
Manufacturers have a huge opportunity to improve their financials by managing the risks inherent in their capital investment projects better. Below is an excerpt from an article in The Oliver Wyman Risk Journal which describes our firm's approach to managing the risks involved in building power plants, factories, transportation infrastructure, and other large investments. This unique approach has helped our clients to reduce their cost overruns and delays on such projects by 20 percent or more.

MAXIMIZING RETURNS ON LARGE INVESTMENT PROJECTS

At any given moment, more than 200 large public and private capital investment projects, each worth at least USD 500 million, are in progress globally. Thousands more valued at USD 100 million are under way. These gargantuan numbers are bound to become even bigger. An estimated USD 53 trillion needs to be invested in public infrastructure by 2030 to keep the global economy on a firm path to recovery, according to a recent study by the OECD supported by Oliver Wyman's Global Risk Center.

Unfortunately, unless organizations improve how they manage the risks inherent in large projects, these investments could suffer from huge losses. Consider: The construction of a nuclear power plant typically runs over budget and is 150 percent behind schedule. In addition, utility companies forego roughly USD 1 million in revenues every day that a plant's construction is delayed. Indeed, the real cost of a delayed construction project can be more than five times the cost estimated during the development phase.

Oliver Wyman's project experience has shown that companies can often reduce cost overruns and delays by at least 20 percent by professionally managing the risk of large infrastructure projects. At every stage of a project's life cycle, organizations can improve their large projects' returns significantly by making risks transparent, and subsequently quantifying and anticipating them. At the same time, companies must flexibly adapt both the focus and plans for their project to changing conditions and difficulties as they arise. In addition, they need to establish key milestones that can be tracked to avoid potential problems before they negatively impact a project's results.

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STAGE I: INVESTMENT DECISION

By identifying the risks inherent in different options, companies can quantify and take into account how their fundamental project decisions will impact a project's future returns – even before deciding to invest in a specific project. They can prioritize competing projects and thus build a project portfolio with higher risk-adjusted returns. By including operational, technical, and economic information in their risk assessment, railway companies, for example, can choose the capacity-expansion option which yields the most stable returns in different economic scenarios.

STAGE II: PROJECT PLANNING

Companies need to design a project plan so that it will have the most flexibility after examining different trade-offs. Sometimes achieving the highest risk-adjusted return means acquiring extra materials and additional staff. For example, a company may buy two sets of a key piece of equipment and then save one in case something goes wrong. Such deliberate redundancies help mechanical engineering companies and suppliers to avoid costly delays when it becomes necessary for them to increase their capacities.

STAGE III: PROJECT EXECUTION

Another key to improving a large project's returns is for managers to monitor its operational and financial performance closely. Operational key performance indicators, such as accident frequency and maintenance quality, as well as future-oriented cost/benefit analyses of countermeasures can help to improve both the stability and the quality of the process. By setting up an early warning system, a leading European utility company, for example, was able to avoid delays during the construction of a power plant and saved several hundred million euros as a result.

In our experience, companies that apply state-of-the-art risk management techniques to their large projects can significantly reduce delays and cost overruns. World-class businesses are increasingly tapping this potential.

THE OLIVER WYMAN RISK JOURNAL

The Oliver Wyman Risk Journal is a collection of perspectives on the complex risks that are determining many companies' futures. It provides insights on how companies can improve their performance by managing risks more effectively. The Risk Journal highlights how emerging risks are developing into pressing threats. It also explores the urgent need for companies to develop more risk-aware cultures. Other perspectives examine how enterprises can better meet new challenges introduced by developments such as rising sovereign risk and increasing scarcity of financial resources. An online version is available at www.oliverwyman.com/riskjournal.

