

# GLOBAL CRISIS: THE EFFECT ON THE MIDDLE EAST CONSTRUCTION SECTOR

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This paper looks to identify the effects of the global crisis on the Middle East construction sector. It draws mainly from personal experience, management of both public and private projects as well as interaction with key people from the Middle East construction industry. The major findings that emerged were as follows: a) The adverse effects of the ongoing crisis can differ significantly throughout the Middle East countries. b) The work culture is changing on a daily basis. c) How hidden opportunities exist even during these challenging times. This paper will provide valuable information to construction related companies for the current situation in the Middle East and solutions for moving ahead in the best possible ways will be revealed and discussed.

**KEYWORDS: crisis, construction, effects, opportunities.**

## INTRODUCTION

The global economic crisis has seriously affected the Middle East construction sector. The “Mecca” of the construction world is now facing its toughest ever challenge and companies are worried on how their future will shape up in the region. The answer is not easy and in certain cases merely speculations can be made. The crisis has definitely heavily and unexpectedly affected the majority of construction related companies.

2010 is expected to be even more challenging than 2009 as numerous companies are still going through this year based on existing contracts. This can also be predicted by the fact that foundation contractors are now facing a huge crisis. Many ongoing projects face uncertainty due to important liquidity problems. Material prices have been reduced in some cases by as much as 70%. This resulted in projects being retendered, even in cases where contractors had already mobilized on site. The sudden change in finance availability and end-user demand are the two main factors responsible for this slowdown.

Each country in the Middle East region has developed over the years in different ways, under its own pace, standards, setting different goals and hence the effects of the crisis can significantly differ. Figure 1 presents the percentage of projects on hold in each country of the Gulf co-operation council (GCC). We can see that the U.A.E. is responsible for an impressive 91% which is mainly due to Dubai’s heavier development and investment compared to the rest of the GCC. The total value of projects either on hold or that have been cancelled in the GCC at the moment is estimated to be approximately \$249 billion.

Table 1: Percentage of projects on hold/cancelled in the GCC

Location	Percentage (%)
Dubai	81
Abu Dhabi	10
Rest	9

The following sections present an overview of the most important countries in the GCC in terms of construction. By using personal experience as a basis, their current and future situation is analyzed and discussed.

### **U.A.E.**

The two major cities of U.A.E., Dubai and Abu Dhabi will be dealt with independently as they were found to have fundamental differences.

#### **Dubai**

The construction industry in Dubai is facing a sharp slowdown as a result of the economic crisis. Property prices fall, jobs are cut and projects are axed. Dubai is the Middle East city which is feeling the crisis at its hardest, mainly because everything was developing at a blistering pace. Huge residential and commercial projects have been either put on hold with a tentative starting date in most cases not announced or significantly scaled down. By extending construction schedules clients are given more time to observe and assess the overall market situation.

More than half of the construction projects have been put on hold, with more expected to be deferred in 2009 and 2010. Huge residential projects, one alone designed to be twice the size of Hong Kong, have been put on hold as well as a series of artificial islands. While the real estate sector is being hit hard this is not the case with infrastructure. Although delays in payments from public authorities have created a major concern, the Dubai government recently launched a second \$10bn sovereign bond programme to ease tight liquidity conditions which is slowly bringing back optimism to construction companies.

It is interesting to point out that the number of arbitrations has dramatically increased the last few months because of clients cancelling, postponing projects or just holding payments.

#### **Abu Dhabi**

Abu Dhabi saw its major boom starting 2 years ago and predictions are still talking about a city which could even surpass Dubai in the years to come by experiencing only minor effects due to the crisis. The U.A.E. capital is currently in the advantageous position of having a financial surplus and the possibility of carefully choosing the correct projects to initiate.

Till date, only a few commercial buildings have been postponed for 6 to 12 months while infrastructure projects are still going ahead. Abu Dhabi has been facing for the last years a

major problem in housing availability for expatriates. An average of 2 months is needed for an expatriate to find suitable accommodation. The shortage of housing units reached 7,500 units in 2007 and 20,000 in 2008. Hence, a slowdown in this area is considered highly unlikely.

The Abu Dhabi government considers infrastructure as a key for its economic development as well as the success of the Abu Dhabi 2030 plan which is intended to increase the city's population by 35% in 21 years and transform the capital into a global center. Already, big steps are taken into that direction and bids have been recently received for the consultancy services of the upcoming 130km metro.

## **Bahrain**

Bahrain is a small country and always considered to have a stable economy. In fact, the Bahrain Stock Exchange has been the least affected among the key Gulf bourses. There are not too many huge projects and the end-user demand is still high. Bahrain has been trying to promote itself as a business friendly country and at the same time also making steps to increase its tourist numbers. Since August 2006, there is a Bahrain-U.S.A. free trade agreement which significantly contributed to the growth of the country.

The construction slowdown can be easily spotted in the foundations contracting business. Prior to the crisis non-availability of foundations contractors would even lead to delays in projects while this is clearly no longer the case. Bahrain's real estate market is feeling the effects of the global financial crisis, but its modest growth rate should prevent it from seeing a sharp decline. There are a few projects being put on hold but this is mainly the case with mega-projects which are now deemed too ambitious for such a small country. One of the exceptions seems to be the \$3 billion Bahrain-Qatar causeway which due to significant funding from Qatar could commence at the end of this year. In that case, Bahrain which already has road access to Saudi Arabia since 1986 would heavily reinforce its already geographically strategic position in the GCC.

## **Qatar**

Qatar continues to be the fastest growing economy in the GCC, with one of the largest per capita incomes in the world. By not focusing on real estate and tourism the country seems to have been only slightly affected by the ongoing crisis.

Infrastructure works however are not following last year's pace and the public works authority is currently restructuring. There is a major focus on health and business related construction where funds are already secured. Public works in Qatar appear to have more obstacles than any other GCC country and there have been cases where major international contractors stopped bidding for government projects. However, due to the existing opportunities that will be disregarded attracting the interest of all major contractors. Large real estate projects are currently being redesigned, nevertheless projects of such nature had never been a real focus in Qatar and this policy is definitely not going to change now.

The Qatari government seems optimistic about the future stating that increase in the oil and gas production will compensate the fall in their prices. In any case, the monetary reserve will help satisfy the needs of the country if necessary.

## Oman

Oman has never been at the same level of development as the previous described countries. Nevertheless, it has had an interesting amount of building projects going on in order to enhance its popularity as a traditional tourist destination in the Middle East. Progress in big real estate projects is still doubtful but certain developers seem to be determined to go ahead. Moreover following Bahrain's example, on 1 January 2009 Oman signed a free trade agreement with the U.S.A. lifting all tariff barriers to consumer and industrial products.

Oman at the moment is surprisingly issuing several infrastructure tenders including numerous bridgeworks, with the new Muscat and Salalah International Airports in particular attracting the interest of contractors worldwide. Prior to the outbreak of the crisis, only 6 or 7 contractors would usually compete for public works in Oman whereas nowadays this number has risen to approximately 25. Another fact that makes the country so appealing is that the government has all project funds secured and no significant payment delays have been reported from contractors in 2009.

## Saudi Arabia

Saudi Arabia is a market attracting a lot of attention lately. However, people are doubtful even at these challenging times if development can easily take place. One of the most encouraging facts about Saudi Arabia is that its population is characterized by rapid growth and that at least 60% is under 20 years old.

Several Dubai based companies are now focusing their efforts in this country where mega projects are planned. Up to now, one of the major drawbacks of Saudi Arabia was the low living quality level offered to expatriates as opposed to U.A.E. or Bahrain. The heavy development in the nearby countries never created the need for major contractors to focus in Saudi Arabia. However, things have changed in Saudi Arabia's favor and contractors are concentrating their efforts in what is now considered the biggest market in the region. Impressive projects are being awarded such as the new railway system that will link the Kingdom's Holy cities with a total cost of \$1.78bn and completion due for Hajj 2012.

Summarizing the comparison between GCC countries, table 2 shows the value of ongoing projects in the area.

Table 2: Value of ongoing projects in the GCC

Location	Ongoing (US \$bn)
Dubai	698
Abu Dhabi	270
Saudi Arabia	210
Qatar	220
Oman	104
Bahrain	140

## **Changes in work culture and positive effects**

As a result of the ongoing crisis, radical changes are taking place in the work culture.

It is easily noticeable that consultants are going into much more detail regarding quality and structural calculations than before. This is mainly due to the reduction in workload and time pressure allowing them to address issues which they did not before. Although contractors might argue that this is simply done for impressions, a more thorough check from consultants enhances quality and safety. Numerous articles were written in the past years pointing out the lack of quality and major errors in projects in the Middle East and particularly Dubai as a result of unreasonable time pressure on site and in the design offices.

Value engineering is finally coming into place as clients are looking to cut down on costs. New technologies will be introduced. Even though Dubai and generally the Middle East was the center of construction throughout the last decade it is surprising how old methods of construction were still being implemented.

Reduced workload will allow local authorities to focus on items such as unified building codes. It is surprising that the UAE for example does not have one and it is said that government approval on this subject has been pending for more than two years. Besides, the country lacks a proper classification of contractors. Each emirate has its own building code and classification system that varies in criteria. Working on the above areas can only ease operations in the near future.

End users are finding this a right time to buy property as prices have dramatically fallen. Moreover, due to the fact that sales are no longer flourishing owners are putting their properties in the rental market creating more supply than demand as opposed to seven months ago. Rental rates have fallen up to 40% in certain regions creating a necessary correction in the market.

## **New competition**

It is obvious that companies throughout the world eye Middle East construction market in a bid to escape global economic crisis. Even though the slowdown in the region is significant, the number of ongoing and future projects is still enough to attract major attention. A lot of importance has to be given to companies coming from Spain. Till now few Spanish companies and especially infrastructure contractors had a presence in the region as work was booming both in Spain and South America. This is rapidly changing and it will be interesting to see how the likes of big Spanish contractors will shape up the market.

In Spain, the financial crisis is also seriously affecting the real estate market. Lack of liquidity not only has an impact on households as many people cannot get mortgage loans, but also on companies who cannot find financial support for their construction projects. Housing projects in Spain throughout the last years were equal in number to the ones in UK, Germany and France together. It is expected that many contractors involved in such projects will be extremely eager to enter the Middle East market.

## **Emerging markets**

Need for projects is naturally creating new markets. It is said that several companies are performing feasibility studies in Iraq for real estate works. In fact there are projects worth of US \$2.18 billion on the table. Already major contractors are under negotiations for jobs in Iraq as the country is due to spend \$15 billion during 2009 on repairs to its infrastructure, oil and energy facilities. This figure represents 25% of the country's draft 2009 budget.

Recently two major Middle East based developers announced a \$15 billion development in Kurdistan and a \$10 billion project in Baghdad.

It seems that Middle East developers have found a "safe haven" during the crisis as Northern Africa and especially Morocco properties are considered to be the best investment opportunity at this given moment. A real estate project worth \$1,3 billion was recently completed and all main Middle East developers are heavily trying to promote their Moroccan projects. With the likes of projects aimed to dramatically increase the number of tourists in the coming years it is clear that there is a lot of room for infrastructure and hotel property market improvements.

## **Keys for success and opportunities**

In this section an attempt is made to identify which are the key factors for moving ahead as a company during the crisis while maintaining one's capabilities to the maximum and possible damages to the minimum. Also, ways on how to explore potential opportunities are discussed.

Closeness to the customer is a success factor nowadays. Helping clients in issues such as deadline pressure, safety and quality will give a company the edge. There are price-sensitive customers and also cost-conscious ones. It's important to make sure that the customers look at one product from a total cost point of view and not just the purchase or rental price. Items such as formwork which represent a small amount of the total investment can have a huge impact on daily progress as well as safety, quality and hence total project budget.

The numerous lay-offs seem to imply that human capital is only considered as a cost element in a company's balance sheet, decreasing in hard times and increasing in booming periods. Smart companies know that human talent is what will make the difference between success and failure especially when things are gloomy and uncertain. Companies with a visionary strategic plan should now invest on human capital considering this period as a tremendous opportunity for building on future growth. The pool of possible applicants has never been bigger.

Instead of brutally reducing personnel a company should identify major risks, calculate all the direct and indirect costs associated with alternative strategies and policies, and evaluate necessary steps which could reduce the need for layoffs. Examples would include retraining and transferring redundant employees, freezing or reducing hiring and changing pay and working hours.

Moreover, opportunities should be explored to increase the volume of work. An example is in sourcing work that might have been outsourced earlier. Diversification can also give a new motivation to employees. Cross-functional teams can be created to develop these plans and implement them. Employees working in companies following steps such as the above will

feel much more connected to their employer and a team feeling will be cultivated which can make a huge difference in the output.

This is the time for companies to invest in programs that create diverse skill sets. By maintaining a strong talent pool, firms will have people with the necessary skills when the markets pick up again. Companies heavily affected by the crisis have come to recognize the importance of effective senior executive planning and resourcing. Firing employees should be the last resort.

Moreover, as workload is being reduced in most cases it would be wise for companies to resolve outstanding internal problems. Now is time to reflect on past mistakes and see how these can be improved in the future.

The nature of this sudden crisis proved the vast importance of carefully choosing financial terms in construction contracts. Although this statement might sound simplistic, several cases have been found where subcontractors engaged in the same field and country have significantly different payment terms in their subcontract agreements. Mislead by the non-stop financing of recent years, numerous companies found themselves not worrying too much about payment terms in contracts and not covering their interests with the use of letter of credits for example. Hence, many of their ongoing projects are now facing problems due to unpaid invoices creating huge cash flow problems. A major advantage of companies which correctly used letter of credits is the option of stopping site works in case of not getting paid. The last resort would be to demobilize from the project which would still not have very important cost implications for them. Their clients knowing that will probably give priority in being punctual to their payments.

Companies with a background in public works have obviously an important advantage at the moment. However, with the likes of small companies dropping prices below cost just in order to ensure some continuity throughout the crisis period makes things difficult. There is no doubt that contractors are heavily competing for projects. And that competition is bringing a wider range of bids for public projects and potential for big savings. Clients however should be very prudent when awarding projects. Receiving offers under the estimated budget might be very attractive but the client should have very reliable information on the contractor's financial situation. A contractor attempting to get jobs at under-cost prices might be a dangerous option as at any given moment could go out of business.

## **CONCLUSIONS**

Times are for sure challenging and big changes have been made in a very short period. Future projects will focus much more on real needs of the region and we will be seeing a lot less of super-expensive and luxurious projects. It is clear that till now infrastructure works are less affected than real estate.

As a result of the slowdown, competition is now fiercer not only by already settled companies decreasing their prices but with new companies coming into the region. At the moment big industry players seems to be focusing in Abu Dhabi, Qatar and Saudi Arabia. Bahrain and Oman still have opportunities but in smaller scale while countries such as Iraq and Kurdistan are suddenly attracting much more attention and are considered to be emerging markets. Further investigation and discussion can be done on the Kuwaiti construction market which was not described in this paper due to lack of personal experience. Yemen which belongs to the GCC was also not included due to its currently small contribution in the construction

industry. However, this might drastically change if plans for a Middle East-Africa bridge linking Yemen to Djibouti go ahead. In such an event it would be very interesting to study the trade effects of possible good importations from Russia, India and China to Africa.

It is time for companies to brainstorm about how they will go through the crisis. Layoffs should only be used as a last resort. Quality and value engineering are now more important than ever. A tough combination of quality, low price and meeting client demands should be the vision.

There are still opportunities during these difficult times but not as obvious as before. People will see this as a huge challenge, shall be more motivated and this will bring out the best of them. Companies will be tested and truly skilled people will have a chance to prove their worth.

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