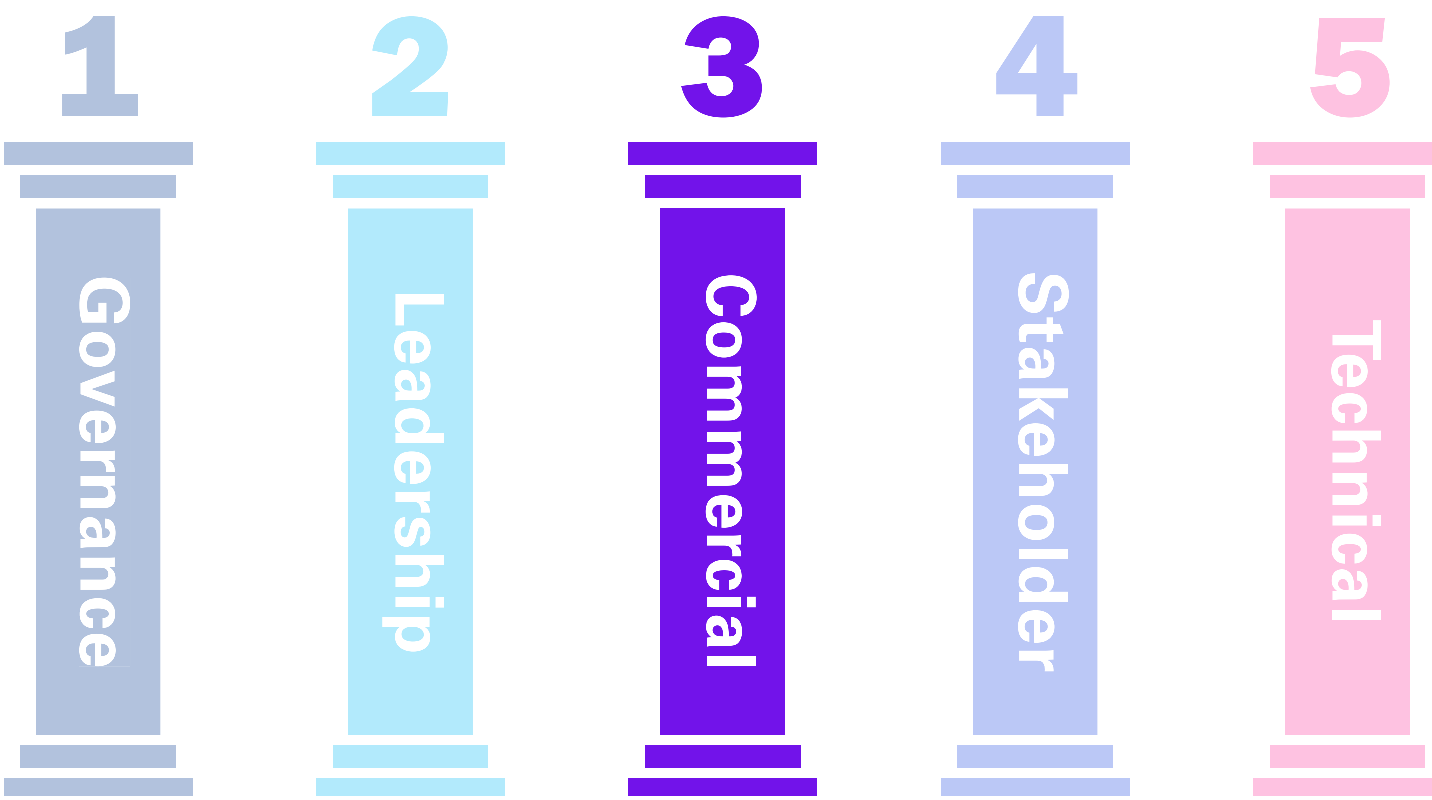
Major projects: Commercial

Balancing risk and reward

Successful project delivery relies on addressing two fundamental questions: What does the owner want to achieve? And, what will the market accept in terms of risk and potential reward? The answers to both will incorporate a balance of technical requirements, stakeholder objectives, and legal and financial considerations, alongside the economic drivers for the project. And, ultimately, it’s this balancing act that defines the commercial pillar.

This balance is unique to the risks and specific considerations of every project and is constantly shifting with market conditions and the economic environment.



Five pillars of major project success

What will the market accept?

An organization's ability to strike a commercial balance is unique to each project's specific risks and considerations, which are constantly shifting in response to market conditions and the economic environment. For better or worse, commercial strategies are beholden to these ever-changing factors, meaning they must reflect the realities and limitations of the markets both at the start of the project and throughout its various phases. This requires ongoing considerations for how rising interest rates, supply chain stressors, labour shortages, project risks and other factors will influence the successful delivery of a project and its ability to attract willing partners.

In short: Aligning a commercial game plan with current market conditions can be akin to aiming at a moving target.

In response to this market disruption, we have seen owners consider a broad range of contract types as they plan their major capital projects. Their approaches range from construction management to public-private partnerships (PPPs) and collaborative and, more specifically, alliance contracts, which are the most recent approach to be adopted from abroad and involves the owner, contractor and engineer developing the project in collaboration. The selection of the delivery model is a fundamental component of defining the relationship between the owner and other parties. Getting it right is fundamental.

What does the owner want to achieve?

There is no cookie-cutter approach to optimizing the delivery of a project. The strategies, mechanisms, and stakeholders that shape a large project will differ from one owner to the next. Similarly, owners should not be tempted by standard templates or swept up in the newest trend in contracting strategies. Rather, they are better served by looking critically at a commercial strategy based on the project's specific goals, partnerships, and current market conditions.

Narrowing in on a commercial strategy that fits your organization begins with breaking down the overarching question of what the project is meant to achieve into smaller considerations that touch on all five major project pillars. The next step is aligning them with owner risk tolerance and corporate objectives.

A matter of risk

Successful delivery of a project is driven in large part by fair and efficient risk allocation. It's about understanding the risks that will materialize throughout a project's lifecycle and ensuring they sit with a party who is most comfortable and capable of taking them on.

For project owners, getting risk allocation right means pulling at various levers ranging from risk allocation to collaboration incentives, and payment and performance regimes, among others. It's important to utilize these levers to design a commercial strategy that is fair, realistic, and sustainable for every stakeholder based on the project's specific requirements.

It's akin to a balancing act. Owners must allocate risk in ways that protect their organization and helps them deliver the desired performance within the cost and schedule allocated, while aligning with their organizational capabilities, competencies, and capacity. At the same time, transferring too much risk to partners can make the project unattractive in the market, edge out room for innovation, and saddle contractors with risks they cannot manage, which in turn can give rise to disputes, team breakdowns, and outright project failure.

Allocating risk in today's environment can also be a tougher sell. Supply chain issues continue to linger and labour markets are stretched too thin, meaning contractors have more choices and are less willing (or able) to take on risk. As a result, owners are typically taking on more risk than they would have had to only five years ago and having to explore more collaborative style contracts where risk is shared for their major capital projects.

More than a contract

A sustainable commercial strategy does not rest on its contracts alone. True, it's critical to define the scope of a project relationship and embed agreed-upon expectations and accountability from the start. However, a major project is a long-term, multi-year commitment that requires ongoing efforts to maintain that trust, collaboration, and accountability throughout each phase of its evolution.

After all, markets change and parameters shift. What made sense commercially from the onset may not be optimal years into the initiative. While contracts and the mechanisms within are foundational elements of any project, so too is moving forward with the understanding that establishing a commercial strategy is more than a one-time transaction; it is a long-term relationship that must be managed and nurtured.

Answering the question

Ultimately, the definition of a commercially successful project is one in which everyone wins and the objectives of all parties are aligned. Moreover, it is a scenario in which owners have sustained financial backing and stakeholder support to survive the journey, and where risk is effectively managed and shared to the extent that all parties feel confident in making a long-term commitment to the project's success. At the end of the day, a project's commercial success is supported through the implementation of the other major project pillars, ensuring that all parties can deliver on the contract that set the initiative in motion.

Read more in KPMG's Major projects – five pillars of success

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