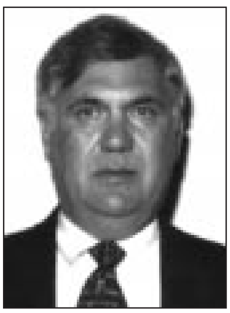
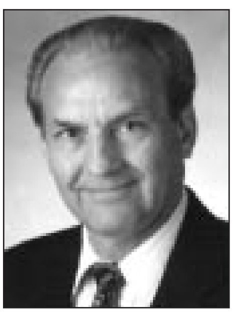
EQUITY PARTICIPATION IN PROJECTS

SALLY LOVE

Sally Love, Paragon Consulting Group



Tommy Thompson, Union Camp Corp.



Elgie Harrison, Cedar River Paper Co.

This is the fifth article in a series taken from the TAPPI Engineering Management Committee ROUNDTABLE discussion held during the 1997 TAPPI Engineering and Papermaking Conference in Nashville, TN.

Equity participation aside, what is your position on partnering or strategic alliances?

Gerard Closset: We have not actually done that. We have studied it, and we believe that this is something that we are going to want to do in the future. We believe that if you choose a partner or partners wisely and you establish a long-term relationship, there is much more to gain than lose. We believe that it will require a fair amount of time and patience and that it may take one or two projects to really get the partnership going well. We believe that it is a way of achieving lower cost for the project, if it works right. I realize that I'm describing an ideal situation, but one of the goals would be to get the right people, the right team from the engineering consultant, and our company together to do the best job on the project. That's the kind of thing that we would strive for in a partnership.

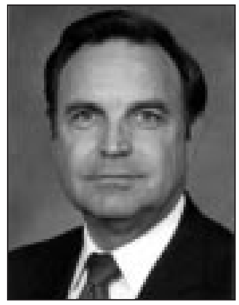
Are you inferring that you would not get the best people if you just went out and hired the engineering firm instead of getting them as a partner?

Gerard Closset: You really have to work at that. Most of the time you do, but sometimes when business is booming, it's a little hard to get. One of the carrots, so to speak, for getting into a partnership would be to work long-term with the same team of people. Those people would know our company and know our people and could work very well on the projects.

Larry Crawford: Long-term is ideal, but I'm not going to worry too much about it. On a project-by-project basis, if I could get into a situation with an engineering firm, construction firm, or a combination where there are certain penalties and bonuses, then okay. If there were penalties and bonuses based on project cost, schedule, facility capacity, proven test capacities over long periods of time, and product quality, then most of the things those people do are going to be in our best interest. That's the kind of deal we want to get in on.

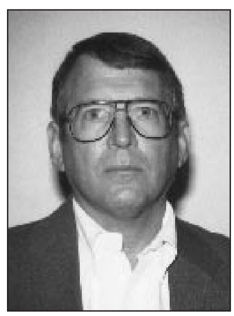
Howard Johnson: I agree with that as long as you get to that point through competitive bidding. That way you have your best price, best schedule, and you have all your warranties in place. Then if you've got a bonus-penalty situation, it will work well for both parties.

Dick Ellis: I think partners are extremely important. I want them



Howard Johnson, Bowater Inc. Southern Division

Gerard Closset, Champion International Corp.

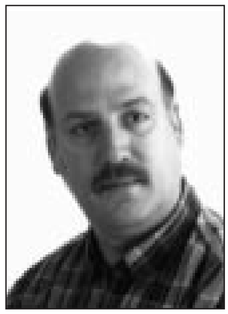


Larry Crawford, International Paper Co.

Dick Ellis, Inland Packaging and Paperboard Inc.

Jim Emerson, MacMillan Bloedel Packaging Inc.

Ben Thorp, Georgia-Pacific Corp.



Byron Alvey, Willamette Industries Inc.

Pedro Pedroso Georgia-Pacific Corporation

for two reasons. First, for the long-term relationship so that the initial study and the initial conceptual design is done well enough that we can bid out final engineering. Secondly, to build cookie-cutter units no matter what their sizes, whether it's a $500,000 biological reactor or $6000 press unit, we can cookie-cutter them in the kind of mills and operations we have. What I've found so far conceptually is that not just one engineering firm is satisfactory. We're looking for partners where several engineering firms can work together with different expertise and even work with other consultants as part of an overall team. We also want teams of vendors to support our projects.

Howard Johnson: There are places for partnering, but you have to have checks and balances periodically along the way to make sure that it is still a win-win situation for both parties. If you don't have that, then one day you'll wake up and find out that it's not a good relationship for one of you.

Isn't one of the advantages of an alliance or partnership that you get preferred teams on a continuing basis that saves you money?

Pedro Pedroso: Yes, especially when that team gets to know the mill, the personnel there, and the equipment. When you don't have to get all the engineers coming in and learning the equipment and where everything is, it saves time and money.

Jim Emerson: Speed is a real advantage of partnering, and we all know that speed is money in our business. If you don't have to go through a repetitive education process among people that you deal with, I think that can lead to a competitive advantage.

Byron Alvey: We talk about having a dream team and keeping that team together for the next project. Well, the next project is not the same as the last one, and the dream team is going to be different for the next project. It's having the right people on the right project that makes the difference.

Tommy Thompson: We do not partner. Our workload and backlog varies. If we were constant, then I think partnering would have merit. We generally have three or four companies that we have a relationship with. When we have a project to do, we go to those firms and ask them to propose their best team. Certainly, we consider cost, but it's also the people available at that time. That is the approach that we take to select the right engineering firm.

Ben Thorp: Too often we start talking about partnering before we know what we're talking about. Function does not follow form. Function comes first. What is it we want to do? Why do we want to do it? How do we want to do it? When we know that, then we can start talking about whom we want to do it with and why do we want to do it that way. We need to define up front what's really critical for us and get that down. Then if there is somebody that wants to partner around that for a project or for three projects now and later, that's fine. We have to be very clear about our objectives. When you're very clear about your objectives, you can write a contract. When you're very clear about your objectives, you can form a partnership. I can't find much difference between the two.

Elgie Harrison: When you sign a contract with someone, they'll do the best they can for the money you pay them. In a partnering relationship, you have common goals with common incentives. With that comes efficiencies that you can't count on with just a contract.

We started using the industry as a benchmark for how long it would take to do a project and how much materials cost. Once we chose our partner, then together we did other competitive bidding so we could get all our project costs and our schedule outlined at the beginning of the project. Even after doing that together, we were able to bring the project in three months sooner than we had planned. Even though we had hoped for that result, it was still a little bit of a surprise.

On our second project together, we trimmed everything down to the point where we shouldn't have been surprised a second time. This time we came in four months early. It was clear that the same group was getting better at doing the same thing.

Ben Thorp: But if you have defined what is needed, what you want, and if the persons that you're dealing with have also defined in detail their needs and wants, I find very little difference between a contract and a partnering relationship. The elements for a good contract and the elements for a good partnership are exactly the same. The problem with contracts is that we tend to treat them too callously, and we don't write into contracts what we really ought to be writing into them.

Elgie Harrison: The difference for us was in the relationships and the speed with which that relationship allows you to make decisions.

Is there an ideal length for an engineering partnering relationship and would you prefer one engineering partner or several?

Jim Emerson: There is no magic number, but I would think three years as a maximum. Since firms change and people change firms, you need to limit the relationship.

Howard Johnson: I think it's probably not just one firm in most cases but rather two or three.

Larry Crawford: I would want to work with more than one. As far as duration, as long as we're receiving value it could be three years or 30 days notice. I don't ever want him in my business or into the financial calculations of our projects primarily because they are competing for completion of those projects and that gives them an insider trader status.

What kinds of partnering efforts do you have underway with equipment vendors, or do you think that you're better off to bid competitively?

Elgie Harrison: We have some experience with single supplier relationships that can lead to partnering over time. The supplier becomes aligned with your long-term needs and goals and also develops a comfort level that you are going to buy from him rather than jump to his competition with each new buying situation.

Pedro Pedroso: We do some sole sourcing in our mill for things such as nondestructive testing, insulation contractors, and electrical switch gear. We competitively bid to select the supplier. Then we award a contract for three years and review it on a yearly basis. After the three years, we may go to a five-year plan. In one situation, we have a contract on a yearly basis tied into the market cost for raising prices. We have saved a lot of money as a result.

Howard Johnson: For a number of years, we had an exclusive relationship, not necessarily a partnering situation, with a major supplier. All of a sudden, we woke up and found out it was not in our best interest. However, today we're doing some other partnering corporate-wide on both consumables and equipment such as pumps and motors. We get to that point with competitive bidding. We feel that we're saving money. We have built in checks and balances to make sure of that. We have the right to trial other suppliers periodically to ensure that the relationship we have is still workable for them and for us.

Would any of you panelists partner with each other?

Jim Emerson: I think that is going to occur naturally through consolidation of our industry whether we like it or not. Sooner or later, we're going to be partners. We just don't know which ones.

Elgie Harrison: About the only way you would do that on purpose would be with someone with whom you were not competing already in your area. You might have a relationship with someone such as in Europe and then do a joint venture in Asia. I don't think it's feasible to think in terms of two strong competitors in the same market area jumping into partnering relationships. TJ

Sally Love, president of Paragon Consulting Group, was moderator of this Engineering Management Roundtable.