DIVERSIFICATION STRATEGIES OF TURKISH CONSTRUCTION COMPANIES

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ABSTRACT

The macroeconomic, political, legal and social environment where the construction company operates is one of the major determinants of its performance. In a highly competitive and unstable environment, one of the critical success factors is maintaining an adaptable organizational structure so that the company can satisfy changing needs of clients and survive in a dynamic environment. Moreover, in order to sustain competitive advantage, differentiation of services by offering innovative construction and management techniques is compulsory, which implies continuous improvement of value chains. However, increasing efficiency of a construction value chain for a continuous workload is usually contradictory to the objective of having a flexible structure to cope with instabilities of demand and supply. In most of the developing countries, due to instability of economic and political environments, construction companies have to optimize their investments to enhance production and management capabilities so that they should increase efficiency, but at the same time they should not lose their adaptability to market up and downs. Due to frequent ups and downs in the effective construction demand, the general aim of Turkish construction companies is usually not to achieve efficiency for a continuous workload, but to achieve flexibility, even at a cost. Sustainability of competitive advantage depends on the balanced level of flexibility and efficiency in turbulent markets.

Within the context of this paper, related and unrelated diversification strategies of Turkish contractors will be investigated. The reasons and benefits of diversification will be discussed, based on the findings of a questionnaire conducted to analyze market strategies of Turkish contractors. Results show that, by investing in sectors other than construction (tourism, health, telecommunication, etc.), contractors aim to secure a stable cash flow and survive during recessions in the construction industry. Thus, unrelated diversification is utilized to achieve flexibility. Similarly, diversification in fields related to construction helps the contractors to ensure efficiency of construction works by increased control of price, quantity and quality of supplies. As flexibility and efficiency hardly co-exist, the success of companies lies in maintaining a balanced portfolio. Finally, some critical success factors for diversification will be listed, and it will be discussed how innovative Turkish contractors can be in strategic management activities to generate adequate diversification strategies. It will be concluded that construction companies should find the optimum level of diversification in order to achieve synergy, increase efficiency and yet remain flexible.

KEYWORDS

Diversification; competitive advantage; Turkish contractors.

INTRODUCTION

The aim of companies which are aware of the dynamic forces that shape the competitive environment is to ensure sustainability of competitive advantage, rather than immediate profit maximisation as a result of a temporary competitive position. There is an increasing concern that sustaining competitive advantage is not possible without innovation. Innovation is mainly about searching for alternative ways of doing things, development of new services and seeking ways for continuous improvement.
Although the role of innovation to achieve and sustain competitive advantage depends on the rules of competition in a given market, innovation may result in increased success through the employment of the following two mechanisms:

1. **Differentiation**: Innovation provides unique features to products/services and results in greater client satisfaction. Innovation in construction can be achieved by using latest technology, modern materials, automation at site, enhancing the use of capital and/or using modern management techniques. However, how innovation increases competitiveness depends on the characteristics of the market and the client. In the construction sector of developing countries, competition is mainly price-based, as the major client is government. Therefore, it seems that there is no reward for innovation since the client usually does not pay for the added value of innovation. Apparently, this argument is not valid for all sub-sectors of the construction industry. For example, in major infrastructure projects carried out using a BOT (Build-Operate-Transfer) model in Turkey, innovative financial solutions provide an important source of competitive advantage. Similarly, private housing projects constitute a niche where users are usually willing to pay for innovative design solutions and material selection.

2. **Low cost/rapid construction**: Innovations in the value chain are known to result in cost and time savings leading to higher competitive advantage based on price factors. Even if the clients do not pay extra money for differentiation as a result of innovation, innovations are necessary for their own sake to decrease costs, increase quality and save time. Egbu et al. (1998) report a correlation between a firm’s efficiency/profitability and its ability to innovate. In their research, they provide examples of innovation in the construction industry: innovation in foundation engineering (piling business), automation in production of construction materials and digital information technology (property sector). Experience shows that innovative construction and/or management techniques may result in great cost savings and high profitability in the long run.

Motawa, Price and Shar (1998) report findings of a research carried out to determine sources of innovation in the construction industry and note 290 innovations in the building industry. According to their findings, the majority of process innovation emerges in smaller enterprises. Smaller enterprises are mainly involved in process innovation and larger firms are more involved in product innovation. This implies that the first mechanism explained above (differentiation advantage) is more valid for large companies where the clients are willing to pay for their differentiated services; whereas the second mechanism (low cost advantage) is more valid for smaller enterprises which maximise benefits of innovation by cost reductions in their value chains. Intelligent buildings developed by Bouygues and IBM can be given as an example for product innovation. A new mini-piling system that is cheaper and faster than the conventional method can be an example of innovative processes. The aim of all organisations should be to innovate in products and/or processes as a result of effective situation audits and environmental scanning to find out alternative ways of doing things. Although innovation may result in different sources of competitive advantage, firms should increase their capacity to innovate in accordance to the forces of competition in selected markets, client needs, company strength/weaknesses, power culture in the company, organisational structure and strategic plans.

Innovations can be grouped under different categories: design innovations, construction method innovations, technology/equipment innovations and management innovations. Innovations in strategic management and corporate planning activities may result in increased success in highly turbulent and competitive environments. One of the critical tasks of strategic management is formulation of market strategies. The objective of this paper is to investigate how diversification strategies affect the competitive advantage of construction companies in selected markets. The unstable socio-economic environment being experienced in Turkey necessitates that contractors should find ways to cope with fluctuating market conditions. Adaptability and flexibility are among the most critical success factors to survive in such turbulent environments.
Diversification into markets unrelated to construction provides contractors with alternative paths to follow during downturns of the construction sector and increases their flexibility. In order to secure a balanced cash flow and survive during recessions in the construction industry, diversification into unrelated markets is a widely utilized strategy in the Turkish construction sector. The first hypothesis in this paper is “Construction companies which are diversified in other sectors can secure a more balanced cash flow and their competitiveness increase due to higher flexibility”.

Secondly, integration into markets related with construction gives contractors differentiation advantages, independence and robustness to related market conditions. Accordingly, the second hypothesis is “Construction companies which are diversified in related construction markets increase their competitive advantage as a result of higher efficiency and differentiation of services”. The validity of these two hypothesis will be questioned by using the findings of a survey, which was carried out to investigate mainly the market strategies of Turkish contractors. Why Turkish contractors diversify into related/unrelated markets and effects of diversification on their competitiveness (adaptability and differentiation abilities) will be discussed in the light of the findings of the aforementioned survey.

The survey was sent to 119 Turkish construction companies. This target population has been determined to be the big-medium sized contracting companies, most of which are diversified into related and/or unrelated markets, and preferably involved in international projects. The number of returned surveys is 60. In this paper, only the part of the survey which is about related and unrelated diversification will be mentioned. Finally, how the construction companies may innovate in market strategy formulation and implementation will be discussed together with some critical success factors for diversification.

FLEXIBILITY AND EFFICIENCY

Adaptability to environmental conditions can be achieved by a flexible structure. A flexible structure to cope with unstable demand is usually contradictory to increasing efficiency of construction works. In the survey mentioned above, 90% of the respondents agree (62% agree, 28% strongly agree, 5% disagree and 5% is undecided) with the argument that “Due to fluctuations in the construction demand, the general aim in the construction industry is not to achieve efficiency for a continuous workload but achieve flexibility even at a cost” (Hillebrandt et. al, 1995). Unstable demand necessitates the utilisation of cash stabilisation strategies to survive during downturns and makes flexibility a critical issue for Turkish contractors. In more developed countries, where political and economic fluctuations are less, increasing managerial and operational capabilities can be of major concern where construction companies of developing countries have to consider external threats rather than internal weaknesses.

This issue is explained by researchers (Hillebrandt et. al, 1995) in terms of planning having two directions; planning for flexibility, and planning for efficiency. Flexibility is related with identification of alternative paths for development while efficiency is to do with deciding on the courses of action for efficient travelling along selected paths. During booms, firms do not spend much time on thinking about flexibility issues and spend money to achieve efficiency in construction firms. However, mostly, recessions show that planning for efficiency without considering flexibility is useless. Flexibility can be achieved by diversification, joint venturing, subcontracting/outourcing and capacity reduction through leasing equipment. Flexibility can increase success of diversified companies as a result of decreased costs of having excess capacity. Also, cash flow generated from unrelated markets can be used for construction works during times of trouble (delayed progress payments etc.) and decreases the risk of bankruptcy. On the other hand, integration into markets related to construction usually increases efficiency of construction works but decreases the company’s flexibility because of increased sensitivity to construction market ups and downs. This paradox - to diversify or to focus - is known as the “agility paradox” as defined by Osborn (1998) and it is also mentioned by Heney (1985) as problem of “specialisation versus diversification”. In turbulent
markets, organisations need to be flexible in order to respond quickly to market threats yet they have to remain stable in order to learn and grow, based on their strengths. Consequently, a level at which both efficiency and flexibility abilities co-exist should be found and an optimum diversification level should be maintained.

MARKET STRATEGIES OF TURKISH CONSTRUCTION COMPANIES

Whether a company should plan for efficiency or flexibility depends on the environmental factors affecting the activities of that company. Strategies used by organisations also depend on the risk attitudes as well as exogenous factors. When realities of Turkish construction industry are concerned, a randomised environment with high turbulence is a good description of the current situation, and which strategy to use depends on the risk attitude of contractors.

In order to increase responsiveness to turbulence of construction market in Turkey; two types of strategies are being used:

1. Turbulence-insulating: Conglomerate (unrelated) diversification (different services in different markets) that is based on forming a portfolio of techniques and markets whose fortunes are unrelated to one another is an insulation strategy. Also, joint venturing or forming strategic alliances are coalition strategies used to insulate turbulence. Moreover, globalisation can be named as concentric diversification (providing same services in a different market) among insulation strategies.

2. Turbulence-reducing: Vertical and horizontal integration strategies are turbulence reduction strategies that decrease competitive risks by buying competition in related markets.

Regardless of which turbulence-insulating or reducing techniques are used, market strategies for construction companies can be summarised into two groups; namely survival and growth strategies (they are also known as momentum and development strategies, respectively):

1. Survival strategy: Survival strategy covers the growth in the current construction markets by improving the current situation and services. This strategy is a focus strategy where the major aim is to improve the performance in specific markets in order not to lose the current competitive advantage. Development of a quality assurance system, reorganisation/restructuring efforts, human resources ability development, productivity improvement, use of IT to support construction and management tasks can be listed among the methods utilised by construction companies to sustain their competitive advantage in current construction markets.

2. Growth strategy: Growth strategy can be associated with entrance into new markets in the construction industry, entrance into construction-related markets or penetration into unrelated markets.
   • Entrance into new construction markets: Emergent construction markets like earthquake-resistant building, rehabilitation of damaged buildings, BOT projects and real estate development can be mentioned among the popular markets. Internationalisation decisions can also be covered under this type of strategy. Construction companies enter emergent construction markets in which they can build a competitive advantage and strengthen their positions in the construction industry.
   • Related diversification: This strategy covers the entrance into construction-related markets like pre-construction activities (eg. production of construction materials), post-construction services (eg. operation of power plants) or complementary services/production (eg. manufacturing of furniture). Related diversification strategy covers the development of new capabilities and increasing resources (investing in new equipment, hiring new personnel, etc.) to provide new services in construction-related markets.
Unrelated diversification: This strategy covers the growth in markets unrelated to construction. Entering attractive sectors that are thought to minimize risks and increase profitability in the portfolio, firms may increase the number of markets they are serving and number services they are providing. Tourism, finance, energy and foreign trade are among the popular sectors where the Turkish contractors are diversified.

The advantages of related and unrelated diversification will be investigated in the next section.

SURVEY FINDINGS

Diversification in unrelated markets
Markets in which Turkish contractors are most widely involved are shown in Figure 1. The most popular sectors are tourism, operation and management of facilities, finance, sales and foreign trade. The tourism sector is attractive for construction companies as they were given incentives to build and operate luxurious hotels in the southern coasts of Turkey, in the mid-1990s. Also, building schools, shopping centres, hospitals etc. and operating them to secure cash flow is widely utilised by big construction companies. Most construction companies operating in international markets are involved in the finance sector in order to facilitate preparation of financial packages and similarly, in foreign trade, to facilitate import/export of goods related/unrelated with construction. Energy production and sales is also very popular among Turkish contractors. Interview results also demonstrate that; energy, telecommunication and food sectors are among the most attractive markets for contractors nowadays.
Reasons for unrelated diversification
The respondents are asked to rate the relative importance of listed reasons for unrelated diversification; the following reasons were found to be the most important drivers for unrelated diversification (as given in Table 1).

1. Survival/growth: Companies declared that diversification in unrelated markets is seen as a survival strategy during recessions in the construction sector. Construction industry is known to be risky as most of the companies face the risk of non-continuous construction workload and the cost of idleness is significant during these recession periods. One way to survive during these times is to use cash generated by other businesses to fund overhead expenses of the construction business. Usually, contractors use the cash generated by construction works to invest in unrelated markets. It is also worth mentioning that one of the major reasons for unrelated diversification, as stated by many respondents, is to grow. In this respect, unrelated diversification is conceived as a survival and growth strategy.

2. Financial risk reduction: One of the most important reasons of unrelated diversification is spreading risks by a diversified portfolio. By investing in different markets, overall financial risk to the company is minimised.

3. Cash stabilisation: Evening out of cyclical effects in the construction sector also received significant importance ratings from the respondents. Due to the fluctuating nature of construction demand, ensuring a stable workload and cash stabilisation are among the major aims of the construction companies. Thus, flexibility becomes a critical issue and diversification is a way to achieve flexibility.

Higher profitability in ‘shining’ sectors also affects unrelated diversification decisions of contractors. It is also evident from the survey results that personal interests of shareholders play an important role in selection of unrelated markets in which to invest. To derive indirect benefits for construction works is found to be a minor reason, showing that contractors do not consider a synergy concept while choosing unrelated markets. Similarly, to derive tax/incentive benefits received a low rating on average. Most probably, this is due the fact that it is important only for a limited number of sectors like tourism, and not applicable for many others. Finally, it can be concluded that unrelated diversification is seen as a financial risk reduction method and has cash stabilisation advantages for construction companies as a result of increased flexibility.

Table 1. Reasons of unrelated diversification
(Using a Likert scale of 1 to 5, where 1 and 5 show the least and most importance levels respectively)
Diversification into related markets
When Figure 2 is examined, it is clear that most popular construction related markets in the manufacturing sector are ready mix concrete-cement production, manufacturing of pipe/infrastructure elements, prefabricated/precast building elements, construction machinery and equipment and steel elements/reinforcement. In the services sector (Figure 3), Turkish contractors are mostly involved in operation of facilities, feasibility studies, market research consultancy, interior design/decoration and BOT projects (operation of power plants). During the interviews, it was recorded that the most attractive markets are BOT investments, property development and establishing real estate investment partnerships. One of the trends is that big Turkish contractors are taking the role of investors, rather than only acting as contractors. They are also offering project packages where they carry out market research and feasibility studies, prepare the financial package for the owner, design, construct and offer maintenance and repair services for the facility.

![Figure 2. Number of companies operating in different markets related with construction (manufacturing)](image-url)
Reasons for related diversification

Stated reasons for related diversification, as given in Table 2, can be summarised as follows:

1. Controlling quality, quantity and price of supplies: Contractors aim to decrease their dependence on suppliers and try to ensure that materials/equipment satisfy the required quality standards. Also, as they are able to produce at lower prices, it gives them cost advantage. Moreover, they can differentiate their construction services by producing and using high quality products. In addition to controlling the quality, quantity and cost of supplies, unavailability of necessary materials in the market is another driver for related manufacturing. If contractors cannot find the required products in the market, they sometimes decide to produce them themselves.

2. Improving the efficiency of construction works: By producing their own materials, they minimise the risk of unavailability of materials or delays at site and they can plan and organise construction works more efficiently. Efficiency of construction works increases competitiveness of companies and results in higher profitability.

3. Cost savings: Although some investment is necessary initially, in the long run, it pays back with lower cost of construction and price advantage in tenders.

All of the above mentioned reasons have the same theme: The major aim is to provide direct benefits for construction works through lower dependency on suppliers, lower risk of delay, lower costs and higher quality. Less important reasons are spreading financial risks, using under-utilised capacity and high profitability of related markets. This result shows that increased profitability by investing in related markets is not an important motive for related diversification. Minimisation of technical/construction-related risks is a more important reason than decreasing financial risk by a diversified portfolio. As a conclusion, contractors invest in construction markets to increase...
efficiency of construction works, gain lower cost advantage and differentiate their services. Making higher profits by investing in manufacturing activities as a separate business is a secondary objective.

Table 2. Reasons of related diversification
(Using a Likert scale of 1 to 5, where 1 and 5 show the least and most importance levels respectively)

<table>
<thead>
<tr>
<th>Reasons</th>
<th>Mean</th>
</tr>
</thead>
<tbody>
<tr>
<td>To control quality, quantity and price of supplies</td>
<td>3.71</td>
</tr>
<tr>
<td>To improve efficiency in construction works</td>
<td>3.69</td>
</tr>
<tr>
<td>To obtain cost savings</td>
<td>3.62</td>
</tr>
<tr>
<td>To achieve independence</td>
<td>3.24</td>
</tr>
<tr>
<td>To spread financial risks by investing in new markets</td>
<td>3.18</td>
</tr>
<tr>
<td>High profitability in the construction-related markets</td>
<td>3.09</td>
</tr>
<tr>
<td>To use under-utilised capacity</td>
<td>3.04</td>
</tr>
</tbody>
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Critical success factors for diversification

- Success of unrelated diversification of the construction company depends on how cash generating and cash hungry sectors are combined in the portfolio together with existence of special expertise to carry out different businesses. As the major aim of unrelated diversification is stabilisation of cash flow and financial risk reduction, in order to achieve these benefits, companies should be involved in sectors that have complementary cash flows. For example, during winter periods, in most geographical regions, construction works are suspended. Accordingly, a construction company may operate in a market which generates cash during this low demand period. Another critical issue is that companies should have the necessary expertise to be successful in businesses unrelated with construction. Sectors that give synergy to construction works like finance and foreign trade should be preferable, rather than totally diverse fields (e.g. manufacturing of unrelated goods, like food).

- Attractive markets related to construction are those proved to increase efficiency of construction works and lead to cost reductions. If alternative goods and services could be found easily in the market with more favourable prices, those markets may not worth entering. So the decision criteria should be: efficiency, high demand but low supply in the market, expertise of the company and existence of features that complement contracting services.

- Unrelated diversification can be a burden during economic recessions as, mostly, all sectors are affected from the recession. Recessions experienced by contractors showed that substantial growth may lead to big disasters during general recessions. A focus strategy resulting in limitation of activities in construction and construction-related businesses proved to be a better strategy to survive during recessions rather than unrelated diversification (Geroski and Gregg, 1997; Hillebrandt et. al., 1995). As a final note, diversification may help cash stabilization during recession periods in construction, but in a general recession diversification in many unrelated fields may make the position of the company worse.

- Recessions experienced in Turkey (1994,1998-1999) showed that most attractive survival strategy is to “focus on core competencies” and strengthen the position in the construction-related markets. Differentiation of services without increasing the costs becomes the critical success factor during recessions. Offering non-traditional services (design-build, self-financing etc.), preparation of financial packages for the client, providing equity for projects, identification of projects for the client may help the contractors to increase their workload. Leaving unrelated businesses and keeping the businesses that create synergy (e.g. finance sector) increase survival ability. Most attention should be given to spreading risks between different markets and sectors during recession, as failure in one business should not lead to failure of the company, which is not uncommon during recessions. Land development and housing is a profitable use of cash generated by construction companies during booms, but this attitude changes during recession. Due to lack of funds in the market, houses can not be sold easily and converted to cash. Thus, to keep the negative cash flow low, contractors should not
be engaged in long-term housing development projects in the pre-recession period. In short, balanced diversification between cash generating and consuming businesses, concentration on core business and creating or entering new markets in the existing markets may help firms to survive and increase competitiveness rather than diversification in many unrelated fields.

**STRATEGIC MANAGEMENT FUNCTIONS FOR SUCCESSFUL DIVERSIFICATION**

The arguments and findings mentioned above demonstrate that in order to solve the “agility paradox” and remain both efficient and flexible in turbulent markets, construction companies should utilise innovative diversification strategies and aim for limited growth. A systematic approach is necessary for environmental scanning, evaluation of market attractiveness, competition/competitor analysis, cash flow forecasting and demand prediction. A business development division within the company, responsible for strategic situation audits, environmental scanning, strategic options generation and determination of critical success factors for market strategy implementation provides guidance for the selection of innovative market strategies. Companies can also innovate in management tools used for market analysis to decide into which markets to diversify. For example, an environmental scanning model based on strategic internal and external information systems backed up by IT tools for demand forecasting, scenario planning and evaluation of construction market attractiveness may help the companies to determine which markets to enter or withdraw from. Similarly, innovative diversification strategies may cover creation of new markets by offering new products (eg. intelligent buildings) and processes (eg. a new tunnelling method). Early entrance into high demand domestic/international markets related and/or unrelated to construction, which can only be possible with high scanning ability and entrepreneurial capacity, may result in increased success for construction companies. It should also be noted that, in order to benefit from being early entrants into a market, investors should develop innovative differentiation strategies which can not be easily imitated by competitors in the long run.

**CONCLUSION**

The survey findings imply the validity of the following two hypothesis about diversification;

- Diversification into markets unrelated to construction is perceived as a way to achieve flexibility by Turkish contractors. During recessions in the construction sector, they are able to maintain a stable cash flow and decrease financial risks.
- Diversification into markets related to construction is perceived as a way to achieve efficiency in construction works. By investing in sectors related with construction, Turkish contractors aim to differentiate their services and control quality, quantity and price of materials. In this respect, they are able to decrease construction related risks rather than financial risks.

As it has been discussed throughout the text, the “agility paradox” can be solved by formulation and implementation of the right market strategies. Turkish experience shows that construction companies which are not highly diversified into unrelated markets perform better during economic recessions. Focusing on markets related with construction gives them the ability to differentiate and innovate based on experience. Investing in sectors that give synergy to construction works is a more viable strategy when compared with investing in sectors totally unrelated with construction. Flexibility can also be achieved by creation of/investing in new markets related to construction. Development of the right market strategies requires advanced environmental scanning, portfolio analysis, cash flow forecasting, market analysis and evaluation capabilities. Firms that can innovate in the use of strategic management tools are expected to give better market selection decisions and sustain competitive advantage in the long run.
REFERENCES


