CONSEQUENCES OF ECONOMIC DOWNTURN ON CONSTRUCTION INDUSTRY AND ITS REMEDIES

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ABSTRACT

The construction industry is most significant sector for development of any country. The state of construction industry directly reflects the state of economy of the country and has substantial effect on GDP growth. Our paper aims to study the consequences of economic slowdown on construction industry and to analyze various strategic initiatives taken by different construction firms to combat such times and to come out with remedial tactics in the form of conclusion which can be referred by construction firms to sail smoothly in the grave situation of economic downturn. Also to study the impact of Government interventions like FDI with policy liberalisation play an important role to combat economic downturn.

Keywords: Construction Industry, Economic Downturn, Real Estate, Strategy, GDP (Gross Domestic Product), FDI, Government.

1. INTRODUCTION

The Money either holds the project together or allows it to fall apart. The success of any construction project depends on the cash flow. During the time of economic slowdown investors lose faith in economy and due to divestment the capitalisation of the construction firm declines. With less number of investors, the firm heeds to sell the property/flats at less value and thus their profit margin shrinks. The recession is part of natural economic cycle, the economy which expands for the span of 6-8 years experiences slowdown for the period of six months to two years. Construction industry is the most significant for the development of country. In India it is second largest economic activity after agriculture. The construction industry which witnessed robust growth from the period of 2004-
05 to 2007-08, experienced massive slowdown from the third quarter of financial year 2008-09. About 31 million people lost jobs in India and construction industry experienced jittery due to slowdown. Government initiatives like FDI play a key role in such testing time. The rational approach of the government can help attenuate this grave situation. Economic slowdown acts as a litmus test and the construction firms must brace up and formulate appropriate strategies. As it has been rightly said, business with right strategy and vision come out stronger from the times of depression.

2. REVIEW OF LITERATURE

2.1 Sandeep R Sahu and Shreekumar Menon (2011) observed that, how the global crisis in 2007 affected the whole world including India and its real estate business. The real estate business saw a decline in revenues, net profit and eventually property prices in India. This was all part of an economic cycle which was experiencing a recession. Consumers all over the India started losing confidence. Economic downturn proves to be a litmus test and companies with stronger fundamentals and ability to make quick strategic decisions continued to operate. Projects of the real estate developers in the time of recession have been stalled due to the lack of funds. Various companies were forced to sell their properties at lower value. Different strategies to cope up with such situations have been discussed in the paper. Developers were reluctant to take financial decisions in order to revive demand but eventually gradual slash down in prices was introduced. Recognizing the need of developing multiple streams of revenue, some cash-rich developers vertically diversified (or attempted to diversify) their businesses into telecommunication, financial services, insurance, etc. As part of long term strategy, instead of selling off properties, developers began to enter onto lease agreements with larger companies for commercial space. The long term rental arrangement, though at reduced rates, guaranteed a steady stream of income. Indian real estate companies also embarked upon various cost cutting strategies. Capital intensive projects that had no impact on company’s revenues in the short term were either put on hold or scaled down, and even cancelled. A number of companies also downsized their extra manpower, thereby putting companies on the risk of losing essential talent in exchange of short term cost savings. Some real estate firms did not even hesitate in outsourcing their marketing strategies. Many developers increased their focus on customer satisfaction. Customers were provided the facility of checking the status of construction of their properties by logging on to a website.

2.2 Shweta Rai and Prateek Ghawate (2013) observes the current infrastructure scenario in India and how its been affected by recent slowdown. Development of infrastructure is the key to achieving GDP growth and it can present excellent opportunities. Slowdown in construction industry is observed due to delays in getting approvals, lack of new awards being made and lack of alternatives to fund new projects. GDP growth is held back to 1.5 to 2% due to the bottlenecks in infrastructure expansion. Indian construction sector suddenly lost stream in the last fiscal due to the global financial turmoil. It happened after spectacular growth of 12%. It also affected steel, cement, power, petroleum, aluminium, IT and ports industries. Private equity investments declined in oct-dec 2012 by 32%. Even orders from overseas firms dwindled. Biggest bottlenecks are clearances, dilatory procedures and troubleshooting with diverse stakeholders for infrastructure projects. Revamped approach must be made to improve rural infrastructure. Companies would have to part away with their stakes in current assets or raise further equity. Various steps were taken for infrastructure development. It is concluded that infrastructure groundwork can have massive scale in India if government deploys more funds in infrastructure. If there is development in infrastructure, rapid growth across all markets can be expected. With friendly policies from government and rising investment trends, Indian construction industry can offer promising growth and opportunities.
2.3 Tudor NISTORESCU and Cristiana PLOSCARU (2009) observed the impact of economic and financial crisis in the construction industry in Europe. The economic crisis is the result of mortgage sub-crisis and economic downturn in USA. The construction industry witnessed the standstill with growth rate of meager + 0.2% for the financial year 2008-09. The crisis also had substantial effect on employment growth which contracted by 2.5% for year 2008-09 and further by 1.5% in both EU and euro area. Construction sector has a major pie of 10.4% of total EU GDP in 2008. Most of the construction companies went into bankruptcy and were completely insolvent to pay the annuities. Analyzing the situation most of the investors postponed their plans to invest in real estate despite lesser interest rates. Most of the potential stakeholders considered renovation, retrofitting and maintenance of existing property as a viable option. The measures taken by government saw the delayed effect and the expectations of the constructors were unattended.

2.4 Avinash Nafday (2011) in his paper argues the strategies for the professional engineering firms during economic recession. Managers of different firms can choose an appropriate strategy or strategies that capitalize on their strengths, eliminate weaknesses, and seize opportunities and combat threats. This is called as SWOT (STRENGTH WEAKNESS OPPORTUNITY THREAT) analysis. Further the SWOT analysis is done on various internal as well as external factors of the firm. During the times of recession the firm size does not matter since both small and large businesses are equally likely to succeed or fail depending on their individual circumstances. The first strategy is the survival strategy since surviving is the most important thing during recession. The survival strategy is to focus internally, and endeavour to maintain the status quo. Organizational inertia and lack of systematic analysis make focus on immediate survival rather than dealing with long-term objectives. The implicit assumption is that instead of trying to acquire new customers or make other changes, it is easier to retain current or past customers. It is presumed that they provide the best source of growth because they can more easily be enticed to buy additional company services or find new uses for the current services. The second strategy is the retrenchment strategy. The retrenchment strategy, involving expenditure cuts on a wide variety of activities working hours, employment, marketing, research and development, training, inventory, pay freezes is steered by the common belief that it is easier to reduce operating costs than to generate additional revenue. However, cost cutting needs to be executed prudently, with intelligence and thoughtful decision making. In addition to cost reduction, firms can opt to enforce savings by working longer hours without overtime, taking concessions from suppliers, streamlining work processes, rescheduling debt, and using productivity enhancing tools. The next strategy is aggressive growth. This strategy aims to succeed using better strategic thought to reposition the business, taking intelligent risks, identifying winning business sectors, making tough business decisions, investing for the future, improving capabilities through innovation and differentiation of capabilities from competition to emerge the winner when the slowdown ebb. Further some firms can also try to enter into related businesses during the times of recession. Some firms can even try to diversify their business. They can expand their business through joint marketing with other engineering companies and specialized contractors. Another way to expand revenue stream is a merger with or an acquisition of another firm to penetrate new markets, geographies, clients, or service lines. A successful merger or acquisition can result in the organization becoming stronger, more robust and better positioned for long-term sustainable growth. Another diversification ploy is to expand the geographic reach of the organization, especially in nascent international markets, which have tremendous demand for design and construction services in infrastructure, water, and power projects. Some organizations look at innovation and technological upgrades as a way to get ahead of their rivals and position the firm for future growth. While many new businesses use it as a strategy for entering the marketplace. They invest in research, development, new service offerings, and technological advancement and introduce fundamental innovations intended to redefine the basis for competition.
2.5 Basawaraj Konnur and Aditya Hundekar in their paper argues to restructure the strategies for construction companies through RBV (resource based view) theory. In order to cope with the economic crisis construction companies advocating decrease in their manpower resources. They don’t recognize the importance of employee’s idiosyncratic capabilities, proprietary construction processes and equipment that cannot be obtained in the factor markets. Reducing employee’s strength cannot be a remedy to economic crisis. The theme of the RBV theory is that privately held resource is a basic source of advantage in competition, given that the resources are valuable, rare, inimitable and non substitutable. Resources are typically defined as either assets or capabilities. Assets, which may be tangible or intangible, are owned and controlled by the company. Capabilities are intangible bundles of skills and accumulated knowledge exercised through organizational routines. It is here argued that the management must turn its attention to resources that are intangible in nature as such resources can be protected from competitor duplication by legal property rights. Also, that intangibles such as organizational and reputational assets do contribute more significantly to firm success than tangible assets. According to RBV theory, if resources can be readily obtained in the factor markets or can be easily imitated by competitors, they cannot represent a meaningful source of economic benefit. Further strategies must be focused on internal and external learning methods. This is further extended by examining the ability of company to build idiosyncratic capabilities in construction sector that cannot be easily duplicated and have no ready substitutes. To confer competitive advantage, capabilities must not be possessed by all competing firms, they must be difficult to imitate or duplicate through other means, and contribute positively to performance.

2.6 Dr. Narendra Kothari (2010) observed that, how FDI can revive the dangling economy. The paper accessed the impact of FDI in India and economic growth achieved through FDI flows. Trends on FDI flows from year 2002-2010 is studied. The construction industry which was unorganized, fragmented achieved certain degree of financial stability growth and development. The liberalized government policies made Indian economy conducive to carry out construction activity and thus attracted foreign investors. The policy liberalization was initiated by government to avert the effect of economic downturn. FDI in India’s booming real estate jumped 80 times between year 2002-2010 which effectively revieved economy. India was considered as dominant host country for FDI in Asia and Pacific region with inflows of INR 40205 crore between 2005-2011.

3. CONSEQUENCES OF ECONOMIC DOWNTURN ON CONSTRUCTION INDUSTRY AND ITS REMEDIES

Economy expands for 6 to 10 years and then slows down for a period of about 6 months to 2 years causing consumers to lose confidence in the market. Economic downturn causes delays in getting approvals and even creates a deficit of alternatives to fund new projects. Economic downturn is testing time for the firms which are into construction industry. With huge amount of capital locked in and digression of customers due to loss of faith in economy put firms into fix position. While reputation of firms plays a key role and reputed firms feels the subdued effect of economic downturn. A mediocre firm has no other option than to shrink profit margin and sack handful of employees.

Government initiatives like FDI with liberalized policies play an important role and give push to this imbroglio situation.

The firms which do the homework and plan in advance can combat such downturn. During the time of slowdown strategies framed by firms plays the key role and thus the firms are in position to apply specific strategies for unforeseen problems and thus can sustain their business in tough times.
4. KEY STRATEGIES FOR FIRMS TO SURVIVE IN ECONOMIC DOWNTURN

4.1 SWOT (Strength Weakness Opportunities Threats) Analysis

SWOT analysis involves specifying the objective of the business venture or project and identifying the internal and external factors that are favorable or unfavorable to achieve that objective. SWOT analysis focuses on capitalizing strengths, eliminating weaknesses, seizing opportunities and combating threats.

4.2 Survival Strategy

This strategy focuses on internal factors and tells to make a sincere attempt on the present state of things. This strategy involves scoping out defensible positions within the industry structure with the objective of retaining existing clients that bring in a major part of the revenue and becoming their trusted source for advice. Some of the strategies are reactivating dormant accounts, contacting past clients or customers, and getting them to do business again; providing a superior level of service and adding value to existing services; quoting reasonable and affordable fees and prices in bids; providing low cost add-ons to generate additional revenues; and finding ancillary assignments with current clients by presenting them with solutions for some of their nagging issues.

4.3 Retrenchment Strategy

The retrenchment strategy involves expenditure cuts on a wide variety of activities (working hours, employment, marketing, research and development, training, inventory, pay freezes) is steered by the common belief that it is easier to reduce operating costs than to generate additional revenue. However, cost cutting needs to be executed prudently, with intelligence and thoughtful decision making. Is it better to selectively lay off employees, realign compensation, restrict hours. Cutting costs wantonly without understanding the consequences may be degrading to a firm’s prospects, making it difficult to face competitors when the economic tide turns. It has been observed that many businesses fail when the market is improving rather than during the dip because they are unable to compete.

4.4 Entry in Related Business Areas

At the times of recession, many civil engineering firms can delve into trendy new initiatives such as green buildings, sustainable power and energy, geographic information systems, parks and recreation, medical records and data analysis, transportation and construction oversight, subsurface utilities, and energy-efficiency projects.

While retail, office, industrial, and residential construction has come to a stagnantion, healthcare still offers good prospects. Many civil engineering firms have also been able to find productivework by associating with the wind and solar power niche in the power industry, small electrical substations, biomass, storm water management, and site design.

4.5 Aggressive Growth

This strategy aims to succeed using better strategic thought to reposition the business, taking intelligent risks, identifying winning business sectors, making tough business decisions, investing for the future, improving capabilities through innovation and differentiation of capabilities from competition to emerge the winner when the slowdown starts. The business model must consider market selection, capabilities required, value chain configuration, and value appropriation. The Company should target segments where it has a low market share, where strong competitors are absent or cannot retaliate in a timely manner, or where incremental efforts can lead to large payoffs.
4.6 Diversification  
Construction firms can expand business through joint marketing with other engineering companies and specialized contractors. For example, electrical contractors specializing in environmental work can help to develop a turnkey approach to bidding for energy-efficiency projects in green buildings, augmenting it with traditional design, civil engineering, fabrication, construction, and maintenance services.

4.7 Mergers and Acquisitions  
Merger and acquisition strategy to achieve growth takes advantage of synergies to defend or strengthen market position, grow into a new geographical allocation with higher likelihood of success, reduce costs by eliminating redundant expenses, reduce competition, create barriers for entry of other firms, increase revenues from economies of scale, acquire niche technologies and talented people, and bring in additional clients from related business segments. “Synergies are present where the acquisition of one firm by another creates a firm of greater value than the two firms on a stand-alone basis”. For companies with strong balance sheets and good banking relationships, recession provides a good opportunity to acquire badly managed high-quality assets or distressed businesses for bargain-basement prices.

4.8 Entry in Emerging Markets  
Construction firms can also expand the geographic reach of the organization, especially in nascent international markets, which have tremendous demand for design and construction services in infrastructure, water, and power projects. Many engineering and architectural firms are using the recession to position themselves in overseas markets, where demand is often growing in double digits. Their aim ranges from diversification of client base and future income stream to the use of overseas offices for outsourcing worldwide project work from low-cost locations.

4.9 Divestiture Strategy  
Divestiture of business and closure of establishment is a macrolevel retrenchment strategy that is used to prune or close poorly performing units, sell a division or business line that no longer fits, or divest noncore assets to recoup good economic value. Therefore, 2009 witnessed increased divestiture activity to monetize the assets that are no longer deemed strategic and use the capital to pay down debt, invest in the core business, or compensate retiring owners.

4.10 Innovation or Technological Upgrades  
Some organizations look at innovation and technological upgrades as a way to get ahead of their rivals and to position the firm for future growth, while many new businesses use it as a strategy for entering the marketplace. If a firm decides to use a website for showing the current stage of the project to their customers without needing them to visit the site then such customers will be satisfied with the service and will help in maintaining the good reputation of the company.

4.11 Restructuring Strategy Through RBV (Resource Based View) Theory  
In the times of economic slowdown most of the companies cut down the resources such as man power for surviving. Further, they don’t recognize the importance of employee’s idiosyncratic capabilities, proprietary construction processes and equipment that cannot be obtained in the factor markets. Privately held resource is a basic source of advantage in competition, given that the resources are valuable, rare, inimitable and non substitutable. Strategies must be focused on internal and external learning methods. This is further extended by examining the ability of company to build idiosyncratic capabilities in construction sector that cannot be easily duplicated and have no ready substitutes.
4.11 Waiver in Stamp Duty, Registration Fees, Free Amenities, and Enhanced Marketing Strategies

The questionnaire survey which we conducted in Pune (India) for the above said topic suggested following strategies. The builders smell the situation of downturn with customers response, during slowdown there is less number of enquiries about the projects and eventually less conversion of enquiries into sales. So constructors resorts to strategies like waiver in stamp duties, registration fees and free additional amenities. Due to weak consumer sentiments extensive marketing about the project is done with help of advertisement hoardings, telemarketing, participation in property expo’s to reach out to untapped and potential customers.

5. GOVERNMENT INTERVENTION TO AVERT DOWNTURN IN CONSTRUCTION SECTOR

5.1 FDI in Real Estate and Infrastructure with Liberalization in Policies

FDI with liberalized policies attract foreign investors. With large amount of money infused by these investors give push to the downtrodden sector. The sector becomes organised with implementation of new technologies and thus plays substantial role in reviving economy.

5.2 Giving More Impetus to Affordable Housing

The government can give impetus to affordable housing. This can be done by giving incentives to the developers who invest their resources in affordable housing schemes. Guidelines for the affordable house must be framed by the government and the developers must adhere to these guidelines and must provide budget homes for middle-class families. Low cost housing will attract the customers and thus can will encourage customers to invest money in this slowdown scenario.

5.3 Making Home Loans Affordable

The government must cut down interest rates on housing loans. There is huge positive effect of this step as it increases liquidity in the economy. Consequently real estate will reap more dividends. Cutting down interest rate will attract buyers and more money is infused in the industry.

5.4 Raise Tax Incentives on Housing Loans

By raising deduction limit on account of interest payment on housing loans. This kind of income tax exemption will attract investors and will give push in slowdown condition.

5.5 Eliminate Multiple Taxation on Property Purchase

In most of the countries there are multiple taxes on purchase of property. The consumers needs to pay multiple taxes like value added tax (VAT), service tax on top of stamp duty and registration charges. A single taxation regime like goods and service tax (GST) must be introduced by government to eliminate multiple taxes.

5.6 Proper Mechanism for Dispute Redressal

There must be proper mechanism for dispute redressal in the country. This kind of environment will attract foreign investors and thus government must make an efficient body for redressal of disputes of stakeholders.

5.7 Enabling Faster Project Approval

Faster project approvals process will beef up the supply pipeline, help bring prices down and will ensure that real estate remains a viable business option. Single window time-bound clearance of reality project will cut down project time and cost.
5.8 Reducing Stamp Duty and Registration Fees

The reduction in stamp duty and registration fees will attract more buyers.

6. CONCLUSION

In this paper, from the past researches it is observed that many construction related firms come across recessionary market conditions at one point during their existence. In order to cope with the prevailing downturn, construction companies can use any of the above strategies matching their firm’s resources and capabilities and can come out of such times. Even the government should consider the above initiatives in order to alleviate recessionary situations.

REFERENCES

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