

THE NEEDS OF THE CLIENT

Steve Brown

SYNOPSIS

In the rapidly changing global economy to which we are all increasingly exposed, we are directly affected by the significant and profound influences that are affecting world markets. One of the most significant particulars from a South African perspective has been the consistent downward pressure in world commodity prices which, once cyclical trends are discounted, shows no sign of relenting. The inevitability of this trend coupled with the realisation that a weakening currency provides, at best, only temporary relief has forced the major commodity exporters to realign their businesses. Concurrent with this economic change has been an increasing awareness both externally and within the industry of the importance of both health and safety as well as environmental management. These changes have been most profound and have changed the entire outlook of an industry.

The fundamental change which has occurred to combat this new economic and social order has been particularly apparent within the mining industry although there are indications that these changes are filtering through into other major industries. In its most basic form these changes have led to a concentration of activities which can be classified as core business. In the mining field this is increasingly being interpreted as purely mining related activities as opposed to the more traditional mining and support activities. This, coupled with the safety and environmental pressures mentioned previously, has enormous implications for the conveyor manufacturing industry. It is essential that these implications are fully understood if both parties are to benefit from the opportunities and avoid the pitfalls.

One of the major requirements of any organisation entering the 21st century is that the exposure to risk, particularly in areas no longer considered as core business, needs to be reduced to an absolute minimum. This is often coupled with a reduction of the various technical departments within the organisation. This trend can be seen clearly in the rapid reduction in the size of the various mining house head offices during the last decade. This trend has, to varying degrees, changed the specifications for conveyors. These specifications have moved from a fully detailed approach, where often the last nut and bolt was specified by the client, to a design and build turnkey type of project. This approach, while it may lead to more complicated tendering and adjudication procedures, inevitably results in a more competitive market place with new technology driving technical innovation and excellence at a pace which was rarely seen in the past. It is significant that the cost of overland conveyors has declined significantly in real terms over the past decade largely as a result of the above pressures. Although this reduction in capital cost is extremely welcome and has increased the market share for conveyor systems, it is insufficient on its own to meet the challenges of the next millennium.

In the future the client will require an increasingly flexible and demanding package from the conveyor manufacturer. This package will take many forms and will have to be tailored to meet the specialised needs of an individual client. It is probable that in some cases this will result in not only a design and build contract but will include, at a predetermined cost, the ongoing maintenance or even the operation of the conveyor for some or all of its design life. This will have major potential benefits for the client as it will permit a true life cycle cost analysis to be undertaken at the adjudication process, however, it will have major implications for the supplier. In this scenario the supplier will suddenly be exposed to many additional risks. These will certainly include the obvious financial related issues as well as those associated with health, safety and the environment.

Although at first it may seem as if this type of contract offers little benefit for the supplier the reverse is in fact true. It offers the prospect of a steady income over a number of years after the initial construction has been completed. This is probably even more relevant as we enter an era where "mega" type projects are likely to be relatively scarce. The other major benefit for both the supplier and client is that it eliminates or reduces the tendency to install the absolute minimum specification of equipment required in order to win a tender. In other cases it may be necessary, particularly with the fledgling areas of the mining industry, to offer suitable leasing or other financial options. This is obviously a major change compared to the current scenario of isolated coexistence and is obviously full of potential challenges and pitfalls to both parties.

which would require careful defining of the relationship between the client and the contractor. It is almost inevitable that this type of relationship would have to evolve into some form of partnership or alliance operating on a predefined shared risk and reward basis in conjunction with a degree of mutual trust if it were to succeed. In this type of relationship it is also important to rise above the level of unsustainable hype and buzzwords at the earliest stage in the project if unrealisable expectations are not to be generated within both parties.

One major area where the client is becoming increasingly demanding relates to the issue of safety. This is a two pronged attack with the emphasis correctly being focused on both the installation of the conveyor and its subsequent operation and maintenance. In many cases it is the contractor who exerts the most influence in these areas and liaison with the client is essential at the design stage. There are numerous examples of conveyors which, having been designed and fabricated, are almost impossible to erect safely. This is an area which in the past tended to be ignored as it vanished once the construction activities were completed, provided that no serious injuries occurred. In this age of pre-emptive risk assessments, however, this is no longer acceptable and most, if not all, clients will require a detailed risk analysis be undertaken prior to site activities taking place. It is also not unreasonable to anticipate that the adjudication of major projects will, in the not so distant future, include a detailed evaluation of a contractor's previous safety record. This approach should present cause no tribulations to the more responsible contractors, of which there are indeed many, however it will have significant implications for those who have adopted a more cavalier attitude towards safety.

The area where the greatest contribution to safety can take place, however, relates to the ongoing operation and maintenance. In the past we have seen numerous instances of poor design resulting in, for example, inadequate guards which, once removed for repairs, are almost impossible to reassemble correctly or lifting beams installed in the most inaccessible positions. It is important for both the supplier and contractor to address these issues at the earliest possible stage.

In summary, it can be stated categorically that both the client and the contractor are going to be faced with significant and often conflicting requirements in the future. The requirements of the client are likely to become even more fragmented with one size definitely not fitting all than they are at present, however, they will largely revolve around the ongoing reduction in capital and operating costs as well as an ever increasing awareness towards safety and the environment. These challenges will be difficult to achieve and it is inevitable that casualties will occur, however, if we are to remain or regain our competitiveness in the world market place it is essential that we adapt to the changing order.

The relationship between the client and the contractor in the conveyor industry has been evolving steadily over many years. This pace of change, which was fairly comfortable for both parties, has started to accelerate at a pace more akin to revolutionary being largely driven by economic factors both within and external to the industry.

The views and opinions contained within this paper represent those of the author and do not necessarily represent those of any specific company with which the author is associated.

INTRODUCTION

Why are the needs of the client important?

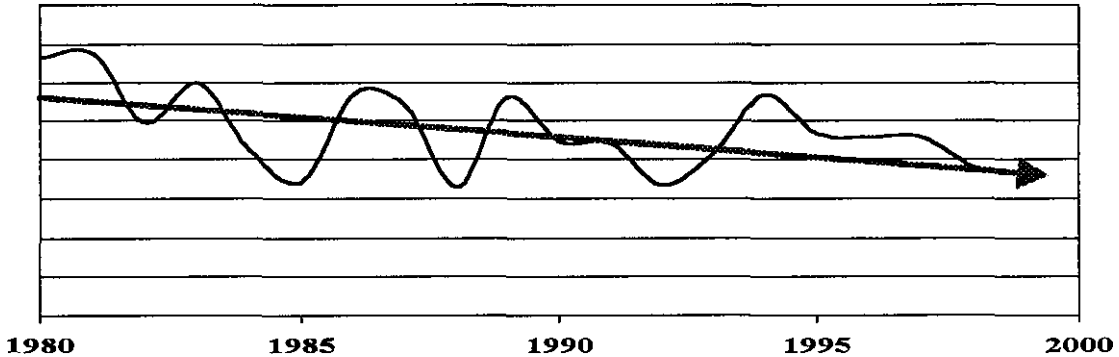
Without the client there is no industry. The client may adopt alternative technologies unless the industry understands the needs. Understanding these needs may allow new technology to be adopted which in turn may create new opportunities for technology substitution. Unless the needs of the client are understood it is difficult to plan for the road ahead.

Who is the client ?

Traditionally clients for the belt conveying industry come from large mining houses, emerging mining organisations, large industrial companies, quarrying and export facilities and other sources.

GLOBAL INTEGRATION

Global integration has changed the way we do business. Commodity Prices are in decline and it is anticipated that they will continue to do so. Competition for capital is growing both internally within Southern Africa as well as externally and is expected to continue to do so in the future. Health, Safety and Environmental issues are constantly increasing and a declining Rand does not increase our competitiveness or profits. Our South African labour costs are no longer considered low in world terms and we are disadvantaged in terms of location, taxation and education.



Competition for Capital

Global integration means global competition. Internal discount or hurdle rates are increasing and there is a perceived political risk. Some of our larger corporations are moving offshore and we have high real interest rates. A project in RSA is now ranked against say one in Australia and one in South America when capital is applied for. The hurdle rates may vary from country to country with RSA being disadvantaged near the top of the scale. The economic meltdown, which occurred in the emerging Asian markets during 1998, added further pressure as South Africa continues to be classified as a similar emerging economy with a high debt burden.

The effect of the declining Rand

A declining Rand gives only 6 - 9 months short term benefit on costs or exports and because of the currency instability investment is discouraged. Forward cover remains expensive and is not without risk while a declining Rand increases interest rates thereby reducing investment.

A Mining Industry perspective

The mining and associated industries have traditionally made up a major portion of the conveyor contracting industries workload. It is therefore relevant to examine current and future trends in this area. These trends can be seen repeated in many other industries.

TRADITIONAL APPROACH Extremely detailed technical enquiry

The client issues an extremely detailed technical enquiry with the tender document resembling an encyclopaedia. Tendering is expensive and updating the documentation is difficult.

Minimal scope for individual innovation.

Resulting from this approach means that there is minimal scope for individual innovation since the scope definition inhibits innovation. The adjudication process is simplified but design limitations tend to get repeated and the expertise of the contractor is may not be fully utilised.

Conservative approach the norm.

Resulting from this approach are limited updates to specifications and hence conservatism in design which is offset by there being minimal risk that the system will not work.

Capital cost taking precedence in adjudication

In the adjudication process capital cost takes precedence and it is rare for the true ongoing costs to be taken fully into consideration. The client must take the blame for this and if an evaluation of ongoing costs is required as part of the adjudication process the client must inform the tenderers on how this will be undertaken.

Health and Safety often add-on.

Health and Safety requirements are often an add-on and older specifications are frequently massaged to comply with current requirements.

Lengthy adjudication and approval process.

The size of the documentation for tendering inevitably results in a lengthy adjudication and approval process to achieve a fair adjudication. As all the risk remains with the client it is imperative that no stone is left unturned during the adjudication process. It is not uncommon for validity extensions to tenders being required.

Design life not fully defined.

It is rare for a design life to be specified at the tender stage and this is many times longer than the guarantee period. The project life is often vague beyond ten years. This omission may lead to either under or over design, neither of which is desirable.

Comfortable for contractor and client

The traditional approach, which is auditable and repeatable, is comfortable for both contractor and client primarily because each party understands the risks but also partly due to the inherent natural conservatism that we all tend to revert to. The vast majority of the risk remains with the client although contractor reputations may be tarnished, not always fairly, in the process.

THE CURRENT APPROACH More open scope of work.

There is now a more open scope of work, if at times poorly defined, which is partially attributable to the reduction in size of technical departments in most major organisations.

Innovative designs appearing.

This has led to a very competitive market, with more innovative designs, which address the increasingly stringent technical, health, safety and environmental issues. However, the costs for tendering have increased and adjudication procedures are invariably complicated. There has been a real reduction in capital cost costs however there has been a minimal improvement in operating costs as a result of these innovations.

Worryingly low profit margins.

Of concern is the worryingly low profit margins and the Boom/Bust Scenario which is now in repeating its second or third cycle. Pricing is frequently cut throat and quality usually suffers and significant extras are almost inevitable. It is fair to say that there are too many contractors chasing too few tenders. In many cases the contractors fixed overhead costs are still perceived as being excessive.

Minimal transfer of risk.

There has been only a minimal transfer of risk and the operating costs remain with the client. A perception exists that risk transfer increases costs and this leads to a Get-in/Get-out Quick scenario.

Standard Packages

Computer technology has allowed for rapid alterations to designs to be undertaken however further progress is still required in this field. The cost of design modifications, even at an early stage remains unacceptably high.

The comfort zone is eroding

All the above has led to an erosion of the comfort zone.

Risks are slowly starting to be shared and ongoing costs are being evaluated, although often poorly.

The client is increasingly demanding spares backup and availability and often has unreasonable expectations.

There are structural problems within the conveyor industry and they are unlikely to go away. The market has never been more competitive and the heady days of the late 70's and early 80's will not return.

If we continue as we are it will lead to a further contraction of the industry.

THE FUTURE ?

Traditional industries are maturing.

The mining and processing industries are maturing. Mineral reserves, in many instances, are declining in grade.

It is likely that projects will become less frequent and smaller and more cost sensitive.

Mistakes of the past cannot be repeated.

Health and safety issues are now a primary motivator.

In all probability brownfields expansion projects will increase materials handling requirements.

More flexible packaging.

There is a need for more flexible packaging.

One size will not fit all and the package should be tailored to meet the true requirements of the client and hence understanding the clients needs is essential. Niche markets are to be targeted.

Provision to upgrade/downgrade systems at a later date should be incorporated into design packages. This further highlights the need for an accurate assessment of the design life of the project.

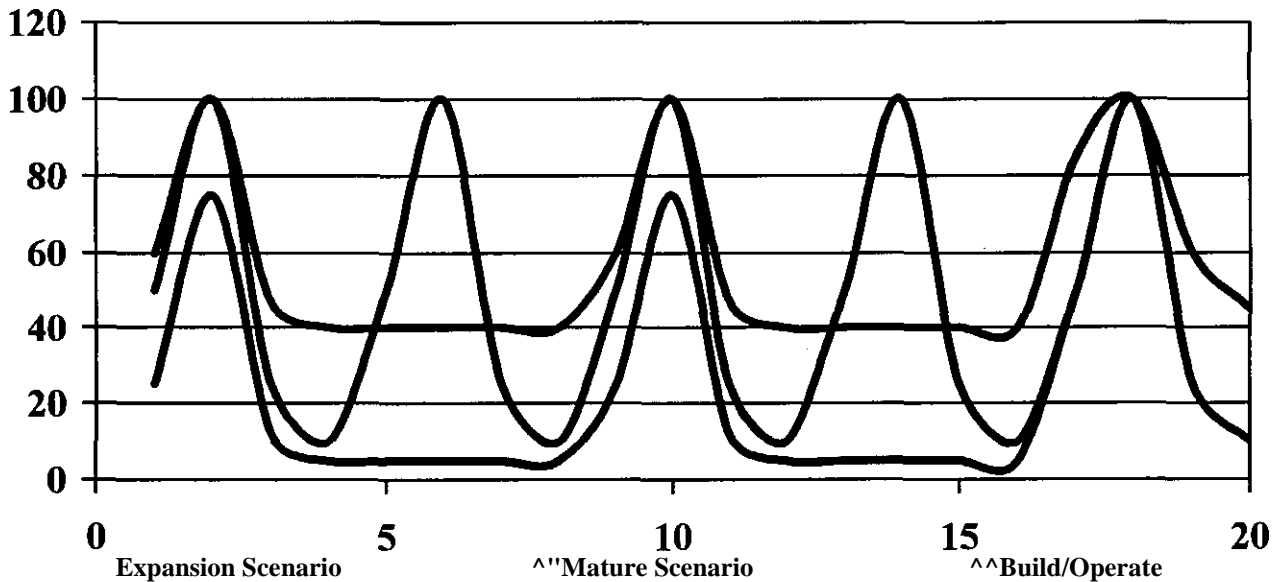
Design / Build / Operate.

There is an increasing trend world-wide to design, build and operate materials handling systems thus transferring risk from the client and enabling the client to focus on core business.

Resulting from this, generally, is a more efficient operation.

On the contractor's side he can benefit from an ongoing cash flow (insert fig).

The client benefits from guaranteed availability, predictable ongoing costs and full maintenance, major repairs and auditing.



Financial Considerations.

As far as financial options present themselves, first prize is obviously for both client and contractor to benefit in the future. Many clients will increasingly consider leasing and equity options. In particular this may apply in particular to the fledgling empowerment industries. The client will expect to impose penalties for non-conformance, in both delivery and operational performance and continue the transfer of risk. The contractor will be required to participate in a spares holding arrangement.

Partnership / Alliance potential

The potential exists for a partnership / alliance arrangement. Such an arrangement, once it has been fully established, should result in fast reaction times. It is a prerequisite of such an arrangement that the scope definition is accurate, that mutual trust exists and most importantly the results must be auditable. A sustainable partnership / alliance should produce true risk and reward sharing hence a win/win scenario is imperative. The selection of client/contractor may of necessity be prolonged and small projects should be initiated (not on a cost plus basis) to initiate the learning curve.

Additional safety requirements.

Safety requirements will assuredly become more arduous and past safety performance will affect selection.

The client will be looking for improved safety at lower cost at a time when skill levels are decreasing and will continue to do so. Offshore pressure on safety will increase from parent companies and customers.

It is envisaged that more attention will have to be paid at an early design stage to safety aspects during erection and ongoing operation and maintenance.

Design life cycle.

The design of the system should cover the entire project life and the "Rolls Royce" syndrome must be avoided where only a "Volkswagen" is actually required.

The clients ambitions must be matched to reality with, in particular, the elimination of untried technologies and overspecified systems.

Maintenance procedures will have to be simplified and incorporated into the early phases of the design.

There will have to be an understanding of clients internal discount structure. **Increased**

fragmentation of the market.

The number of mega-sized projects is dwindling with niche markets emerging and to satisfy the clients requirements technology must be suitably matched and optimised. New players, from other industries are likely to emerge, due to other engineering industries contracting and there will be a tendency for these companies to move into the conveying field. Life is going to get harder not easier.

SUMMARY

- The last decade has been evolutionary
- The next decade will be revolutionary
- The market will continue to fragment
- Flexibility is the key to survival
- Projects will be shorter, faster and more cost sensitive
- Niche markets will exist
- There will be a reduction in the number of suppliers
- The best and most adaptable companies will prosper
- Maintaining the Status Quo will result in extinction
- Casualties will occur
- The cyclical market will lead to investment windows of opportunity and equally windows of despair.

IN CONCLUSION

The needs of the client remain similar to those which have been historically applied namely a cost effective, safe and reliable conveyor system. The means of achieving these is however continually changing. The industry needs to sell its expertise, which it continually claims to have, in total systems to the client.

The views and opinions contained within this paper represent those of the author and do not necessarily represent those of any specific company with which the author is associated.