

A Review of Growth for Construction Service Companies in Global Markets

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Abstract

Throughout the developed world, professional services play an increasingly important part in an economy, with many countries showing a substantial positive trade balance for services. Yet, there has been relatively little research on construction services (CS) and, in particular, how well professional service companies (PSFs) perform in the international arena. The method for collecting services export information differs to the way in which goods and products exports data are gathered because of the intangible nature of services.

Organisational growth of companies aims to share risks across different regions and sectors, however, the rapidly changing business environment challenges companies with the increasing foreign ownership and changes in procurement. The complexity of today's international construction services organisations raises two questions: how the organisations can successfully manage growth and what are their motives for international trade.

The research focuses on top UK consulting engineering companies to understand their organisational strategy, their export strategy, and drivers for overseas activities. The data will feed a model of professional services exports, which can help to inform the way services export data could be collected to better reflect the industry's performance.

Keywords

Professional services, Exports, International business

1. Introduction

Construction services exports play an important part of any economy, and, like other services, are growing rapidly. Services now account for around 75% of UK output. Large engineering and architectural (EA) consulting companies have traditionally sought work overseas and have a good export record. However, there is increasing internationalisation of medium sized EA firms seeking greater opportunities beyond their domestic market. What is significant over the past twenty years is the growth of large EA firms with global reach, driven mainly by mergers and acquisitions, and some being quoted on the stock exchange. The large firms have a payroll in excess of 5,000 people and turnover in excess of £300 million per annum. The largest in the world are located in the USA, but European and Chinese firms are growing at a rapid rate. What characterises the EA firms is their reliance upon knowledge, skills, and competencies. Their domestic markets are highly competitive with the majority of firms being under 20 people.

An EA firm with a turnover of £50 million cannot be compared with a construction organisation with a similar turnover. The EA firm sells manhours, whereas the construction firm outsources most of the work and is engaged in managing risk. Exporting EA services is an easier proposition than exporting construction. The growth in EA exports reflects the changing nature of the delivery of professional services.

Measuring the performance of EA exports is undertaken through the official construction services export statistics; their collection is complex and reflects a business model of a decade or more ago. The EA business model is now more complicated with different ownership regimes, joint ventures/collaborations, the establishment and use of overseas offices with not all income being repatriated, and inter company trading; this affects both the export and the foreign direct investment (FDI) statistics.

In this changing environment, EA companies must have a good understanding of their markets, opportunities and their strengths and weaknesses. This paper considers today's business model and the drivers of overseas growth for companies. It uses company 'portraits' to review the success/growth of EA companies in international markets .

2. Research Methodology

The aim of the research is to understand how and why professional service consulting companies, in the construction industry, manage/form/adopt strategies to meet changing business models. The case study method is the most appropriate when research is focusing on relations between contemporary events and dynamic occurrences. Results/outcomes/interpretations of case studies cannot be generalized to a whole population, but they can be used to form/expand grounded theories.

Several criteria are considered in the selection of sample companies:

- Financial representation of overall services activities in the international construction sector
- Regional spread of activities overseas
- Availability of organisational growth history data, and business unit information

The first stage of data collection is designed to collect publicly available information through company histories. These data (together with the literature review) are used to form the basis of grounded theory/framework on the international growth of consulting companies. Further stages of data analyses and justification of the proposed framework involve interviews with industry participants.

The final stage of this study is to identify a model to fully represent today's construction services export business model. A realistic representation of EA companies in national statistics is only possible through efficient measurement of international activities.

3. Background

Competitive advantage can result either from implementing a value-creating strategy that is not simultaneously being implemented by any current or potential competitors (Barney *et al.*, 1989; Barney, 1991), or through superior execution of the same strategy as the competitors. Sustainability is achieved when the advantage resists erosion by competitor behaviour (Porter, 1985, p.20). In other words, a firm must avoid duplication by other firms of the skills and resources underlying its competitive advantage (Barney, 1991; Bharadwaj *et al.*, 1993). A firm's assets/resources are either tangible or intangible, with the intangible assets being far more difficult to duplicate. Branding, reputation, intellectual property and organizational culture are intangible as well as the human qualities of leadership and entrepreneurship.

This paper draws on a number of theories that contribute to the discussion of successful companies, industries and nations - strategic management, international trade, competitive advantage, internationalization and the resource-based view (RBV) – with a focus on those theories based on firm competitiveness, strategy, and internationalization. The aim is to form a common understanding of international business activities for construction professional service firms.

3.1. Setting the Scene – Global Market

Globalisation has been around for the past two decades, but its changing nature is impacting today’s business (Fraser and Oppenheim, 1997; Etemad, 2004). These impacts are through:

- 1) Greater mobility, integration of capital markets and increased connectivity;
- 2) Expansion of activity, opening up of national boundaries with fewer trade barriers,
- 3) Rapid changes in technology that allow knowledge and human capital to be leveraged worldwide.
- 4) The growth in the acceptance of the World Trade Organisation regulatory framework for the conduct of business

Construction business has changed, from the old world viewed mostly through an economic lens to a new world where societal, technological, environmental and political factors also play an important part. The changes in the construction services market have taken place in waves, each one of a different duration and magnitude – see Figure 1.

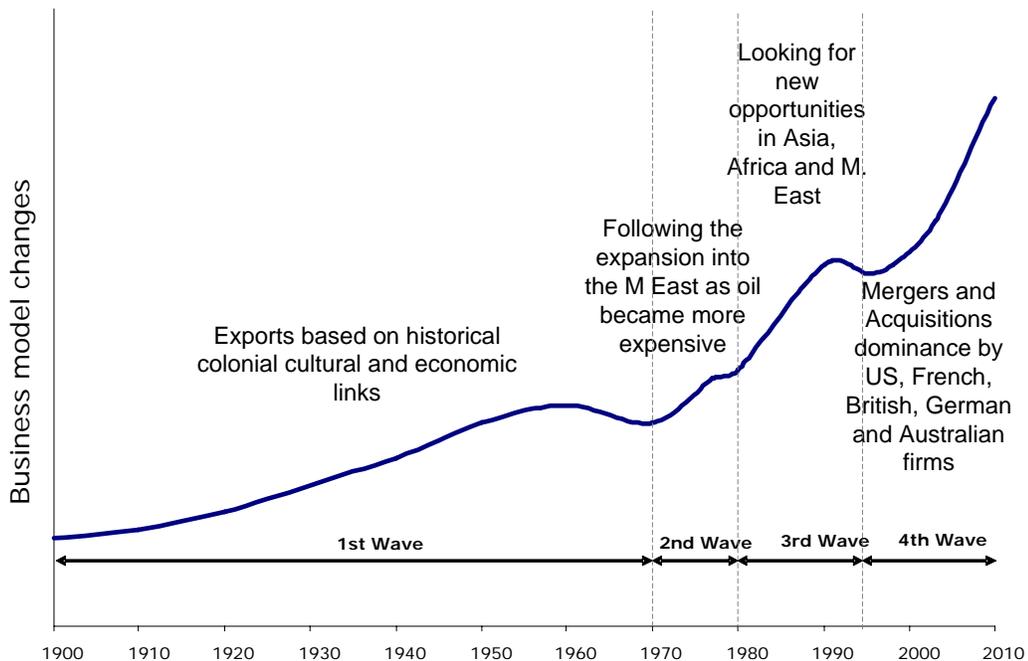


Figure 1: Waves of Change in Construction Exports

The pace of innovation and project delivery has changed; with greater interdependency and a desire to deliver projects faster using the latest information and communication technology. Business has become more complex and more influenced by world events such as the shortage of finance, the price of energy and materials, and the movement of labour. Governments have increased the layers of bureaucracy and governance procedures. This change has made markets more inter connected and more sensitive to each other, and thus more complex. For example, the increase in energy prices led to price inflation in steel,

cement, plastics and numerous other materials. Information/knowledge is worthwhile as long as it creates value. The new world order is set on a “share-to-get” based knowledge collection which allows fairly easy replication of information by “follower” companies. Technological and communicational enhancements urge the replication of information-process-products with such low cost and time that the value of “new” business approach declines. This results in an increasing demand to differentiate from the rest and a new pace of innovation is triggered.

Uniqueness of a service/product is dependent on how it is processed in the creation and marketing stages. Creation of a product/service is basically dependent on the technological or skill base related assets of a company whereas, marketing and selling of those (services in this case) is a combination of market share, entry mode and intangible attributes such as reputation and legitimacy of product/service. Unlike some construction activities undertaken on a regional basis, construction service firms are driven by evolving business approaches for survival; especially when companies aim for international coverage.

4. Internationalization of Professional Service Firms

EA firms outgrow their domestic market when there is insufficient work to fuel the aspirations and growth plans. They may wish to spread the workload risk. EA firms will have opportunities to go overseas to developing countries to undertake government aid projects, where a country seeks to offer opportunities to its home based professional services firms. Internationalisation does not happen by default, it happens by design. Internationalization is a combination of push and pull factors. Globalisation, and the change in international business, push companies to position themselves within a global competitive environment. The pull factors include overseas aid projects and clients taking the firm to new markets. They can no longer afford to remain in their domestic market where global competitors seek opportunities.

Construction projects are complex, requiring collaboration of different disciplines with design, engineering and consultancy services requiring an established professional expertise. Opportunities presented by globalization pull construction service companies to seek work in different parts of the world. Some international expansion is due to demand by newly industrialised nations who need new/improved infrastructure, yet lack the expertise to design and manage these projects (Aharoni and Nachum, 2000). Jones (2008) states that the importance of geography has not disappeared, and that trade and investment follows some strong location patterns which indicate that the world is more regionalized than globalized.

There are several studies for defining motives for international business and foreign investments (Dahringer, 1991; Nachum *et al.*, 2001; Dunning and Narula, 2004; Helpman *et al.*, 2004; Chittor, 2007). Their main focus is the motives for internationalization of manufacturing companies. However, three of these can be applied to construction services:

- **Market Seeking:** is a primary (and defensive) motive for expanding business overseas. The rise of market seeking strategies by big companies goes back to the post World War II era. However, with globalisation in 1980s, the need for greater international business became vital for the survival of a company. Market seeking is partly influenced by the desire to reduce the workload risk, where one region may be short of work whilst another is experiencing an abundance of work.
- **Resource Seeking:** With the breakdown of national borders and an increase in international work, there is a need for intense competition in cost cutting resources. An example of this is the resource transfer between Europe and Asia. The main resource for a professional service firm is

its skill base (work force). With the search for a local work force in new markets, firms also need to overcome socio-cultural barriers.

- **Efficiency Seeking:** mainly adopted by European companies. Process outsourcing is a common way of business process improvements. Services companies seeking to achieve asset diversification and risk minimization, move into different foreign markets. Efficiency seeking requires an advance organisational structure therefore mergers, acquisitions or partnership formations are common ways to strengthen core competencies. Similarly, services firms have outsourced their CAD work to low wage economies that are efficient in the application of CAD techniques as evidenced by India, Pakistan and China.

The internationalization of construction services (CS) companies is through changes in skill and financial capabilities. Both of which, must be tailored by organizational changes. Firms have internal drivers such as: building on core competencies, sharing costs and risks, advancing financial resources, economies of scale, and reaching new consumers in foreign markets. In the search for these incentives, companies follow diverse entry methods while growing into new markets. A characteristic of CS firms is that they will follow their clients overseas, sometimes being taken overseas by the clients for projects. When venturing overseas they must comply with the registration and ownership requirements which will often necessitate joint venturing, or acquiring an indigenous firm to meet the registration requirements.

The traditional measure of a company's growth overseas is the direct export of skilled workers; this does not always require the establishment of an overseas office. The mobility and flexibility of human, as opposed to physical, assets means that consulting firms have greater overseas opportunities than contracting firms. Overseas activities can be integrated either through international or foreign area divisions or through product divisions that span both domestic and foreign markets (Caves, 1996). Representative offices are more likely to be utilized when the company sees a potential for growth or continuity of work flow in that targeted region or market. A sustainable existence in a foreign market requires a level of localization. A general shift towards efficiency and asset seeking in a market forms a basis for outsourcing of services through local work force employment.

Partnerships and Joint Ventures (JVs) are common ways to enhance the skill base of two or more parties for specific objectives. JVs are generally established between a local and foreign company when there is a need to combine skill or financial resources with local know-how. Acquisitions are takeovers (friendly or hostile) of one company over a targeted company, whereas, mergers are more complex and aim to form a bigger company by combining skill bases, financial resources and, more importantly, a shared vision and objectives. These complex dynamics between parties makes mergers harder and more time consuming to establish. The ownership structure of the firm is a crucial issue as many service firms are privately owned by a principal or small group of owners. The owners must be incentivised to ensure the smooth transition of the acquisition by an earn out over a period of time. This ensures the owners do not walk away from the business. The dominant motive behind mergers and acquisitions is financial performance improvement. IVE (2009) states that large firms can spread or pool the risks of many business units under one larger unit of ownership and that they are more attractive to lenders and shareholders which make them more competitive in a global market.

5. Case Studies

Aharoni and Nachum (2009) explain the difficulty in defining the globality of a professional service firm, especially when compared across industries. The number of established offices or geographical distribution of current projects can be deceptive, especially in the case of EA firms where the business can be undertaken without the existence of multiple offices. Horst's (1972) hypothesis is that the firm runs

through its opportunities in the domestic market before incurring the transaction cost of going abroad. The firm takes on ventures abroad only after it has accumulated some critical mass of assets.

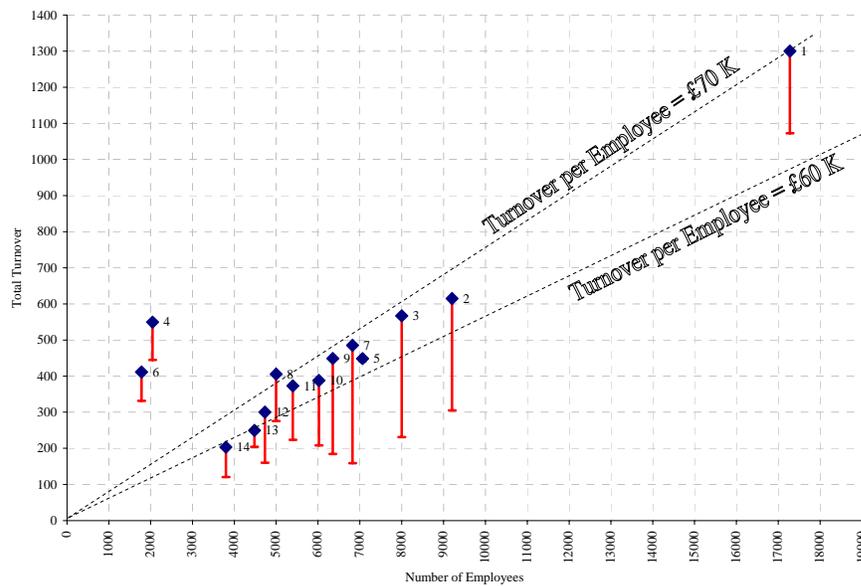


Figure 2: Leading Consulting Companies and their Overseas Turnover

This hypothesis was applied to the firms chosen for this study. Figure 2 shows a graph of the firms, plotting their number of employees against total turnover. The size of their overseas turnover is represented by a red margin line below the company’s data point. Considering the selected companies, a linear relation between their turnover growth and number of employees is shown in the figure. Most companies fall in the region delimited by £60K to £70K turnover per employee margins, whereas the overseas capacities of these companies differ regardless of their “size”. This variance in overseas activities of the consulting companies conflict with the assumption that number of employees and turnover are two common indicators of growth of an international service company. Once companies outgrow their host markets and manage to be an international player, overseas capacity can vary with different strategies and economies of scale.

Fourteen globally-active EA firms were chosen for this study. Eleven firms had more than £300 million of annual turnover in 2007 and employ more than 5,000 people. Their activities spread though various business units and geographically separate regions. Neither number of active regions nor breadth of skill base, explains their success in overseas, nor does the number of offices compared to overseas turnover gives clues about the effect of ownership patterns in different regions. Successful implementations of organisational growth together with careful definition of niches in different regions are the key to success.

This study reviews the ownership changes of these companies in order to develop a model (see Figure 3) relating to the international business motives of EA companies. The common theme from the portraits of the successful firms developed is their modest beginnings. The companies started out very focused and small-scale. The initial objective of the firms was to build a persuasive reputation for their products and differentiate themselves from their competitors. The growth of a construction service firm from national roots to international grounds can be tracked in different ownership stages while relating these actions to international business motives.

In most cases this objective governs the first financial threshold, opportunity (big project) or quality/uniqueness in core skills. Companies manage to build a sustainable name/reputation in the market by achieving good quality work and innovative design solutions. This eventually provides a flow of successive projects (see Figure 3). Reviews through the company histories showed that they continued

with their routine through 1900 to 1950 until they were able to grow organically and felt the need to do international business. A great potential for new construction projects arose in developing countries after the Second World War.

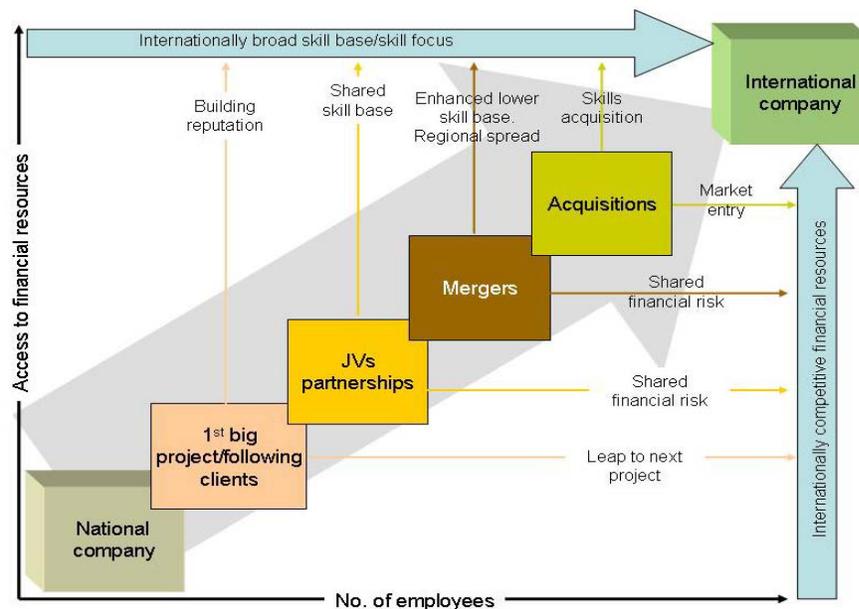


Figure 3: Ownership Changes through Becoming Multinational Company

After their leap/breakthrough, companies search for growth in different regions and skills. The objective of the firm shifts to sharing and distributing the risk and cost through short to long term partnerships. First ventures were through more familiar and less risky foreign environments with powerful local partners through partnerships and direct exporting. This expansion in knowledge and regional resources allows companies to broaden their skill base to an internationally competitive level. At this point, companies move in a multinational and diverse enterprise level with greater access to financial resources and more employees.

Starting from 1980s companies looked for new opportunities through opening markets such as Asia, Africa and Middle East. Mergers and acquisitions (M&As) substantially increased after the 1980s. Investment banking and expanding economies became more involved in developing and operating in the construction industry. The consultancy firms grew and became more financially sensitive to global economies. Companies preferred advancing their financial power to leverage their weakness in different markets by either acquiring small rivals or forming profitable partnerships through mergers. M&As let companies infiltrate through new markets through large investments and merger of skills and market shares.

Leading companies do not stand still and rest on their traditional competences, instead they develop new competences that respond to, or anticipate, emerging business conditions. A shift is occurring in the relative emphasis from internal technological and reliable process competences toward external relationship competences (Mascarenhas *et al.*, 1998). The project based construction sector lacks the continuity of investment finance flow which limits the work potential to regional level. Nature of construction industry forces firms to be more competitive over others for survival in the global environment. Breakdown of national borders through globalisation, pushes down barriers, however, local knowledge is still crucial for taking new market opportunities.

6. Conclusions

The increasing importance and growth of services makes it essential to understand the motives and strategies of construction service firms working overseas. Companies face rapid changes in the construction business environment, such as globalisation, increasing foreign ownership and changing forms of procurement. As many SMEs face the challenge of global competitors, some can no longer afford to remain in their domestic market, others have outgrown it. Companies deploy different ownership tactics in pursuit of sharing risks through different regions and various sectors.

The use of case studies allows the development of a theory, or in this case a model, to be grounded in the data collected and analysed. The model seeks to provide a generic framework which helps to explain the drivers and processes of business development. The research focus is limited to economic indicators of companies rather than their detailed internal dynamics. The consulting companies surveyed have grown and survived business and economic cycles. The way in which they coped with economic and social crises and changing modes of business can be a useful lesson for SMEs wanting (or needing) to achieve internationalization.

A company's choice of market is closely linked to the psychic distance of that market. For example, although the physical distance might be great between say the UK and the USA, the strong links between the two, the language similarity make the psychic distance very short. Historic, colonial links with many countries in Africa means a short psychic distance for UK companies. This study showed that building a reputation in the market proves to be the key motive for a successful PSF. Reputation works to overcome psychic distance, entry barriers and can achieve financial leverage for projects. However, there remains some debate over the appropriate indicators of growth and how to measure success. Neither ownership structure nor financial or skill-related capabilities of a PSF can fully explain the dynamics behind the success of international service company. With this study we aimed to deliver a fresh start to better understand the complicated traits of international business for construction services.

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