

The impact of digital transformation on construction companies' diversified strategy

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The construction industry globally operates in a highly competitive environment, with narrow EBITDA margins. Unexpected events, such as the current COVID-19 crisis, present additional challenges. Engineering and Construction (E&C) companies have been diversifying their business portfolios. The motivations behind this are common to all sectors and consist of growth, synergies, reduced risk and cash flow recurrence and stability.

Digital transformation brings new challenges and new diversification opportunities. In this article we explore how E&C companies will ramp up growth now and into the future.

What motivates companies to diversify their business?

Companies continue to re-invent their business portfolio to leverage a set of specific drivers, involving construction and non-construction activities. These are: increased synergies, harnessed competitive advantage and knowledge, as well as higher profitability, shorter life cycles and more recurring revenue from non-construction activities. However, since these activities usually require higher investment levels than pure construction, diversification entails risks such as the burden of debt.

Two-way diversification strategy

Construction groups have been diversifying their business portfolio and, more recently, have done so mostly through M&A activity. They do this by providing non-construction services to construction customers and performing several activities included in the asset life cycle.

01. Providing non-construction services to clients

Firms are providing a full spectrum of solutions to extract value from technologies and the key business expectations of each client. The core goal is to shift from an exclusive focus on E&C to becoming a "full" business partner.

In recent decades, firms have been investing mainly in developing their offering of services in consulting, staffing solutions, procurement and supply chain, real estate and management (such as operations management, facilities management and IT). Certain players are also investing in less related areas, such as fashion and hospitality.

02. Performing activities included in the asset life cycle

Expanding the business portfolio also means offering an integrated set of solutions throughout the asset life cycle. To become end-to-end solution providers, companies have been investing heavily in concessions, water and waste management, energy systems and plants, maintenance and asset management solutions, remodeling and turnarounds.

The agenda for the future

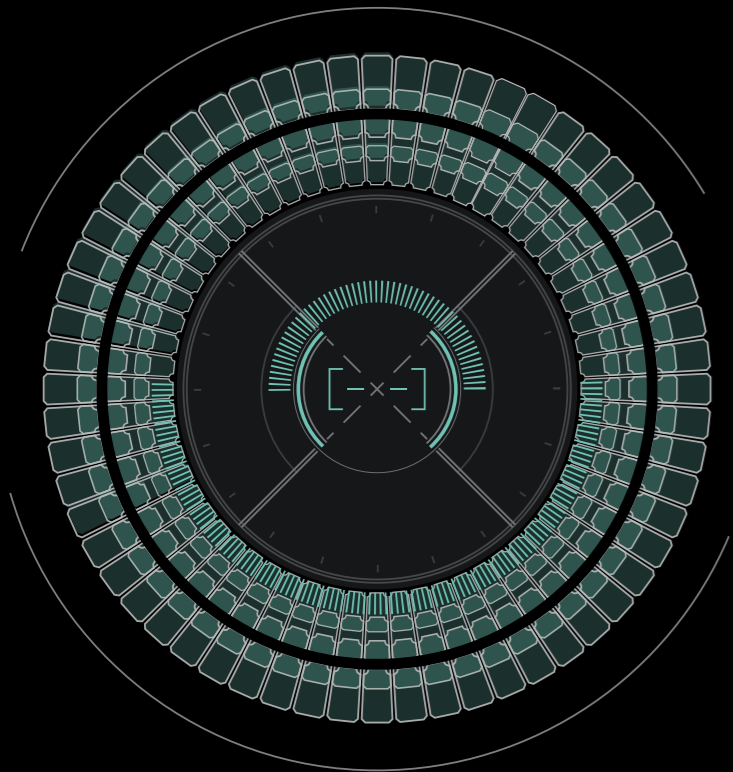
Construction 4.0 will continue to transform the industry through digitization (through, for example, the automation of construction sites and artificial intelligence). Market disruption forces companies to be agile, i.e., to reassess their strategy and operations in a timely manner. Companies need to be flexible

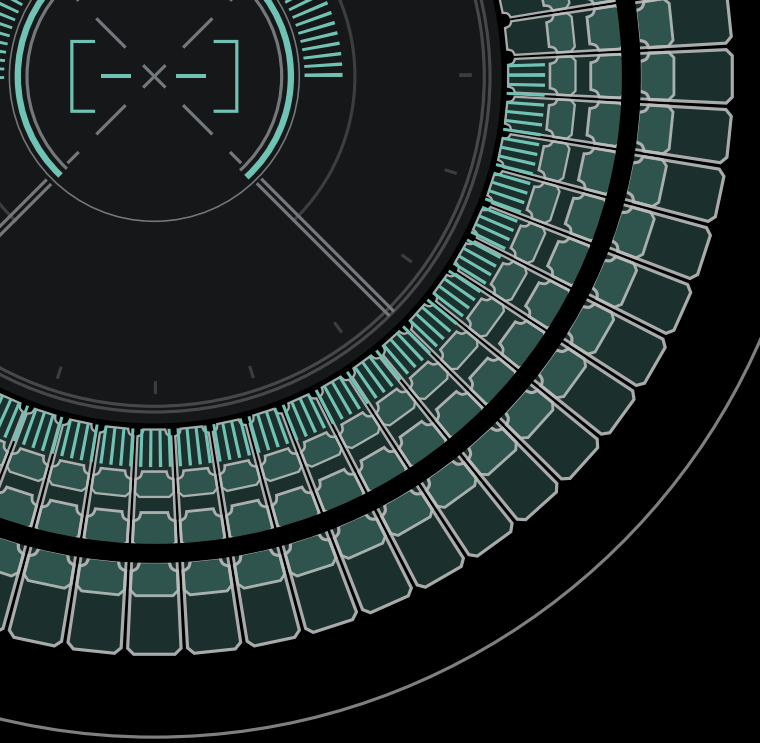
enough to adjust quickly to the market, lean enough to be competitive and innovative enough to deliver quality and new services. In less than ten years, we will have witnessed a massive industry and business reconfiguration.

In E&C, exploring new ways to grow will remain the building block for generating profits and building market share. Revenue and knowledge will be increased through dedicated innovation hubs, business incubators and accelerators and corporate venture initiatives. Competitive advantage and strategic market positioning will be achieved through partnerships with universities, start-ups and experts in niche technologies/knowledge areas, enabling firms to potentially become specialists. Participation in cross-market discussions and initiatives and a strengthened position in the value chain will be attainable by acquiring stakes through M&A activity. This is a path that results in improved financial performance and risk management and a growing market share, whether centered on the core business or not.

At the same time, E&C companies with different diversification levels, ranging from pure construction to diversified groups, are expected to hit the market differently, following their own particular strategies. For diversified companies, the future will bring additional trade-offs and challenges.

Construction groups with an extensive presence across segments will firstly have to evaluate which segments to serve, even before defining the assets/initiatives in which to invest. Intuitively, they will have to be selective and prioritize investments (to an even



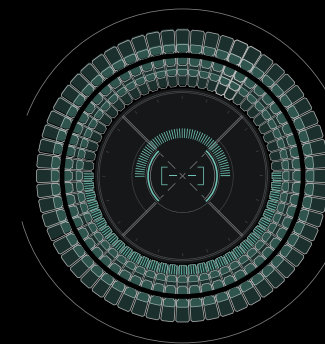


greater degree), choosing between building up core activity, integrating the value chain and embracing new businesses. Despite this, and following market trends, the construction segment will continue to have the biggest share of the pie, after divestments of non-core businesses. Companies will rethink their participation in knowledge-intensive segments to free up investment capacity for capital-intensive segments (construction). Pure construction players will keep the focus on their single core business and invest in strategic assets, such as technology, to develop competitive cost advantage (efficiency).

Conclusion

E&C is an industry in evolution. In the coming years, companies must continue to invest in technology if they are to sustain their position. Innovation and growth will be centered on core business, despite the potential collateral contribution to diversification. Diversified E&C groups will come up with reinvented business portfolios and the growth and competitiveness of other activities, especially non-construction, are expected to fall.

There are two key takeaways: the need to explore new ways to grow as a key success factor and the importance of making strategic decisions tailored to the degree of diversification and profile of each company.



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