



## White Paper 2022-06

### How To Adapt to the Increasing Share of Financial Owners

*An increasing proportion of large industrial and infrastructure owners are pure financial players. Such owners lack the deep industry and technology experience of more traditional industrial owners. This creates a number of issues in terms of project execution and performance.*

*In this White Paper we investigate the consequences of this trend on owners and contractors for the actual execution of such projects.*

#### Introduction

Following a general economical trend, pure financial players are increasingly getting involved directly as owners in large industrial and infrastructure projects with the objective to create an asset that will deliver substantial and regular returns over their lifecycle. This can be through special purpose vehicles or directly as funds taking majority equities in projects or industrial operators. Often those financial players will look to exit the project with substantial return on equity at a shorter horizon than the infrastructure lifetime through refinancing exercises (typically 5-7 years); financial owners actually only concentrate on the project development phase.

While usually very cognisant about financial structuring, financial owners have much less competency on technical or industry-specific aspects. Beyond hiring a limited number of industry experts to help frame their investments, they thus generally seek the support of owner assistance or project management contractors to effectively deliver the projects. They will also often delegate asset operations and maintenance to third party companies.

However, this setup may create issues and project performance concerns, mainly along three dimensions:

- Excessive expectations regarding project and asset performance,
- Lack of competence of the owner to drive the right technical decisions during project definition and execution, in the interest of the full lifecycle value of the asset. This is also linked to poor governance including inadequate control of key project milestones,
- Lack of alignment of interests between owner and owner assistance leading to decision delays. This additional complexity may have a significant impact on project delivery.

#### Excessive expectations regarding project and asset performance

We quite often observe that pure financial owners may have unrealistic expectations as to project and asset performance. This includes in particular:

- Unrealistic schedule expectations for the project (both for definition and execution phases)
- Unrealistic ramp-up expectations after start-up
- Unrealistic owner operations costs.

In addition to the disillusion that will come sooner or later on the overall return on investment, unrealistic expectations will lead to excessive pressure being put on teams and contractors leading to counter-productive behaviours (for example, skimping on quality, or high team turn-over) which will aggravate the situation further. Unrealistic expectations are actually recognised as a major contributor of project complexity.

The solution is to use adequate benchmarking (and clear explanations that can be substantiated if some expectations significantly deviate from the benchmark) as well as a particularly rigorous estimating process prior to Final Investment Decision. A high percentage of both project (Capex) and operation (Opex) costs is expected to be actually backed up with contractor and supplier offers, and the overall execution schedule also needs to be consistent with benchmarks for similar facilities in comparable circumstances.

In addition, particular care should be given not to underestimate the actual project management costs, as well as the IT infrastructure setup costs for both project and operation phases. While limited in percentage of the overall project, they can still represent significant sums and are the first ones to get 'optimised' out. The early involvement of the operator and the inclusion of their preparation work in the overall schedule is also an essential success factor.

#### Lack of competence of the owner

While competence can to an extent be provided by contractors supporting the owner, the owner still needs to internalise a sufficient level of competency. The following reasons apply:

- It is not recommended to delegate to a contractor substantial work and decisions that may impact the project without a minimum level of control to check that the work is effectively delivered.
- The owner must maintain a minimum of knowledge and control on the project to avoid the risk of being taken hostage by one of the contractors. For example, this requires investing in a document control system, sufficient contract management resources, and have minimum project control oversight (cost, schedule, risk and scope) in particular when taking the full owner view of the asset lifecycle and all ancillary related project scopes.
- Essential project milestones such as project reviews at key decision points (end of Preliminary Feasibility, Final Investment Decision (FID), Mobilisation on Site etc) must remain under the control of the owner as well as the detailed specification of the work to be performed for each project phase. A proper governance framework must be in place to ensure that

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good project definition at FID is reached. This is a strong predictor of project success and future asset operational performance,

- Essential decisions, including those regarding Capex vs Opex, will remain with the owner, which is the only one able to perform such decisions, and they need to be taken effectively and timely during the course of the project.

Even in cases where the owner assistance may be part of the same group of companies, and thus can be supposed to be working in the same overall interest, we have found through experience that it remains essential to maintain a strong owner team including a minimum level of competence. This does not require a very large team but incorporating a limited number of very experienced personnel with experience in similar projects for the specific industry, at least an experienced project director and an experienced senior contract manager, as well as minimum scheduling and project control resources to maintain sufficient oversight on the project. Those owner resources should be included in an integrated, co-located team for maximum effectiveness. Most of those resources being experienced project professionals are used to moving from project to project and they can be hired for the duration of the project, which will span over several years anyway. Refer also to [White Paper 2020-06 'How Essential It Is That the Owner Team Has Sufficient Project Experience For Project Success'](#).

### Lack of alignment between owner and owner assistance contractors

Owners often resort to specialised contractors offering owner assistance as a way to compensate for their weak project management infrastructure. Contractors obviously will have a different interest than the owner and incentives are never fully adequate to bridge this difference.

It is important for the owner to recognise the difference in interest with its owner assistance contractors (generally keen to

sell more man-hours), in particular when it comes to decision-making. We often observe that in this kind of setup, decision making is protracted due to unclear rules of delegation to the contractor and lack of owner competence. This creates significant project performance issues to the usual delight of the project contractors (which find substance for claims in delayed reviews and decisions) and of the owner assistance contractors (which benefit from a longer and more difficult project). In general, lack of owner decisiveness is one of the major causes of poor project performance.

Some solutions include:

- A continuous investment in aligning the teams working on the project, integration and co-location of the teams under the supervision of the experienced owner Project Director,
- A clear split of responsibilities and a clear contractual setup (e.g. are contracts for the project officially placed by the owner or the owner assistance?) and associated strong contract management capabilities,
- Strong contract management by the owner of the owner assistance contract and of the support contract from the future operator.

### Summary

The trend towards financial pure players as owners for major industrial and infrastructure projects reinforces the need to have a clear view of the minimum skills and competency that an owner needs to have and cannot delegate - even to apparently benevolent owner assistance contractors. General expectations in terms of owner competency apply, and financial owners must be ready to internalise a limited number of experienced project personnel that will allow them to effectively drive project performance and avoid being taken hostage by contractors.

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