

External Factors Affecting the Success of International Companies in the UAE Construction Industry

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Abstract

In addition to the inherent complexity of the construction business, international projects are even more complicated due to conditions such as different political and legal matters. International projects are difficult to manage as the risks are higher and less predictable. Many international firms set their eyes on Dubai and the United Arab Emirates (UAE) as a way to mitigate the effects of the financial problems in their home countries. The UAE construction market is currently at the age of growth and prosperity. The objective of this paper is to determine, weight, and rank external factors that contribute to success of an international construction company in the UAE. Success factors can be divided into two broad groups: internal & external. Internal factors are those that are firm-specific while external factors are country specific. External success factors were identified through literature review and interviews with industry practitioners. The importance (weight) of these factors was calculated using the Analytic Hierarchy Process (AHP) based on a survey of 31 professionals. The external factors are divided into four categories including financial, economic, political and cultural & social factors. Each category includes a set of four success factors. The results indicate that financial factors are the most important category with a weight of 0.444 followed by economic factors (0.265), political factors (0.176) and cultural & social factors (0.115). The top five factors include owners' financial strength, tax incentives, access to cheap labor, positive market characteristics and ease of import/export.

Keywords

Success factors, International Construction, United Arab Emirates

1. Introduction

During the past few decades, the construction industry became more innovative and complicated. In addition to the inherent complexity of construction business, international projects are even more complicated due to conditions such as different political and legal matters. These projects are difficult to manage as the risks are higher and less predictable. Gunhan and Arditi (2005b) described the international market for construction related services as complex, uncertain and risky. The construction industry in the United Arab Emirates (UAE) has witnessed an unprecedented increase in terms of the number, size and

complexity of construction projects. Many international firms set their eyes on Dubai and the UAE as a way to mitigate the effects of the financial problems in their home countries. The UAE construction market is currently at the age of growth and prosperity. The demand for one of a kind, innovative and quality projects is at its peak. Construction in the UAE is risky. El-Sayegh (2008) assessed the risks in the UAE construction industry. The top two identified risks are inflation and sudden changes in prices, and owners' unreasonably imposed tight schedule. Faridi and El-Sayegh (2006) identified the main causes of delays in the UAE. These include preparation and approval of drawings, inadequate early planning and slowness of the owner's decision making process. Zaneldin (2006) also studied claims in the UAE and concluded that a claim due to the changes to the contract is by far the most popular cause of claims in the UAE construction industry. Extra work, delay, and different site conditions are ranked next respectively. Zaneldin (2006) recommended mitigation of these claims by clear and complete design with minimum error and discrepancies, establishment of efficient quality control techniques, having clear written contract and efficient risk management and partnering strategy.

International firms can enter the UAE market in several ways including establishing a local office or form Joint Venture (JV) with local companies. The establishment of a local office requires a local sponsor unless the office is setup in one of the free zones. Foreign ownership is restricted to certain degrees. The other norm of doing business in the UAE is through joint ventures. Bing and Tiong (1999) categorized critical success factors for joint venturing in international business as partner selection, agreement, employment, control, subcontracting, engineering contract, good relationship and renegotiation.

International firms must possess certain characteristics that enable them to be successful in the UAE construction industry. Li *et al.* (2005) cited a definition by Rockart (1982) for Critical Success Factors (CSFs) as: 'those few key areas of activity in which favorable results are absolutely necessary for a manager to reach his/her goals'. This definition can be extended to include the key areas of activity in which favorable results are absolutely necessary for a firm to achieve its goals. As in projects, success is defined as the achievement of the overall goals and objectives. Defining CSF's is important. Abraham (2003) advocates the adoption of a critical success factor methodology to enhance construction organization success and identify elements that are essential for organizations to achieve this success. Gunhan and Arditi (2005a) evaluated factors affecting international construction. They identified the most important strengths to include track record, specialist expertise and project management capability. The most important threats included loss of key personnel, shortage of financial resources, and inflation and currency fluctuations. Cheah *et al.* (2004) stated that "if studied thoroughly and managed efficiently technological, financial, economic, political, operational, and many other areas may contribute positively to the success of a company".

The objective of this paper is to determine, weight, and rank external factors that contribute to the success of an international construction company in the UAE.

2. Research Methodology

The first research objective was to determine the external success factors for international firms in the UAE construction industry. This was accomplished mainly through literature review and interviews with industry practitioners. At the end of this phase, 16 success factors are identified. The second research objective was to measure the importance of these success factors. The Analytic Hierarchy Process (AHP) was used to determine the weights. AHP was created and developed by Saaty (1980) as a methodology that provides a hierarchy for one to one comparisons of many decisions, both qualitatively and quantitatively. It is a mathematical decision making technique that synthesizes, assesses, and prioritizes different alternatives and selects the best option. AHP can be used as a measurement tool to measure the weights of several criteria or factors. Shapira and Goldenberg (2005) found that this method has the capacity to handle a great number of different criteria in a way that truly reflects the complex reality.

AHP makes the decision making process simple and measurable. Laddering the alternatives, AHP makes pair wise comparison of the alternatives using preference scale indicating the strength of one factor over the other. While making pair wise ratio based comparisons, one might be inconsistent. Therefore, the Inconsistency Ratio is calculated and ratios greater than 0.1 indicate inconsistent assessments (Saaty, 1980). The importance (weight) of these factors was calculated using the Analytic Hierarchy Process (AHP) based on a survey of 31 professionals. Table 1 shows the respondents' profile.

Table 1: Respondents' Profile

Category	Respondents		
	Number	%	
Years of experience	> 20 years	16	51.6
	11 - 20 years	8	25.8
	< 10 years	7	22.6
Role	Owner Representatives	7	22.6
	Construction Management Company	14	45.2
	Contractors	10	32.2
Average Project Size	< 100 (Million AED)	4	12.9
	100 – 500 (Million AED)	13	41.9
	> 500 (Million AED)	14	45.2

Note: 1 US\$ is equivalent to 3.67 AED (2014)

3. External Success Factors

The external factors are divided into four categories including financial, economic, political and cultural & social factors. Each category includes a set of four success factors. Figure 1 presents the hierarchy of these factors.

Financial factors include ease of currency conversion, tax incentives and free zone availability, access to cheap labor and owners' financial strength. Wang *et al.* (2004) defines foreign exchange and convertibility as the extent in which currency exchange rate fluctuates and the difficulty at which the currencies convert. Tax incentives and free zone availability are considered success factors that attract foreign investments. Taxation system of the host country might encourage foreign construction firms and affect the proposed price for the project. Free trade zone is areas of a country where tariffs and quotas are eliminated and bureaucratic requirements are lowered in order to attract business. Free zones allow easy export and import of products and can greatly enhance the network between host and foreign countries. Another important factor is the access to cheap labor. Labor constitutes a large part of the construction cost. Additionally, the quantity of labor hours in performing a task in construction is more susceptible to

the influence of management than are materials or capital. Owner's financial strength helps on timely payments and prevents the contractors' and other business parties' bankruptcy. The nature of construction projects results in late revenues which induces debt and loans on the owner. Therefore, the financial ability of owner to pay due debts will prevent owner's bankruptcy.

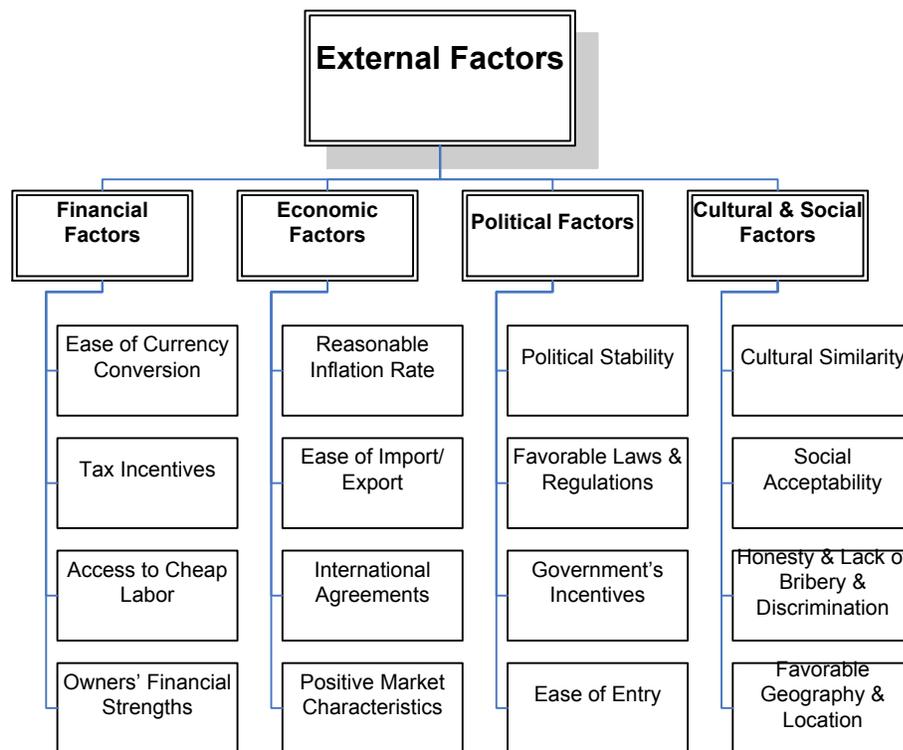


Figure 1. Critical Success Factors (External)

Economic factors include reasonable inflation rate, ease of import/export process, availability of international agreements and positive market characteristics. A reasonable and constant inflation rate is important. This factor refers to unforeseen inflation due to undeveloped local economic and banking system (Wang *et al.* 2004). Ease of import/export process refers to the processes of import and export of products and ease of transportation to and from foreign country. Supply of appropriate quota by government may encourage business. Availability of international agreements between the foreign and host countries may increase the chances of success. The UAE has international agreements with a number of countries including Arab League, Australia, United Kingdom, United States of America, Canada, and China among others. These international agreements encourage investors and foreigners to make business in the UAE, particularly construction business due to the high risk involved. Market characteristics include market power in terms of level of competition among suppliers of the service or the product, the level of technology involved in type of project, market demand, and market size and life cycle. The involved threat of substitute products or services that decreases the chances of winning bids, particularly from local construction companies that provide similar service or project. Market characteristics also contain the owner or buyer's power in terms of the level of sophistication and quality required in the project. It refers more precisely to the host country's client power in the financial strength, reputation, level of quality demand, and relationship with other international companies.

Political factors include political stability, favorable laws and regulations, government's incentives and ease of entry. Political Instability refers to frequent changes in government, agitation for change of government or disputes between political parties or different organs of the state (Wang *et al.*, 2004). It is

related to the people and their satisfaction which reflects the stability of the government system. To construction business, political stability is of importance because the business contains legal processes that are directly connected to the rules and regulations of the government. Any instability might delay the processes or create confusion that put the owner, consultant, or contractor at risk of claims and/or abuse. Favorable laws and regulations extends to all the areas related to construction such as economy, finance, industry, production of raw materials and wages and employment regulations. Inconsistent laws and application of strict and difficult regulations might cause delay, extra cost, and waste in resources, mainly, when it is not accompanied with legal judgment reinforcement. Therefore, it is necessary to establish standard laws and regulations that all companies understand and easily fit in (Reina, 2003). Government's incentives may include necessary influence of the government on project's procedures and disputes, policies on foreign firms, etc. that will ease the relationship between the home countries' parties and foreigners. Entry mode alternatives relative to international construction consist of lone operation, joint venture operation, and operation through a subsidiary. There may be variations of these entry modes; however, the entry mode determines the strategy and structure of the project. Market entry strategies must rhyme with the project in terms of flexibility and compatibility.

Cultural and social factors include cultural similarity, social acceptability and positive environmental consciousness, honesty, lack of bribery and discrimination, and favorable geography and location. The difference between foreign company and the host country may be due to one or many of the differences in work culture, education, values, language, racial prejudice, etc. This eventually will affect the communication among parties and conflict and dissatisfaction may arise (Reina, 2003). Existence of cultural similarities will result in good relationship between parties. The social Acceptability and positive environmental consciousness factor requires need for attention to environmental benefits. Social awareness about effects on society and environment may discourage business with construction companies that neglect these values. Paying bribes to win contracts will discourage positive competition and significantly corrupts reputation of the host country. Besides, the company that bribe might not be competent enough for the project. The corrupt local government executives demanding bribes or undue payments are obstacle to administration process of a construction project. Reina (2003) found that "Of all major industries, international construction is the one indulging in the most flagrant corruption." The result of price discrimination in favor of local contractors is lower bidding price for local competitors that will decrease the comparative advantage of the international construction company. The favorable geography and location factor refers to closeness of location of the foreign and the host country. Transportation and mobilization is in direct effect of this factor. Existence of water ways, seas, and ocean that directly link the two countries improves the network. Also, the similarities of weather and climate conditions can play a positive role.

3 Perception of UAE Professionals

Thirty one construction professionals participated in the survey. The respondents were asked to compare the factors against each other and the categories against each other. The responses were aggregated. Expert Choice software was used to perform the AHP calculations. The local and global weights for each factor were calculated. The inconsistency was calculated to 0.01 which is acceptable.

Figure 2 shows the comparison between the categories. It is clear that the financial factors are the most important category with a weight of 0.444 followed by economic factors (0.265), political factors (0.176) and cultural & social factors (0.115). Table 2 presents the external success factors ranked by their global weights. The top five factors include owners' financial strength, tax incentives, access to cheap labor, positive market characteristics and ease of import/export.

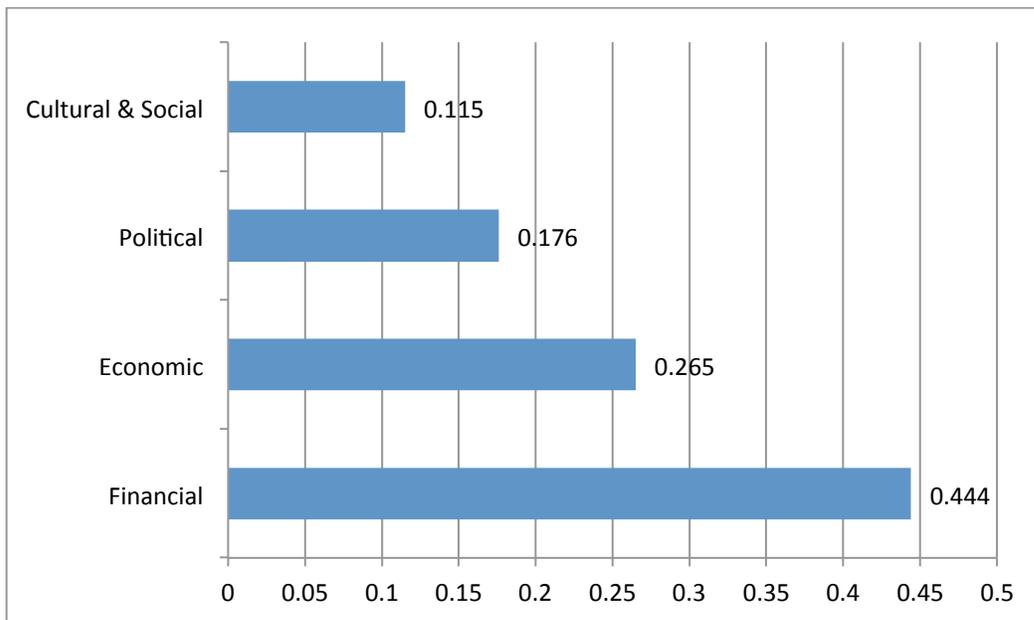


Figure 2. Overall Weight of Categories

Table 2. External Success Factors – Ranked by Weight

Rank	Factor	Weight
1	Owners' financial strength	0.17
2	Tax incentives and free zone availability	0.115
3	Access to cheap labor	0.105
4	Positive market characteristics	0.082
5	Ease of import/export processes	0.073
6	Availability of international agreement	0.056
7	Ease of currencies conversion	0.055
8	Reasonable inflation rate	0.053
9	Favorable laws and regulations	0.053
10	Political stability	0.051
11	Honesty & lack of bribery and discrimination	0.05
12	Ease of entry	0.039
13	Government's incentives	0.033
14	Social acceptability	0.025
15	Favorable geography and location	0.021
16	Cultural similarities	0.019

It is not surprising that the owner's financial strength is the most important factor. The financial strength affects the ability of the owner to pay on time. During the financial crisis, late payments to the contractors

were a common practice. Some projects got even cancelled due to the inability of some owners to finance the project. International firms need to look closely at this factor. This is of importance since foreign construction firms have limited information on reputation and financial strength of the owner. If the owner is financially strong, the chances of project success improve considerably.

The second key success factor is tax incentives and availability of free zones. The UAE does not apply any federal income tax for general businesses. An income tax decree has been enacted by each Emirate, but in practice, the enforcement of these decrees is restricted to foreign banks and to oil companies. Personal incomes, including all forms of salary and capital gains wherever arising, are not subject to taxation in any of the Emirates. Free zone also, gives the right of ownership of business to foreigners. Among other free zones, the massive Jebel Ali Free Zone (JAFZ) has become one of the largest industrial complexes worldwide.

Access to cheap labor is also important and ranked third. Migrant workers, who comprise 95 percent of the country's workforce, are from South Asian countries such as India, Pakistan and Bangladesh. Their wages are considerably lower than USA or Europe. This access to cheap labor improves the profit margin for international firms. The fourth factor is positive market characteristics. Positive market conditions allow construction companies to enjoy higher profit margins as the increase in available construction work reduce the competition. The UAE is currently experiencing the start of another boom in its construction industry with the announcement of new mega projects and the preparations to host EXPO 2020 are well underway.

4 Conclusions

Identifying and assessing critical success factors is important for international construction companies. Each country has its unique characteristics and business environment. The UAE is not an exception. The UAE has a unique construction industry and market conditions. International construction companies need to evaluate these factors before undertaking business in that country. This research was aimed at identifying and assessing the critical success factors in the UAE construction industry. The results indicate that financial factors are the most important category with a weight of 0.444 followed by economic factors (0.265), political factors (0.176) and cultural & social factors (0.115). The top five factors include owners' financial strength, tax incentives, access to cheap labor, positive market characteristics and ease of import/export.

The identified list is intended to be a guide for construction companies to focus their effort to improve the performance of their business. This list is not intended to be all-inclusive. Future research studies may add other factors that gain weight over time, but are not considered within this list.

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