



Oryx Middle East



# Construction Industry in the UAE

Strategic Assessment





## Abstract

This paper provides a strategic assessment of the construction industry in the United Arab Emirates (UAE). The major questions considered are: the structure and composition of the industry, the strategic principal groups, the industry trends, the life cycle, and a critical examination of the implication for strategy change after the 2007 financial market downturn. The implications for strategy change are examined using Porter's 5 Forces Model and SWOT analysis.

## Preface

The UAE construction industry represents a correlation among four major forms of capital: industrial, commercial, financial and property. This configuration is structured by the strategies of the leading construction organisations. This article discusses the relationships between the major players and the resulting industry structure.

The structure described in the article combines the national, industrial and economic environment specific to the UAE. Concerning statistics, the official UAE sources have to be addressed carefully because the construction industry is still emergent. Therefore, in this article, the environment is assessed based on statistics compiled by the International Monetary Fund and Oryx Middle East research team.

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## Players' organisation

The industry structure in the UAE is mainly shaped by the Joint Ventures (JVs) between foreign and local organisations. Local shareholders usually account for 51% of share capital, due to the 49% foreign ownership restriction in companies registered in the UAE. However, the distribution of profits is flexible and is not necessarily aligned with the percentage of ownership.


JVs combine the advantages of both partners: a) The authority for business management and strategic decisions is usually assigned to the experienced foreign company, which has the best knowledge and expertise, the capital to acquire the required market share, and a clientele base from the international and local arenas; and b) Local shareholders bring links, contacts and a deep understanding of the specific conditions of the UAE's market. These dominant firms set the rules of the game for product and site policies, pricing strategies, marketing approach, and construction standards and contracts.

### Construction companies may be classified in the following strategic groups:

- ▶ Real estate developer (owner, client, bank, fund),
- ▶ Project manager,
- ▶ Design and supervision consultants,
- ▶ Design and built contractor,
- ▶ Sub-contractor (specified, MEP),
- ▶ Building materials and services suppliers.

The players in each strategic group share similar competitive characteristics and distinguish themselves from other groups. The typical relationship between strategic groups is linear: the real estate developer announces a plan for a project and assigns a project management company to develop and supervise a project. The contracting companies submit their bids for the project; after a set of negotiations, the developer awards the contract; and the contractor takes the responsibility for the accomplishment of the job within the set budget and timeline. The contractor may sub-contract a job or part of it to a sub-contractor or do the entire job. During the construction period, the contractor will involve building materials and service suppliers.

This classification presumes that the different strategic groups in the construction industry are not necessarily in direct competition with every other group, but only with companies active in the same group. Additionally, because companies of one strategic group depend on players from other groups for their own success, there is typically cooperation between companies from different groups.



Each construction project involves a particular configuration of four forms of capital: industrial, commercial, financial and property. These four types of capital, combined with the six strategic groups, form the matrix structure of the construction industry in UAE.

All companies from any strategic group have both a commercial and a financial strategy, since they buy and sell (commercial strategy) and borrow and lend money (financial strategy) in order to accomplish their job. Players that control the production of some of the commodities they sell must also develop an industrial strategy, and players that acquire and hold stocks of real estate are involved in property investment (property strategy).

### **Competitive market**

Statistics of market shares in the construction industry prepared by Oryx Middle East in December 2007 display a clear picture of the leading firms involved in contracting activity. We may see that 18 organisations control 48% of the market share. The top five companies account for 25% of the market and 11 more for 1% to 2% of the market. We may assume that the remaining 52% are dealing with smaller scale projects.

The two major causes of this large spectrum of players are the emergent nature of the market and the division into strategic groups, which increases the competition by segmenting the industry into sub-industries, where smaller players can easily find a place.

The best description for this type of market structure is a competitive and fragmented market.

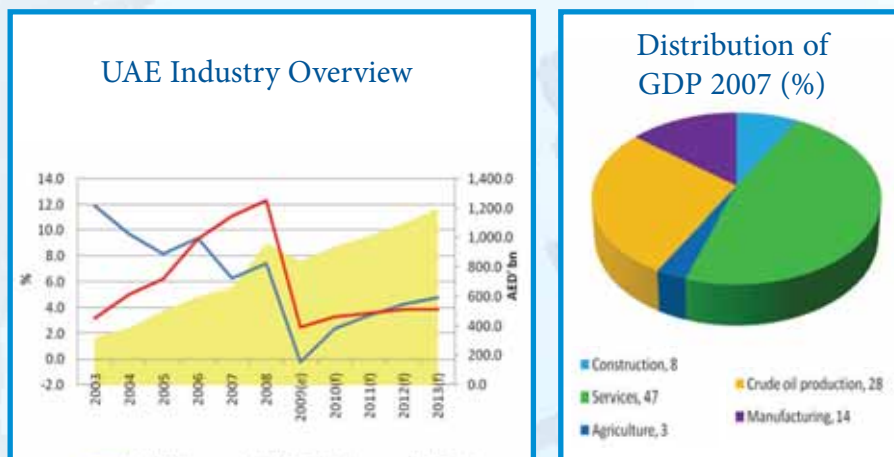


## Industry trends

The world's third largest re-export centre after Hong Kong and Singapore, the United Arab Emirates is the most important trade centre in the region. With a policy of stringent public spending, increased oil revenues, and economic diversification partnered with a fourth consecutive zero-deficit budget, the UAE appears set to strengthen its position as a primary regional trade, business and investment powerhouse.

With a real GDP annual growth of 4.4% on average during the period 1991-2000 and 7.2% during 2001-2008, the UAE's economic growth was amongst the strongest in the world. Despite an expected drop of -0.2% in 2009, due to the financial crisis and low price of crude oil, a 2.4% recovery is expected for 2010, and a strong recovery, above 4%, for 2014.

While oil exports continue to play a major role in the UAE economy (about 30% of the GDP), the economic boom of the last years is also due to the UAE's economic diversification strategy in the non-oil sectors. The construction industry, considered one of the key sources of employment, income and growth, contributed about 8 and 12% respectively of the GDP and non-oil GDP in the last years. This share is high compared to Western countries.



## Industry life cycle

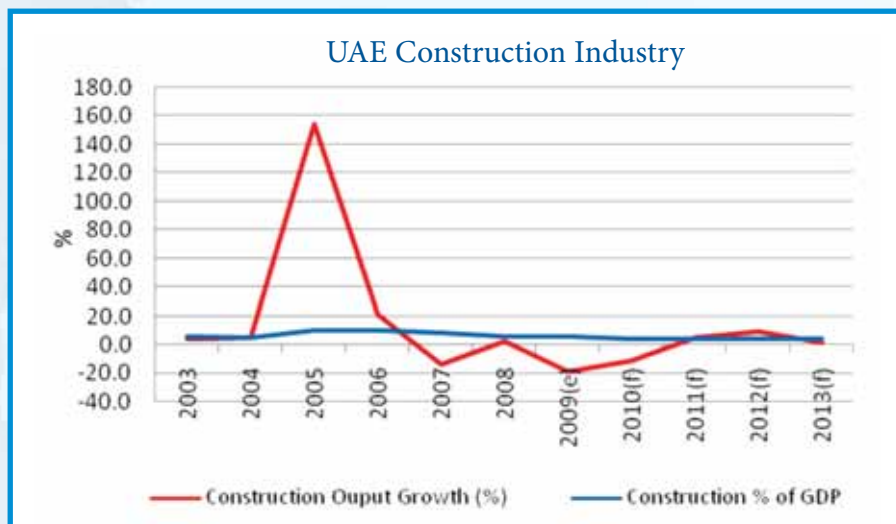
The construction industry in the UAE emerged in Dubai in the 1950s, when Shaikh Sayed bin Maktum, together with his son Rashid, decided to transform Dubai into a 'permanent haven for coastal shipping' and launched the Dubai Creek improvement project. A project valued at £600,000 was funded by 'Creek Bonds', bought by the leading merchants in the region at six per cent interest, as well as a loan from Kuwait.


In the late 1950s the ruler of Abu Dhabi, Shakhbut Bin Sultan Al Nahyan, supported Western oil exploration, which earned Abu Dhabi \$70mn a year in the mid 1960s. As oil revenues increased, the construction industry rapidly expanded, as evidenced during the rule of Sheikh Zayed bin Sultan Al Nahyan when he undertook a massive construction program, building schools, housing, hospitals and roads.

The industry started to expand during the economic development at the end of 1990s, contributing in average 9 per cent of the GDP.

The year 2005 showed a rocketing increase in construction industry output, which peaked the next year at AED' 62.4bn. Since then, the output has maintained a high level - above AED 40bn per year.

Figure 3. UAE Construction Industry Dynamics





The ability to attract large overseas investments, notably in the construction industry, has raised the UAE's status as a source of funding for the global economy. The dramatic growth in its economy has led to the creation of a dynamic business environment, something that has brought an influx of foreign investors to the UAE.

In December 2007, the Construction Industry Review by Oryx Middle East warned: 'Although the overall outlook is favorable, the downside risks from the global economy have increased.' In 2008, when the world economy crumbled, the UAE still continued to build.

The 2007 recession didn't affect the UAE's construction industry until 2009, and it particularly affected Dubai. Dubai's non-oil sector has been most affected due to its linkages to global trade and financial markets and by the fall in real estate prices. The global correction in residential real estate markets has generated large declines in house prices and construction activity worldwide (a median annual decline of 7%), especially in the UAE (a decline of 35%), in the third worst position after Latvia and Estonia.

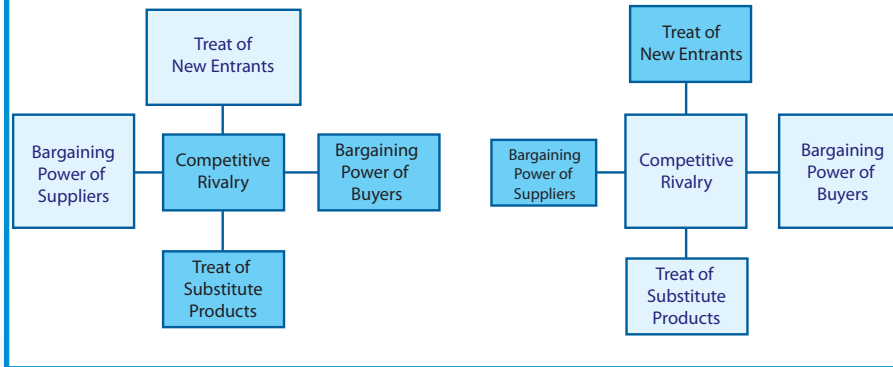
### **Strategy change and competitive issues**

The 2007 financial market collapse affected and still affects the construction industry in the UAE. Projects were delayed, put on hold, or cancelled at an unprecedented rate. Companies' confidence declined and organizations began to rethink their strategy and prepare for a dramatically changing landscape by analyzing their micro-environment: markets, customers and competitors. Many organisations experienced problems adapting to the environmental changes, and, unprepared for a change, they adopted a survival strategy rather than a growth strategy.

Using Michael Porter's framework (Porter, M. E., 1979) of the competitive dynamics that shape the industry, we may analyze the change in forces at work in the construction industry.



## Porter's 5 Forces Model



The changing dynamics in the competitive environment heralds the end of the previous market expansion and suggests that the companies need to reassess their strategy in order to remain viable and move forward. The 2007 recession in the construction industry's economic environment created severe competition and changed the nature of the business. Consequently, there may be major structural changes in the industry.

The severe competition may force organisations to submit tighter tenders, and it will push companies to reduce their labour force. Companies will be required to adopt even more flexible forms of organisation and management in order to quickly respond to change, for example, a numerical flexibility so as to vary the headcount according to changes in the level of demand, such as an increase in the number of temporary contracts. Companies also may start to outsource the production of materials to sub-contracting companies.

### SWOT

A SWOT analysis is a handy mnemonic to help corporate planners think about strategy (Economist, 2009). A SWOT analysis is typically an audit of both the external environment (opportunities and threats) and the internal environment (strengths and weaknesses) of the organisation. In many situations, organisational strengths and weaknesses are aligned with the industries strengths and weaknesses on a macro-economical level. Although, Porter's 5 Forces Model is a set tool for industry analysis, SWOT analysis provides an additional advantage for a strategic industry evaluation.



## SWOT - UAE Construction industry

### STRENGTHS

Oil-rich country  
Political stability  
International business and investment from overseas  
Growing non-oil sector  
Tax free environment  
Attractive salaries

### WEAKNESSES

Inflation growth  
Currency value instability (AED peg to USD)  
Oil production spending increase, government saving decrease  
Shortage of skilled manpower  
Image of the 'Disney World in the desert'  
Disparities between Emirates

### OPPORTUNITIES

The rise in oil income  
Progress toward diversification into service sectors such as high-tech, logistics, ports, tourism, financial services, health, education and media  
Global increase in oil consumption and oil price rise  
Private sector-led economic expansion promotion

### THREATS

Restart of Iran's nuclear weapons programme  
Conflicts in the GCC region and worsening security  
Downside risks from the global economy  
Worsening international financial market conditions  
Competition from other emergent markets in the Middle East and worldwide





## Identification of strong players in the new competitive environment


In today's ever-changing environment, predicting the future is nearly impossible. But precise evaluation of the economic environment may provide a pattern. Through an in-depth review of the 2009 structure, some light can be shed on the possible future pattern.

During the recession period, a number of various size companies were not adequately prepared for the future uncertainty and were forced to liquidate their company. Only the strongest companies remained in the playing arena, and these can be divided into three groups:

1. Local companies dealing in the construction industry only,
2. International companies dealing in the construction industry only,
3. Groups of companies dealing in various industries.

Local companies were able to withstand the crisis due to a strong clientele base in the governmental sector. The country had a budget surplus from the previous years and could still continue previously planned infrastructure development. In addition, in mid-2009 government pledged a bailout to banks with an initiative to support local businesses. The most impressive example was the US\$ 10bn Dubai bailout from Abu Dhabi mid-December 2009.

The second group, international conglomerates, may be driven by very pragmatic considerations such as 'is there a business or not'? They move with the flow in environmental change. While during the industry boom period they expanded their operations and labour force in this region, during tougher periods they will shift their labour force to other countries where jobs exists, for example to South Africa or Saudi Arabia. South Africa has to finish the construction projects for the FIFA World Cup scheduled for 2010, and Saudi Arabia is developing the industry to accommodate their plans for the future Kingdom's infrastructural development and economic prosperity.



The last group, companies active in various industries, may follow the same move as the second group by shifting their activities from the construction industry to the other sectors with which they deal, or even to develop in new, more promising sectors.

As displayed in Figure 4, in 2009, the competitive rivalry in the construction industry has increased. In this context, it may be projected that only well-placed companies with strong local relations will survive and grow in the future in the construction industry. Stable companies with core customer relationships will be better advantaged to take the lead.


Companies that are generalists may also be more likely to survive because they are better able to adjust to change by shifting their investments and labour force from one activity to another in line with market movements. When the construction industry recovers, they will still be present in the country and will be able to reinvest in the sector. On the contrary, a specialist company is more likely to be obliged to withdraw as soon as the market becomes tougher.

Schematically, the crisis will be particularly harmful to small and medium-sized companies active in only one or two strategic groups. Local companies will continue to benefit from the sustained development of governmental projects; and generalist companies will temporarily shift their activities to other countries and/or sectors, waiting for the recovery of the construction industry in the UAE.

## Conclusions

The recent worldwide economic downturn has meant changes in the UAE's dynamic business environment. With less construction work available and heavy competition for projects, construction companies working in the UAE have been forced to reassess their strategies in order to remain viable. While local construction companies will probably weather the storm because they have a strong clientele base in the governmental sector, foreign companies may have to consider a number of options.

Foreign construction companies that have strong, stable local relations, and particularly companies that are more generalist in nature, are most likely to stay in the UAE and continue working through any tough periods.



The large international construction conglomerates are likely to assess the global environment and, if necessary, shift their labour force to other countries that are working on large construction projects.

Companies that are more generalist in nature may also have the flexibility to shift their activities to other countries while waiting for the recovery of the construction industry in the UAE, and companies that are active in various industries may also move to other markets or other sectors. The companies that are most likely to have to leave, and most likely to be adversely affected by tough economic times, are those small and medium-sized companies that are specialists or are active in only one or two strategic groups, with the result that their lack of flexibility narrows their options.

Generally, construction organisations employed in this region will have to continually work with an emergent change management process in order to be in equilibrium with the national, industrial and economic environment.

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