



## White Paper 2021-11

### How Contractor Capability Should Be The Main Driver for Contracting Strategy Development

*When it comes to developing a contracting strategy for a project, owners would like to have a minimum number of contractors to avoid having to deal with interfaces. At the same time, contractors often wish to expand their scope as an opportunity for development. This often leads to over-extended contractor scope compared to their competency, creating delivery challenges for the project. In this White Paper we explore this issue, showing that it is more important to focus on actual contractor capabilities even if this leads to a larger number of contractors that need to be coordinated.*

#### Why contractor scopes are often over-extended compared to their capabilities

There are two converging reasons for this situation:

- Most owners' dream (or their financier's) is to be able to have a single contractor providing an operating asset under a turn-key EPC contract, with the additional benefit of some performance guarantee; or at least to minimise the number of contractors involved to avoid having the complication of coordinating them and having to manage interfaces,
- Owners with tight schedules requesting their project development engineering contractor (Front-End Engineering Development or FEED contractor) to extend themselves by taking procurement and construction responsibilities,
- Contractors try to develop themselves to take EPC contracts on the basis that they present opportunities for business development and larger opportunities for revenue and profit; and are astonishingly ready to commit to much broader scopes than they are actually experienced in (even if that means subcontracting).

Another issue for international projects is that local content requirements may significantly restrict the available choice of contractors and may thus force to use contractors without the full competency or capability. Some development support will then be needed.

#### Typical examples of over-extended contractor scopes

This leads to situations such as the following real-life examples:

- Experienced equipment providers (E+P) proposing to take on construction on an EPC basis, sometimes even in remote countries or in conditions they don't have any experience in,
- Experienced fabricators or construction companies that propose to cover engineering and procurement in an EPC lump sum basis, whereas they are used to contract on a re-measurable basis without taking any other risk than their own productivity,
- Pure design studies companies proposing to cover an EP or even EPC scope without a proper infrastructure to manage procurement and even less to manage the full EPC scope.

A specific and frequent variant of this phenomenon is when contractors organise themselves in consortium to respond to the wish of the owner to have a single contract (as often dictated by the contracting strategy developed by the owner – ref [White](#)

[Paper 2021-10 “How to Map a Project Contractual Strategy”](#) - and reflected in the bidding documents). This type of setup generally fails when the consortium partners do not invest early in a proper collaboration approach, which is generally linked to a longer-term strategic alliance. As a rule, many short-term consortiums fail when they are setup to respond to an owner need for an integrated solution with contractors that have never worked together.

Exceptions include consortiums where the scope of each contractor is quite segregated and independent, or consortiums that have developed a long-term habit of working together.

**Experience shows repeatedly that it is better to coordinate a number of contractors competent on their scope rather than to over-extend scopes beyond their abilities.**

#### Consequences of over-extended contractor scopes

Contractors that do not master their scope are significant threats to the actual execution of the project and its success. The owner will need additional supervision and could find itself in the need to guide or even get involved in the actual delivery to compensate for areas of contractor weakness, while not being organised and resource to do so (refer to our [White Paper 2020-10 “How to Fight The Trap of Do-It-Yourself Approaches on Large Complex Projects”](#))

In reality, there are not many successful contractors really able to implement EPC projects reliably and that have survived enough years to accumulate a substantial track record. EPC contractors able to deliver an international project with a global supply chain are even rarer. This feat requires a substantial investment in people, processes and systems that are not easy and take a long time to build; and will lead to more expensive quotes. Even for renowned EPC contractors, this capability to manage EPC projects will be limited to certain scopes where technology is mature, and experience has been developed over years. EPC contracts outside their experience are risky.

Contractors that typically launch themselves into EPC projects without the right preparation and infrastructure will find themselves ill prepared and poorly staffed and swamped with coordination issues, inadequate alignment of quality or safety requirements amongst the full value-chain, and inadequate budgeting and forecasting of the actual effort needed to deliver the project. In addition to substantial delays, this can occasionally lead to contractor bankruptcy or at least to behaviours aimed at forcing the owner to provide additional financing for the project.

For a contractor, managing EPC projects is fraught with huge risks and the rewards are not always commensurate. At the moment there is for example a definite trend from smaller contractors that have explored the EPC world to revert back to a less exciting but much less risky equipment supplier (EP) model.

## The contractor competency rule

If there was a single rule to follow in terms of contractual strategy, it would be that it is essential to hire contractors on scopes for which they are competent (and their competency is proven by their track record). Hiring contractors on scopes for which they are inexperienced is a sure recipe for failure.

Competency includes a proven track record in terms of HSE, and the actual demonstrated usage of best-in-class HSE practices, which should be a decisive criterion. It is also important to understand that the notion of competency when it comes to the construction phase also requires adequate experience in the specific country, its rules and habits; and of the site conditions (for example, arctic projects require experienced contractors for those specific climatic constraints). In brownfield projects, competency also includes experience working on the specific site under site requirements, therefore long-term maintenance and improvement contractors are often the most competent for the tie-ins of new units.

## The contracting strategy will in fact reflect the contractor market

On this basis, it is generally not a good idea as an owner to follow through on the wish to have a single contractor if there are no competent contractors on the market able to cover the entire scope.

It is much safer to have a contracting strategy built around a set of reputable contractors on scopes where their experience is proven. For each of those contractors, stretching of the scope beyond their usual remit should be strictly limited to be acceptable (often with the aim to better manage interfaces with other contractors). A proper in-depth contractor qualification process is required to fully understand the extent of the actual experience of the contractor, and of its proposed project team.

Thus, in reality the contracting strategy should account for the competencies available on the market, which the owner will have to combine in an adequate manner to cover the entire project scope. The contracting strategy should also account for the number of capable contractors so as to enable competition and choice during the bidding phase. Even if this requires a higher expectation from the owner to coordinate the full project (and thus possibly adding another contractor to perform this work on behalf of the owner), this approach will be much preferable in terms of project success.

The additional cost of coordination of the owner between competent contractors will be more than compensated by the avoidance of the risk of incompetence: it will represent 1% or 2% of the overall project cost, to be compared to the potential consequences of project failures which are at least an order of magnitude higher.

## Summary

The contractor competency rule would look quite straightforward and reasonable enough however experience shows that it is too often not followed, often due to various stakeholder pressures such as financing or project governance. Still, experience shows repeatedly that it is better to coordinate a number of contractors competent on their scope rather than to over-extend scopes beyond their abilities. Punctual consortiums as a way to push down the coordination activities are not either a good solution if the consortium participants don't have the experience of working together or a proven coordination capability. At the end, the contracting strategy will be defined by the actual contractor market at the time of launching the project.

*Note on terminology:*

*In this paper we use the usual Engineering (E), Procurement (P), Construction (C) terminology. An EPC scope is a scope covering the full cycle; EP covers only engineering and procurement for an equipment, etc.*

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