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Is it Reimbursable Cost, Target Price or Guaranteed Max?

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Topics for Today

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- ⌘ Our Biggest Challenge To Effective Risk Management
- ⌘ Exhibit A: Risks hiding in Reimbursable cost clothing
- ⌘ Exhibit B: When does a target price transform into a GMAX?
- ⌘ How to address our Biggest Challenge

Our Biggest Challenge to Effective Risk Management

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- ⌘ Fluor has an established approach to Risk through our Business Risk Management Framework (BRMF) process
 - Corporate Risk group, 5 Risk Officers and nominally 50 risk representatives located globally
 - Established risk practices, risk list and risk bulletins
 - Proprietary software for evaluating risks of all kinds
- ⌘ Once a Risk project is identified, there are clear approval requirements
- ⌘and yet, if the nature of the project risks are not accurately communicated, the best risk practices in the world **will not work!**

Exhibit A: The Wolf in Sheep's Clothing (a.k.a.- Risks in Reimbursable Clothing)

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- ⌘ Fluor's Business Risk Management Framework (BRMF) places special review and approval requirements on Risk Projects.
- ⌘ Inside of Fluor saying that a prospect is "Reimbursable Cost", results in us lowering our guard
 - ...and yet, taking similar risks under a "Reimbursable Cost" format can actually result in higher risks for the EPC Contractor
 - A reimbursable cost format can mean less contractor control and ability to direct the execution:
 - Schedule guarantees and LD's
 - Performance guarantees and LD's
 - Warranties

Exhibit B: When Does a Target Price Contract become a Guaranteed Maximum Contract?

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- ⌘ In these tough times, we have started to see clients and internal individuals represent prospects as RC with a Target Price when they are really much more onerous.
- ⌘ To be clear, Fluor is comfortable with Lump Sum or LSTK execution in many of our markets and regions....but we see Guaranteed Maximum Contracts in a much less favorable light:
 - Loss of control in execution
 - All or part of under runs are a lost opportunity with the same risk on over runs
 - Increased difficulty with valid CO approvals
 - Increased difficulty in including event contingency in a fashion that it will be reimbursed
- ⌘ So when is a Reimbursable Cost prospect with a Target Price really a GMAX?

Recent Case Study on RC vs. GMAX

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- ⌘ Power project was booked and awarded on the basis that it was “Reimbursable Cost” with a target price
- ⌘ With this description it drew very limited management review and yet:
 - It was actually a guaranteed max contract with no reimbursement above the target price
 - As a GMAX contract it is difficult to add event contingency and get it as part of compensation
 - Numerous other guarantees, including schedule LD’s on over 25 separate dates, were included in the contract
- ⌘ Current Status: In excess of a \$10 million loss, with more than that in unapproved change orders and a substantial schedule delay
- ⌘ The best Risk Management system in the world can not prevent such an event if a failure to communicate, or a delay in communicating, prevents the system from being implemented

When a Project is Identified as a Risk Project Makes a Difference

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- ⌘ The early identification of Risk Projects allows for the development of mitigation strategies that maximize competitiveness
 - Execution Strategies
 - Avoidance Strategies
 - Risk sharing strategies
- ⌘ Conversely, the late identification of Risk Projects results in the mitigation of last resort (adding money to the bid or into project cost) being the only one still available

Why the Failure to Communicate?

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- ⌘ An accident or an intentional act?
- ⌘ Misunderstanding of what the Risk Group is attempting to accomplish?
 - Perception that Risk Management is a “blockade to awards” rather than a “tool to new profit making awards”
 - Perception, or the actual Failure, of the Risk Management team to search for solutions that make our offerings competitive while still mitigating risk
- ⌘ The “Lemming” effect
 - Listen for the words “it is market” as a way to identify that the lemming effect has taken hold
 - If you are comfortable with jumping off a cliff along with everyone else, why spend a lot of time mitigating risk

Addressing the Communication Challenge

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- ⌘ 1st Principle of solid risk management-
establish a common risk language for
communication
- ⌘ Educate and continually reinforce that Risk
Management is aligned with sales and
operations in working to win and execute
profitable work
 - We are not the “risk police”
 - We are a key part of effective “commercial strategy”
 - Ensure that if the “Risk Group” is involved early, our
win percentage goes up and the percentage of
profitable projects goes up even more

Each of our organizations contain experienced and innovative people who want to do what is right

To varying degrees each of our organizations have effective Risk Management practices in place

By adding the third, and most important element, truly effective communication, we can complete the bridge to truly effective Risk Management

Oh, and by the way, if we complete the bridge we can even Save the Lemmings!