Viewpoint

Confronting Core Market Decline

Portfolio diversification in the industrial services sector

Portfolio-led diversification can create a wealth of new growth opportunities for industrial service providers, but also presents new challenges. In this article, we highlight some critical success factors for the effective transition to a portfolio service offering in the context of changing customer expectations and sustained market volatility.

The industrial services sector is multi-faceted, comprising a range of services, from the maintenance and decommissioning of existing installations to the design and execution of new build projects, both onshore and offshore, across a multitude of vital industry verticals, including oil and gas, power generation and process manufacturing. In 2013, the market was estimated to be worth in the region of €20bn in Europe alone, and by 2018 this market is forecast to reach €26bn, representing a 5.7% CAGR[1].

However, the sector faces a number of challenges. The significant and sustained reduction in the oil price since June 2014, to which many industrial service providers are heavily exposed, has impacted investment and demand for critical services. In addition, environmental regulation is limiting the lifetime and profitability of assets in certain sectors, forcing industrial service organizations to pursue alternative growth markets. For example, coal-fired power stations would appear to face a bleak future in the UK; a third are expected to close by 2016 and the government has proposed that all are shut down by 2025. At the same time, while not all client organizations are ready to transition to portfolio-based procurement, customer needs are nonetheless evolving and interest in portfolio solutions is growing, driven by the potential to improve capital productivity, reduce supplier interface costs and enhance profitability.

In this paper, we first consider the challenges that organizations can face when seeking to implement a portfolio strategy. We then introduce ADL's High Performing Business (HPB) Model and highlight some critical success factors (CSFs) for effective transformation, based on our experience of working with leading industrial service providers to develop new operating models to deliver such strategies.

Challenges in portfolio strategy transition

It is with this forecast decline in core markets and changes in customer expectations in mind that many industrial services companies are challenging established service offerings, and the organizational models that support them. They are reorganizing themselves to efficiently target new market sectors, potentially with revitalized, portfolio-style offerings. However, doing so is not without its difficulties, including specific issues relating to post-merger integration, business processes, internal capability development and governance.

1. Strategic intent not matched by sufficient post-merger integration activities

As an alternative to the challenges of attempting organic growth, many industrial service providers have chosen to pursue a growth-by-acquisition strategy as a means to achieve scale benefits and enhance their overall offering to the market, as rapidly as possible. However, the attainment of target benefits is contingent on clear leadership, resolute decision-making and regular communication. This is especially true in the immediate wake of an acquisition, when ways of working and cultures are formed, and the seeds sown by which the envisaged integration benefits, may be realized.

1 Source: Frost and Sullivan, 2014

As the below case insight highlights, the consequences of delaying the integration of acquired entities, or failing to do so effectively, can result in issues with the existing organizational model, that tangibly impact the delivery of a strategy.

Case Insight – Organizational Model Review, Global Industrial Services Provider

In 2015, ADL completed an organizational model review for a leading industrial services provider.

The organization had pursued an aggressive growth-by-acquisition strategy to support its transition to a portfolio of integrated, enhanced margin services. However, while each acquisition had been supported by a clear strategic intent, the relative absence of post-merger integration activities was impacting the effective functioning of the business. In particular, efforts to diversify into a portfolio of services were being severely hindered by:

- Business unit-driven approaches to the market, resulting in an uncoordinated approach to customer engagement
- Processes, systems and incentives not updated to reflect business needs and encourage required behaviors

To address these issues, the organization embarked on the development of a revised organizational model that addressed the root causes of legacy integration issues and laid the foundations for an effective portfolio strategy transition. Key elements of the final solution included:

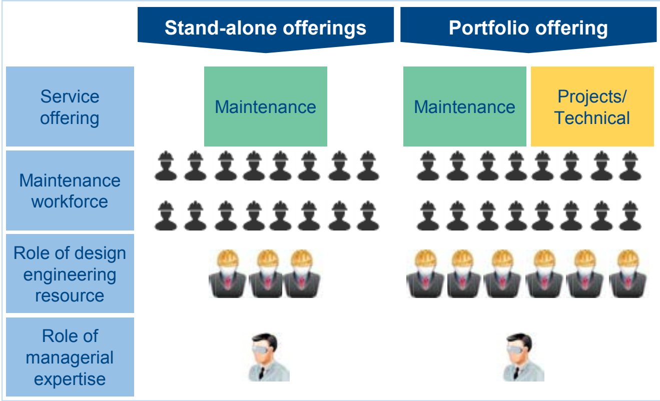
1. Review of acquired business unit activities to ensure alignment to overall group strategy
2. Confirmation of interfaces and ways of working between business units, including detailed plans for key account management and customer relationship management
3. Clarification of how proven but limited pockets of expertise would be leveraged across the organization to support specific growth objectives in core and emerging markets
4. Plans for the rationalization of multiple legacy systems and realization of back office savings

2. Capability and incentives not updated

Effective portfolio strategy implementation also requires the development of the capabilities and incentives to support the transition from a maintenance-focused organization to one that is increasingly focused on higher margin project-led work.

As summarized below, the transition from a maintenance-led organization focused on the provision of manual workers labor to a hybrid resourcing mix with a greater emphasis on technical and leadership elements, carries important implications. Failure to prioritize the development of a broader set of capabilities can mean that providers struggle to complement a compelling portfolio strategy with the required behavioral changes.

Resourcing Mix Transition



Sources: Arthur D. Little analysis

Even if an industrial services provider has a proactive talent development program in place, this will only deliver the required results if accompanied by effective incentives, at individual and group level. In our experience, providers can underestimate the difficulty of modifying existing incentives, including the thorny issue of P&L ownership, because of the implications for individual status and rewards. Yet without these changes, a commitment-capability gap may emerge between portfolio ambitions and the ability to implement.

These challenges may be further aggravated by issues with succession planning. Even the most successful companies can become heavily reliant on the technical expertise of an ageing workforce, and lack the concrete plans to replace these resources and retain capabilities. Attracting highly technical skills at short notice can be extremely difficult, especially in regional or remote localities, and may inhibit the ability to deliver against growth objectives at a time when there is an urgent need to pursue new growth opportunities in alternative markets.

3. Business processes support status quo, not future vision

Although there can be many benefits of embedding standardised processes across an organization, in the context of a newly established portfolio offering the subtle differences between portfolio disciplines and service lines may not always be best served by a rigidly standardised approach.

Just as there are important differences in the resourcing mix as organizations migrate to a portfolio offering, so there may also be differences in the characteristics of these offerings, and their respective markets and customers, that impact the relevance of the business processes applied. For example, one would expect the design and build of a new large-scale storage facility for a process plant to be a less commoditized, more technical offering than a traditional, entry access solution based on scaffold installation, therefore requiring a longer tendering process (see Table below). However, where processes are not adapted to reflect these differences, a default 'one size fits all' approach can ensue. In summary, tendering processes that do not accurately reflect the requirements of different offerings and markets, or that are over-engineered, may lead to heightened levels of commercial and technical risk, and foster employee disengagement, reinforcing organizational siloes.

Process issues may also manifest themselves in the quality of internal and external interfaces. Internally, as the portfolio matures, the need for collaborative working across disciplines is likely to grow. Externally, service providers may find that existing processes for managing the client relationship, including those for example related to key account management, are ill-suited to handling an increase in the number and complexity of service offerings that a portfolio strategy implies.

Comparison of service line characteristics

	Maintenance Service Line	Technical Service Line
Example	Traditional entry access solution based on scaffold	Design & build of a large-scale storage facility
Indicative contract length	Long (12-18 months)	Medium (1-6 months)
Typical contract type	Time & materials	Fixed price
Commoditisation of offering	High	Low
Typical contract turnaround time	Short	Longer
Technical engineering input	Low	High
Technical delivery risk	Low	High

Sources: Arthur D. Little analysis

Unaddressed, these issues have the potential to undermine efforts to break down divisional siloes and change engrained mindsets related to accountability and culture. From the customer perspective, the experience can be one of a disjointed or even chaotic approach to relationship management, hindering efforts to build trust and achieve meaningful sell-on, or 'pull through' from one service offering to the next.

4. Governance struggles with additional complexity

Like existing processes and systems, current governance structures are, in most cases, not designed to support the more complex cross-business interactions and decision-making that a portfolio strategy can require.

For organizations that seek to implement a portfolio strategy without ensuring that the required governance is in place, or whose efforts are constrained to reactive, tactical initiatives, there are multiple potential implications:

- Issues with contract management and project write-downs can suggest that the governance framework may be struggling to effectively control commercial and delivery risk.
- Unclear definition of disciplines and service offerings, to outdated job descriptions, resulting in unclear roles, accountabilities and reporting lines.

While the former may lead to financial penalties and reputational damage, in the long term the latter is no less serious, and can lead to include impaired employee productivity, reduced effectiveness of business development activities and disjoined talent deployment mechanisms and development pathways.

Customers can also end up being exposed to these issues, impacting the buying decision. For example, while an customer may be receptive to a portfolio service offering, he/she also needs to have confidence that the provider has the required governance and capabilities in place to practically manage the complex interdependencies between closely integrated services, in both project and maintenance environments.

Critical success factors for effective transition to a Portfolio Service Offering

ADL's experience suggests that, faced with the issues highlighted in this paper, industrial service providers need to adopt a holistic approach to organizational development to deliver sustainable improvements in financial performance and generation of shareholder value.

High Performing Business (HPB) Model

Sources: Arthur D. Little analysis

To help industrial services providers navigate this process, ADL uses its HPB™ Model to assess current organizational models, establish organizational requirements and provide a platform for sustainable business growth, through alignment of strategy, processes, resources and competencies and organization.

Based on these four dimensions, there are a number of CSFs that industrial service organizations should consider when seeking to transition to a portfolio of integrated services:

Strategy

- **Drive strategic alignment:** as a first step, it is important that misalignment between the organization's portfolio strategy and business unit activities is addressed. In the case of acquired entities, it may be necessary to revisit the strategic rationale behind the acquisition and question the extent to which this is being realized. For every part of the organization, there needs to be crystal clarity on how business unit value propositions support the portfolio strategy. Equally, cases of duplication and, potentially, conflict between business units need to be addressed.

Resources and Competencies

- **Update incentives:** an appropriate incentive regime is a cornerstone for effective portfolio transformation, and must engage all resource types. Parochial concerns over P&L ownership need to be de-fused, for example by migrating to alternative P&L/cost models. The temptation to avoid short-term conflict and design the future model around key individuals should be resisted.
- **Develop required capabilities:** to deliver a compelling multidisciplinary offer, providers need to ensure alignment between specialist resource demand, existing capability supply and talent and succession planning. To facilitate effective 'pull through', the portfolio offering needs to be clearly understood, not only within the corporate office but also at site manager level.

Processes

- **Revise business processes:** providers should recognise the limitations of attempting to deliver a portfolio offer, without updating in-situ processes. Equally, the heterogeneity of service offerings and tendering processes required to meet client needs must be recognized. The portfolio offering must be complemented by a coordinated go-to-market approach that can deliver deeper customer relationships.
- **Consolidate back office systems:** from a systems perspective, organizations need to move beyond short term tactical wins and address the root causes of fragmented back office systems and inflated overheads.

Organization

- **Leadership and communication:** finally, effective portfolio strategy implementation requires visible and sustained senior leadership support. Leaders should take care when considering whether to defer change efforts, as often this can result in lost momentum, and encumber change efforts by giving existing processes, cultures and ways of working more time to embed themselves.

Conclusion

The industrial services sector plays a vital supporting role to a number of essential resource and manufacturing industries. However, just as these industries are being forced to take a hard look at long-established business models in response to fundamental market shifts, so industrial service organizations must also recalibrate offerings and capabilities to address the changing needs of their customers.

While this can be a daunting prospect, for those organizations that equip themselves with the four CSFs highlighted in this paper, the chances of translating compelling portfolio strategy into a practical portfolio offering will be greatly enhanced.

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Arthur D. Little

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