

## Strategic management: An Eastern Cape construction SME case study

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### Abstract

Small and Medium-size Enterprises (SMEs) fulfill an important role in the long-term growth and development of the economy of the country. The development and growth of construction SMEs are important for all countries, as a strong SME base has the capacity to produce a high-quality infrastructure for the country.

However, research has revealed the high failure rate of small businesses within the first five years of their existence in South Africa. In addition, research also indicated that lack of long-term planning and lack of strategic thinking are major contributing factors to the failure of most SMEs.

For instance, despite the considerable growth in the industry in the past decade due to government's considerable infrastructural spending occasioned by the 2010 FIFA World Cup, the majority of construction SMEs failed to use the opportunities gained in this period to develop into established construction entities. This study investigates how strategic management can be applied to address the problems faced by construction SMEs, and to explore techniques and tools of strategic management that can make a significant contribution to their growth and development.

The research findings, based on a literature review and a qualitative research approach, suggest that, although many construction SMEs perform poorly, some have the potential to grow and develop into more established entities by proactively managing their firms strategically. In addition, the findings indicate that SMEs that practise strategic management perform better, and that there are many advantages for SMEs that adopt strategic management principles at the organisational level.

**Keywords:** Construction industry, small and medium-size enterprises, strategic management

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## Abstrak

Klein en mediumgrootte ondernemings (KMO's) speel 'n belangrike rol in die langtermyn groei en ontwikkeling van die ekonomie van die land. Die ontwikkeling en groei van konstruksie KMO's is belangrik vir alle lande omdat 'n sterk KMO-basis die kapasiteit het om 'n hoë-kwaliteit infrastruktuur vir die land voort te bring.

Nietemin, navorsing het gewys na die hoë mislukkingsyfer van kleinondernemings binne die eerste vyf jaar van hul bestaan in Suid-Afrika. In aansluiting hierby, toon navorsing ook dat 'n gebrek aan langtermynbeplanning en die gebrek aan strategiese denke groot bydraende faktore tot die mislukking van meeste KMO's is.

Byvoorbeeld, ten spyte van die oorwegende groei in die industrie in die verlede as gevolg van die regering se oorwegende infrastruktuurbeplanning vir die 2010 FIFA Sokker Wêreldbeker, het die meerderheid Konstruksie KMO's misluk om die geleenthede in hierdie periode te ontwikkel na gevestigde konstruksie-entiteite. Hierdie artikel ondersoek dus hoe strategiese bestuur toegepas kan word om die probleme wat deur konstruksie KMO's ervaar word aan te spreek, en om tegnieke en toerusting van strategiese bestuur te ontdek wat 'n merkbare bydrae tot die groei en ontwikkeling kan maak.

Die navorsingsbevindings wat op 'n literatuurstudie en 'n kwalitatiewe navorsingsbenadering gebaseer is, stel voor dat alhoewel baie konstruksie KMO's swak presteer, het sommige die potensiaal om te groei en te ontwikkel na meer gevestigde entiteite deur proaktiewe strategiese bestuur van hul firmas. In aansluiting hierby dui die bevindinge ook aan dat die KMO's wat strategiese bestuur toepas, beter vaar, en dat daar baie voordele is vir KMO's wat strategiese bestuurbeginsels op organisatoriese vlak aanneem.

**Sleutelwoorde:** Konstruksie-industrie, klein en mediumgrootte ondernemings, strategiese bestuur

## 1. Introduction

The development and growth of construction Small and Medium-size Enterprises (SMEs) are important issues for all countries, as a strong SME base has the capacity to produce high-quality infrastructure for the country (Ofori, 2009: online). Furthermore, construction SMEs also stimulate economic activity in other sectors of the economy (Ofori, 2009: online). However, construction SMEs face many problems when dealing with construction projects, and, as a result, poor performance and poor quality of work are unfortunately prevalent among SMEs in the construction industry (Dlungwana, Noyana, Nxumalo, Rwelamila & Van Huysteen, 2002: 2).

The lack of any long-term planning and the lack of strategic thinking often lead to the failure of SMEs businesses (Analoui & Karami, 2003: 36). However, organisations that practise strategic management usually outperform those that do not (Hunger & Wheelen, 2003: 4; Analoui & Karami, 2003: 10). There is, therefore, the need to investigate how strategic management can be applied to address

the problems faced by construction SMEs by exploring techniques and tools of strategic management that can make significant contributions to the growth and development of construction SMEs in South Africa. Hence, the primary objective of this study is to report on the success factors of a construction SME in the Eastern Cape. These will be used to develop strategic management guidelines for similar entities.

## 2. Literature review

The South African construction industry has experienced a decade of considerable growth and success, particularly as a result of the government's considerable infrastructural spending. According to a report by the Department of Agriculture and Land Reform (2008: 7), the construction industry managed to increase its contribution to South Africa's GDP by 18% between 2003 and 2008. However, the global recession has, as in most sectors, put a dampener on growth, but the industry was one of only a few sectors to have increased its contributions to GDP during the recession. For example, in the 3<sup>rd</sup> quarter of 2009, it increased its contribution to GDP by 8.4% from what it was in 2008 (Statistics South Africa, 2009: 41). However, the growth in the construction industry cannot be considered in terms of the number of contractors moving from the lower to the upper grades of the CIDB register of contractors. In fact, 89% of all registered contractors that can be categorised as SMEs fall within level one of the Construction Industry Development Board's classification system as indicated in Table 1 (CIDB, 2010: online).

Table 1: CIDB National Register of Contractors: May 2010

Grade	CE	EB	EP	GB	ME	SW	Total grades	Percentage
1	20.200	1.007	1.836	57.900	2.525	10.237	93.705	89.04
2	1.532	172	84	2.058	185	438	4.469	4.25
3	512	90	46	539	83	90	1.360	1.29
4	727	168	117	755	132	115	2.014	1.91
5	522	147	132	464	150	156	1.571	1.49
6	567	50	57	487	75	47	1.283	1.22
7	224	19	36	195	36	28	538	0.51
8	72	2	9	60	16	7	166	0.16
9	47	6	16	32	21	10	132	0.13
Total	24.403	1.661	2.333	62.490	3.223	11.128	105.238	100.00

Source: CIDB 2010

In terms of the 2004 CIDB Regulations, made by the Minister of Public Works in terms of the CIDB Act, 2000, construction SMEs in the lowest level of the CIDB's National Register of Contractors are restricted in terms of the size of the projects for which they may tender (CIDB Regulations, 2004: online). Construction SMEs registered in grade one, which is the lowest level, may only tender for projects up to a value of R200.000. Contractors in grade nine may tender for an unlimited value (CIDB, 2004: online). The bottom structure of the construction industry is thus overloaded, while the top structure contains only an elite few that have the benefit of competing for multimillion rand projects, as the contractors in the lower levels are restricted to tendering for small non-complex projects (Cameron, 2007: online). For this reason, the CIDB has continually expressed its concern over the high concentration of lower level contractors that fail to move up the grades (Cameron, 2007: online). The situation in the Eastern Cape is particularly a source of concern as the CIDB (2010: online) noted that the number of grade-one contractors in the province is disproportionately high at 91.8% of all contractors registered in the Eastern Cape (Table 2). When compared with other provinces, for instance, the percentage in the Eastern Cape is significantly higher as grade-one contractors constitute 58.0% and 61.5% of the total number of registered contractors in the Western Cape and KwaZulu-Natal, respectively.

Table 2: CIDB's Register of Contractors registered in the Eastern Cape: October 2010

Grade	CE	EB	EP	GB	ME	SW	Total grades	Percentage
1	2.736	96	194	8.228	175	1.186	12.615	91.81
2	128	12	7	210	9	58	424	3.09
3	89	9	9	59	4	10	180	1.31
4	101	11	5	81	9	11	218	1.57
5	51	10	14	44	15	14	148	1.08
6	49	4	1	45	2	1	102	0.74
7	17	4	3	16	1		41	0.30
8	6			7			13	0.10
9	1						1	0.01
Total	3.177	146	233	8.690	215	1.280	13.741	100.01

Source: CIDB 2010

Although construction SMEs face similar problems as do their counterparts in other sectors of the economy, they have to deal with the unique characteristics of the industry, with adverse implications for

the firms (Ofori, 2009: online). In brief, in the South African construction context, construction SMEs face many problems when dealing with construction projects and, as a result, poor performance and poor quality of work prevail among SMEs in the construction industry (Dlungwana *et al.*, 2002: 2). As an illustration, the construction industry is driven mainly by projects and thus the success of companies is "inextricably linked to the success of the projects they execute" (Barry & Sebone, 2009: 186). It follows that, if SMEs consistently deliver poor quality on projects, the projects may fail and this, in turn, may lead to the low success rate of SMEs. In addition to the problems faced by all SMEs in all the sectors of the economy, Ofori (2009: online) identifies three unique characteristics of the industry that have adverse implications for construction SMEs:

- The contractor's low level of bargaining power in view of the tendering process;
- The project-based nature of work which implies discontinuity, and
- The way in which work is financed, in other words the client only pays for work that has been completed.

## **2.1 Strategic management in construction**

Due to the industry's inherent characteristics, strategic management can be deemed important to businesses operating in the construction industry where the degree of rivalry is high and where adverse competition is a serious threat to the success of a business (Skaik, 2009: online). The strategic management process usually starts with strategy formulation. Before an organisation begins the process of strategy formulation it should scan its external environment to identify threats and opportunities, and its internal environment to identify strengths and weaknesses (Hunger & Wheelen, 2003: 30). Environmental analysis must precede strategy formulation in the strategic management process. Environmental analysis is a tool used by businesses to avoid strategic surprise and to ensure the long-term health of the business (Hunger & Wheelen, 2003: 30).

## **2.2 Strategy formulation**

The strategic formulation process begins with the crafting of the mission statement, which provides the framework within which the business's strategies are formulated (Hill & Jones, 2008: 8). The mission statement sets out the purpose of the company and provides a basis for strategic objective-setting and decision-making. It is important that the mission statement be communicated and made clear

to all internal and external stakeholders of the business. It should be understandable and clearly make sense to all stakeholders, in order to avoid confusing stakeholders about the purpose of the firm (Analoui & Karami, 2003: 114).

The second step in strategy formulation is specifying achievable objectives (Analoui & Karami, 2003: 122). Strategic objectives provide guidance on how the business should fulfil and reach the goals specified in the vision and mission statements (Dess, Lumpkin & Eisner, 2010: 29). According to Hunger & Wheelen (2003: 6), the objectives of a business are the end result of planned activities, which should stipulate time frames for the achievement of measurable goals. In this regard, it is often argued that business owners should develop SMART objectives, in other words objectives that are specific, measurable, appropriate, realistic, and time-bound (Dess *et al.*, 2010: 29). They are specific in that it is exactly clear what it is that the business is required to achieve in order to reach the objectives. They are measurable in that each objective has a yardstick which measures progress against fulfilling the objective. It is appropriate in that the objectives are consistent with the vision and mission of the business. It is realistic in that it is on target with the business's current capabilities and available resources, as well as with the opportunities that currently exist in the organisation's environment. According to Analoui & Karami (2003: 129), the third step in strategy formulation is developing strategies by:

- Conducting a SWOT analysis;
- Conducting an industry analysis;
- Conducting a resource analysis, and
- Taking into account the business's strategic objectives.

### **2.3 Porter's five forces**

In formulating strategy, it is important for the strategist in the business to analyse the industry in which the business operates (Analoui & Karami, 2003: 77). Harvard Business Professor, Michael Porter, is a pioneer with regard to the concept of industry environment and industry analysis (Pearce & Robinson, 2003: 67). The cornerstone of his work is the concept of five forces that shape competition in an industry (Pearce & Robinson, 2003: 67). Porter's five forces model is the most commonly used analytical tool for examining a business's competitive environment (Dess *et al.*, 2010: 56). According to Porter (1985: 4), competition in an industry depends on five forces. The competitive forces are the threat of new entrants (also described as

barriers to entry), powerful suppliers, powerful buyers, the threat of substitute products, and rivalry.

The threat of new entrants refers to the possibility that the profits of established firms in the industry may be eroded by new competition (Dess *et al.*, 2010: 56). In general, the contracting sector of the construction industry has low barriers to entry coupled with a high degree of fragmentation (Cheah & Chew, 2005: 552). The capital investment requirements for entry are low; there is an efficient rental equipment market, and the subcontracting mechanism offers advantages to construction SMEs (Acar & Oney-Yazici, 2006: 443). Access to distribution channels is, therefore, not problematic for construction SMEs. Entry is easy for construction SMEs at the lower end of the industry in terms of firm size (Langford & Male, 2001: 52). As project size, complexity and technological requirements increase, fewer firms are able to undertake such work (Langford & Male, 2001: 52).

In terms of the power of suppliers, Acar & Oney-Yazici (2006: 438) contend that the five forces model is based on the assumption that when suppliers are powerful, they can exert pressure on the producers to capture some of the industry's profits. One of the indicators of the power of suppliers in an industry is the number of suppliers in the industry. A supplier group is powerful if the industry within which it operates is dominated by only a few companies (Hunger & Wheelen, 2003: 39). When suppliers dominate an industry, it means that the cost of switching suppliers is high, and the suppliers are said to be more powerful in an industry (Acar & Oney-Yazici, 2006: 438).

As far as the power of clients is concerned, buyers and clients in an industry are powerful if they are able to force prices down, bargain for higher quality or more services, and play competitors against each other (Dess *et al.*, 2010: 58). Buyer power refers to the impact of the client on an industry (Acar & Oney-Yazici, 2006: 438). The power balance between a business and its clients determines the extent with which the business has the freedom to set its product price. In the construction industry, construction SMEs have a contractual relationship with their clients and the price of the product is, therefore, determined before the construction phase. Thus, the clients have a high bargaining power as they specify demands associated with projects, and the switching costs for clients are also low as many contractors operate in the same market (Acar & Oney-Yazici, 2006: 440).

In addition, the threat of substitute products refers to the ability of substitute products to satisfy the same need as another product, hence posing a threat to the existing service providers or producers (Analoui & Karami, 2003: 83). Acar & Oney-Yazici (2006: 443) argue that a substitute product, as meant by Porter, does not exist in the construction industry, because no other product can replace, for example, a building for residential purposes. The degree of rivalry is the amount of direct competition in an industry (Hunger & Wheelen, 2003: 37). If the degree of rivalry is intense, rival businesses target customers of other businesses using attraction strategies such as publicity and advertising (Analoui & Karami, 2003: 83). A competitive move by one business could have an effect on the other competitors (Analoui & Karami, 2003: 83).

#### **2.4 Competitor and resource analysis**

Competitor analysis is a tool for analysing the external environment and, more particularly, the industry. According to Pearce & Robinson (2003: 76), competitive analysis is a tool in terms of which a business determines which firms are its competitors and what the major determinants of the competition are. It profiles the current and potential future strategies of competitors and attempts to work out their possible responses to any changes in the strategy the firm may make (Langford & Male, 2001: 76). Resource analysis, on the other hand, is a tool for analysing the internal environment. The main reason for analysing the resources of a business is to explore those resources that enable an organisation to compete and survive against its competitors. The resources of a business are those assets that contribute to the generation of value added (Analoui & Karami, 2003: 92). Resource analysis determines the extent to which the resources of a firm add value, and it provides the business with a competitive advantage over its rivals (Analoui & Karami, 2003: 92).

#### **2.5 SWOT analysis**

Langford & Male (2001: 75) indicate that a SWOT analysis is shorthand for describing the strengths and weaknesses of a business and the opportunities and threats it faces. The main purpose of the SWOT analysis is to identify strategies to exploit external opportunities, counter threats, build on and protect strengths, and eradicate weaknesses (Hill & Jones, 2009: 19). A SWOT analysis involves both external and internal environmental analysis. A SWOT analysis is used regularly in business to stimulate self-reflection and group discussions about how to improve the business and how to position it for success (Dess *et al.*, 2010: 81).



SWOT analysis has its limitations, as it is merely a starting point for a discussion on how to develop effective strategies to deal with threats and weaknesses and to exploit opportunities and strengths (Dess *et al.*, 2010: 81). In other words, SWOT is not an end itself, but a means to the kind of action steps necessary to enact strategic change (Dess *et al.*, 2010: 81).

## **2.6 Levels of strategy**

According to Pearce & Robinson (2003: 6), the hierarchy of strategy comprises three levels: the corporate strategy at the top, the business strategy in the middle and the functional level strategy at the bottom of the hierarchy (Pearce & Robinson, 2003: 6). The corporate strategy decides what type of business the organisation should be in and how the overall group of activities should be structured and managed (Analoui & Karami, 2003: 53). For instance, in the construction industry, subcontracting and joint ventures (JV) are corporate strategies that could be used by construction SMEs to grow and develop their businesses (Ofori, 2009: online). A construction SME may also decide to form a joint venture partnership with a larger established business. In the construction industry, among SMEs, a JV is used as an opportunity for the SME to grow and develop the company (Ofori, 2009: online) in the domestic market and to win construction contracts, by means of the bidding process, that it would not normally win through the competitive bidding process if it were to rely on its own skills, experience and resources. Another strategy is the diversification strategy. For example, when construction firms diversify, they go into related markets such as property development, housing development, supplying building materials, plant and equipment hiring as well as mechanical and electrical engineering (Langford & Male, 2001: 106). Such diversification allows the business to divert resources from within its current profile to the diversified activities (Fellows, Langford, Newcombe & Urry, 2002: 196). In other words, it makes more sense for construction businesses to diversify into related areas as they can source the inputs needed for the new products from within their current capabilities, skills and resources.

In addition, business level strategies determine how the business will compete in the selected market arena in which it chooses to operate (Pearce & Robinson, 2003: 6). In fact, a business that practises strategic management adopts one or more generic strategies that characterise the business's orientation in the marketplace (Pearce & Robinson, 2003: 13). The three generic strategies are the cost

leadership strategy, the differentiation strategy, and the focus strategy (Dess *et al.*, 2010: 15).

Kenyon & Mathur (1997: 179) define cost leadership as having "lower equivalent costs than competing substitutes". The low-cost leader is a business that can produce at the lowest cost and thus gain competitive advantage in any market by being able to provide the products and services at the lowest cost (Analoui & Karami, 2003: 132). When a business is able to differentiate its products along some attributes which customers value, and the cost of doing so is lower than the extra revenue envisaged, then differentiation strategy is an appropriate strategy to pursue (Analoui & Karami, 2003: 133). In other words, the customer feels that the cost to buy the product is well below the product's value in comparison to other available alternatives (Pearce & Robinson, 2003: 193). The purpose of the differentiation, according to Kenyon & Mathur (1997: 78), is to make the business's product less price-sensitive. In other words, customers give less weight to the price in their buying decisions (Kenyon & Mathur, 1997: 78). In the construction industry, the level of conformance with governing standards and specifications, the extent to which innovative means and methods of construction are used, the quality of workmanship, the quality of human relations, the rigour involved in schedule management, and the level of professionalism in construction management practices are usually the differentiating factors in the construction service (Arditi, Makinde & Polat, 2008: 256).

In addition, a focus strategy, often referred to as a niche strategy, focuses on a narrow segment of the market (Analoui & Karami, 2003: 134). When a firm decides to adopt a focus strategy, the firm will typically concentrate on finding a niche in the marketplace and will develop its competitive advantages for that niche. According to Hernandez (2008: online), companies that develop and exploit a particular specialty niche tend to have a greater degree of success than "those that try to be all things to all customers", as a successful focus strategy depends on clearly defining the niche, conducting an analysis of the niche, and reaching out to the niche by satisfying the niche market's own particular needs.

### **3. Research method**

In this study, a qualitative approach was followed because the aim is to gain an understanding of the problem. A single case study method was chosen for this study as it allows collecting rich data and assists in the understanding of phenomena in their real life and

context (Acar & Oney-Yazici, 2006: 438). Therefore, a construction SME operating in the Eastern Cape was chosen as the subject for the case study.

The interview was used as the primary data-gathering method for this study. More specifically, a focus interview was chosen and questions were carefully designed to provide adequate coverage for the purpose of the research. The concepts and topics in the literature review were used to elicit information from the respondent.

#### **4. The case study**

The business selected for this study is an Eastern Cape-based construction SME. The business was selected for the following reasons:

- The owners successfully developed the business from a micro or very small enterprise to an established medium-sized business, that is now capable of successfully completing multimillion rand projects within the time, cost and quality constraints of the project.
- The owners applied strategic management tools to develop the business.

One of the managing members of the construction SME was interviewed to obtain the primary data for the research. More specifically, a focus interview was used and questions were carefully designed to provide adequate coverage for the purpose of the research. The interviewee is one of the four owners actively involved in the management of the business and is also the business's chief strategist.

##### **4.1 Interview results: The history of the SME**

*Is the SME managed by the owner or an appointed manager?*

The construction SME is managed by its owners.

*What is the size of the SME in terms of number of employees and annual turnover?*

The business has now grown into an established medium-sized enterprise both in terms of annual turnover and in number of employees. It is currently employing 200 employees and is thus at the upper end of the definition of a medium-sized enterprise in terms of number of employees. The business is capable of successfully completing multimillion rand projects in both general building and

civil engineering construction works. It focuses mainly on specialist concrete rehabilitation works, which is a very narrow segment of the construction industry within the civil engineering works category.

*What type of legal entity is the SME?*

It is a close corporation owned by five members, of whom four are actively involved in the management of the business.

*How long has the SME been operational?*

The business started in 1996 as a very small enterprise. When the business started it only employed 20 permanent employees who were all unskilled labourers. All the skilled labour required for a project executed by the business was initially outsourced by subcontracting to other construction SMEs. In the beginning the business only concentrated on small projects for general building works such as painting, repairs, renovations and waterproofing. As the business grew and more opportunities arose, the business started recruiting more semi-skilled and skilled labour. In 2004, the firm shifted its focus from general building works to civil engineering construction works. The business has now grown into an established medium-sized enterprise employing 200 employees, capable of successfully completing multimillion rand projects, in both general building and civil engineering construction works. Its focus is mainly on specialist concrete rehabilitation works, which is a very narrow segment of the construction industry within the civil engineering works category.

*Has the SME ever participated in any contractor development programme in terms of which it received mentoring, the benefits of targeted procurement or any other type of development assistance?*

No.

*In which geographical areas does the SME operate?*

The business operates in the Eastern Cape.

## **4.2 Interview results: Strategy formulation**

### **4.2.1 Strategic objectives**

*Do you set strategic objectives for the SME? If yes, give examples.*

The business has set the following strategic objectives:

- To be registered as a Grade-8CE contractor in terms of the CIDB grading classification system by the year 2011.

- To be a large enterprise by the year 2013.

*Are these objectives SMART (Specific, Measurable, Appropriate, Realistic, Time-bound)? If yes, please explain the metrics to determine whether they are smart or not.*

In this regard, the organisation is already registered as a grade-7 contractor, which means that registration as a grade-8 contractor is the next milestone to reach. Furthermore, the business has already reached the upper end of the description of a medium-sized enterprise in terms of the number of employees permanently employed in terms of the National Small Business Act, 1996. If the business grows any further in terms of number of employees and annual turnover, and if it starts operating on a national level, it will be regarded as a large enterprise. The strategic objectives are also time-bound in that there is a time frame for reaching each of the objectives.

Being registered as a grade-8CE contractor means that the business would be able to tender for projects up to R130 million rand. This would have a positive impact on the annual turnover of the business. The business would also benefit from decreased competition as there are only seventy-two businesses registered nationally in grade 8CE, as opposed to 224 businesses registered in grade 7CE (see Table 1).

To achieve these objectives, the firm has set certain action plans in motion. In this regard, the business registered as a grade-7CEPE contractor. PE stands for potentially emerging. Potentially emerging contractors are allowed to tender for certain projects falling within the maximum tender range of one grade higher than their current grade, provided that the client has earmarked the project specifically for potentially emerging contractors.

#### **4.2.2 Corporate level strategies**

*Which corporate level strategies, if any, does the SME apply?*

The construction SME grew from a very small enterprise to an established medium-sized enterprise by employing a variety of strategies at the corporate level, including joint venture partnerships, acquisitions, subcontracting, vertical integration and diversification.

*Why have you decided on the particular corporate strategy and how does the strategy contribute to the success of the SME?*

#### 4.2.2.i) Joint venture partnerships

The firm has successfully used joint venture partnership as a corporate strategy to develop the business very effectively since 2001. In 2001 the business was able to tender for its first multimillion rand construction project by entering into a joint venture partnership with an established enterprise. The project involved repairs and renovations at the Port Elizabeth Prison. The firm, on its own, had the human resources in terms of skilled labour that was required to tender for the project, but did not own the resources in terms of plant and equipment that was required to successfully complete the project. The firm was not able at the time to put up the guarantees required for a large project. Clients in the construction industry require contractors to provide security for the successful completion of large projects in the form of bank or insurance guarantees to the value of 10% of the contract price. Since the firm did not at that point have the financial resources necessary to obtain a bank guarantee it pooled its resources with an established enterprise that had the necessary plant and equipment and could obtain a bank guarantee required for the large project. The joint venture successfully completed the project, and the firm benefited from the project in that they gained the necessary experience from working on a large project and their turnover increased for the duration of the joint venture partnership.

In 2003, another opportunity arose to complete a multimillion rand project for renovations at the Nelson Mandela Metropolitan University in Port Elizabeth. The firm once again pooled its resources with an established firm through a joint venture partnership in order to tender for the project. It successfully tendered for and completed the project. The project provided the firm with a consistent income for a period of two years from the commencement of the project and it enabled the business to grow to an extent where it employed 80 permanent employees when the project was completed. The strategy of forming joint venture partnerships worked effectively because, by pooling its resources together with a larger firm that owned the plant and equipment necessary to tender for larger projects, the firm was able to provide sustainable and consistent revenue for the business. By forming joint venture partnerships, the firm took responsibility for its own growth and development instead of relying on government initiatives such as contractor development programmes.

#### 4.2.2.ii) Acquisition

In 2004, the construction SME acquired all the assets of an established construction firm. By acquiring this firm, the construction SME acquired the necessary financial and physical resources in order to tender for multimillion rand projects on its own without having to form joint venture partnerships with other businesses. In addition, it enabled the construction SME to direct its business operations towards concrete structural civil engineering works. Before the acquisition, the construction SME mainly focused on general building works, such as masonry, painting and waterproofing. The decision to venture into civil works was also informed by the fact that profit margins in general building works were becoming smaller as more construction firms entered the industry. With the necessary financial resources the construction SME was able to actively recruit suitable qualified employees to supervise civil engineering works. This enabled the business to tender on its own for its first multimillion rand civil engineering works project to the value of R12 million in 2004.

#### 4.2.2.iii) Subcontracting

The firm uses subcontracting both as a means to conclude agreements with main contractors in order to execute portions of a larger project and as a strategy to outsource certain parts of projects of which they have been appointed as the main contractor.

Outsourcing parts of a project to subcontractors enables the construction SME to remain flexible in the type of construction projects for which it tenders. For instance, a specific construction project might have various sections over different disciplines. A project that has been classified as general building works seldom exclusively consists of only general building works. It might have an electrical works section or a mechanical engineering works section. Should the construction SME's workforce not have a particular skill required by a particular section of the project, it merely outsources that part of the contract to a subcontractor who specialises in the particular skill. For instance, electrical works are often outsourced to electrical subcontractors.

In the same way, the construction SME undertakes specialist work outsourced by large construction enterprises through a subcontract arrangement. By subcontracting and dealing directly with a main contractor, the construction SME is able to sidestep the very competitive bidding process it would have to go through in order to contract directly with the client. The main contractor remains responsible to the client to finish the work in the time and to the

standard agreed to in the contract and, therefore, carries all the risks of executing the work on the contract. For example, the construction SME has subcontracted for large enterprises such as Murray and Roberts and WBHO.

#### 4.2.2.iv) Vertical integration

The construction SME applied vertical integration successfully when specialist imported material, supplied by only one supplier in the Eastern Cape, became very expensive. The construction SME investigated the opportunity to import the material directly from Germany, and discovered that it was more cost-effective to import the material in bulk directly from Germany. This decision entailed importing material in bulk and stocking the material as it was not cost-effective to purchase and ship material every time the business successfully tendered for a project. When the construction SME does not successfully compete for a project, it sells the imported material to the rival business that won the tender. This meant that they started to compete directly with the local supplier of the imported material. The business benefited from vertical integration in that it removed its dependency on a supplier that dominated a specific market and that became too expensive. Furthermore, it gave the construction SME a cost advantage over its competitors, in that it was able to reduce its cost of sales in respect of the particular product.

*If the SME has diversified, which markets have you diversified into? Why?*

#### 4.2.2.v) Diversification

The construction SME decided to diversify into a related market such as property development. The idea is not to construct new developments, but rather to carefully choose old dilapidated buildings located in an area with potential, renovate them and sell them at a profit. The plan is still in its infancy stage and the construction SME is currently seeking suitable property in the correct area. The reason why the construction SME decided to diversify is to increase profitable growth. The construction SME already has the necessary skills, capabilities and resources within the business necessary to branch into this related area.

### **4.2.3 Business level strategies**

*Which business level strategies does the SME follow?*



The construction SME follows a combination of cost leadership strategy and focus strategy. Price often trumps all in construction services, and by consistently pricing their tenders lower than their competitors, the construction SME was able to secure tenders on a consistent basis. An example of this is:

*According to the interviewee, the preliminaries and general section in a tender document for a construction project usually constitutes about 20% of the overall tender price and consists inter alia of costs such as supervision and site management costs. One of the reasons why the construction SME is able to price lower is because their site management is not top heavy, in other words, they are able to cut out unnecessary supervision staff and appoint only the supervisory staff necessary to supervise the project to the quality standard required by the client. This perhaps goes to show that the firm ensures that supervisory staffs are competent enough to deliver projects to the required targets.*

Another reason why the construction SME has a cost advantage over their competitors is because of the advantage they have in owning all of their access equipment as opposed to hiring the equipment. An example of access equipment is scaffolding equipment necessary to gain access to a site. According to the interviewee, the costs associated with hiring access equipment could total 25% of the overall costs of a project. The construction SME did a cost-benefit analysis to compare the costs of purchasing their own plant and equipment to access sites, as opposed to hiring equipment for each and every project. Although initially a huge capital investment was required for purchasing the equipment, these costs and the maintenance costs were easily offset by the fact that they have no charge for hiring access equipment in the pricing of a tender for each project and could consistently tender lower for projects. Furthermore, depreciation on assets and renting out the access equipment to other construction firms during the times when it is not required by the construction SME further offset the purchasing and maintenance costs of the plant and equipment. These factors enabled the construction SME to consistently win more projects on the basis of price and give them a competitive cost advantage.

The construction SME found a niche in the construction market in that they are one of only ten serious competitors in the Eastern Cape in the specialist concrete rehabilitation works market. Specialist concrete rehabilitation works is a specific market within the broader civil engineering construction works market. The fact that they have found this niche market means that they have a golden opportunity

to dominate the specific niche market, as the company benefits from decreased competition of bids.

### 4.3 Interview results: Porter's five forces analysis

- *Do you consider the entrants of new construction firms into the industry to be a threat to the business success of the SME?*
- *What strategies, if any, have you designed to neutralise the threat of new entrants?*

The construction SME is very aware of the threat of new entrants, especially with regard to the niche market that the business serves. In order to combat the threat of new entrants, the business analyses the techniques and resources of its competitors at the tender stage in order to assess whether it could possibly be edged out on price. It then proceeds to price its tender in such a way that it combats any threats their competitors may pose in this regard in the future.

- *Can you easily substitute the services and products supplied by your suppliers (in other words, is it easy to shop around, switch one supplier for another)?*
- *What effect, if any, does the power of suppliers have on the business success of the SME?*
- *What strategies, if any, has the SME put in place to neutralise the power of suppliers?*

According to the interviewee, there are sufficient suppliers in the industry to allow the construction SME to play suppliers off against each other in order to obtain a better price. Suppliers do not wield any significant power in the construction industry. It is possible to negotiate lower prices with suppliers. In the one instance where one of the suppliers of specialist imported material did wield significant power in terms of being the only supplier of the specific material in the Eastern Cape, the construction SME was able to neutralise the power of the supplier through vertical integration. In other words, the SME took over a link in the chain controlled by one of their suppliers by importing the material, stocking it and when they failed to secure a particular tender, selling it off at a markup to rival firms who secured the tender. In other words, they became a supplier of the imported material and entered into competition with the existing supplier in the market.

- *Can your clients easily force down prices by playing one business off against each other?*
- *If yes, how does the power of the client affect the business success of the SME?*

The clients in the construction industry wield bargaining power as price trumps all construction procurement. Especially in the general building class of works, there are so many competitors that the profit margins of SMEs are consistently being driven lower. The construction SME operates in a niche market and the degree of rivalry in the particular niche is lower than in the other classes of works. For instance, there are only ten serious competitors in the particular niche in the Eastern Cape. The new entrants in the market over the past three years have increased the rivalry to a degree, but because of its cost advantage, the firm has been able to withstand the threat of new entrants.

#### **4.4 Interview results: Competitor analysis**

*How do you determine or predict the competitive behaviour of your competitors?*

For each tender, public sector clients organise compulsory pre-tender site meetings. All potential bidders are invited to attend and no construction SME may submit a tender for a particular project unless it has attended the pre-tender site meeting. The construction SME considers the pre-tender site meeting as the ideal opportunity to know exactly who the competitors are for a specific tender. The construction SME analyses all the competitors in terms of their human resource capability which allows them to estimate the rival's labour and supervision costs. They also analyse their rival's resources in terms of plant and equipment and is able to estimate what effect these resources will have on the way the preliminaries and general section of the tender document is priced.

#### **4.5 Interview results: Resource analysis**

*Which of the following resources enable the SME to compete and survive against your competitors?*

- *Tangible resources (equipment, property, plant, machinery).*
- *Intangible resources (brand name, technology).*
- *Organisational capacities and capabilities (human resource skills and competencies, management style).*

The construction SME's tangible resources in terms of their plant and equipment are a source of competitive advantage for them. For example, unlike most of their rivals, they do not have to hire access equipment such as scaffolding for each project, as the SME owns its own access equipment. In this way they save on costs for hiring equipment which, according to the interviewee in civil engineering

works, could easily constitute 25% of the tender price. When the plant and equipment is not required, the SME leases the equipment to its competitors. The interest paid on the capital sum spent on purchasing the equipment and the maintenance cost of the equipment are offset against the rental earned on the equipment and the tax saving caused by the depreciation on equipment. The resources are costly for other SMEs to imitate and they, therefore, provide the construction SME with a competitive advantage.

The construction SME's human resources are also a source of competitive advantage. The SME's elaborate training and compensation strategy ensures that they retain the skills and competencies in the organisation in order to maintain their competitive advantage.

#### **4.6 Interview results: SWOT analysis**

*Do you conduct SWOT analysis to determine the SME's strengths and weaknesses, and opportunities and threats?*

According to the interviewee, the construction SME conducts SWOT analysis to keep abreast of its strengths and weaknesses and to identify threats and opportunities in their environment. In the past, loss of skilled workers to larger firms offering higher salaries threatened the business success of the SME, but it has been able to weather the storm by adopting the human resource strategies to combat the threat. Currently, the construction SME regards new entrants entering their niche market as its biggest threat. They are, however, confident that they will be able to keep new rivals at bay by maintaining their cost advantage.

The construction SME regards its major weakness to be the lack of standardised processes within the organisation to ensure that the SME's operations run smoothly and that waste is kept to a minimum. The interviewee indicated that one of the problem areas identified is the lack of synchronisation between the pricing of the tender and the actual buying of the supplies for the tender. The lack of synchronisation has in the past caused rework and waste on a project. The strengths of the construction SME are its highly skilled workforce, its ability to innovate and be on the cutting edge of the latest technology, and its extensive resources in the form of plant and equipment. These strengths are continuously exploited to ensure that the construction SME maintains its competitive advantage.

## **5. Conclusions and recommendations**

Based on the literature reviewed as well as the lessons from the case study, it can be argued that strategic management provides development opportunities for construction SMEs. An SME intending to survive and succeed in the competitive industry must thus evolve corporate and business strategies such as joint venture partnerships, acquisitions, subcontracting, vertical integration, and most importantly diversification of its business and project portfolio. In order to maintain competitive advantages, the construction SMEs should also adopt either a low-cost strategy or any other strategy such as focus strategy, marketing strategies, training and retention strategies to ensure that the company's order book is constantly at a certain acceptable level.

In addition, construction SMEs should be aware of Porter's five forces that influence the industry. These forces are the threat of new entrants, the power of suppliers, the power of clients, rivalry and the threat of substitute products. Strategies should be devised to neutralise the threat of new entrants. If these strategies are no longer effective and the degree of rivalry threatens the business success of the SME, the SME should consider targeting a different market area of the construction industry for the business's services. For example, the case study organisation started as a very small SME that focused on general building services such as painting, repairs, renovations and waterproofing and then diversified into the civil engineering sector due to poor profit margins in the building sector.

## **6. Further research**

This study showed how strategic management guidelines can be applied to construction SMEs to facilitate their growth and development. The study covered a wide variety of concepts of strategies applied by construction SMEs. As price is such a key determining factor of whether an enterprise is awarded a tender, one area which is of particular importance for construction SMEs is maintaining a cost advantage. Therefore, research should be carried out to examine in more detail how construction SMEs may maintain a cost advantage while still delivering a product that satisfies all the client's needs. The issues that deserve particular attention are, for instance, how lean construction and designing a shorter works programme could contribute to cost advantages.

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