Fluor's Restructuring Misses the Mark[1]

Fluor's strategic review announced on September 24 2019 uses the all-too-familiar playbook of reducing costs through capital reallocation, overhead reduction, and project management. Although necessary, this singular focus on cost-cutting is unlikely to fix the more fundamental problems with Fluor's strategy. Like many other EPC companies, Fluor's CEO and board appears to have missed the mark by downplaying customer value.

The C-CUBES™ Customer Value Index (C-CVI) provides a consistent metric of customer value for the energy sector. The C-CVI is based on over 6,000 customer evaluations of 110+ major energy companies. A score of 100 on the C-CVI indicates a company that is delivering the highest level of customer value, and a score of 0 indicates the lowest customer value. The average C-CVI for the energy sector is 76.3.

Customer value drives earning, believe it or not. Figure 1 compares the earnings performance of companies with their C-CVI. The pattern is clear and telling. Fluor, McDermott, and SNC-Lavalin, the three competitors with low C-CVI scores have consistently missed earnings estimates, even as their leadership has cut costs. With higher C-CVI, KBR and Jacobs have met or beat earnings estimates.

We have used machine learning technology to confirm this strong predictive association of customer value and stock returns, using a larger database of 600+ B-to-B companies. The EPC sector is no exception!

Figure 1: Customer Value Index and Earnings

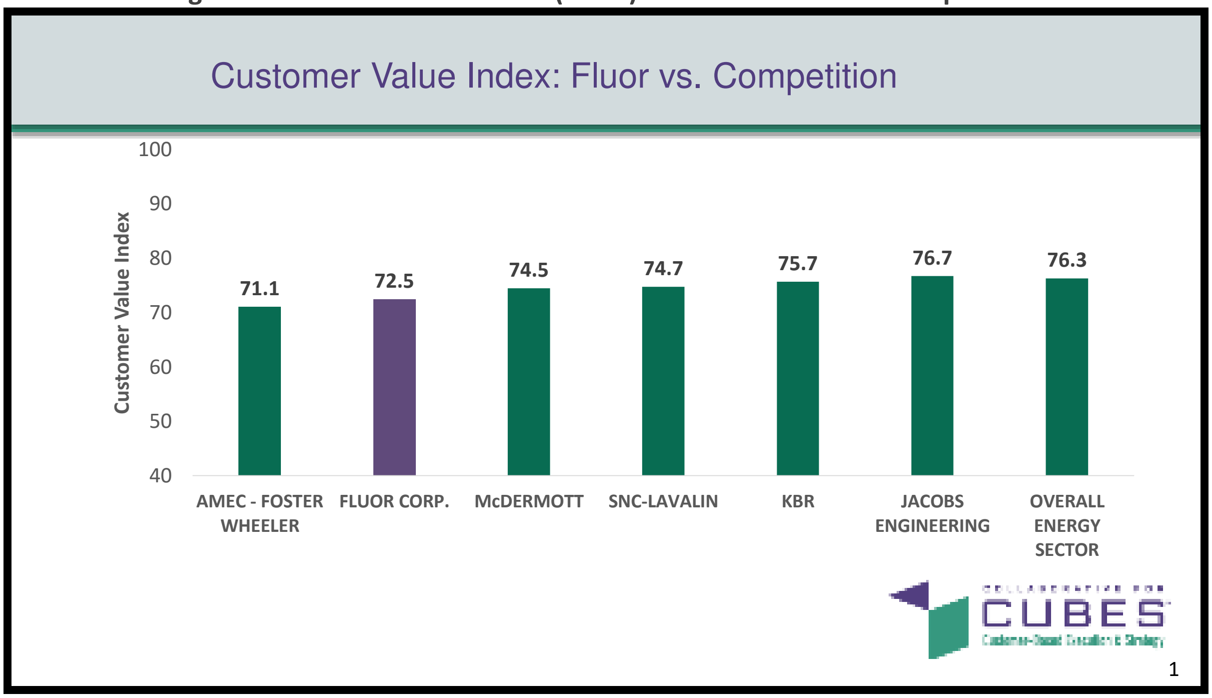
Customer Value and Earnings: Hit or Miss?

	C-CUBES™ Customer Value Index	2018 Q3	2018 Q4	2019 Q1	2019 Q2
Amec Foster Wheeler	71.1	N/A	N/A	N/A	N/A
Fluor	72.5	Missed	Missed	Missed	Missed
McDermott	74.5	Missed	Missed	Missed	Missed
SNC-Lavalin	74.7	Beat	Missed	Missed	Missed
KBR	75.7	Met	Beat	Beat	Beat
Jacobs	76.7	Beat	Missed	Beat	Beat

2

Fluor ranks very low on customer value, as perceived by customers. Relative to its competitors such as Jacobs (76.7) and KBR (75.7), Fluor's C-CVI is 72.5. As far as customers are concerned Fluor is not satisfying their needs as well as its competitors. To wit, Fluor's September 24, 2019 restructuring announcement *does not once mention the word customer*. Fluor's 29- slide Strategic Review posted online, *mentioned customer satisfaction only once* claiming that Stork, a division had "maintained focus on safety, client satisfaction, and profitability while completing necessary consolidation, restructuring, and making divestments."

Figure 2: Customer Value Index (C-CVI) for Fluor and Select Competitors



A strategy driven by cost cutting is misguided. Fluor's focus on relentless cost cutting, bid selection, and project management will make it more inward-looking. It will erode customer value and dampen revenues.

In an analysis of 626 B-to-B companies rated by 4,105 customers we measured cost focus and customer focus for each company. Then we related cost and customer focus to sales and margins. On average, customer-focused companies had 31% higher sales and 21% higher gross margins than cost-focused companies!

These results mirror the results of our 2014 study of 429 mergers—companies with a parallel focus on cost efficiency and customer value created 530% more shareholders value than cost-focused companies. Cost-focused companies eschewed revenue expansion opportunities hurting top line.

Now What? With their inward-looking approach, leadership and board members at many EPC companies will damage long-run performance unless the goal is to explore strategic options. A better way forward starts with customer value and its drivers to focus the company's strategy. The cost focus is a natural *consequence* of disciplining operations and initiatives to support critical customer-value drivers that build revenues. By itself, cost cutting is not a strategy. Customers, after all, are the main sources of cash flow for any company.