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Toward a customer-centric construction-equipment industry

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In a time of considerable change, European OEMs see value-creating opportunities in demand from outside markets and in aftermarket services.

The construction-equipment industry is in the midst of considerable change. Demand has been highly volatile and is currently weak, the customer landscape and expectations of OEMs are changing, new and potentially revolutionary technologies are coming (for instance, electrification and big data), and competitors from emerging markets are getting stronger. Change is not new in construction equipment. But what is unique about this moment in the industry's development is that many of these changes are converging and hitting the industry all at once.

Although most trends have global impact, these shifts will likely be accentuated in Europe. The European market has traditionally been complex, with a variety of local specifications, and fragmented, with OEMs focused on national markets. Although the market has been consolidating for years as demand and standards globalized, Europe remains more complex and fragmented than other markets. Today more than 450 OEM groups are active in Europe, and even though almost 75 percent have revenues of less than €100 million, across the board, they have more than 40 percent of their business in other continents. Furthermore, the European demand situation has been challenging for several years because construction activity is low.

To develop a perspective on these changes, we took the pulse of industry players (see sidebar, "Our methodology"). Of more than 75 OEMs surveyed in Europe, 69 percent are positive about the next five years. On average, they expect their own revenues to grow at 5 to 6 percent annually and their margins to improve by two percentage points by 2020. This positive outlook for the medium term is generally shared by industry experts; however, they are more conservative about the next year or two and are thus also more modest about the total growth and margin prospects through 2020. The high growth expectations are largely driven by the industry's recovery after the demand slump in recent years.

European OEMs highlight two trends as the primary value-creating opportunities for the next five years: the demand from markets outside Europe and the increasing importance of aftermarket services (exhibit). Asian, Middle Eastern, and African markets are expected to have the greatest growth prospects, and aftermarket services may allow margin boosts in developed markets. But to capture the potential of these two trends, it is essential that

Our methodology

A survey of 78 OEMs was carried out between November 2015 and January 2016, covering groups active in Europe. The participants included both large multinationals (headquartered inside and outside of Europe) and smaller local players, including those with construction-equipment-related revenues that range from less than €10 million to more than €5 billion, representing most regions of Europe and all primary machinery types. Research results and outcomes of the survey have been interpreted and analyzed in discussions and interviews with more than 30 industry experts. These include McKinsey professionals who serve many of the industry's leading OEMs; current and former senior executives from OEMs of many sizes, geographies, and machinery portfolios; and independent industry experts and consultants. A core panel of expert industry executives convened regularly during the analysis of the research and the writing of the report to review and pressure-test findings. The survey and parts of the reviews were conducted together with the Committee for European Construction Equipment.

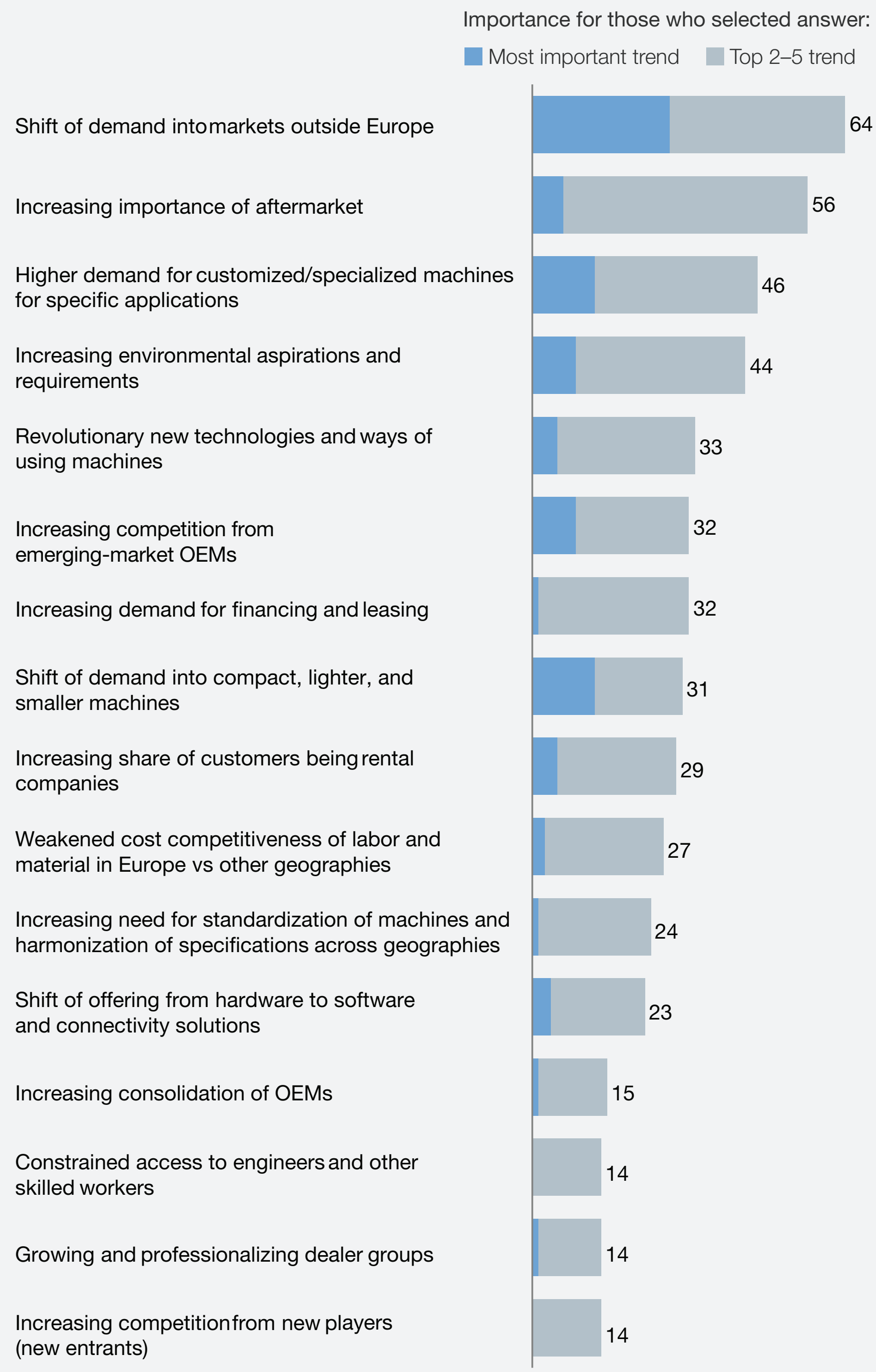
European OEMs offer differentiated products, services, and solutions. These players see emerging-market competition as a key threat and will not be able to compete with them on price in most cases. Differentiation requires a deep understanding of their customers' businesses and a leading technology position—when it comes to the actual machines, as well as the ecosystem surrounding the equipment.

When European OEMs describe their most successful peers in recent years, they emphasize excellence in operational scale and low-cost production and sourcing as the capabilities underpinning their success. The construction-equipment industry has traditionally been heavily focused on engineering, but the manufacturing factors of scale and cost have become a priority as international competition intensified. Looking forward, OEMs point to a drastic shift in their priorities. The most important criteria for success in the future are perceived to be developing a deep understanding of how customers create value and being on the technological forefront. This goes hand in hand with the foreign market and aftermarket opportunities. While these opportunities are by no means new, there is a distinct change in the mind-set and focus of OEMs regarding how to go after them—they're shifting their emphasis from operations to a customer-centric perspective.

Exhibit

OEMs consider the shift of demand into markets outside Europe and the increasing importance of aftermarket services the key trends.

Share of OEMs ranking trend among 5 most important, %



McKinsey&Company | Source: McKinsey European construction equipment survey, 2015–16

This shift is happening now as a result of several converging trends in the industry on both the OEM and customer sides. The two parties, as well as dealers in between, are drawn together, for example, as machine data reaches a pivotal point for OEMs to support customers on operations. The rising complexity of machines, which requires deeper expertise, and customers' growing focus on their core, including increased outsourcing of maintenance and repair, also bring OEMs, dealers, and customers closer together.

Industry experts agree that this shift is a critical step in securing long-term prosperity for European construction-equipment OEMs. However, the new mind-set and priorities must be translated into concrete plans and actions. To gain deep customer insights and stay at the forefront of technology, OEMs need to take several steps:

- collaborate closely with dealers to gain access to and deliver on customer insights
- raise R&D investments and make other selective investments to keep pace with accelerating technological development
- develop refined performance-related offerings for customers
- modularize product portfolios to retain scale benefits while differentiating the offering
- build new capabilities and rebalance governance from operations to customers
- strengthen their agility and action orientation in corporate processes

Construction equipment in Europe is about to transform, and many potentially disruptive changes could come faster than anticipated. But there is a healthy optimism among industry players about what lies ahead. OEMs see opportunities both to grow and to increase margins, and they are clear on the shift in mind-set and focus required to succeed. The move from an operations-focused perspective to a customer-centric one is a major step in the right direction. This now needs to be translated into strategic choices, concrete actions, and visible changes in the daily business. By acting urgently and decisively, construction-equipment OEMs in Europe have great prospects in the years to come. □

Download the full report on which this article is based, *Reengineering construction equipment: From operations focused to consumer centric*, on McKinsey.com.

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