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As Opportunities Emerge, Strong ERM and Innovation Will Rule the Day

Is the construction sector on the rebound after the global economic recession that began in 2008? The construction industry and financial analysts are in some disagreement as to whether measurable recovery is under way, particularly as many countries continue to experience budget and deficit constraints. While the rate of growth may be in debate, opportunities are emerging. The fastest way to grow will be through innovation. And with new innovations arise new risks.

A March 2011 report, published by global economic consultants Global Construction Perspectives and Oxford Economics and sponsored by PricewaterhouseCoopers, predicts growth in the US construction sector to average 7.8 percent over the five year period from 2010 to 2015 and will contribute to some \$14.5 trillion USD in construction spending through 2020. Remarkably, the report predicts that global construction will outpace global GDP growth over the next ten years, forecasting that \$97.7 trillion USD will be spent globally in the next decade, and that the sector will expand by 5.2% on average every year outpacing GDP growth, with China, India, the United States, Indonesia, Canada, Russia and Australia producing the major portion of the construction growth.

The construction industry is rapidly globalizing through expansion and acquisition as contractors develop their global platform to take advantage of opportunities in emerging and expanding markets and differentiate revenue streams. This "on-the-ground" reality is reflected in the shifts being seen in global contractors' focus. While 2010 saw revenues in the US, Middle East and Europe decline, international contractors saw revenues rise in Latin America, Africa and Australasia. Both developed and developing economies recognize that improved infrastructure and energy are critical to continued growth and prosperity. As a result, opportunities are emerging in several construction markets, including:

- Energy Infrastructure, including fuel and power
- Healthcare
- Infrastructure, including roads, highways, bridges and transit, and also communication and utility infrastructure
- Mining and resource development

At the same time, demand in these markets is driving an expansion in the sheer size of construction projects. Projects are getting bigger and contractors are pushing them out at faster speeds. Consider what is happening in the Southern Hemisphere and the drive to access some yet untapped natural resources such as liquefied natural gas (LNG). Projects in Australia, intended to supply LNG to energy markets like India and China, are costing well into the double-billion digits. When the Irving, Texas-based Fluor Corporation (Fluor) announced its 2nd Quarter 2011 earnings in August, the company reported a USD 40 billion backlog of projects, setting a new company record.

In addition to these growing markets, opportunities are emerging in Alternative Project Delivery including Public/Private Partnerships, GAAP Financing and Integrated Project Delivery. Among Fluor's previously mentioned backlog are 25 oil and gas front-end engineering and design (FEED) projects. All of these methods of project delivery will present opportunity for the global capital markets to participate in project finance. As the construction industry and its partners participate in these growing markets, both Enterprise Risk Management (ERM) and innovation play a crucial role, and have the ability to positively impact the bottom line growth of the industry.

Employing comprehensive and strategic ERM should not only seek to minimize negative risk exposure, but equally important, should identify those risks which can translate into profit and increased margin.

Exposure to risk is endemic in the construction industry. Larger projects – especially the multi-billion dollar 'gigaprojects' seen in today's market – carry bigger risks. These projects demand more everything – more logistical prowess, supplies and staff, to name a few. Hence, employing comprehensive and strategic ERM should not only seek to minimize negative risk exposure, but equally important, should identify those risks which can translate into profit and increased margin. Most contractors perform some form of ERM on a project basis. As we emerge from the global economic crisis and survey the new landscape, contractors must not only fully understand the transfer of risk which is taking place, but also begin to aggregate their risks.

Budgetary and financial challenges are also impacting – and to some extent reshaping – certain sectors of the construction industry. Issues of budget and finance are at the forefront of the discussion of infrastructure construction and how critical infrastructure projects

should be funded. The structure, terms and conditions of construction sector Public Private Partnerships ("P3") is advancing, and the construction industry and its partners should be a part of this discussion, fully understanding the risk transfer and the opportunities which will emerge. Evolution and innovation in project procurement strategies and methodologies is also demanding that project stakeholders more effectively address project life-cycle costs and opportunities. The construction industry has traditionally distinguished design, construction, and operations & maintenance (O&M) as separate and distinct phases of project procurement – and addressed risk financing and risk transfer needs on a similarly fragmented basis. New procurement realities require a far less "siloed" approach, and greater long-term "lifecycle"-oriented collaboration between design, construction, O&M and project finance participants.

Enhanced ERM will be essential in this environment to address the significant transfer of risk – to allow contractors not only to mitigate such risk, but also to recognize, allocate and recover its cost. This opportunity will, in turn, drive innovation. This atmosphere presents new prospects for the risk management industry to add value to business relationships with clients, helping manage new and emerging risks in a changing environment. Construction insurers and surety providers are becoming a bigger part of the process from the start of these projects. By listening to their customers, understanding contractors' changing needs and challenges, insurers and the surety market are establishing strong and collaborative working relationships with their construction clients. They are staying abreast of changing market conditions in how construction projects are financed and the type of performance security owners and lenders are requiring on projects with private financing. By working closely with contractors, the risk management industry is gaining a strong understanding of the risk associated with project of all sizes.

With appropriate enterprise risk management that engages innovative insurance and surety products, contractors can build a strong competitive market advantage.

About the authors

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