatively higher fall in backlog volume compared to 2008 – possibly because the credit crunch was felt earlier there than in other parts of the world. However, this region also saw the best profit performance in the same period, suggesting that companies have been driving efficiencies in the supply chain.
The last year or so has taken an inevitable toll on margins, although not as much as might have been expected. For the majority of those responding, new business has been achieved without large-scale cuts in profit margins, with 31 percent managing to avoid any decreases at all.

During the fast growth years of 2005 to 2008, efficiency understandably took a bit of a back seat. However, once the credit crisis hit home, some contractors may have started to look at ways to make their businesses leaner. As one respondent from the UK commented: “Although prices are under pressure, our ability to drive costs out of the business and supply chain has meant margins have remained the same.”

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**Future prospects**

When asked about the future, most of the respondents are again fairly positive. Almost two thirds (64 percent) are confident that profits will either rise or at least be maintained. Having completed longer-term backlog projects, many executives expect new bid opportunities to arise as a result of pent-up demand from before the credit crisis. Once more, there were some regional variations, with contractors from Asia considerably more upbeat about their prospects. Such a view may be influenced by the substantial government stimulus programs in this part of the world, notably in Hong Kong.
“Some very advantageous changes to supplier contracts have been agreed to – this will have a great impact on profitability within the coming 12-18 months.”

Respondent, Finland

“Hong Kong is seeing the largest-ever infrastructure development in many years.”

Respondent, China

“We’ve dedicated ourselves to the stimulus package and have acquired a government-based business.”

Respondent, Australia
KPMG Comment:
An industry built on firm foundations?

Although the construction sector appears to be in fairly good shape, will 2010 be the year that it feels the pain already experienced by other sectors of the economy? Many companies appear to be living off the profits of contracts secured before the credit crunch, and whether such performance can be maintained is dependent upon a number of factors, not least a general economic recovery.

One key question is whether the projects that were put on ice in the years of under-capacity will re-emerge. Many of these were in the energy sector, and their future funding may be reliant upon prices of oil, gas and other raw materials remaining above certain thresholds.

Of perhaps greater concern is the impact of the much-publicized government stimulus packages; indeed these may already have contributed to the relatively healthy condition of the industry.

In some regions, as the survey shows, there is considerable optimism over government funding. Asia Pacific appears to have been the foremost beneficiary of such aid to date, with China/Hong Kong singled out for particular attention. The political/business environment in this market may simplify the process of initiating and completing public projects, as there are fewer overall contractors, most of whom are either state-owned or have close ties to governing bodies.

In other regions, notably North America and Europe, there is real concern that most government initiatives may be slowed down by the lengthy process involved. And with spending controlled by state and local governments, this is likely to result in projects such as roads and bridges, which are typically carried out by smaller regional contractors, rather than the major players.

A number of bodies, including the World Economic Forum (WEF), are studying government stimuli, looking at how the public and private sectors can work together effectively to get the most out of this funding, reducing inefficiencies and achieving the right balance between different infrastructure projects.

One of the big challenges facing the industry is the positioning needed to make the most of any government support. Companies already strong in infrastructure look to be in pole position for the next few years; others may play catch-up by acquiring businesses with a strong government order book.

Regardless of the perceived benefits of government support, it is likely to have had a positive impact across the business sector in all regions to some extent. The skeptics should certainly consider what the sector may have looked like without such an injection.
Retaining talent

HR strategies

In the wake of the downturn, a majority of contractors have made some form of staff cuts. However, the overall response appears to have been measured, with the recent war for talent fresh in the minds of top management.

Like almost all sectors, the construction industry has chosen to rationalize its staff levels, yet a significant minority of 35 percent has not seen reductions. When you consider that, just a year ago, the scarcity of good people – particularly project managers – was considered the single most pressing issue facing the sector (as highlighted in the 2008 KPMG Global Construction Survey), it’s understandable that many companies are reluctant to let go of hard-won resources.

The reductions appear to have been spread evenly across the workforce. Rationalization of indirect employees such as back-office staff is to be expected, but it’s surprising that a third of respondents have chosen to let go of some project managers, given their relative importance. In previous years, when resources were tight, it’s likely that some inexperienced workers received project management training to fill the gaps. Subsequently, the job cuts may have focused more on this group, rather than on seasoned professionals.

There were some regional differences, with far fewer respondents from Asia Pacific choosing to release project managers. Contractors in this part of the world may be wary of losing such people at a time when more government contracts are being handed out.


diagram

Levels of staff most affected by reductions

Aside from redundancies, few contractors have felt the need for drastic steps to cut workforce costs – and 28 percent have not considered taking actions to align workforce with workload. This suggests that resources are still needed to work on backlog projects, and that many companies are quietly optimistic over future demand. Only a fifth (22 percent) have made salary cuts and only one in ten have implemented pay freezes or low salary increases. Smaller companies with annual turnover of less than US$250 million are far more likely to have decreased employee pay.

“Having been through a down cycle before, we know it is critical to retain key personnel. Our headcount reductions were done with this in mind.”

Respondent, US
Even those who have seen bigger falls in demand seem keen to keep their best people. One respondent from the US noted that: “We’re retaining people with critical skills and keeping them utilized on studies internally or externally in the absence of projects.”

**Steps taken to align workforce with workload**

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<tr>
<th>Percentage</th>
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<tr>
<td>22%</td>
<td>Salary reductions</td>
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<td>18%</td>
<td>Reduced working hours</td>
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<td>15%</td>
<td>Considering but not implemented</td>
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<tr>
<td>9%</td>
<td>Unpaid sabbaticals</td>
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<tr>
<td>7%</td>
<td>Sabbaticals at reduced pay</td>
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<td>10%</td>
<td>Salary Freeze/Low Salary Growth</td>
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<td>Downsizing/Layoffs</td>
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<tr>
<td>9%</td>
<td>Reduction of new applicants/contract workers</td>
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<tr>
<td>6%</td>
<td>Encouraged to take leaves</td>
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<tr>
<td>5%</td>
<td>No Overtime payments</td>
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<tr>
<td>28%</td>
<td>Not considering</td>
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<tr>
<td>9%</td>
<td>Other</td>
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Number of respondents: 108
Respondents could select more than one option
Source: Navigating the storm: Charting a path to recovery? Global Construction Survey 2009, KPMG International

The overall confidence in the sector is also reflected in future HR plans. Of those who have not yet let any staff go, only a third (35 percent) expect to do so over the next 12 months.

**Building and maintaining a strong team**

The economic downturn has, temporarily at least, provided some relief from the battle for scarce human resources. In the 2008 survey, an overwhelming majority of 84 percent felt that the industry as a whole was not doing enough to address skills shortages. Yet in 2009, the focus on recruitment and retention has been less intense.

Only a quarter (24 percent) of all respondents feel the need to offer better compensation packages to attract candidates. Such a practice is far more common amongst contractors with an annual turnover of less than US$1 billion, and is particularly popular in the Asia Pacific region. Such a move may well be linked to the aforementioned generous government stimulus packages in this part of the world, making construction companies keen to boost their resources.
How is your organization attracting the best people?

Not all companies are quite so bullish, as evidenced by this Australian respondent: “Staff retention is not seen as an issue as there are limited employment prospects in the industry. The collapse of construction in Dubai has seen people return to Australia, increasing the labor supply in most relevant disciplines.”

Only 27 percent of respondents are building relationships with top academic institutions to attract candidates. This is somewhat surprising given that such links are considered an important way of attracting high-quality graduates into the industry.

Retention of key talent is however still viewed as critically important. The survey participants are employing a wide range of efforts to retain good people, focusing on training and education, improved communications, and giving greater responsibility to individuals. Companies with annual turnover of more than US$1 billion are paying greater attention to succession planning, perhaps wary of the demographic change in many societies that is hastening large-scale retirement of older, experienced workers.

42 percent of respondents from Asia Pacific are using higher compensation packages to attract the best talent.
The war for talent has not yet been won

The recession may have temporarily eased the skills shortage, but the industry should not forget the clear message from the corresponding 2008 survey: the need to attract high-quality people into a career in construction.

There has certainly been a reluctance to let too many employees leave, resulting in relatively few job cuts. Understandably, the majority of losses have involved indirect labor, with companies careful to retain project managers in particular.

However, only a small proportion of respondents seem willing to invest in relationships with schools and universities, which is a concern given that construction has to compete with other engineering sectors for the best young talent. Professions such as accountancy, law and consultancy have placed a big emphasis on establishing a strong reputation on campus, painting a picture of exciting careers with a variety of options. In a 2009 KPMG survey of private infrastructure providers¹, 54 percent cited the need for early education and awareness programs to attract good people into the industry.

According to one European respondent we spoke to: "The skill shortage is a huge issue, and is expected to remain so for many years to come." The industry should be prepared to make the appropriate investment in talent to help ensure a future supply of qualified professionals.

Another challenge facing some companies is to broaden the skill base, as they seek to gain a share of anticipated new infrastructure contracts. Some of the executives taking part in the survey suggested that they may have to acquire companies with infrastructure expertise, although these may be relatively small-scale purchases.

The ultimate test of the sector’s HR strategies will come when demand starts to rise again. Only then will engineering and construction companies discover whether their investment in good people has given them sufficient capacity.

¹The Changing Face of Infrastructure, Frontline Views from Private Sector Infrastructure Providers, KPMG International/Economist Intelligence Unit, July 2009

"The skill shortage is a huge issue, and is expected to remain so for many years to come."

Respondent, Luxembourg
A growing emphasis on risk management

The recession appears to have intensified contractors’ efforts to manage the risks associated with projects. What was once considered a weakness of the sector now seems to be receiving extensive attention.

Many of the companies participating in this survey have devoted considerable time and resources to improving risk management, through investment in systems and more comprehensive assessment and management of risk. Some companies are focusing on due diligence, checking the credentials and financial stability of clients; others are carrying out more in-depth analyses of performance risks on mega-projects. A vast majority (73 percent) of respondents say they have increased their focus on risk management in the past 12 months.

The following comment from one Japanese participant is fairly typical: “We’re increasing the level of control over risk management before accepting orders from customers, including tightening up our credit exposure management.”

Larger contractors with annual turnover greater than US$5 billion have been the most attentive to risk issues, which is to be expected given the scale of many of their contracts.

73 percent are devoting more time and resources to risk management

“...We’re entering into more strategic partnerships and joint ventures when executing larger projects, in order to spread the risk and leverage key strengths.”

Respondent, US

By far, the single biggest concern when evaluating a project is the bid evaluation stage, according to respondents. The smaller companies taking part in the survey consider this phase less critical; it’s possible that their risk management processes are less rigorous, or that the size and complexity of their bid opportunities are lower.

Less than one in ten (9 percent) cited commodity pricing as a pressing element of their project risk management, which suggests that customers or subcontractors are taking the main risks, providing greater price certainty on steel, coal, cement and other key materials.

Contractors appear to have management of cost escalation under control – which is consistent with the findings of the 2008 KPMG Global Construction Survey. These risks are either dealt with through cost escalation clauses in customer contracts, or else they are passed onto subcontractors in the form of fixed-price contracts.
Most pressing element of project risk management

Given that the credit crisis has delayed or even led to the cancellation of some projects, it’s interesting that respondents do not expect buyers to assert greater power by insisting on more fixed price contracts in 2010. Indeed, in the Americas region, the incidence of fixed price contracts with customers is predicted to decline in this period.

Predominant contract types 2009 – 2010 (expected)

Managing cash in a downturn

In the recent boom years, there was arguably lower priority given to cash management, so it’s no real surprise that a number of respondents now report falling operating cash flows along with a decline in advance customer payments. The pressure on margins has probably been an influence.

The credit crisis may have ushered in a more diligent approach and the following quote from a construction professional in Australia may reflect a growing trend: “By setting performance measures other than profits and overhead, we aim to educate staff on the importance of good cash flow management and how it impacts the business.”

Impact of current economic conditions on liquidity

Number of respondents 108. Respondents could select more than one option.

Source: Navigating the storm: Charting a path to recovery? Global Construction Survey 2009, KPMG International
The sector’s risk management has been under the spotlight for some time. The World Economic Forum set up the Engineering Construction Risk Institute in 2005, and one of its first reports estimated that under-managed project risk alone was costing the industry US$3 - 4 billion annually in profits\(^2\). Executives taking part in the 2007 KPMG Global Construction Survey also cited risk management as the industry’s number one priority.

Our survey findings suggest that there’s since been considerable progress. The sustained investment in risk management appears to be having a positive influence on behavior, with a greater focus on due diligence; greater evaluation of risk at the bid phase and throughout a project; assessment of potential loss-making projects; enhanced oversight of subcontractors; and improved cash flow management.

However, such achievements should also be replicated at an organizational level, which involves looking at some of the broader risks facing the business. These could include emerging industry risks such as available financing for projects, expected levels of government stimuli and availability and cost of energy and raw materials. Scenario planning can play a valuable role in evaluating the impact of such macroeconomic factors.

Another important consideration is aligning risk management practices with corporate strategy. For example, does the incentive structure encourage unnecessary risk-taking (as was the case in the financial services industry)?

Establishing an effective risk culture is also important in encouraging employees to be risk-aware and to take responsibility for their decisions. This should hopefully reduce the prospect of individuals closing a potentially risky deal, and generally assist in balancing growth with prudent behavior.

And, of course, all of these issues need to be part of a broader organizational model, with appropriate processes and reporting that enable management to keep an eye on how and where decisions are made, with clear controls that define individuals’ risk-taking approach.

The industry can feel justifiably pleased with its progress in tightening up project risk management. Those companies that can sustain this momentum across all their activities should not just reap commercial benefits, but also help to satisfy regulators’ expectations of good governance and enterprise risk management.

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"We shall continue to expand our geographic footprint in preparation for economic improvements."

Respondent, Australia
In the midst of a recession, faced with the choice of retrenchment or expansion, it seems that a fair proportion of construction companies are choosing the latter. Almost four out of ten respondents (38 percent) say they’ve continued to develop regionally or globally, whilst only 12 percent have actually contracted their activity. Such assertiveness may be due in part to encroaching competition in home markets by foreign rivals desperate for business.

The economic conditions have not completely dampened ambition in the sector, with geographical growth very much on the agenda. However, few contractors believe sustainability brings genuine competitive advantage, viewing it more as a ‘must-have’ to satisfy clients and regulators.

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“We’re expanding beyond our core focus of building construction to include local and federal government supported infrastructure projects, waterfront and sustainable energy projects.”

Respondent, US

Impact of economic conditions on your service offerings

- 7% We offer new goods and services previously provided by sub-contractors (increased vertical integration)
- 10% We offer new goods and services outside the traditional scope of contractors (increased horizontal integration)
- 20% No change
- 64% We have reduced the number of goods and services we previously offered

Number of respondents 108. Respondents could select more than one option
Source: Navigating the storm: Charting a path to recovery? Global Construction Survey 2009, KPMG International

Sustainability and competitive advantage

Being green may not necessarily bring direct commercial benefits. Although 56 percent say sustainability helps position their organization as being innovative and environmentally aware, a number of the executives involved in the survey feel that this is merely a minimum requirement for inclusion on short lists.

Such a mindset is in stark contrast to the 2008 KPMG Global Construction Survey, where 70 percent claimed that a sustainable approach to construction would lead to increased profits. It’s possible that the recession has reduced the availability of funds to invest in innovation in sustainability.

From a regional perspective, respondents from the Americas were considerably more enthusiastic about the benefits of sustainability, with 56 percent in that region claiming that this capability will get them invited to bid on a broader range of projects.

Advantages of sustainability

- Positioned in the industry as an innovative and/or environmentally aware company: 56%
- Opportunity to partner with additional types of clients: 29%
- Invited to bid on a broader range of projects: 28%
- Enhances our ability to execute projects in new geographies: 21%
- Other: 26%
- Not applicable: 10%

Number of respondents 108. Respondents could select more than one option
Source: Navigating the storm: Charting a path to recovery? Global Construction Survey 2009, KPMG International

When asked what their customers were seeking from sustainability, the respondents cited a profitable and cost-efficient construction process, along with energy-efficient structures, with environmental impact in third place. This suggests that customers are still more concerned about the commercial than the green benefits. Efficiency also figures highly amongst respondents to a 2009 KPMG study of private infrastructure providers where “Making infrastructure more efficient” was considered to be the single most important method to achieve competitive advantage through sustainability.

Footnote: ³The Changing Face of Infrastructure, Frontline Views from Private Sector Infrastructure Providers, KPMG International/Economist Intelligence Unit, July 2009
“Sustainability is not a competitive advantage since all major competitors offer the same standards. It’s a must to meet the benchmark.”

Respondent, Austria

Areas of sustainability considered most important to customers

- Profitability/cost efficiency: 63%
- Energy efficiency: 55%
- Environmental impact: 53%
- Attractiveness to end users/investors: 25%
- Other: 18%
- Many customers aren’t focusing on sustainability: 6%

Number of respondents 108. Respondents could select more than one option.
Source: Navigating the storm: Charting a path to recovery? Global Construction Survey 2009, KPMG International

The issue of safety appears in many ways similar to that of being green: you need to show a good record to compete, but it won’t necessarily differentiate you from your rivals. Therefore, it’s not too much of a surprise that virtually all of those involved in the research have invested substantially in a safety program, and half (49 percent) confirm that these programs continue to be an important criterion when potential customers evaluate their credentials.

From a regional perspective, respondents from Europe, Middle East and Africa feel that safety is far less critical. One construction executive from Australia, on the other hand, noted that: “A safety program will be very important for contract awards – particularly in the government sector.”

Competitive impact of your safety programs

- The company’s safety program has been and will continue to be an important customer evaluation criteria for contract awards: 49%
- The company’s safety program is important, but has not been a significant customer evaluation criteria for contract awards: 22%
- The company has invested significant resources in developing and maintaining a safety program and the return on investment is measured: 14%
- The company has invested significant resources in developing and maintaining a safety program, but it has not been able to measure the ROI: 9%
- The company has invested sufficient resources in a safety program: 5%
- The company has not invested sufficient resources in a safety program: 2%

Number of respondents 105.
Source: Navigating the storm: Charting a path to recovery? Global Construction Survey 2009, KPMG International
According to the survey respondents, a sustainable approach may not win you any business outright – but a lack of it can jeopardize your chances. Yet can being green bring you more than just a place on a short list?

Concern over future energy supplies and CO\textsubscript{2} emissions create a number of opportunities for competitive advantage that have yet to be fully exploited.

In a bid to reduce energy demands and emissions, the World Business Council for Sustainable Development produced a study into creating “zero-net-energy” buildings, utilizing technologies and knowledge available today.\textsuperscript{4} Such structures have considerable cost-saving benefits for customers/buyers and also address ethical needs. The natural next step would be buildings that actually generate energy.

A zero-emission, energy-efficient supply chain can benefit engineering and construction companies commercially, as well as enhance their reputations. One example is the use of concrete, which is acknowledged to be a major emitter of CO\textsubscript{2}. The development and use of alternative materials could potentially reduce building costs and position the contractor as an innovator.

And, looking further ahead, the impact of climate change may call for a different approach to construction altogether, enabling buildings and infrastructure in some parts of the world to better withstand natural disasters such as hurricanes or flooding.

There is some progress being made. As one respondent from Japan remarked: “(We are) focusing on research and development of the environmental issues such as new energy, land pollution, and global warming. We’re even establishing a head office of environmental business, pulling together our environment-related operations.”

Changing the business model to truly integrate sustainability may be a bold move, but, with the right investment in innovation, it may also be a wise move.
The construction industry has been lobbying heavily to be exempted from any accounting rule changes on revenue recognition. These have the potential to radically alter the timing of when revenue – and thus profit – is recognized, which could lead to a series of peaks and troughs. This could paint a distorted picture of a company’s financial condition and confuse analysts and shareholders.

Only 7 percent believe that such a move would actually lead to an improved understanding of company performance. And almost two thirds (63 percent) feel revenue recognition would either reduce understanding of results or degrade the ability to forecast revenues and profits. In short: most feel that existing revenue recognition standards are more aligned with the nature of construction work.

The opposition was most strongly voiced by respondents from the Americas region; in the US, the practice of “percentage-of-completion” accounting is particularly well-established.

A majority of those taking part in the survey are concerned about the impact of proposed changes to revenue recognition. Feelings towards IFRS are less strong, with many taking a neutral stance towards these new reporting standards.

IFRS, on the other hand, provoked far less emotion. Those respondents from companies that have already adopted the new reporting standards are mostly either positive or neutral about their impact. And, for those still awaiting the conversion to IFRS, fewer than two in ten (18 percent) express negative feelings on how it may affect their business.

Views on the proposed accounting rule change on revenue recognition

<table>
<thead>
<tr>
<th>Views</th>
<th>Positive Responses</th>
<th>Negative Responses</th>
<th>Neutral Responses</th>
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<td>An improved understanding of company’s</td>
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Number of respondents 108
Respondents could select more than one option
Source: Navigating the storm: Charting a path to recovery? Global Construction Survey 2009, KPMG International
The future shape of the industry
The changing nature of the construction sector may impact its structure. The growth in mixed-use, inner-city developments – fueled in part by government stimuli – calls for a wider set of skills than is available in many smaller construction companies, which may lead to a rise in joint ventures. Furthermore, the increasing complexity of projects, restricted access to capital, and more stringent planning regulations (often for environmental reasons) all favor larger businesses, which could mean more acquisitions.

Therefore, it’s no big surprise that almost three quarters (73 percent) of respondents expect to see more consolidation, as competitive advantage becomes more and more dependent upon size. Contractors in the Asia Pacific region expect relatively less consolidation, possibly because, in markets such as Australia, the established players are already fairly large, as well as being limited by strict competition rules.

Expected consolidation between mid 2009 and end of 2010

- Significantly more consolidation: 23%
- Slightly more consolidation: 26%
- No change: 2%
- Slightly less consolidation: 50%

Number of respondents 105
Source: Navigating the storm: Charting a path to recovery? Global Construction Survey 2009, KPMG International

Impact of IFRS
(Where the country in which you are headquartered has already adopted IFRS)

- Positive: 14%
- Neutral / No specific benefit or harm: 29%
- Negative: 57%

Number of respondents 94
Source: Navigating the storm: Charting a path to recovery? Global Construction Survey 2009, KPMG International

Perception of the impact of IFRS
(Where the country in which you are headquartered has not yet adopted IFRS)

- Positive: 18%
- Neutral / No specific benefit or harm: 18%
- Negative: 64%

Number of respondents 95
Source: Navigating the storm: Charting a path to recovery? Global Construction Survey 2009, KPMG International
KPMG Comment: A difficult break from tradition

The proposed new accounting rule change on revenue recognition has set alarm bells ringing in many parts of the industry. The long-established usage of “percentage-of-completion” (POC) accounting that has existed in many regions is now under threat.

The way that revenue is recognized differs from country to country, so the changes are likely to have varying degrees of impact. For markets such as the US, UK and Australia, where engineering and construction companies primarily employ POC, the concern is understandable. In certain European countries, where POC arrived recently with the adoption of IFRS, the proposed changes can mark a possible return to old ways.

The construction industry has certainly been vocal in its opposition. The proposed changes have the potential to delay revenue recognition for a project until that work is fully completed. For a longer-term project, that could mean several years of zero revenue. This could endanger certain business models and possibly deter those considering financing a project. (However, the impact could be countered by dividing a project into different segments, dependent upon completion times.)

On the plus side, the proposed new rules do take some of the risk out of a project. Under the existing approach, the revenue recorded earlier in the project is based on a number of assumptions that may change, such as material and resource costs. If these costs go up or down, then the initial revenue recorded may be revised in subsequent periods. By waiting until completion before showing revenue, virtually all costs have already been incurred, thereby removing the need for profit estimates over the life of the project.

The situation regarding revenue recognition is currently one of “wait and see,” as the International Accounting Standards Board (IASB) mulls over the exposure draft that discusses the potential new rules.
Conclusions: next steps

So far, the construction industry appears to have weathered the economic storm – but how well-positioned is it to thrive in the future? This survey has raised a number of questions the sector should seek to address:

Evaluating and exploiting future demand
The sector has been shielded so far from the worst of the recession, due to the longer term nature of construction projects, previous under-capacity, and the impact of government stimulus packages. Companies should now identify sources of future growth, whether in the energy sectors or in infrastructure projects resulting from the aforementioned stimuli. By closely monitoring opportunities, they can position themselves to benefit from such projects.

A continued need to invest in talent
Even at a time of rising unemployment, contractors should continue to plan for, and build, the workforce of tomorrow. This should involve greater engagement with schools, colleges and universities, as well as secondments and other part-time opportunities. This can help inspire a new generation of talented construction professionals.

The increasing investment in infrastructure projects demands new kinds of skills for those businesses not strong in this area, especially those surrounding new technologies developed to address sustainability, energy efficiency and the impacts on climate change. They may have to consider hiring specialized staff or – as some have already done – acquiring companies with a strong public sector profile.
Fully integrated risk management
Having invested substantially in managing project risk, contractors should also focus on broader risk management across the business. In creating a risk culture, they should align individual decision-making with corporate strategy and reward appropriate behavior. Clear responsibility and accountability, along with strong controls, can play a big part in improving governance and satisfying regulatory requirements.

Seeking innovation in sustainability
Creating energy-efficient, low-emission buildings and infrastructure, and building these same qualities into the supply chain, can bring commercial benefits. It can also help engineering and construction companies differentiate themselves as genuine innovators in sustainability. By measuring the return on investment in sustainable practices and outcomes, companies can focus their resources on the areas that have the greatest potential return.
All survey responses were gathered through face-to-face interviews in mid-2009 with 108 senior leaders—many of them Chief Executive Officers—from leading engineering and construction companies in 30 countries around the world.

The interviews were carried out by senior representatives from KPMG member firms specializing in the Engineering & Construction industry, with the questions reflecting current and ongoing concerns expressed by the clients of KPMG member firms.

Respondent companies’ turnover ranged from less than US$250 million to more than US$5 billion, with a mix of operations from global through regional to purely domestic.
<table>
<thead>
<tr>
<th>Number of employees</th>
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<th>Company turnover</th>
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Number of respondents 108
Source: Navigating the storm: Charting a path to recovery? Global Construction Survey 2009, KPMG International
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